“KNOCK, KNOCK… WHO’S THERE?” KEY ELEMENTS OF THE EU FDI SCREENING REGULATION

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In this article, the authors – European Commission experts in this new field – set out the background for the adoption of the European Union FDI Screening Regulation and explain its key features, including the cooperation mechanism established, and, the substantive test applied to review the potential impact of FDI transactions on security or public order. The article also highlights the sustained increase in the number of EU Member States with national screening mechanisms, prompted also by the European Commission's call upon all Member States to have a national screening mechanism in place. The authors conclude that while the Regulation does not change the European Union's openness to FDI, the Regulation represents an important step towards safeguarding the collective security of the European Union and its 27 Member States.

The adoption on March 19, 2020, and the full implementation and application as of October 11, 2021, of the EU FDI Screening Regulation[2] (hereinafter "the Regulation") represents a first in terms of the European Commission playing a direct role in the security screening of Foreign Direct Investment ("FDI") into the European Union. The Regulation establishes a network between EU Member State screening authorities and the European Commission, and sets out the mechanics for the operation of the network. The European Commission role is effectively two-fold, i.e. ensuring that screening EU Member States take the concerns of other EU Member States into account (including through more informal interaction), and, stay vigilant in terms of the potential impact of certain FDI on so-called projects and programmes of Union interest. This, clearly, represents an important development.

The main features of the Regulation are described below.[3]

It is important to keep in mind that the Regulation does not in any way, shape or form diminish the European Union's general and well-recognised openness to FDI. Such FDI also supports a significant number of jobs and contributes to the vibrancy of the European Union. Rather, the Regulation is a carefully tailored instrument for assessing, for certain FDI transactions, who is knocking on EU doors, which door they are knocking on, and what security and public order related implications may stem from the particular FDI.

Just recently European Commission Executive Vice President Dombrovskis described the necessary balance between the continued EU openness to FDI and measured prudence, and the Regulation itself, in the following words:

The EU is and will remain open to foreign investment. But this openness is not unconditional. To respond to today's economic challenges, safeguard key European assets and protect collective security, EU Member States and the Commission need to be working closely together. If we want to achieve an open strategic autonomy, having an efficient EU-wide investment screening cooperation is essential. We are now well equipped for that.[4]

I. WHY?

The EU political decision to establish an EU-wide cooperation mechanism for FDI screening, and the subsequent legislative process leading to the adoption of the Regulation was sparked by a number of factors. These included the changing nature and profile of foreign investors, with an increasing number of government-owned or directed (e.g. state-owned enterprises, sovereign wealth funds, and others) investors, as well as a growing trend among like-minded economies to more carefully screen certain FDI for possible security and related implications.

The process was also sparked by a growing recognition on the part of the European Commission and EU Member States of the need to address two blind spots under the system prevailing at the time (2017), with FDI screening exclusively done by EU Member States, rather than the European Commission. The blind spots were a) the fact that a particular FDI may have implications in more than one EU Member State – both given the highly integrated nature of the Internal Market, as well as the possible presence of a target company in more than one EU Member State (be in term of physical presence, i.e. a subsidiary, or through the provision of goods or services), and, b) the need to also assess the possible risk from a particular FDI for so-called projects or programmes of Union interest.[5]

2 Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, available here https://eur-lex.europa.eu/eli/reg/2019/452/oj.

3 Further information about the Regulation is available here http://trade.ec.europa.eu/doclib/press/index.cfm?id=2006.

4 See https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1867.

5 Recital 19 of the Regulation states as follows as regards such projects or programmes and the rationale for their inclusion under the coverage of the Regulation: *"Furthermore, it should be possible for the Commission to provide an opinion within the meaning of Article 288 TFEU with regard to foreign direct investments likely to affect projects and programmes of Union interest on grounds of security or public order. This would give the Commission a tool to protect projects and programmes which serve the Union as a whole and represent an important contribution to its economic growth, jobs and competitiveness. This should include in particular projects and programmes involving substantial Union funding or established by Union law regarding critical infrastructure, critical technologies or critical inputs. Those projects or programmes of Union interest should be listed in this Regulation. An opinion which is addressed to a Member State should also be simultaneously sent to the other Member States."*

Such projects and programmes are set out in a dedicated Annex[6] to the Regulation and include e.g. Horizon 2020 and Galileo and the Trans-European Networks for energy, telecommunication and transport. Prior to the adoption of the Regulation, EU Member States, when screening FDI under their national screening mechanisms, would understandably be focussing on the possible implications of a particular FDI for their own jurisdiction, rather than that of their neighbours or the EU more widely. This has changed with the Regulation and the more institutionalised cooperation established under same. What has also changed is not only the sheer number of Member States, which have introduced a national regime to screen FDI: from 11 out of 27 in 2017 to 18 at the time of drafting this article, but also the scope of existing legislations with e.g. Germany, France, Italy and Spain all having extended their regimes by covering more sectors and more transactions.[7]

II. WHAT?

In terms of coverage of the Regulation, it applies to all sectors, and without any *de minimis* thresholds or the like.

