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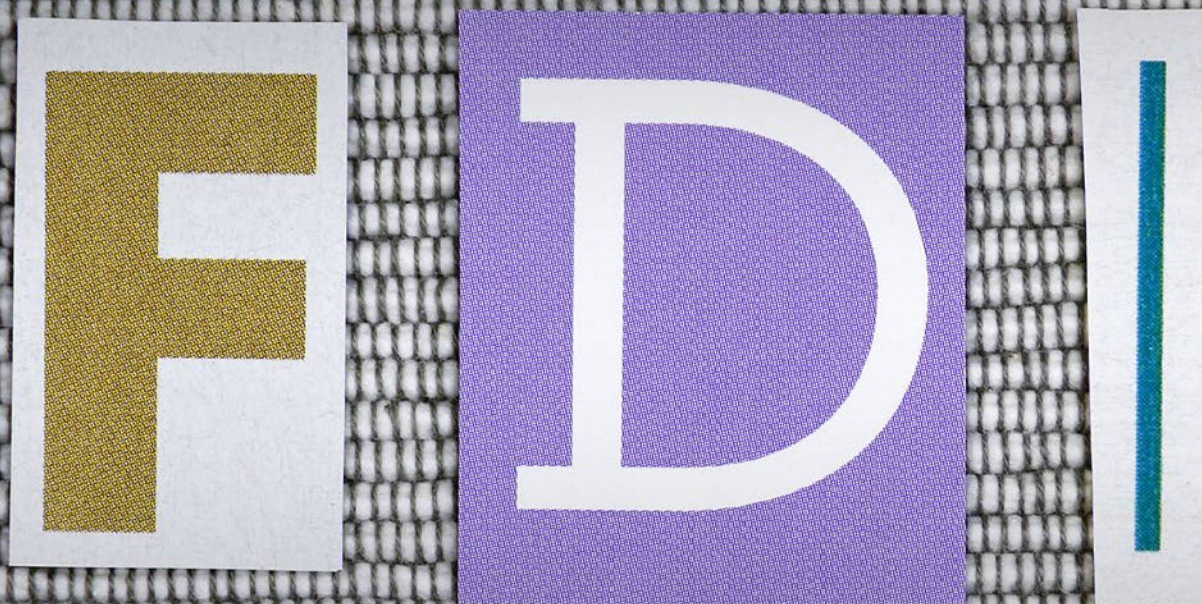

Foreign Direct Investment

CPI COMPETITION POLICY INTERNATIONAL

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LETTER FROM THE EDITOR

Dear Readers,

Competition rules inevitably interact and come into conflict with other domains of economic regulation. This is very clear in the case of rules concerning government (and, in particular, foreign) subsidies. Both concern distortions of competition, but the former focuses on the conduct of private companies, whereas the latter constrains the actions of governments.

In the EU, for example, this dichotomy is reflected in the distinction between the antitrust rules (Articles 101 and 102 TFEU) and the State Aid rules (Articles 107 et seq). Moreover, competition-distorting subsidies are subject to disciplines under international trade agreements, and the rules set out under WTO agreements, which are independent from competition rules *per se*, yet nonetheless have obvious implications for their application in practice.

One area that has been deemed to be of concern of late has been foreign direct investment ("FDI"), i.e. the investment by foreign governments (or companies) in economic activities carried out within a host state. Recently, there has been political concern about a potential regulatory gap, whereby foreign governments could subsidize the activities of favored companies, while escaping the rules that would apply to subsidies granted by the host state itself.

This type of concern has crystallized in the form of the European Commission's May 2021 Proposal for a Regulation on Foreign Subsidies Distorting the EU Internal Market, among others.

The issues raised by the interaction between trade, political, and other geopolitical concerns and the competition rules are myriad. This Chronicle consolidates pieces that place the latest developments in this complex domain within an analytical framework, analyze the latest developments, and plot a way forward for this complex debate.

As always, thank you to our great panel of authors.

Sincerely,

CPI Team

SUMMARIES

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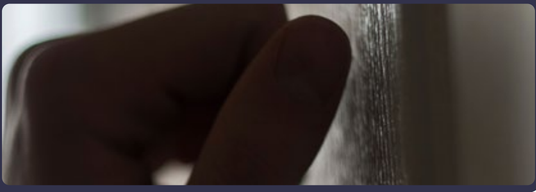

“Knock, Knock… Who’s There?” Key Elements of the EU FDI Screening Regulation

By Stefan Amarasinha & Damien Levie

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.

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Foreign Direct Investment Review – Recent Developments in Europe

By Peter Camesasca, Horst Henschen & Martin Juhasz

The article provides an overview of recent developments in foreign direct investment (“FDI”) review across Europe. In describing what is meant by FDI review, it outlines that there is no unilateral definition for the concept of FDI, but a common trend towards more rigorous screening and extended mandatory filing requirements. Specific jurisdictional updates follow, concerning amendments to existing FDI regimes in the UK and Germany respectively, alongside recent enforcement practice in those jurisdictions. Newly-introduced FDI regimes in the Czech Republic, Denmark, the Netherlands, and Slovakia are summarized and finally, the authors take an outlook to other policy developments, like the European Commission’s Foreign Subsidies Proposal, and explore their implications on M&A transactions.

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Much to Be Worked Out: The European Commission’s Proposal for a Regulation on Foreign Subsidies Distorting the EU Internal Market

By Matthew Hall

The European Commission’s May 2021 Proposal for a Regulation on Foreign Subsidies Distorting the EU Internal Market is an eye-catching measure due to its expressly extra-territorial nature. It applies to any business – including EU businesses – engaged in an economic activity in the EU and lays down rules and procedures for investigating subsidies from a non-EU Member State that distort the EU internal market and for redressing such distortions. Included are compulsory notification regimes for acquisitions and when engaging in certain public procurement procedures in the EU. The Proposal would extend in part the EU State Aid regime (which controls the grant of subsidies by EU states) to subsidies granted by non-EU countries (foreign subsidies). If adopted, companies should expect active enforcement as the Commission will allocate some 145 FTEs to enforcing the rules. Companies should consider the implications and start collecting relevant information in order to comply now.

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The Rise of Foreign Investment Control – A Global Snapshot on the State of Play of More Industrial Policy Enforcement

By Christian Ahlborn & Christoph Barth

Over the past three years, many countries have introduced new rules or strengthened existing foreign investment regimes, widening the range of sectors to which they apply. This is a trend exacerbated by COVID-19, which saw an additional proliferation of rules focused on the protection of pandemic-related supply chains and avoiding any opportunistic exploitation of depressed company valuations. This new environment has translated into a higher degree of intervention, with many jurisdictions requiring approval even for non-controlling minority shareholdings. Notification numbers have spiked globally, adding uncertainty and complexity to transactions. Separately, several countries also allow foreign investment review authorities to call in transactions over which they have jurisdiction even if a filing was not required. In this article, we look at the latest developments and their implications across a number of key jurisdictions globally.

SUMMARIES

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The French Dilemma: Preserving FDI in France While Exercising Greater Control

By Marie-Laure Combet

While boasting of its (renewed) first place at the top of the ranking of attractive European countries from the point of view of foreign direct investments ("FDIs"), France has adopted various amendments to its FDI regime over the past three years, which have had as their effect to subject foreign investments to increased scrutiny but also, as a side-effect, to increased legal uncertainty. This move towards greater scrutiny is not surprising as protectionism is on the rise globally. But it may appear a bit contradictory with the objective to preserve France's attractiveness to FDIs. It hence raises the question of reconciliation between those seemingly contradictory intentions. In this article, it is suggested that an initial approach could consist in reducing the legal uncertainty currently faced by foreign investors subject to the French FDI regime. It may not solve entirely the dilemma, but it is undoubtedly part of the solution.

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Canada's Expanding Approach to National Security in Foreign Investment Reviews

By Neil Campbell & Joshua Chad

The primary focus of Canada's review of foreign investments has shifted from an assessment of an investment's economic benefits in Canada to an assessment of national security risks. The range of potential national security concerns has broadened beyond traditional areas such as national defense, terrorism, and organized crime, to include the potential use of artificial intelligence, advanced technologies, critical supply chains or sensitive personal data to harm Canada's security. Procedurally, most national security reviews are initiated following a non-Canadian investor submitting the standard notification required to be filed after acquisition of control of a Canadian business, and extending this process to minority investments could reduce the uncertainty that currently applies to such transactions.

