

New EU Foreign Direct Investment Regulations Take Effect

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Introduction

The European Union has recently taken a significant step in regulating foreign direct investment (“FDI”). As of October 11, 2020 a new EU regulation related to inbound foreign investment (the “FDI Regulation¹”) became binding on all 27 Member States.² The new FDI Regulation does not create a stand-alone mechanism to vet foreign investment akin to the Committee on Foreign Investment in the United States (“CFIUS”) or national security review systems established by individual Member States. Rather, the new EU FDI regime establishes minimum standards for Member States’ review systems, creates an information sharing channel between the EU Commission and Member States, and institutes a formal mechanism for the EU Commission and Member States to provide feedback on FDI that occurs within the European Union.

This new development by the EU is part of a broader trend among Western countries to strengthen FDI regimes. In 2018, the U.S. Congress modernized and strengthened CFIUS, lowering the jurisdictional thresholds for the types of transactions CFIUS has legal authority to review and making some transactions subject to a mandatory filing requirement. More recently, Australia, Israel, Japan, and a number of European countries have taken steps to expand their FDI regimes or are considering such steps in the near term. These developments reflect in part ongoing efforts by the United States to bolster allied countries’ FDI regimes through intelligence sharing and a more streamlined CFIUS review process for certain investors from “excepted” foreign states (currently, the United Kingdom, Canada, and Australia). They also reflect the effects of the COVID-19 pandemic, which has highlighted the national security considerations associated with a broader range of industrial and commercial supply chains and has

left many companies potentially vulnerable to investments from and takeovers by what some U.S. officials have referred to as “adversarial capital.”

Background

In recent years, roughly half of the Member States have adopted national security/public interest review mechanisms to screen foreign investments that occur within their countries. Until now, the EU had not adopted standards or a review mechanism to screen inbound investments at the supranational level. The lack of a uniform approach to national security reviews among Member States led the EU Commission to adopt the FDI Regulation in March 2019, which now has come into force as of 11 October. As discussed in greater detail below, the new EU FDI system intends to supplement, rather than replace, Member States’ national review systems.³

The New EU Regime

Minimum Requirements for Member States’ Review Mechanisms

The FDI Regulation does not require Member States to implement FDI reviews at the national level or to screen particular types of investments. Member States remain free to choose whether to adopt domestic review systems.

However, the FDI Regulation requires Member States that elect to implement a national security/public interest screening system to meet certain minimum standards. For example, all Member States’ review mechanisms must establish transparent criteria that “do not discriminate between third countries,” protect confidential information, and authorize third parties to seek recourse against screening decisions made by competent authorities.

In addition, Member States that adopt these review systems must file annual reports with the EU Commission by 31 March of each year. These reports must detail the application of national screening mechanisms, including decisions to allow, prohibit or subject FDI to mitigating measures. Member States also must note FDI decisions made at the national level that are likely to affect projects or programs of EU interest within their territory.⁴ The annual reports also will detail aggregated information on feedback received from other Member States regarding FDI, including comments on proposed transactions and requests for additional information.

Relevant Criteria to be Assessed by Member States

The FDI Regulation specifies illustrative criteria that the Commission and Member States may consider when assessing the potential effects of a foreign investment on security and public order, including:

- Critical Infrastructure;
- Critical Technologies (including dual use technologies);
- Supply of Critical Inputs;
- Access to Sensitive Information; and
- The Freedom and Pluralism of the Media.

The EU Commission and Member States also will consider other factors, including whether (i) the foreign investor is owned or controlled by a foreign government; (ii) the foreign investor has already been involved in activities affecting security or public order in a Member State; and (iii) there is a serious risk that the foreign investor engages in illegal or criminal activities.

In addition, the FDI Regulation mandates Member States that have adopted review mechanisms to assess potential foreign takeovers of companies that may be involved in EU-funded projects or programs of Union interest. Such projects and programs of Union interest “involve a substantial amount or a significant share of Union funding” or are covered by EU law regarding critical infrastructure, technologies or inputs that are essential for security or public order. The FDI Regulation details eight such projects, including Horizon 2020, Copernicus and Trans-European Networks for Transport.

The New FDI Apparatus

The FDI Regulation does not establish a stand-alone review mechanism at the EU level. More specifically, the FDI Regulation does not authorize the EU Commission to review, block, or impose mitigating measures on proposed foreign investment that occurs within the European Union. In this way, the FDI Regulation is notably different than CFIUS and the national security/public review mechanisms adopted by Member States at the national level. The FDI Regulation expressly notes that decisions with respect to blocking or imposing mitigating measures on foreign investment are in the exclusive domain of Member States.

However, the FDI Regulation creates an information sharing mechanism pursuant to which EU Members States must inform the EU Commission and other Member States

of FDI that occurs in Member States that is subject to review at the national level. For such FDI transactions, Member States are obligated to share with the EU Commission and other Member States information regarding: (i) the ownership structure of the foreign investor; (ii) the value of foreign investment; (iii) products, services, and business operations of the foreign investor; and (iv) the date of the transaction. Other Member States and the EU Commission can request additional information regarding such investments, which must be provided by the reviewing Member State “without undue delay.”

The FDI Regulation prescribes that the EU Commission and other Member States may issue non-binding opinions and comments “within a reasonable period of time” regarding whether FDI transactions pose a threat to the national security of one or more Member State, or could undermine EU programs or projects. The EU Commission and other Member States must issue their opinions and comments within 35 calendar days from receiving the relevant information from the Member State concerned, although this time frame can be extended by 20 calendar days if the EU Commission or other Member States request additional information regarding the transaction at issue.