What matters under the Regulation is whether a particular FDI poses a risk to the security or public order of more than one EU Member State (or to projects or programmes of Union interest).

The Regulation sets out a number of cumulative conditions as regards FDI and the assessment of same under the Regulation. For starters, the Regulation only applies to *foreign* direct investment, rather than intra-EU investment.[8] However, the Regulation addresses the issue of possible circumvention (calling also on EU Member States with a national screening mechanism to reflect this)[9] of investments from within the European Union by means of artificial arrangements that do not reflect economic reality and circumvent the screening mechanisms and screening decisions, and where the investor is ultimately owned or controlled by a natural person or an undertaking of a third country. One example of circumvention could be an FDI transaction where a foreign investor establishes a shell company within the EU for purposes of the investment; another example could be an investment financed and led by an investor established in a third country, but the investment is made through an EU-based company, which has no economic activity, or employees.

Also, the Regulation does not apply to reorganisations of a target company when such reorganisations do not entail a change of control and influence over a target company. Nor does it cover portfolio investment by foreign investors when such investments do not bring about any participation in the control over a target company, or privileged access to sensitive information.

One thing which has not changed with the Regulation is that the EU Member States are the port of call for foreign investors seeking authorisation for a particular FDI, and ultimately responsible for a decision regarding same, not the European Commission. The European Commission, leaving aside possible *ex officio* action taken by the Commission under Article 7 of the Regulation, only becomes involved in the screening of a particular FDI through a notification submitted by one (or more) EU Member State(s) pursuant to Article 6 of the Regulation.[10] The Regulation does not seek to somehow replicate or replace the screening undertaken by Member States.

For the actual assessment of an FDI transaction, Article 4 of the Regulation sets out a non-exhaustive list of factors relating to the investment target and the foreign investor that EU Member States and the screening Member States and the European Commission may take into account when assessing the possible security and public order implications of a particular FDI.

As regards the investment target, Article 4, in addition to listing critical infrastructure (physical or virtual), and critical technology and dual-use items, also lists factors such as supply of critical inputs, (e.g. raw materials), access to and/or control of sensitive information (including personal data), and, freedom and pluralism of the media as factors to be taken into account when assessing a particular FDI.

6 The Annex can be updated, as necessary, and this has already been done. Available here https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2020.304.01.0001.01.ENG&toc=OJ:L:2020:304:TOC.

7 A comprehensive list of the FDI screening mechanisms of EU Member States is available at: https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf. For e.g. Spain see Royal Decree-Law 8/2020, on urgent extraordinary measures to address the economic and social impact of COVID-19, Final disposition 4, and, Royal Decree-Law 11/2020, of March 31, adopting urgent additional measures in the social and economic sphere to confront COVID19, Transitional disposition 2, Final disposition 3.

8 Article 2, (1).

9 Article 3, (6).

10 Article 9 sets out the minimum requirements for the elements and content of notifications submitted by Member States. The so-called notification form B provides a further breakdown of the elements set out in Article 9, also to assist national screening authorities and foreign investors in providing the necessary information. See https://trade.ec.europa.eu/doclib/docs/2021/april/tradoc_159530.pdf.

As regards the investor, Article 4 also lists certain characteristics of same, including whether the investor is directly or indirectly controlled by a foreign government, whether a foreign investor has previously been involved in activities affecting security or public order in an EU Member State, and, any serious risk that a foreign investor engages in illegal or criminal activities.

III. HOW & HOW LONG?

Given the time-sensitive nature of many FDI transactions, and also the fact that an assessment by the European Commission and notified Member States under the Regulation is not intended to replicate or replace the assessment by a notifying EU Member State under its respective national screening mechanisms, the time-lines established under the Regulation are deliberately kept extremely short. The other reason, more of a general policy nature, why time-lines for the cooperation mechanism are kept extremely short is to avoid FDI screening unduly slowing down M&A transactions and foreign investments.

Once a notification has been submitted by an EU Member State under Article 6 of the Regulation, this triggers a so-called Phase 1, the duration of which is a maximum of 15 calendar days. During Phase 1, other Member States who believe the notified FDI is likely to affect its security or public order, or, who have relevant information to share with the screening Member State, can reserve the right to provide comments, and ask questions.