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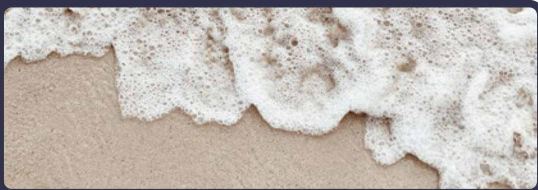

The Importance of Competitive Neutrality in Promoting FDI and Sustainable Recovery

By Sophie Flaherty

Competitive neutrality principles encourage FDI by promoting a level playing field among competitors. When certain market players, such as SOEs, or selected private firms, are granted unfair advantages or are subject to different rules, the domestic and international competitive landscape may be distorted. As FDI is essential in ensuring sustainable recovery from the current crisis, governments should pursue measures that ensure effective competition in their home economies and that encourage the implementation of international competitive neutrality standards. This article will focus on the importance of competitive neutrality in encouraging FDI. It will discuss how competition law and policy can help address these concerns and will highlight the importance of international cooperation.

WHAT'S NEXT?

For August 2021, we will feature Chronicles focused on issues related to (1) **State AGs**; and (2) **EAB Antipasto**.

ANNOUNCEMENTS

CPI wants to hear from our subscribers. In 2022, we will be reaching out to members of our community for your feedback and ideas. Let us know what you want (or don't want) to see, at: antitrustchronicle@competitionpolicyinternational.com.

CPI ANTITRUST CHRONICLES SEPTEMBER 2021

For September 2021, we will feature Chronicles focused on issues related to (1) **Tying & Bundling**; and (2) **Free Isn't Free?**

Contributions to the Antitrust Chronicle are about 2,500 – 4,000 words long. They should be lightly cited and not be written as long law-review articles with many in-depth footnotes. As with all CPI publications, articles for the CPI Antitrust Chronicle should be written clearly and with the reader always in mind.

Interested authors should send their contributions to Sam Sadden (ssadden@competitionpolicyinternational.com) with the subject line "Antitrust Chronicle," a short bio and picture(s) of the author(s).

The CPI Editorial Team will evaluate all submissions and will publish the best papers. Authors can submit papers on any topic related to competition and regulation, however, priority will be given to articles addressing the abovementioned topics. Co-authors are always welcome.

"KNOCK, KNOCK… WHO'S THERE?" KEY ELEMENTS OF THE EU FDI SCREENING REGULATION

BY STEFAN AMARASINHA & DAMIEN LEVIE[1]

1 The authors are Policy Officer (Stefan Amarasinha) and Head of Unit (Damien Levie), Technology and Security, FDI Screening, Directorate General for Trade, European Commission. The information (relying solely on public sources) and views set out in this article stem from the authors and do not necessarily reflect the official opinion of the European Commission.

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]

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

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."*

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.

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.

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.

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.

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.

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.

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."*

12 As of June 1, 2021.

MS with screening mechanism/legislative activities

Updated 25/05/2021

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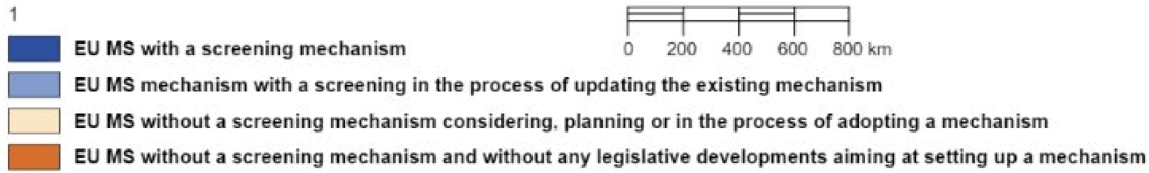

Note not entered.

Member States' notifications to DG TRADE

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

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."*

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."*

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.

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.

FOREIGN DIRECT INVESTMENT REVIEW – RECENT DEVELOPMENTS IN EUROPE

BY PETER CAMESASCA, HORST HENSCHEN & MARTIN JUHASZ[1]

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I. INTRODUCTION

The European Union ("EU") has traditionally been one of the world's most open economies for foreign direct investments ("FDI"). While it remains an attractive and open destination for investment, public officials continue to voice their concerns about investments into strategic companies and key technologies within the EU. The European Commission ("Commission") has recently presented its EU trade policy reflecting the concept of open strategic autonomy.[2] Therein, the Commission maintains its aim to strengthen multilateralism while emphasizing that the EU will take a more assertive stance in defending its interests and values.[3] The Commission particularly seeks to address what it perceives to be unfair trading practices and finds that the EU "*needs to equip itself with tools to operate in a more hostile international environment if necessary*."[4]

In that context, the Commission reinstated its call to Member States "*to set up and enforce a fully-fledged FDI screening mechanism 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*."[5] The Commission intends to further strengthen cooperation with national authorities and is even considering "*enhancing the cooperation mechanism established by the FDI Screening Regulation*."[6] This is all part of a broader trend across Europe and beyond towards closer scrutiny of foreign investments and stricter rules on investment review on the basis of public order and security considerations.[7]

This article seeks to describe what is meant by FDI review and provides an overview of recent developments in Europe. It concludes with an outline of other policy developments and their general implications for investments into Europe.

II. NO UNILATERAL DEFINITION OF FDI BUT A COMMON TREND TOWARDS STRICTER FDI REVIEW

There is no unilateral definition of what may be regarded as a relevant foreign direct investment, and Member States apply their own legal tests and standards when it comes to FDI screening. This is in line with Article 4(2) TEU, as to which national security remains the sole responsibility of each EU Member State.[8] In 2019, the EU adopted a framework for the screening of foreign direct investments into the Union (the "EU Screening Regulation"),[9] which entered into full effect on October 11, 2020.

As regards relevant investments, the EU Screening Regulation refers to "*[…] an investment of any kind by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the [target] in order to carry on an economic activity in a Member State*." This shall include "*investments which enable effective participation in the management or control of a company carrying out an economic activity*."[10] Recital 9 of the EU Screening Regulation excludes portfolio investments, which the Commission considers as being acquisitions of shares or debt that do not result in a controlling interest of the investor.[11]

Most of the EU Member States have further specified what amounts to a relevant investment and have provided for quantitative investment thresholds within their FDI regimes. For share acquisitions, these are usually calculated on the basis of equity and/or voting rights.[12] With regard to asset acquisitions, national regimes commonly require the acquisition of a separable business unit, or all essential operating resources

2 Communication from the Commission, "Trade Policy Review - An Open, Sustainable and Assertive Trade Policy," COM(2021) 66 final, February 18, 2021.

3 *Ibid.* p. 4 et seq.

4 *Ibid.* p. 8.

5 *Ibid.* p. 20.

6 *Ibid.* p. 20.

7 See OECD Policy Responses to Coronavirus (COVID-19), Investment screening in times of COVID-19 and beyond, 7.7.2020, available at https://www.oecd.org/coronavirus/policy-responses/investment-screening-in-times-of-covid-19-and-beyond-aa60af47/.

8 See also Article 346(1) lit. b) TFEU with regard to measures for the protection of national security, which relate to arms, munitions and war material.

9 Regulation (EU) 452/2019 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, Official Journal LI 79/1.

10 *Ibid.* Article 2(1).

11 Communication from the Commission, "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)," C (2020) 1981 final, 25.3.2020.

12 E.g. Germany, Italy, Hungary, Spain.

of a company.[13] Some countries also cover cases where effective participation in the management or control is acquired.[14] Less common is for national FDI regimes to rely on *de minimis* investment thresholds; where those exist, they include relatively low safe harbors (commonly set at a value worth EUR 1 million).[15]

Each jurisdiction has its own particularities regarding the sectors that attract the focus of FDI screening, especially regarding the target activities that require mandatory FDI filing. The list of sensitive sectors and activities in Article 4(1) of the EU Screening Regulation is not fully harmonized within the EU, and Member States have different interpretations of what amounts to a relevant critical infrastructure or technology.[16] Different definitions also come into play when considering a 'foreign' investor. Investments into particularly sensitive sectors, like defense, are usually subject to screening for EU and non-EU investments alike. Conversely, the FDI Regulation stresses the focus on non-EU/EEA investments in the sectors mentioned in Article 4(1) by referring to 'third countries'. Other countries, such as Poland, broaden the definition to non-EU/EEA or non-OECD investors.

