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## Council of the European Union Approves Regulation to Screen Inbound Foreign Investment: What Dealmakers Need to Know Now

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On March 5, 2019, the Council of the European Union (the “Council”) [approved a regulation](#) to screen foreign direct investment (“FDI”) into European Union (“EU”) member states on national security grounds. While 14 EU member states maintain national-level investment clearance processes, the EU is now, for the first time, providing a mechanism for member states to coordinate these reviews.

The new regulation (the “Regulation”), which is slated to become effective in April 2019, equips EU member states and the European Commission (the “EC”) to vet FDI affecting security and public order in the EU. By its terms, the Regulation principally applies to investments in sectors deemed “critical” (e.g., critical infrastructure, critical technologies, critical outputs (energy and raw materials), sensitive information (including personal data), media sectors) and investments in important EU projects or programs. Dealmakers considering near-term transactions with a nexus to the EU will need to consider how the new regulations may affect deal timelines, disclosures, certainty and costs.

### The Policy Context

The EU has debated the adoption of an [EU-wide FDI screening regime](#) for several years. In large part, these discussions have stemmed from [concerns about Chinese investments](#) in EU technology and infrastructure companies and anxiety that such investments would lead to loss of cutting-edge technological capabilities. In parallel, the U.S. and other Western countries have [expanded their national security review](#)

[processes](#) to address similar concerns.

While the Council recognized that, in some cases, FDI may present risks to security or public order, the Council also [expressed a desire to maintain the EU's position](#) as a preeminent global destination for FDI. The Council has emphasized that the Regulation will benefit foreign investors by providing greater legal certainty for investors facing disparate screening mechanisms in EU member states, and ensuring better coordination on screening of FDI that may impact security and public order.

Below, we discuss below five key things to know about the new Regulation.

### **1. The Regulation will likely become effective in April 2019.**

The Regulation will become effective 20 days after official publication. Following the effective date, EU member states and the EC will have 18 months to implement its provisions. We anticipate that this process will include, for example, EU member states modifying their national security investment clearance regimes in order to conform to the Regulation's guidelines for countries that choose to maintain such national regimes.

### **2. Member states are not required to enact their own investment screening mechanisms and may maintain existing mechanisms, adopt new ones or choose to remain without them.**

The Regulation provides that mechanisms currently in existence at the member-state level or under development by an EU member state must satisfy the following criteria:

- Transparency of rules and procedures;
- Non-discrimination against foreign investors;
- Confidentiality of information exchanged;
- Possibility of recourse against screening decisions; and
- Measures to identify and prevent circumvention by foreign investors.

### **3. The Regulation requires a broad assessment of whether an investment may threaten "security or public order."**

This assessment should take into account whether the target company operates in sectors most likely to affect security or public order, as well as the identity of the investor.

The Regulation provides that sectors most likely to affect security or public order include:

- **critical infrastructure** (e.g., energy, transport, water, health, communications, media, data processing or storage, aerospace, defense, electoral or financial infrastructure, sensitive facilities, and land and real estate crucial for the use of such infrastructure);
- **critical technologies and dual-use items** (e.g., artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, and quantum, nuclear, nano- and bio- technologies);
- supply of critical inputs (e.g., energy, raw materials and food security);
- access to sensitive information (e.g., personal data) or ability to control sensitive information; and
- the freedom and pluralism of media.

Factors relevant to the analysis of the investor include:

- whether the foreign investor is directly or indirectly controlled, through ownership structure, significant funding or otherwise, by the government of a third country, including state bodies or armed forces;
- whether the foreign investor is already involved in activities affecting security or public order in a member state; and
- whether there is a serious risk that the foreign investor engages in illegal or criminal activities.

Importantly, these lists are not exclusive, and EU member states are not prohibited from taking into account other factors that may be relevant to their analyses.

#### **4. The Regulation mandates increased information sharing between EU member states and the EC upon request.**

Each EU member state must notify the EC of investments that are being screened by the member state's domestic investment clearance regime. After this notification occurs, other EU member states can request information from the recipient member state and provide comments about the proposed investment. In addition, the EC itself may request information and will issue an opinion if at least one-third of member states conclude that a particular transaction is likely to affect security or public order, even if other member states have not provided comments. The EC can also issue an opinion of its own

initiative.

If requested to provide information about a proposed investment by another member state or the EC, the recipient member state's response must include information about the value of the investment, the ownership of the foreign investor, the operations of the investor and target company, the value of the investment, the source of the funding and transaction timing.

### **5. Certain provisions in the Regulation apply only to investments into EU projects or programs of EU interest.**

Examples of such projects and programs include Galileo (the European GPS network), Horizon 2020 (an EU project funding research, technological development and innovation), the Trans-European Networks (the network of energy, transport and telecommunications infrastructure connecting the EU), and the European Defence Industrial Development Programme (financial support for the EU's defense industry to develop defense-related technologies).

The EC may issue an advisory opinion to the recipient member state and can share the opinion with other member states if there is a proposed investment into a company participating in these or similar projects or programs, even when other member states have not requested information.

If the recipient member state does not follow the EC's opinion regarding such investments, it must provide an explanation for this decision.

## Key Takeaways

- **Enhanced scrutiny of FDI is the new normal.** The EU is moving toward a centralized FDI review process that will attempt to align national responses and establish a common set of criteria to evaluate such investments.
- **Each transaction requires a bespoke assessment, based on the buy-side risk profile and the sensitivity of the target company.** Dealmakers must assess how a larger range of constituents – including FDI review regimes in the recipient member state, other member states and the EC – will view EU deals.
- **Coordinated and transparent disclosure matters.** Dealmakers should ensure that public announcements and disclosures are consistent across all EU and non-EU jurisdictions, particularly in light of the Regulation's express encouragement of

member states and the EC to cooperate with national security review bodies in allied countries.

- **More changes are coming.** This new process will evolve as it is tested and the geopolitical landscape reacts to its implementation. Additional changes may emerge from continued consultation between the EC and the EU's FDI screening experts on systemic issues relating to implementation of the new Regulation.<sup>1</sup> Dealmakers should continue to watch for changes to the underlying regulations and the way such regulations are applied.

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1. Council Act (EU) No. 72/18 of 20 February 2019, Regulation of the European Parliament and of The Council establishing a framework for the screening of foreign direct investments into the Union, intro., para. 29, art. 12.↔

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