In circumstances where the investment is not subject to a FDI screening mechanism at the national level, the FDI Regulation prescribes that other Member States may still issue comments if contemplated FDI in another Member State is likely to affect its own security or public order. Before the issuance of either an opinion or comment, further information can be requested about the FDI. The time frame for submitting these comments and opinions is the same as outlined above, though the EU Commission has an additional 15 calendar days to issue its opinion.

Member States must give “due consideration” to other Member States’ comments and to the EU Commission’s non-binding opinion. In relation to projects or programs of Union interest, the respective Member State must “take utmost account” of the EU Commission’s non-binding opinions and provide an explanation if the opinion is not followed.

Limitations

The new EU system only applies to FDI that occurs within the European Union. The regulation does not define what constitutes “foreign direct investment,” but notes that “portfolio investments” are not included within this definition. The EU Commission has explained that portfolio investments “do not confer the investor effective influence over management and control of a company” as they are

“generally less likely than FDI to pose issues in terms of security or public order”. However, the EU Commission further advised that acquisitions of “at least qualified shareholding that confers certain rights to the shareholder or connected shareholders under the national company law (e.g. 5 %)” would not be treated as portfolio investments for purposes of the FDI Regulation.⁵

Covid-19 Related Developments

In light of the Covid-19 pandemic, in March 2020 the EU Commission issued a guidance note for screening FDI in companies and critical assets located in the EU, including those operating in the fields of health, medical research, biotechnology and infrastructures deemed essential for security and public order (the “Guidance”).⁶ The Guidance notes that “today, more than ever, the EU’s openness to foreign investment needs to be balanced by appropriate screening tools”. The Guidance states the pandemic has exemplified the importance of preserving and sharing healthcare and research capacities between Member States and other countries. In addition, the Guidance reiterates that acquisitions, especially in the healthcare sector, may have an impact that transcends national borders, and urged Member States to monitor FDI that occurs within their territories.⁷

Emerging Issues

Through the publication of the FDI Regulation and the more recent guidance, the EU Commission has attempted to explain how the newly established system will operate. Nevertheless, a number of key questions remain regarding how the FDI Regulations will function in practice and how the EU will approach national security/public interest reviews in the future.

- *What Transactions Will be Subject to Review?* The FDI Regulation is designed to address “foreign direct investment.” However, this term is not expressly defined, leaving open questions regarding the types of transactions that are covered. Similarly, “portfolio investments” are not defined either, which creates further ambiguity about the scope of covered transactions.
- *What Role Will Transaction Parties Play?* The FDI Regulation does not specify a mechanism for parties involved in a FDI transaction subject to review to interact directly with the EU Commission or Member States that are not reviewing the transaction at the national level. As a result, it is unclear whether such parties will play a formal or informal role during the review process.

- *How Political Will the EU Process Be?* EU Commission opinions and Member State comments regarding FDI technically are only permitted to address national security and public interest considerations. Nevertheless, it is possible – and perhaps likely – that political considerations outside of those areas will inform EU Commission opinions and lead Member States to issue comments regarding proposed transactions.
- *How Will Multi-Jurisdictional Investments Be Reviewed?* FDI frequently involves cross-border transactions that touch multiple Member States. Assessing foreign investments that involve multiple Member States will present challenges and complications at both the EU and Member State level.

The recent implementation of the FDI Regulation will force the EU Commission and Member States to resolve these – and other – issues.

Conclusion

The FDI Regulation is the EU's first attempt to regulate FDI at the EU level. Although the new EU system is more limited than CFIUS and the review mechanisms established by individual Member States, it is be another factor that parties need to consider when engaging in transactions within the European Union that involve foreign investors. Following the adoption of the FDI Regulation, a number of Member States have introduced or expanded their FDI regimes (e.g., France, Germany, Spain, Italy, Poland), and closer coordination between governments and heightened scrutiny of investments in the EU is expected to ensue.

1. Regulation (EU) 2019/452 of the European Parliament. See <https://eur-lex.europa.eu/eli/reg/2019/452/oj> ↩

2. On July 31, 2020, the EU Commission determined that the United Kingdom would not to participate in EU-level cooperation and information sharing in relation to FDI. The EU Commission's decision was based upon the Withdrawal Agreement, and therefore applies prior to the end of the Brexit transition period. See https://trade.ec.europa.eu/doclib/docs/2020/august/tradoc_158921.pdf ↩

3. On June 17, 2020, the EU Commission published a White Paper dealing with distortive effects of foreign subsidies to the internal market. See https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf. If foreign subsidy rules are adopted, transactions potentially may be subject to three parallel notification systems: EU/national merger control, national FDI and foreign subsidy control.↩

4. *Id.*, See Article 22↔

5. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020XC0326%2803%29> ↔

6. See, https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf ↔

7. On June 17, 2020, the EU Commission announced the publication of a White Paper dealing with the distortive effects caused by foreign subsidies in the Single Market, and is seeking views from all stakeholders on options set out therein.↔

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Suggested Reading

- 27 October 2020 Kirkland Alert Gift, Estate and GST Tax Exemptions
- 21 October 2020 Kirkland Alert CFIUS Goes Back to the Future by Tying Mandatory Filings Pertaining to Critical Technologies to U.S. Export Controls Assessments
- 09 October 2020 Kirkland Alert House's Clean Economy Jobs and Innovation Act Would Create Opportunities and Impose Restrictions on Different Segments of the Energy and Infrastructure Sectors

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