Regardless of national particularities, there is a common trend across Europe and beyond towards more rigorous screening and extended mandatory filing requirements. At the time of writing this article, 18 EU Member States have screening mechanisms in place[17] and the trend of a more thorough FDI screening is followed by other countries around the globe.[18] This development has a tangible impact on global M&A transactions and considerably influences their planning. Most of the FDI regimes contain mandatory filing requirements that are backed with suspensory effect and closing prohibitions. A breach of the latter can often be fined or could ultimately also result in criminal sanctions.[19] National authorities engage in closer cooperation and the increasing exchange of information requires a global FDI strategy for multi-jurisdictional transactions.

III. FDI REVIEW IN EUROPE

Europe has seen significant changes in the FDI landscape, reflected by numerous reinforcements of existing regimes as well as the introduction of new regimes. Some illustrative examples are provided below:

A. UK

Having completed its transition and departure from the EU on December 31, 2020, the UK is working to strike trade deals across the globe from its new international footing. In the National Security and Investment Act (the "NSI Law"), which received Royal Assent on 29 April 2021 and is expected to enter into force later this year, the UK government has begun to define a new approach towards inward investments into the UK. In structural terms, this has involved setting up a new Investment Security Unit within the Department of Business, Energy & Industrial Strategy that will be responsible for receiving and managing notifications under the NSI Law and supporting the Minister for Business who will have decision-making power.[20] Additionally, an Office for Investment has been established with responsibilities to guide investment into the UK and encourage investment for strategic projects. The UK government has also announced domestic initiatives such as the Advanced Research and Innovation Agency as a potential support to developers of critical technology.

The NSI Law will have a retroactive effect, applying to any transaction completed after November 12, 2020. Once in effect, mandatory notification obligations will be introduced by the NSI Law for transactions in 17 sensitive sectors where a 25 percent interest in capital and/or voting rights is acquired. Furthermore, the Government will retain broad discretion to 'call-in' transactions occurring in any sector for review if "material influence"[21] is acquired and including asset transactions, if it has reasonable concerns on national security.

13 E.g. Germany, France.

14 E.g. Germany, France.

15 E.g. Spain, Italy, Hungary.

16 P. Camesasca, H. Henschen & M. Juhasz, Foreign direct investment screening in Europe: A comparative perspective on differences and commonalities within Europe, *Concurrences* N° 4-2020 pp. 268-272.

17 A list of screening mechanisms notified by Member States to the European Commission is available at https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf.

18 Countries that have recently tightened their regimes include for example Australia, the U.S., India, and Canada.

19 For example in Austria, France, Germany and Poland.

20 T. Reilly & K. Kingsbury, UK National Security & Investment Law is Approved by Parliament, *Covington Competition*, May 4, 2021, available on Covington Competition at https://www.covcompetition.com/2021/05/uk-national-security-investment-law-is-approved-by-parliament/.

21 'Material influence' may have expansive meaning if recent UK competition law precedents are applied, and could bring investments of much less than 25 percent in scope of the regime.

These call-in powers endure for up to five years from the date of the transaction, and potentially extend insofar as to allowing scrutiny of transactions occurring outside the UK if the transaction may have implications for supplies or other activities into the UK. A voluntary notification regime will therefore be available, providing a route for investors, who seek legal certainty in relation to transactions that may be covered by the "call-in" powers.

In the meantime and until the NSI Law takes effect, the UK government has been investigating transactions using the pre-existing public interest intervention regime established under the Enterprise Act 2002. This prior regime relies upon the UK's Competition and Markets Authority ("CMA") to provide operational support to Ministers in the review of transactions on a range of public policy grounds, including national security. Specifically, on April 19, 2021, the Secretary of State for the Department for Culture Media & Sport issued a public interest intervention notice in respect of the proposed acquisition of the UK semi-conductor company ARM Limited by US company Nvidia Corporation.[22] The CMA is now due to prepare a report on the USD 40 billion transaction which will inform any further decisions made by the Minister. While waiting for the deal to be cleared, Nvidia has made commitments to maintain ARM's neutrality, an element also considered important when the UK permitted SoftBank's takeover of the company in 2016. Developments on the case may offer an insight into the UK's new approach to FDI, in particular whether the UK's FDI screening tools will be used solely to address national security concerns or wider economic issues as well.

For its part, the CMA has also appeared more proactive in referring transactions to UK Ministers for potential national security or other public policy concerns. On March 3, 2021, the CMA notified the Secretary of State for Business, Energy and Industrial Strategy of potential public interest considerations arising from the proposal by Imprivata, Inc. to acquire Isosec Limited, a developer of software identity tools including for the UK National Health Service. Further, on May 12, 2021, the CMA notified the proposed acquisition of Xilinx by Advanced Micro Devices to the Culture Secretary, likely due to the relevance of Xilinx to UK data infrastructure networks. It remains to be seen (at the time of writing) whether Ministers will take forward a public interest intervention in respect of the Xilinx/AMD transaction; in the meantime, the proposed acquisition of Isosec was abandoned after a Phase II merger control investigation was initiated.

B. Germany

On April 27, 2021, the German government adopted the 17th amendment ("Amendment") to the Foreign Trade and Payments Ordinance ("AWV"), further aligning the German FDI regime with the EU Screening Regulation. The Amendment significantly extended the number of sectors and target activities that require mandatory notification in Germany and also brought significant procedural changes and clarifications.[23] The revised Ordinance entered into force on May 1, 2021 and will apply to all transactions signed thereafter.

The Amendment followed a series of prior legislative changes. In light of the COVID-19 pandemic, the German government had previously adopted the 15th AWV-Amendment in June 2020, which introduced far-reaching filing obligations in the healthcare sector. Subsequently, the first amendment of the Foreign Trade and Payments Act introduced standstill obligations backed by fines and criminal charges in July 2020 for all transactions that require mandatory FDI filing. Together with the 16th AWV-Amendment in October 2020, the German FDI regime was aligned with the requirements of the EU Screening Regulation and the EU cooperation mechanism.[24]

Under the now current regime, mandatory notifications with suspensory effect are required for foreign acquisitions of domestic companies with activities that either fall into the list of defense-related activities (the so-called sector-specific examination), or that concern other sensitive activities under the so-called cross-sectoral examination, such as the operation of critical infrastructures or activities relating to critical technologies.[25] The Amendment substantially extended the list of sensitive sectors under both the sector-specific and the cross-sectoral examination, and went beyond the list of activities contained in Article 4(1) of the EU Screening Regulation. More specifically, the Amendment also addressed activities that relate to autonomous vehicles or unmanned drones, optoelectronics, additive manufacturing processes (3D printing) and certain network technologies.

22 *Ibid.*

23 For further information see P. Camesasca, H. Henschen & M. Juhasz, Technology Sector under Closer Scrutiny – German Government Significantly Extends the Scope of Foreign Direct Investment Review in Germany, *Covington Competition*, May 6, 2020 available on Covington Competition at https://www.covcompetition.com/2021/05/technology-sector-under-closer-scrutiny-german-government-significantly-extends-the-scope-of-foreign-direct-investment-review-in-germany/.

24 *Ibid.*

25 Those critical technologies *inter alia* include satellite systems, artificial intelligence, autonomous driving and unmanned flying, industrial robots, semiconductors and optoelectronics, IT-security equipment, aerospace goods or technologies, nuclear technology, and quantum technologies.

Even though the list of sensitive sectors requiring mandatory filing has been significantly extended over the past few years, prohibition decisions are still rare in German FDI control. While decisions of the German FDI regulator are not published, the few interventions became known to the public:

- In July 2018, the German government decided to prevent the acquisition of a minority stake in the power grid operator 50Hertz by a Chinese investor through an investment by the state-owned development bank KfW in the target, as the then pertinent FDI regime did not provide for powers to block the transaction;
- In August 2018, the Chinese undertaking Yantai Taihai Corporation withdrew from the planned acquisition of the German industrial tool maker Leifeld Metal Spinning, after the German FDI regulator threatened to block the transaction;
- In July 2020, the German government blocked a Chinese investor's proposed acquisition of PPM Pure Metals GmbH, a manufacturer of metals used in semiconductors and infrared detectors, including for military applications;
- In December 2020, the German FDI regulator issued a prohibition decision to the Chinese acquirer Addsino Co Ltd, Beijing regarding the acquisition of IMST GmbH, a German-based manufacturer of components with military applications in satellite/radar communications and 5G;[26]
- Besides that, the German KfW acquired a minority stake in CureVac, a biopharmaceutical company inter alia active in the development of COVID-19 vaccines, in order to avoid its potential acquisition by foreign investors;
- Currently, the BMWi is conducting in-depth investigations regarding several investments in the semiconductor industry and also appears interested in the Nvidia/Arm transaction outlined above, with regard to which German state officials referred to a potential impact of the transaction on European digital sovereignty and cybersecurity.