Where the European Commission, following its initial assessment of a particular FDI, considers that the FDI is likely to affect security or public order in more than one Member State, or a project or programme of Union interest, or where the Commission has relevant information to share, the Commission has the option of issuing a so-called Opinion addressed to the screening Member State. The initial step here will be for the Commission, by no later than the end of Phase 1, to notify the screening Member State of the Commission's intention to an Opinion pursuant to paragraph 3. An Opinion may be issued irrespective of whether any EU Member State has provided comments. The notification to the screening Member State may also include a duly justified and proportional request for information additional to the information initially submitted by the notifying Member State, referred to in Article 6, paragraph 1. This will open a so-called Phase 2, the duration of which is a maximum of 20 calendar days.

It is worth noting that comments and opinions are non-binding for the screening Member State, and the final say as regards a particular FDI undergoing screening in a Member State rests with that Member State, as also stated explicitly in Article 6, paragraph 9. However, the screening Member State must give due consideration to the comments of other Member and to an Opinion of the Commission.[11]

The Regulation is fully reflective of not only the time-sensitivity of certain FDI transactions, but also the business sensitivity of certain information provided by the parties to an FDI transaction undergoing screening. Article 10 explicitly mandates careful handling of any confidential information exchanged and protection of same under national and EU law, just as information provided under the Regulation can only be used for the purpose for which it was requested. This Article is a strong guarantee for companies and their advisors that they can entrust screening authorities and the Commission with sensitive information under the cooperation mechanism.

IV. SO FAR?

With the Regulation only having been fully applied as of October 11, 2020, it would be premature to draw any firmer conclusions.

However, there are two noteworthy factors and developments in particular that warrant attention.

First, the Regulation and the cooperation mechanism established under same has already proven very valuable to the 27 EU Member States and the European Commission. Not only in terms of allowing for comments and Opinions as per the Regulation itself, which allows Member States a far superior overview of FDI into the European Union than previously. But also as the cooperation under the Regulation allows all participants to forge a real network with other screening authorities and the European Commission, thereby also supporting their daily work, and allowing for sharing of information and assessments on a daily basis on specific transactions, but also sharing of best practices.

11 Recital 19 of the Regulation makes clear that: *"The Member State should take utmost account of the opinion received from the Commission through, where appropriate, measures available under its national law, or in its broader policy-making, and provide an explanation to the Commission if it does not follow that opinion, in line with its duty of sincere cooperation under Article 4(3) TEU. The final decision in relation to any foreign direct investment undergoing screening or any measure taken in relation to a foreign direct investment not undergoing screening remains the sole responsibility of the Member State where the foreign direct investment is planned or completed."*

Second, what is more, not all Member States have a national screening mechanism in place. Currently,[12] 18 out of 27 Member States have a national mechanism, with several of the remaining 9 recently having adopted a mechanism to enter into force shortly, or with their domestic legislative process for the adoption of such a mechanism underway or reaching its conclusion.

