

A GUIDE TO THE EU FOREIGN INVESTMENT SCREENING REGULATION

Following formal adoption by the EU Council, the Regulation establishing a framework for the screening of foreign direct investments into the EU will become applicable on 10 October 2020.

The Regulation will allow the Commission to review (but not block) certain investments of "Union interest" and to issue a non-binding opinion to the member state in which the investment takes place. It also clarifies the scope of the issues that member states may take into account when applying their national screening regimes without falling foul of EU law, sets certain common standards for those regimes and implements a system of cooperation and information exchange between member states and the Commission.

The legal confirmation that member states may legitimately block foreign takeovers involving critical infrastructure, technologies, raw materials and sensitive information is likely to lead to some member states introducing new foreign investment screening regimes or broadening the scope of their existing regimes. This, combined with increased exchanges of information between member states, will lead to transactions being scrutinised on public interest and national security grounds that are not, at present, caught.

The Regulation

The Regulation will allow the Commission to carry out a limited review of certain foreign investments and also clarifies and harmonises certain aspects of the national foreign investment screening regimes that are operated by member states (i.e. mechanisms allowing the member state to monitor foreign investments in companies/sectors considered of strategic importance and to oppose them under certain conditions).

The scope of "foreign direct investment" that is covered by the Regulation is broad and includes any investment by a non-EU investor aiming to establish or to maintain lasting and direct links with the investee in order to carry on an

Key issues

- What role will the European Commission have in screening of foreign investments for public interest and national security issues?
- What factors does the Regulation allow national EU governments to take into account when screening such investments?
- How will the Regulation affect coordination and exchanges of information between national EU governments and the Commission?
- How will the Regulation affect the level of intervention in foreign investments by EU national governments?

economic activity in an EU member state, including (but not limited to) investments which enable effective participation in the management or control of a business.

In practice, however, any prohibition or remedies imposed on a foreign investment will continue to be under the national screening regimes of one or more EU member states. Consequently, it will be the jurisdictional criteria of those national regimes – such as the threshold for control or level of shareholding that a foreign investment must satisfy - that will determine which transactions are affected, not the Regulation's definition of "foreign direct investment". Member states will remain free to determine their jurisdictional criteria, subject to a requirement that they incorporate measures to identify and prevent circumvention of the screening mechanisms, such as where investments are made by EU businesses that are ultimately owned or controlled by a non-EU investor.

European Commission review of certain foreign investments

The Commission will have powers to review specific foreign direct investments that it considers likely to affect projects or programmes of "Union interest", but only on public security or public order grounds. However, it will have no direct powers to block or impose remedies on such transactions. Instead, it may issue a non-binding opinion addressed to the member state where the foreign direct investment is planned or has been completed. Member states are required to take "utmost account" of the Commission's opinion and provide an explanation if they do not follow it. Similar consultation procedures in the telecoms and energy sectors have been protracted and highlighted differences in approach between Brussels and national governments.

Projects or programmes of "Union interest" are those that

- involve a substantial amount or a significant share of EU funding; or
- are covered by EU legislation and relate to critical infrastructure, critical technologies or critical inputs which are essential for security or public order.

The legislation contains a definitive list of programmes of Union interest which can be amended by the Commission in the future. The list includes satellite programmes (the Copernicus earth observation programme and the Galileo and EGNOS satellite navigation systems); R&D programmes under the EU's Horizon 2020 programme (in particular, "key enabling technologies" such as micro- and nano-electronics, photonics, nanotechnology, biotechnology, advanced materials and advanced manufacturing systems) and transport, energy and telecoms infrastructure within the EU's Trans-European Networks programmes.

The Regulation does not provide for any obligation for merging parties to notify their transactions to the Commission or to suspend them pending the outcome of the Commission's review. However, it does provide for a binding deadline - 35 calendar days from receipt of information about a transaction - within which the Commission must issue its opinion, which merging parties may decide to take into account when planning timetables for potentially affected deals.

Framework for member states' review

The Regulation does not require member states to adopt or maintain a mechanism to screen foreign investments (at present, only twelve member states operate some form of foreign investment screening). It merely confirms that member states may screen foreign investments provided their regimes

comply with certain requirements. The screening mechanisms must be transparent and establish clearly the grounds for screening and the timeframe for issuing screening decisions. The screening process must also be non-discriminatory between investors of different non-EU countries and allow for the decisions to be judicially reviewed.