Other jurisdictions

Several other Member States have amended or introduced FDI regimes recently, a trend accelerated by the effects of the COVID-19 pandemic.[27] Some of these Member States include:

a. Czech Republic: On May 1, 2021, a new Czech foreign investment control regime has become applicable through the Act on Screening of Foreign Investments ("FIR Act"). The regime applies to acquisitions by non-EU investors of at least 10 percent share interests in domestic companies involved in sensitive activities such as critical infrastructure including information infrastructure, military equipment and dual-use goods. Relevant transactions will be subject to mandatory notifications with suspensory effect. Other transactions can be reviewed ex officio on national security grounds up to five years after completion of the investment. The Czech Republic also offers voluntary consultations to seek legal certainty.[28]

b. Denmark: The Danish parliament recently passed a new screening mechanism entering into force on July 1, 2021, which is applicable to all transactions that are not completed until September 1, 2021. The bill provides for ex officio investigation powers and introduces mandatory filing obligations for investments into targets active in sectors such as defense, IT security, dual-use goods, critical technology and critical infrastructures. The bill further introduces a voluntary notification process for investments potentially threatening national security and public order. The Danish Business Authority is expected to issue executive orders to provide guidance on the bill in the near future. The introduction of the bill is reported to be partly due to a bid by Chinese company Huawei to build Denmark's 5G network.[29]

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26 P. Camesasca, H. Henschen & M. Juhasz, Foreign Direct Investment – German Government Prohibits Acquisition By A Chinese Buyer, *Covington Competition*, Deember 12, 2020 available on Covington Competition at https://www.covcompetition.com/2020/12/foreign-direct-investment-german-government-prohibits-acquisition-by-a-chinese-buyer/.

27 OECD (footnote 7).

28 See Ministry of Industry and Trade of the Czech Republic on Investment Screening, available at https://www.mpo.cz/en/foreign-trade/investment-screening/.

29 Denmark passes law to screen foreign investments for security risks, May 5, 2020, available on Reuters at https://www.reuters.com/article/denmark-security-investment-idUSL1N2MS1CO.

c. Netherlands: A Dutch FDI screening mechanism implementing the EU Screening Regulation came into force in December 2020 (the "Implementing Act").[30] The Implementing Act designated the competent contact point in the Netherlands for the EU cooperation mechanism and specified which ministers are responsible for decisions taken under the EU cooperation mechanism. The Implementing Act further defined the sources that may be used for information gathering under the regulation.

   The Dutch government has presented another draft bill, which is currently undergoing legislative procedure. The draft bill contains mandatory notification requirements for investments in sectors such as sensitive technology and supplies of vital processes. The draft bill is currently being amended by the Minister of Economic Affairs and Climate, who has extended its review period.[31] Notably, the bill is likely to have retroactive effect extending back to 2 June 2020.

d. Slovakia: Slovakia's new regime for FDI screening entered into force on 1 March 2021. The regime introduced mandatory notification requirements for acquisitions of control or ownership (exceeding 10 percent of capital or voting rights) in companies operating critical infrastructures, such as transportation; postal services; energy; communication via electronic means; the management of water; finance; information and communication technologies; healthcare and pharmaceuticals; or heavy industry and agriculture.

IV. OTHER POLICY DEVELOPMENTS AND THEIR GENERAL IMPLICATIONS

The latest developments in FDI screening and their underlying trade policy considerations are echoed by other legislative proposals, which will further impact foreign investments into the EU. While foreign investments are still acknowledged as a welcome source of employment, growth and competitiveness, the regulatory hurdles that arise continue to increase.

Not long ago, the Commission published its proposal for the regulation of foreign subsidies (the "Foreign Subsidies Proposal") and therein *inter alia* suggests a pre-closing notification requirement for transactions that may have benefitted from financial contributions of non-EU countries.[32] The proposal is a result of the Commission's public consultation that followed its White Paper on foreign subsidies from last year.[33] More specifically, the proposal suggests a mandatory notification requirement for acquisitions of EU targets, where the EU turnover of the company to be acquired (or of at least one of the merging parties) is equal to or higher than EUR 500 million and where the undertakings concerned received a foreign financial contribution of at least EUR 50 million within the last three years.[34] Companies based outside the EU that receive foreign state support in any form will therefore need to consider the implications of the proposed regime and potential filing requirements for their future EU-bound activities.

Already by now, the long-established merger control assessment is accompanied by a multi-jurisdictional analysis of FDI-related risks in global transactions. The Foreign Subsidies Proposal may add another pre-closing filing requirement for certain transactions and therefore brings additional regulatory complexity for investments into Europe. Even though the majority of investments into Europe that are subject to mandatory filings, regardless of whether under the current merger control or FDI laws, receive clearance by the competent authorities, the increased scope of mandatory filing requirements and the substantial information required to conduct a filing assessment have a tangible impact on investment planning. Lengthy review periods (often exceeding statutory review periods), uncertainty as to final outcomes and substantial amounts of information requested by screening authorities are detrimental to Europe's attractiveness for foreign investments. Business associations have already complained that the broad scope of mandatory FDI filing requirements could force small and medium-sized manufacturers to withdraw from activities in sensitive sectors.[35] The right balance between the legitimate purposes of investment screening and an undistorted flow of investments will therefore need to be further explored.

30 Ministry of Economic Affairs and Climate, Wet, Staatsblad 2020, 491 of 3.12.2020, available at https://zoek.officielebekendmakingen.nl/stb-2020-491.html.

31 Minister of Economic Affairs and Climate, Investment review planning system to minimise risks to national security, Government Letter, December 8, 2020, available at https://www.tweedekamer.nl/kamerstukken/brieven_regering/detail?id=2020Z24227&did=2020D50922.

32 The Commission Proposal for a Regulation Of The European Parliament And Of The Council on foreign subsidies distorting the internal market, COM(2021) 223 final, May 5, 2021.

33 European Commission, White Paper on levelling the playing field as regards foreign subsidies, COM(2020) 253 final, June 17,.2020.

34 Foreign Subsidies Proposal (footnote 32), Article 18.

35 As stated in a letter from the German Mechanical Engineering Industry Association (VDMA) to the German Ministry of Defense.

MUCH TO BE WORKED OUT: THE EUROPEAN COMMISSION'S PROPOSAL FOR A REGULATION ON FOREIGN SUBSIDIES DISTORTING THE EU INTERNAL MARKET

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Among the various new obstacles to foreign direct investment worldwide, probably the most eye-catching is the European Commission's May 2021 Proposal for a Regulation on Foreign Subsidies Distorting the EU Internal Market.[2] The Proposal stands out in particular due to its solely extra-territorial nature, which was made explicit in the Commission's accompanying press release:[3]

> [The Proposal] aims at closing the regulatory gap in the Single Market, whereby subsidies granted by non-EU governments currently go largely unchecked, while subsidies granted by [EU] Member States are subject to close scrutiny. The new tool is designed to effectively tackle foreign [i.e. non-EU] subsidies that cause distortions and harm the level playing field in the [EU] Single Market in any market situation.

The Proposal applies to any business – including EU businesses - engaged in an economic activity in the EU. This includes a company making an acquisition or participating in a public procurement procedure. It lays down rules and procedures for investigating subsidies from a non-EU Member State that distort the EU internal market and for redressing such distortions.[4] In practice, to some extent it extends the EU State Aid regime (which controls the grant of subsidies by EU states) to subsidies granted by non-EU countries (foreign subsidies).

As the Commission sees it, foreign subsidies may give companies an unfair advantage, crowd out non-subsidized companies, harm innovation and damage the quality and choice of goods and services for consumers in the EU.

According to the Commission, the regulatory gap arises due to foreign subsidies that fall outside the existing EU State Aid, merger control, antitrust and public procurement rules. The State Aid rules only cover support given by EU Member States. The merger and antitrust rules do not enable the Commission (or EU Member States) to consider whether a company may have benefitted from distortive foreign subsidies and similarly the EU public procurement framework does not specifically address distortions to the EU procurement markets caused by foreign subsidies. By applying only to extra-EU subsidies, the Proposal is designed to "complement" and be "fully coherent" with those rules.