MS with screening mechanism/legislative activities

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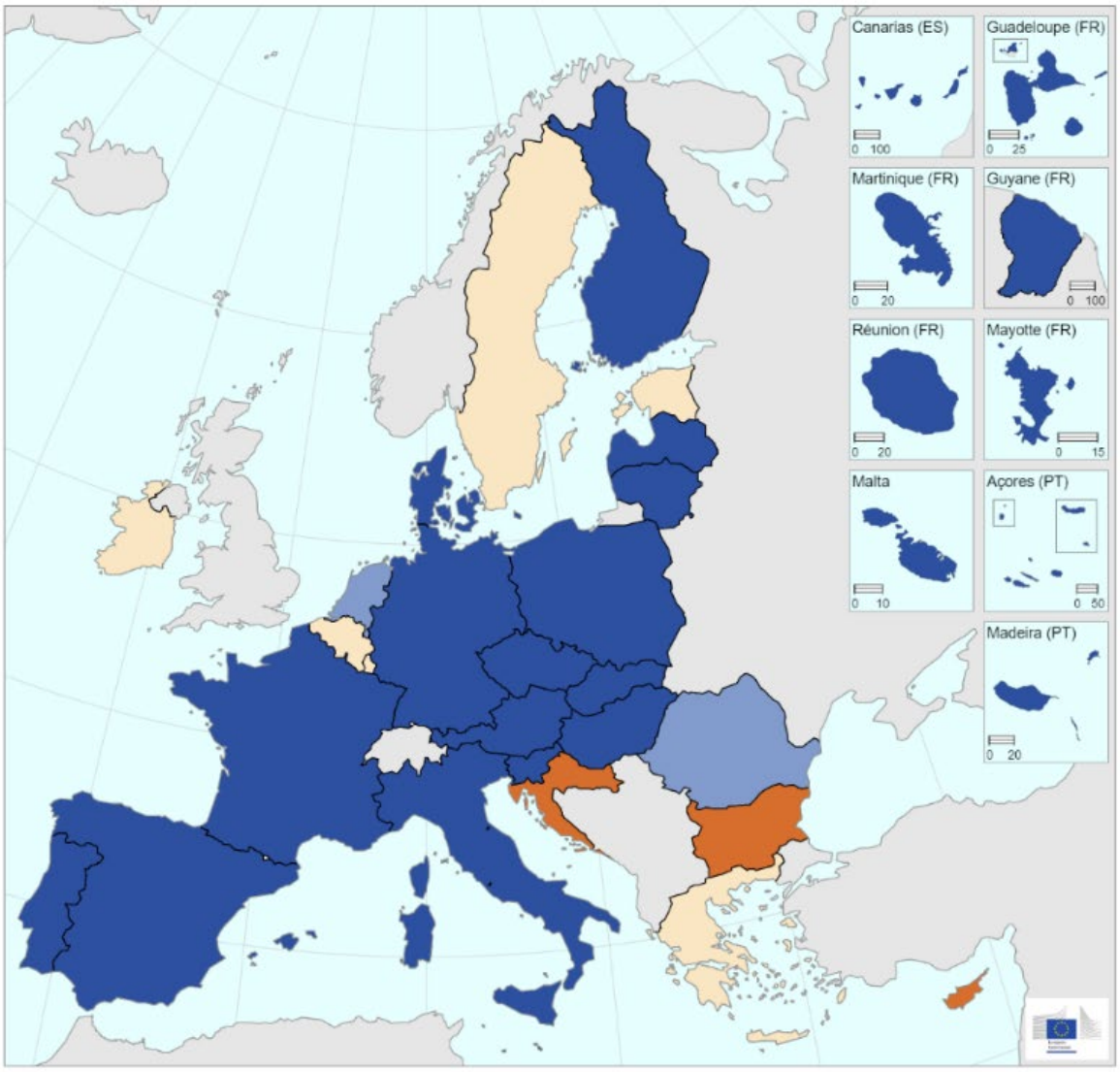

Note not entered.
Member States' notifications to DG TRADE

12 As of June 1, 2021.

The direction of travel in the European Union is very clear, and manifestly one-way: EU Member States, prompted also to a considerable extent by the Regulation, are upgrading and strengthening existing screening mechanisms or adopting new ones. And several of the upgraded and strengthened, or new, screening mechanisms directly and at times quite literally reflect key elements of the Regulation, e.g. Article 4 and the non-exhaustive list of factors to consider when assessing a particular FDI. It is worth noting that, while the Regulation does not require Member States to have a national screening mechanism in place,[13] Article 3 of the Regulation contains a number of important features to be reflected in any such mechanisms, including transparency, non-discrimination, time-lines and possible appeal as regards adverse decisions by screening authorities, as well as an obligation for Member States to notify any screening mechanism to the European Commission, also for purposes of the maintenance of a list of Member States with a screening mechanism in place.[14]

For its part, the European Commission, while fully respecting the confidentiality of individual transactions,has continuously sought to inform the wider public and, more specifically, those directly affected by FDI screening of the ins and outs of the Regulation. Detailed information on the content and operation of the Regulation is publicly available and updated as required by developments, including by way of a detailed Frequently Asked Questions document.[15]

V. LOOKING AHEAD

As indicated above, the Regulation represents an important first in terms of establishing an EU-wide cooperation mechanism for the exercise of the EU Member States' and the European Commission's shared responsibility for, and determination towards, an effective exercise of FDI screening focusing on potential risks for the security of public order in more than one EU Member State, or to projects of programmes of Union interest.

At this point, some questions have arisen in connection with the operation of the Regulation.

One question relates to FDI transactions where the investment target is a corporate group that has a presence in several EU Member States (and possibly also third countries), either by way of subsidiaries in more than one EU Member State, or by the target company providing goods or services in more than one Member State. In such cases, there is a distinct possibility that more than one Member State will screen and notify the FDI transaction under the Regulation, just as one or more Member States will be likely to ask question and provide comments vis-à-vis screening Member States. Idiosyncrasies of national screening mechanisms, including time-lines, raise the question of whether closer coordination and alignment of procedures may be required.