Although the Regulation gives member states full discretion to decide what factors can trigger a screening process, the Regulation provides a non-exhaustive list of factors that may be taken into consideration, which includes the potential effects on:

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

In assessing these effects, the control of an investor by a foreign government, including through significant funding, may be taken into account, as may the presence of a serious risk that the foreign investor engages in illegal or criminal activities or has previously been involved in activities affecting security or public order in a member state.

Cooperation and information sharing

The Regulation imposes information sharing and notification requirements whereby member states will have obligations to:

- notify the Commission of any foreign investment that is subject to a screening process under their domestic screening regime, as well as any other member states whose security or public order is likely to be affected. That notification will include details of the ownership structure and business activities of the foreign investor and target, as well as the funding and timing of the investment. Foreign investors and target companies will have reciprocal obligations to provide this information without delay, if requested;
- respond without undue delay to justified requests by other member states and/or the Commission for information relating to foreign investments planned or completed in their territory, whether or not undergoing screening. Again, foreign investors and targets will have reciprocal obligations to comply with requests for certain information; and
- provide to the Commission an annual report with aggregated information on the foreign direct investments that took place in their territory, the information provided to other member states and the application of their screening regime (if they have one).

In addition, regardless of whether member states have screening mechanisms in place, the framework provides a feedback procedure which allows member states the right to provide comments if they feel that a foreign investment in another member state raises concerns for public order or security. The Commission will also have a right to issue an opinion in cases falling outside the "Union interest" screening regime described above. In either case, the member state in which the investment is taking place will be required to take "due account" of the opinion/comments.

Interaction with other EU legislation

The legislation will not affect the Commission's "one-stop-shop" jurisdiction under the EU Merger Regulation (EUMR). If a foreign takeover is notifiable to the Commission under the EUMR, then any decision of an EU member state to take action against the transaction to protect its legitimate interests must be communicated to, and approved by, the Commission, unless the invoked interest relates to public security, plurality of the media or prudential rules. That will remain the case, even if the decision is taken in accordance with the Regulation.

However, at present it is rare for member states to ask for permission to block or impose remedies on a foreign takeover that falls under the EUMR and the Commission has on a number of occasions taken action against member states for having done so without permission. The clarification in the Regulation that member states may legitimately consider a transaction's impact on critical infrastructure, technologies, inputs and sensitive information may lead to an increase in the number of such requests. However, while an explanatory note to the initial legislative proposals stated that the Commission will ensure consistency in the application of the Regulation and the EUMR, it remains to be seen whether the Commission will take a less strict approach towards protectionism by member states of national champions that are active in strategic sectors.

The legislation will also sit alongside and complement other specific EU regimes that provide for the identification of critical infrastructure and resources in the energy, raw materials and electronic communications sectors and, in some cases (e.g. for gas and electricity transmission systems), require an assessment of the implications of foreign ownership. It also does not affect existing restrictions of foreign ownership of holders of operating licences for certain air transport services, or the EU rules for the prudential review of acquisitions of qualifying holdings in the financial sector.

Comment

In practice, the Regulation is likely to have two broad effects.

First, the increased flows of information on foreign investments between member states is likely to mean that potential public interest and national security concerns are identified more readily by national EU governments, leading to more frequent challenges. An incidental effect may also be a greater risk of leaks of commercially sensitive information.

Second, member states with existing screening regimes are likely to expand their scope to include the various factors that the Regulation clarifies can legitimately be taken into account (set out above). In the past, member states have often refrained from reviewing foreign takeovers of targets active in areas such as robotics and artificial intelligence, in part due to uncertainty as to whether any attempt to block or impose conditions on such transactions

would infringe the European Commission's exclusive jurisdiction under the EUMR, or EU law in general. The Regulation removes that uncertainty and so will start to have these effects even before it becomes legally binding on member states in October 2020. For instance, the German government has already indicated that it intends to broaden the scope of the German foreign investment regime to incorporate the Regulation's list of permissible factors. Over time, the Regulation might also prompt those member states without a regime for reviewing foreign investments to introduce one.

These effects will create greater risks for certain types of transaction and certain investors. However, the Regulation does very little to harmonise member states' national screening regimes. Consequently, foreign investors in targets with activities in multiple EU countries will still need to deal with a patchwork of regimes with divergent legal characteristics and differing cultural and political factors that determine how each regime is applied to their transaction.

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