The Proposal would also complement the existing WTO subsidy rules and EU trade defense instruments, since those apply to the import of subsidized goods, but do not apply when foreign subsidies support investments, acquisitions or bids in procurement procedures, or when services and financial flows are concerned. Finally, the framework in the EU for screening foreign investments (in parallel to merger control) tackles threats posed by foreign takeovers and investments to Member States' security and public order, but not to the level playing field.

So far as concerns its language and general structure, the Proposal achieves its intended complementarity and coherence with the EU State Aid, merger control and public procurement rules in particular. However, there are many uncertainties and practical issues arising which are readily apparent even now. In addition, the general concepts will be alien to many non-EU lawyers, who will often need to interpret the rules for potentially affected companies. Significant lawyers' and company time will be spent understanding and grappling with the issues, some of which are summarized below.

2 European Commission, Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the Internal Market (SWD(2021) 99 final, SWD(2021) 100 final, SEC(2021) 182 final), May 5, 2021, available at https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.

3 European Commission press release, Commission proposes new Regulation to address distortions caused by foreign subsidies in the Single Market, May 5, 2021, available at https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1982.

4 It is notable that, from January 1, 2021, the United Kingdom has been a foreign country so far as concerns the EU.

I. DEFINITION OF A FOREIGN SUBSIDY

According to the Proposal, a foreign subsidy will exist where:

> … a third country provides a financial contribution which confers a benefit to an undertaking engaging in an economic activity in the internal market and which is limited, in law or in fact, to an individual undertaking or industry or to several undertakings or industries.

A "third country" is any non-EU Member State, including governmental authorities at any level, or public or private entities whose actions can be attributed to the non-EU country.[5] Only financial contributions provided by a non-EU country are relevant, so that if an undertaking obtains such partly from an EU country and partly from a non-EU country, then only the element from the non-EU country (or countries) is relevant. In most cases, this should not give rise to an issue, but when calculating the contributions received, a large group will need to make sure that it captures and combines these from any country worldwide (outside the EU).

"Financial contribution" is defined in the Proposal and includes a wide range of possibilities which are familiar to EU State Aid practitioners (including the transfer of funds or liabilities, the foregoing of revenue that is otherwise due (i.e. tax breaks) and "the provision of goods or services or the purchase of goods and services"). The Commission's press release refers specifically to zero-interest loans and other below-cost financing, unlimited state guarantees, compensations, zero-tax agreements, preferential tax treatment, tax credits, direct financial grants and export financing that is not in line with the OECD Arrangement on official supported export credits.

So far as concerns whether that financial contribution provides a "benefit," similarly State Aid principles will be used. Thus, this will be determined on the basis of comparative benchmarks, such as the investment practice of private investors (often referred to as the "market economy" principle), rates for financing obtainable on the market, a comparable tax treatment, or whether adequate remuneration for a given good or service has been provided. Although well-established and litigated principles in the EU, these are still highly complex issues.

The reference to "limited" means that the financial contribution must also be selective. This is also a difficult topic in State Aid law (for example in relation to tax breaks or tax rulings provided by individual countries in favor of particular businesses).

Applying the relevant EU principles in order to determine the position in all relevant countries around the world where a business may have received a financial contribution of any nature (including for example an individual tax ruling) will be a significant task. This is not something that a company will want to carry out in a short timescale when it becomes necessary under these EU rules. It would be much preferable to know the situation already, which will require investigating and recording the position and updating it on an ongoing basis. This is particularly the case since a given foreign subsidy could be assessed more than once under the various heads of review considered below.

II. THE FOREIGN SUBSIDY MUST DISTORT THE INTERNAL MARKET

As noted, the Proposal is aimed at investigating foreign subsidies that distort the internal market and redressing such situations. It is clear that a subsidy must be more than *de minimis* in order to distort the internal market. However, beyond an express carve-out for subsidies totaling less than EUR 5 million over a consecutive period of three fiscal years, there is a lot of room for argument as to when a distortion arises.

In practice, companies monitoring and recording subsidies granted to them will need to take account in particular those which fall within the categories identified as "*most likely to distort the internal market.*" These are: subsidies granted to an "ailing undertaking" where there is no restructuring plan (that includes a significant own contribution by the undertaking); a subsidy in the form of an unlimited guarantee for debts or liabilities of the undertaking; a subsidy directly facilitating a "concentration" (i.e. acquisition or merger); and a subsidy enabling an undertaking to submit an "unduly advantageous tender" in a public procurement procedure, on the basis of which the undertaking would be awarded the public contract.

These are all familiar concepts in EU competition, State Aid and public procurement law, but they are only examples and the Commission will be able to identify a distortion in a very wide range of cases. In that situation, the next question is "balancing." If there is a distortion, the Commission will balance the "negative and positive effects" when deciding whether to impose redressive measures against the undertaking in question or to accept "commitments." This means changes to the operation of the business, or potentially repayment of the subsidy plus interest.

5 The regime is likely to be extended to the European Economic Area ("EEA"), which includes the EU plus Norway, Iceland and Liechtenstein.

The problem is that there is no attempt in the Proposal to define on what basis this balancing will be carried out. The Proposal simply states that the Commission shall balance the distortion on the internal market with positive effects on the development of the relevant economic activity. Those positive effects must presumably be in the EU, but that is not stated.

It's also unclear whether beneficial external effects can be included, most obviously in the sustainability, particularly climate change, area. Given the EU Green Deal and the level of discussion of this issue in relation to general EU antitrust law, this is surprising. An argument against these being relevant is that in the first preparatory document before the Proposal itself, the Commission had referred to a "European interest" test, which clearly allowed broader EU interests to be taken into account so as to counterbalance any distortions. However, this was removed in the Proposal, therefore suggesting a narrower focus.

This is without doubt an area where there will be much lobbying of the Commission and in relation to which litigation is ultimately likely. Creative thinking will be required in many cases to identify positive effects in the EU and how to measure these against the distortion in the EU. Companies will need to be ready to prepare detailed reports dealing with this balancing and in many cases will need to enlist the EU country in which an investment is being made in order to back them up.

It's interesting that, in providing examples of distortive foreign subsidies that might be investigated by the *ex officio* tool discussed below, the Commission singles out the case of an EU subsidiary of a non-EU-country parent which has access to cheap, state-supported financing from the non-EU country and which can therefore unfairly outcompete non-subsidized EU competitors. This makes the point that EU companies also need to consider the implications of the rules.

III. WHAT CAN THE COMMISSION DO IF THERE IS A SUBSIDY? THE *EX OFFICIO* REVIEW

Having established the general principles of what a foreign subsidy is, the Proposal moves on to how and when the Commission can investigate these and therefore when it potentially can accept voluntary commitments given by the recipient or (in the absence of commitments) can take redressive measures against the recipient.

This is the first taste of the procedural provisions, and they follow traditional EU lines. The Commission may examine information from any source and seek "all the information it considers necessary" to assess, on a preliminary basis, whether a financial contribution constitutes a foreign subsidy and whether it distorts the internal market. It can use written information requests and "inspections in and outside the [EU]."

It's clear that competitors of businesses that may have received subsidies will be able to complain to the Commission and try to convince it to examine the situation. As with complaints and litigation about State Aid within the EU, this will become a new avenue of attack against competitors. The Proposal does not require a "formal" complaint, so the Commission might be deluged by a large number of informal letters and complaints about allegedly subsidized third parties.

"Inspections" are commonly referred to as "dawn raids" and under the Proposal the Commission will be able to carry these out not only within the EU but also, remarkably, in other countries. The Proposal does accept that these extra-territorial dawn raids can only take place if "the undertaking concerned has given its consent and the government of the third country has been officially notified and has agreed to the inspection." It is difficult to imagine a situation in which an undertaking (not to mention a third country) will agree to a voluntary dawn raid of this nature. These types of extra-territorial inspections do exist, for example in the medical device sector when products are being considered for approval for sale in the EU. However, a contentious situation such as this, when the undertaking will always have the option of replying to written questions, is entirely different.

This general market investigation tool will allow the Commission to investigate situations such as greenfield investments or acquisitions and procurements below the thresholds for compulsory notification which are discussed below. A standstill obligation will apply.

If, following its preliminary review, the Commission considers there are sufficient indications that an undertaking has been granted a foreign subsidy that distorts the internal market, it is required to initiate an in-depth investigation. This stage ends with a decision that there are no issues (i.e. no distortion or any distortion is outweighed by positive effects), a decision identifying issues and requiring redressive measures or a decision identifying issues and accepting voluntary commitments.