Another question relates to the more exact interplay between the Regulation and other policy instruments and regulators, including merger control,[16] and prudential controls[17] (e.g. for investment into the financial sector or media). It is worth noting that both merger control and FDI screening may use conditions (or mitigating measures) as part of an authorisation for a particular transaction, and a need may arise to ensure

13 See e.g. Recital 8 of the Regulation. In a Communication of 25 March 2020 adopted against the backdrop of the COVID crisis and depressed European asset prices ("Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation)"), the European Commission called upon EU Member States to: *"Make full use already now of its FDI screening mechanisms to take fully into account the risks to critical health infrastructures, supply of critical inputs, and other critical sectors as envisaged in the EU legal framework;" and "For those Member States that currently do not have a screening mechanism, or whose screening mechanisms do not cover all relevant transactions, to set up a full-fledged screening mechanism and in the meantime to use all other available options to address cases where the acquisition or control of a particular business, infrastructure or technology would create a risk to security or public order in the EU, including a risk to critical health infrastructures and supply of critical inputs."* Full text of the Communication available at https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf. The call on all EU Member States to adopt national screening mechanisms was renewed in COM(2021) 66 final COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS - Trade Policy Review - An Open, Sustainable and Assertive Trade Policy in February 2021

14 Available here https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf.

15 All available here http://trade.ec.europa.eu/doclib/press/index.cfm?id=2006.

16 Recital 36 of the Regulation states as follows regarding the EU Merger Regulation: *"When a foreign direct investment constitutes a concentration falling within the scope of Council Regulation (EC) No 139/2004 (13), the application of this Regulation should be without prejudice to the application of Article 21(4) of Regulation (EC) No 139/2004. This Regulation and Article 21(4) of Regulation (EC) No 139/2004 should be applied in a consistent manner. To the extent that the respective scope of application of those two regulations overlap, the grounds for screening set out in Article 1 of this Regulation and the notion of legitimate interests within the meaning of the third paragraph of Article 21(4) of Regulation (EC) No 139/2004 should be interpreted in a coherent manner, without prejudice to the assessment of the compatibility of the national measures aimed at protecting those interests with the general principles and other provisions of Union law."*

17 Recital 37 of the Regulation states as follows regarding prudential controls for the financial sector: "*This Regulation does not affect Union rules for the prudential assessment of acquisitions of qualifying holdings in the financial sector, which is a distinct procedure with a specific objective."*

that decisions in the two areas do not clash.[18]

Last, but not least, the interplay between the EU FDI Screening Regulation and the yet-to-be adopted EU Anti-subsidy instrument[19] has attracted some attention. The proposed Anti-subsidy Regulation is based on three tools, one of which is a notification-based tool to investigate concentrations involving a financial contribution by a non-EU government, where the EU turnover of the company to be acquired (or of at least one of the merging parties) is €500 million or more and the foreign financial contribution is at least €50 million. The FDI Screening Regulation, Article 4, paragraph 2 a) (relating to the foreign investor), lists "significant funding" from a government as one factor that EU Member States and the European Commission may look at as part of its assessment of an FDI transaction. This suggest some degree of overlap and commonality of approach in the two Regulations, which will deserve further attention.

One area for further development is that of international cooperation between the European Commission and like-minded partners. Article 13 of the Regulation envisages such cooperation by stating that "Member States and the Commission may cooperate with the responsible authorities of third countries on issues relating to the screening of foreign direct investments on grounds of security and public order." While some EU Member States will already have cooperation established with certain third countries on these matters, this too would constitute a first for the European Commission.

Looking further ahead, and beyond the day-to-day work on notified FDI transactions and any ex officio action taken under Article 7, the Commission will be submitting its first Annual Report this autumn pursuant to Article 5 of the Regulation. The Report will be transmitted to the European Parliament and the Council, and will also be made available to the public-at-large.

Looking beyond the first Annual report, the Regulation also charts a course for an evaluation by the European Commission, by 12 October 2023 and every five years thereafter, of the functioning and effectiveness of the Regulation in a report to the European Parliament and to the Council. Such reports may contain recommendations for amendments to the Regulation.

We are at the start of a long journey to improve our collective security relating the corporate world. The EU FDI Screening Regulation represents one important part of this.

18 Note e.g. Article 21.4 of COUNCIL REGULATION (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation). The Article recognises public interest (including public security) and EU Member State measures adopted in pursuit of same, but also requires communication of same to the European Commission which will make an assessment *"of its compatibility with the general principles and other provisions of Community law before the measures […] may be taken."*

19 The proposed EU Regulation, aimed at addressing distortions caused by foreign subsidies within the EU Internal Market can be found here: https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1982.

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