These commitments and measures can include a range of structural or behavioral measures, including amongst other options the divestment of assets, the prohibition of certain market behavior, the repayment of a foreign subsidy (plus interest), the reduction of capacity or market presence and giving access to infrastructure. As with merger control reviews, it is inevitable that there will be a significant amount of negotiation of these remedies with the Commission and the subsidized business will need to put forward an analysis of the impact of its proposals.

Importantly, the Proposal allows the Commission to take these decisions based on the "facts available" to it (which may be limited). In addition, the Commission would be able to assume, where an undertaking fails to provide necessary information, that a financial contribution did indeed confer a benefit to it. This puts pressure on a company to cooperate with the Commission and answer its questions, since otherwise the Commission may just proceed on the basis of information provided by complaining competitors. It also puts pressure on a company to understand the scope of the law and what it is intended to achieve. Only then will a company be able to answer in the "correct" way (i.e. tactically to its benefit).

When presenting the Proposal, the Commission recognized that its ability to proceed on the basis of "facts available" would encourage investigated entities to make sure that the Commission has the correct evidence for its decision. The text of the Proposal itself expressly provides that "when applying facts available, the result of the procedure may be less favorable to the undertaking concerned than if it had cooperated."

There is no time limit for these *ex officio* investigations. Therefore, in addition to litigation about whether or not in-depth investigations should be started and their results, it's clear that there will be litigation about their length. Timing of the in-depth investigation in an *ex officio* situation is surely something that must clarified.

IV. WHAT ARE COMPANIES OBLIGED TO DO? COMPULSORY NOTIFICATION OF CERTAIN TRANSACTIONS

The Proposal introduces an additional compulsory notification and pre-closing clearance regime for certain transactions (i.e. a standstill obligation). This will operate in parallel with existing foreign direct investment and merger control notification obligations in the EU.

The new regime closely follows the well-known jurisdictional and procedural rules which already apply under the EU Merger Regulation (as well as the rules for *ex officio* investigations outlined above). In practice, therefore, when analyzing the applicability of the EUMR to a transaction, the jurisdictional review under the new subsidies regime will be overlayed on top of it.

The main differences between the two regimes are: the need for one or more of the parties to be "established in the [EU]"; the EU turnover requirement for the parties which must be met for a filing to be required; and the additional requirement for there to have been a subsidy from non-EU states of more than EUR50 million in the three calendar years prior to notification (the "financial contribution from third countries").

The question of whether a party is "established" in the EU needs clarification. In the case of a simple acquisition, this refers to the "acquired undertaking," which presumably is the parent company of the target group, but this is not clear. Calculation of the required turnover level is relatively easy, with this being set at EUR500 million for the target group in the case of a simple acquisition.

The foreign subsidy level is set at EUR50 million; in a simple acquisition this applies to both the target group and the acquiring group in the three calendar years prior to notification. This is a surprising formulation, since it means that subsidies given to the target are relevant (when the regime is apparently intended to catch subsidies which benefit a purchaser in acquiring an EU target), but it does widen the scope of the regime.

As with *ex officio* investigations, the result of the Commission's review will be that there are no issues (i.e. no distortion or any distortion is outweighed by positive effects), a decision identifying issues and requiring redressive measures or a decision identifying issues and accepting voluntary commitments. All of this will be analyzed as for an *ex officio* investigation and therefore subject to the same concerns.

It's notable that the Commission also has the authority (prior to closing) to require notification of transactions falling below the new jurisdictional thresholds when it suspects that the parties benefitted from foreign subsidies in the three years prior to the transaction. This makes it even clearer that companies active in the EU in mergers and acquisitions must keep good records of all subsidies received so that they are able to deal with questions and issues raised.

V. WHAT ARE COMPANIES OBLIGED TO DO? COMPULSORY NOTIFICATION IN PUBLIC PROCUREMENT PROCEDURES

In some cases, a foreign financial contribution must be notified to the purchaser in a public procurement procedure (i.e. those cases where a public or similar body puts out a contract for tender in accordance with the EU public procurement rules). This is the case when the estimated value of the procurement is at least EUR250 million. That is clearly a significant purchase and therefore the notification obligation will not be relevant in most procurement processes.

Where it is relevant, the notification obligation applies at the time the tender is submitted. All foreign financial contributions received in the three years preceding that notification must be identified or the bidder must confirm that it did not receive any in that period. The purchaser must then inform the Commission about any notification it receives so that the Commission can start a preliminary review (except in relation to timing, again the rules for *ex officio* investigations outlined above will apply).

A difficulty is that, in addition to the lead tenderer, the notification obligation extends to "main" subcontractors and suppliers and the lead tenderer in that case is required to ensure that notification takes place. This puts a significant burden on the lead tenderer, which in this situation is in effect representing third parties and may be providing confidential information the source of which it is not privy to and which it will not be able to verify. Fines can be imposed for intentionally or negligently supplying incorrect or misleading information in a notification, so this is a real concern. It will presumably become standard for individual contractual protections to be put in place to deal with these issues.

Notification of a foreign subsidy does not suspend the public procurement procedure, but under the Proposal the purchaser would not be allowed to award a contract to a company under investigation by the Commission following a purchaser informing it of a notification (standstill obligation). Remarkably, the in-depth investigation in a public procurement case can run up to 200 days. That seems unnecessarily drawn out and it is difficult to understand why it is so much longer than the period for a full preliminary and in-depth review of subsidized acquisitions.

As with transactions, it's notable that the Commission also has the authority to require a notification in any case (even below the thresholds) where it suspects that the bidder has benefitted from foreign subsidies in the three years prior to the tender. Again, therefore, companies active in public procurement procedures in the EU should, if only for this reason, keep good records of all foreign subsidies received so that they are able to deal with questions and issues raised.

VI. CONCLUSION

For many companies engaged in mergers and acquisitions in the EU, the Commission's proposal on foreign subsidies will become a mandatory third tier of regulatory review (alongside the foreign direct investment and merger control rules). However, the scope is wider than that due to the mandatory notification regime for companies bidding in certain public procurement procedures and the ability of the Commission to instigate *ex officio* investigations.

The Proposal is backward looking since it allows the Commission to consider foreign subsidies granted in the 10 years before it comes into force and since for the purposes of the mandatory notification regimes it takes into account foreign financial contributions granted in the three years before it comes into force. This means that, starting now, companies would be well advised to identify and record relevant foreign subsidies on an ongoing basis and going back at least nine years (so that when the Proposal is in force they will be in a position to deal with questions under the Proposal as implemented).

The Proposal now faces a lengthy review process before it becomes law, which (assuming it does) is unlikely to take place before the end of 2022. It is likely to be controversial, in particular since it adds to the increasing complexity of transaction review in the EU. Companies could end up having to file under three regimes (potentially in multiple countries for merger control and foreign direct investment review) which consider different issues and which are operated by different officials and which could require different remedies (or commitments). The Commission should publish guidance on how the different procedures will or should be coordinated at Commission and/or EU Member State level.

In addition, many will argue that the Proposal is too wide-ranging and should be focused on companies from non-market economies with well-funded state-owned enterprises where subsidies (State Aid) are subject to limited oversight. A legitimate question is why it should apply to a third country (such as the UK for example) with which the EU has a strongly-negotiated trade agreement dealing with subsidy control.

Despite this, and the likely length of the review process, it would be surprising if the final text included material changes from the Proposal, since it's understood to have general support amongst EU Member States.

If adopted, companies should expect active enforcement as the Commission will allocate some 145 FTEs to enforcing the rules; quite a significant amount of manpower. The Commission expects to initiate between 30-45 *ex officio* investigations per year and review 60-70 compulsory notifications under the rules concerning acquisitions and public procurement procedures.

Now is a good time for potentially affected companies based outside the EU to consider the implications and start collecting relevant information. They should consider what foreign state support they have received (in any form), assess the risk of potential investigation, prepare justifications to support their position and build internal mechanisms to ensure compliance with the rules going forward.

THE RISE OF FOREIGN INVESTMENT CONTROL – A GLOBAL SNAPSHOT ON THE STATE OF PLAY OF MORE INDUSTRIAL POLICY ENFORCEMENT

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I. INTRODUCTION

The current foreign investment landscape is highly dynamic. In this article, we look at the latest developments and their implications across a number of key jurisdictions globally.

Over the past three years, many countries have introduced new rules or strengthened existing foreign investment regimes, widening the range of sectors and types of transactions to which they apply. Historically, the the focus of foreign investment control used to be on defence and core security-related sectors. Exacerbated by COVID-19 - which saw an additional proliferation of rules focused on the protection of pandemic-related supply chains and avoiding any opportunistic exploitation of depressed company valuations - regimes are now very broad. These days, foreign investment control is relevant in virtually all sectors, from banking to transport, with a particular focus on the tech sector. In particular the focus on the tech sector is a function of the proliferation of more industrial policy considerations and the political desire to protect a country's key capabilities.

In addition, there is an increasingly wide understanding of what may constitute a purchaser warranting control – indeed, under the new UK regime there is no longer any distinction as to the nationality of the purchaser. And in regimes which still have some distinction as regards nationality, the level of corporate influence at which foreign investment control becomes relevant can be very low (10 percent and in some cases even lower) and even internal restructurings may be caught by foreign investment rules.

As a result, notification numbers have spiked globally, adding uncertainty and complexity to transactions – with filings often involving a burdensome, document-heavy, and costly process. The impact on the timing of a transaction may be significant, given that processes are sometimes long and non-transparent. With both outcomes and deal closure timetables harder to predict, companies are advised to consider foreign investment issues upfront, to mitigate any potential delays. Another important consideration is that mandatory filing regimes are often coupled with civil law invalidity of transactions until clearance has been obtained, as well as severe sanctions for non-compliance which may include criminal liability. Finally, several countries allow foreign investment review authorities to call in transactions over which they have jurisdiction even if a filing was not required. These rights can be exercised after a deal has closed and allow authorities to review transactions whose sensitivity was not previously apparent – in certain cases with no limit on the length of time after closing during which the authority may exercise its powers.

All of these trends, which are highly relevant for companies engaged in M&A, are here to stay. While in a few instances COVID-19 specific rules may be lifted, most of the rules are permanent in nature and are adding another regulatory layer to many transactions.

II. EUROPEAN UNION

The European Union does not operate a stand-alone foreign investment review and approval mechanism. The FDI Screening Regulation, which came into operation in October 2020, is intended to complement and coordinate national screening mechanisms, strengthening their effectiveness. It does so in two main ways:

- A Member State that is conducting a foreign investment review of a transaction has an obligation to communicate the fact that a filing has been made to all other Member States and the European Commission. As such, all authorities will become aware of transactions notified in other Member States.
- Both Member States and the EC are able to intervene in the national screening process by making comments or issuing (non-binding) opinions when a foreign investment potentially threatens the security or public order of other Member States, or when a foreign investment could potentially affect projects or programs of Union interest on grounds of security or public order.

Having been operational for nearly eight months, there are some practical implications transaction parties must be mindful of:

- Member States maintain their own forms of notification, requiring varying degrees of information regarding the investor and the target. However, the EU framework requires Member States to complete a set template of information. Notifying parties should therefore expect (and be prepared for) (i) follow-up questions by authorities needing to complete this detail where it was not required up-front as part of the filing form in that country and (ii) certain information contained in filings to be shared more broadly with the EC and other Member States.

- Where the co-operation mechanism applies, Member States and the EC have up to 35 days to share comments or an opinion. This can noticeably prolong already comparatively lengthy review periods in individual Member States while feedback (if any) is awaited. Additionally, Member States are starting their interaction under the framework at different times so their timetables are increasingly divergent.

- There is limited transparency regarding the nature or content of interactions between Member States and the EC – beyond answering questions to assist Member States in gathering the necessary information (and being made aware that an authority is waiting for feedback). Transaction parties are largely left to await the completion of the period within which Member States/the EC may provide comments / issue an opinion to (i) understand any comments/opinion and (ii) meaningfully address any areas of possible concern with the Member State(s) involved.

- The FDI Screening Regulation has increased the level of scrutiny over affected transactions. Extrapolating the early available figures to a full year – and considering that many Member States have only gradually started making use of the mechanism – we expect over 300 transactions to be reported under the mechanism yearly (although it remains to be seen how many of these will attract comment/ opinions).

The co-operation process and its implications for transaction parties will continue to evolve as competition authorities grow more familiar with the procedures and refine their application. What is already clear is that transactions requiring European foreign investment approval face an increasingly complex web of interactions.

III. FRANCE

The French foreign investment regime is a long-standing and well-established mandatory and suspensory regime. 2020 saw the implementation of the last steps of reforms from 2018 and 2019, as well as significant temporary measures introduced in response to COVID-19.

In August 2020, an additional threshold triggering foreign investment screening was implemented, at 10 percent of voting rights for non-EU investors acquiring shares in listed companies. This change followed guidance from the EC calling on Member States to increase their scrutiny of foreign investments in the context of the pandemic. This followed shortly after an earlier reduction of the ownership threshold triggering an approval requirement for non-EU/EEA investors from 33.33 percent to 25 percent. This additional threshold may be extended depending on the evolution of the COVID-19 crisis.

Other key recent changes include:

- The scope of the foreign investment rules was expanded to include two additional sectors, food safety and the press (including online press). Additionally, the definitions of the quantum technologies and energy storage sectors were revised (widened) to include related research and development. As a result, the notification obligations are the same for all foreign investors, regardless of whether they are located within or outside the EU. In addition, the list of sectors falling within the scope of the regime can be extended swiftly as and when needed, by decree, as occurred in the *Alstom/General Electric* merger.

- Simple cases (which make up a majority of cases) now benefit from a shorter review procedure (down to 30 business days, compared with two months previously).

- Confirmation that the target falls outside the scope of the rules now falls on the seller, so this information can be obtained much earlier in the M&A process.

- Conditions imposed on investors can now be relaxed, notably in the case of economic or legal changes.

IV. GERMANY

Germany has one of the most established and active foreign investment control regimes in Europe. The German landscape has shown itself to be highly dynamic and we forecast that it is set to remain so in the future. After undergoing three significant reforms in 2020, further far-reaching amendments were enacted on May 1, 2021.

The regime essentially already had two prongs which continue to be in place: (a) a "cross sector" process for non-EU/EFTA investors which applies a 25 percent filing threshold for all sectors and a reduced 10 percent filing threshold for transactions in sensitive industries and (b) a "sector specific" process for non-German investors, which applies a 10 percent filing threshold for transactions in the wider military sector.

The latest reforms introduced three key changes:

- 16 new sectors were added to the 11 sectors for which the mandatory and suspensory cross-sector filing requirement already applied. For the newly added sectors and four pre-existing ones, a new third filing threshold of 20 percent instead of 10 percent will apply. In addition, the scope of the "sector specific" regime was also broadened and now includes all export-controlled products (including, for example, the mere possession of such products).
- Thresholds were introduced for add-on acquisitions where the total voting rights of the acquirer reach or exceed specific thresholds. Previously, every *de minimis* add-on acquisition triggered a further filing requirement for cases involving a target's activities in sensitive sectors. This concept made little sense where the additional shareholding conferred no further influence over the relevant company. Aside from the new thresholds, the Ministry of Economy has the discretion to combine any clearance decision with a reporting obligation on any further increase of voting rights, even if the thresholds are not exceeded.
- A new concept of "atypical control" as a filing trigger was added, although a broad "circumvention provision" already existed prior to the 2021 reform, which targeted transactions structured to circumvent notification requirements. Nonetheless, legal uncertainty remained for cases falling short of the voting rights thresholds where an investor gained "atypical control" by other means. The new laws provide guidance on such rights, namely (i) obtaining further seats or majorities on management and/or supervisory boards; (ii) veto rights over strategic business or personnel decisions; and (iii) certain information rights regarding information sensitive from a foreign investment control perspective.

We expect the latest changes to considerably increase the number of mandatory filings – which have already nearly tripled since 2017. However, the reform provides for additional staffing at all relevant governmental bodies, and we hope this will shorten the process for straightforward cases, which is relatively long compared to other jurisdictions.

The impact of Germany's current rules will be evaluated by July 2022 and the changing of the guard in September's Federal elections may well see the government alter its approach to foreign investment review.

V. ITALY

In 2020, in response to COVID-19, the Italian Government strengthened and widened the Golden Powers Regulation ("GPR"), which governs the Italian foreign investment screening mechanism.

The reforms extended the scope of the GPR to a considerable number of sensitive sectors (most of them outlined in Article 4 of the EU FDI Screening Regulation), and introduced new notification requirements covering (i) non-Italian investors acquiring control of a company having "assets and relationships" in a sensitive sector (a Sensitive Company) and (ii) non-EU investors acquiring a participation of 10 percent or more of the corporate capital or voting rights in a Sensitive Company.

These reforms have led to a staggering increase in the number of transactions notified to the Italian Government – 341 filings in 2020, compared to just 83 in 2019. However, of the cases closed in 2020, the Italian Government declared almost half to be out of scope, evidencing above all its broad discretion in determining the GPR's application. From public sources, since the adoption of the GPR the Italian Government has only prohibited three highly sensitive transactions – concerning, respectively, the defense and national security, semiconductor and 5G sectors – out of hundreds of notified transactions across various sectors.

The legislative changes introduced in response to COVID-19 are due to expire on December 31, 2021, but postponement of this term or further amendments of the GPR are possible, depending on the progress of the pandemic. Absent a postponement, reporting requirements should significantly decrease, especially for EU investors.

Separate from any more COVID-related changes, the GPR's scope of application may well be broadened further. In remarks to the press on April 8, PM Mario Draghi backed calls for the GPR to be extended to the automotive and steel sectors. We nevertheless expect the Italian Government to remain open to foreign investments in Italy.

VI. SPAIN

In line with many other countries, Spain's foreign investment regime underwent major and rapid change as a result of COVID-19. While its foreign investment regime could previously have been characterized as "generally liberal" – with very few specific sectors subject to prior foreign investment screening – Spain was the first EU country to substantially strengthen its regime in March 2020, enacting several emergency regulations to tackle the social and economic impact of the pandemic. Although the declared aim of the new measures is the protection of Spanish listed and unlisted companies "witnessing the devaluation of their assets" as a result of global crisis caused by COVID-19, we anticipate that these rules are here to stay (even if slight adjustments are made).

The reforms extended pre-closing approval requirements to foreign investments in many strategic sectors, including the security, public policy, and public health sectors. Further, investor-related limitations were introduced, which apply irrespective of the sector affected by the transaction. These limitations apply when the foreign investor acquires a stake of 10 percent or more in the Spanish company or, as a result of the transaction, gains control of that company and (i) is directly or indirectly controlled by the government of a non-EEA country, (ii) has made investments or participated in activities in sectors relevant for the security, public order and public health in another Member State or (iii) is subject to administrative or judicial proceedings in any country as regards criminal or other illegal activities. It should be noted, however, that the new mechanism is very much in line with the EU FDI Screening Regulation.

Furthermore, on a temporary basis (in principle, until December 31, 2021, but this term might be extended) acquisitions by EU/EFTA residents (other than Spain) in (i) listed companies in Spain, or (ii) unlisted companies where the "investment value" is more than €500 million, will be subject to prior approval by the Spanish government, provided (i) the EU/EFTA investor acquires a stake of 10 percent or more in the Spanish company or, as a result of the transaction, gains control of that company; and (ii) the sector of the investment affects "public order, public security and public health."

VII. UK

The UK Government announced the National Security and Investment Bill in November 2020, and in April 2021 it received Royal Assent to become the National Security and Investment Act 2021 ("NSI Act"). It is anticipated to enter into force towards the end of 2021. The NSI Act radically overhauls the UK's approach to foreign investment screening, introducing a new standalone regime. It will subject foreign investment in the UK to some of the highest levels of scrutiny of any regime globally. Notably, the NSI Act contains no turnover or transaction value thresholds, applies to low levels of minority investments, and applies equally to UK as to foreign investors.

The NSI Act introduces a hybrid mandatory and voluntary/call-in system. Notifications will be mandatory for investments in 17 sectors designated as particularly sensitive for national security (wide-ranging from energy, defense and transport to AI, quantum technologies, and satellite and space technologies). In addition, parties can voluntarily notify other transactions where there is a need for deal certainty given expansive UK Government call-in rights covering, amongst other things, assets and IP acquisitions.

The implications for investors will be far-reaching. Based on the UK Government's estimates, 1,000 to 1,800 transactions are expected to be notified each year – a dramatic increase from the 13 reviewed on national security grounds since the current regime introduction in 2003. Faced with mandatory notification obligations in many cases, as well as severe criminal and civil consequences for non-compliance, companies must pay attention to national security risks when investing in the UK.

However, the UK Government has emphasized that the UK remains open for investment and that the new regime aims to proportionately mitigate national security risks. They are keen to stress their ambition that the new regime will enable the fastest, most proportionate foreign investment screening in the world. If realized, this assertion will somewhat mitigate the practical burden on investors.

While the NSI Act is expected to become operational towards the end of the year, transaction parties must still factor the regime into their plans. The NSI Act contains retroactive provisions enabling the Government to "call in" transactions completed after November 12, 2020 and before the regime comes into force.

The Investment Security Unit (the operational unit within BEIS handling notifications and call-ins) is already providing informal guidance on transactions completed during the interim period and that may fall within the scope of the regime. This informal notification also has the effect of reducing what would otherwise be a five-year call-in risk to six months following the Act taking effect.

The Government plans to work closely with investors and business – including through a cross-sector Expert Panel – to help them understand the new regime. Special attention will be given to those sectors requiring mandatory notification. Detailed guidance is expected around July, setting out precisely the scope and definitions of sectors subject to review.

Finally, the existing (albeit narrower) public interest regime under the Enterprise Act 2002 remains in place until the new legislation takes effect, and will still need to be considered alongside the new NSI Act as the public health, media plurality and financial stability heads of intervention will remain in place and apply in parallel after commencement of the new regime.

VIII. U.S.

The U.S. has one of the most mature foreign investment regimes and has a long track record of enforcement. Most reviews are conducted by the Committee on Foreign Investment in the United States ("CFIUS"), which reviews foreign investments in U.S. businesses and real estate, though other authorities may address (sometimes in parallel with CFIUS) transactions involving cleared contractors, businesses that handle export-controlled military technology, or telecommunications licenses.

CFIUS principally reviews foreign acquisitions of control of U.S. businesses, including U.S. operations of non-U.S. companies. CFIUS also reviews non-controlling investments, coupled with governance or information access rights, in U.S. businesses engaged in critical technologies, critical infrastructure, or personal data of U.S. citizens ("TID Businesses"). Pre-closing CFIUS filings are mandatory for 25 percent voting interests in TID Businesses if a foreign government holds a 49 percent voting interest in the investor. CFIUS filings are also required for critical technology investments of any size if (i) the foreign investor receives control or certain governance/information access rights; and (ii) export licenses would be required to share the target's technology with the foreign investor or certain affiliates.

Control is defined imprecisely by CFIUS as the power, direct or indirect, whether or not exercised, to use majority ownership, a dominant minority interest, board representation, contractual rights, or other arrangements to determine, direct, or decide important matters affecting a U.S. business. A limited number of minority shareholder protections are excepted from the definition of control rights. CFIUS interprets the definition of control broadly and has found control when an investor has sought a less than 20 percent voting interest coupled with only one board representative.

Three recent trends in particular are worth mentioning:

- For years, engagement with the CFIUS meant completing a process that took several months, involving lengthy disclosures by the parties and filing fees. But there is now another, less burdensome way to submit CFIUS filings. In February 2020, CFIUS began allowing parties to use declarations in lieu of full notices for all transactions. And by October 2020, CFIUS was clearing approximately 2/3 of the transactions for which declarations were filed. The short-form CFIUS declaration is therefore an increasingly viable option for parties who want to address potential CFIUS risks prior to closing in a more time- and cost-efficient manner. The key to success, however, will be an accurate pre-filing assessment of the potential national security concerns that CFIUS may associate with the transaction.

- Key developments in U.S. export control laws are expected to further complicate the assessment for whether a mandatory CFIUS filing would be triggered for non-U.S. investments in certain U.S. sensitive technologies. Through these changes, U.S. Congress' scrutiny of non-U.S. investors gaining access to U.S. sensitive technologies looks set to continue – and further expansion of U.S. export controls is ongoing, enlarging the number of items that will qualify as critical technologies.

- CFIUS jurisdiction has always extended beyond completion of transactions, but until recently, CFIUS was unlikely to review transactions more than two or three years after closing. Today, CFIUS has an office responsible for identifying past transactions for which filings were not made, and CFIUS leadership has indicated there is no self-imposed time limit on past transactions that it is prepared to review.

IX. CHINA

On January 18, 2021, China's foreign investment regime was extended in scope to capture additional transaction types and more sectors. Under the new measures, all direct or indirect foreign investments within China in certain key sectors require a pre-closing filing.

A filing obligation applies to the following two categories: (i) any investment in military or national security/defense-related industries or in areas surrounding military (industrial) facilities; and (ii) acquisitions of control in key products relating to national security, including agriculture products, energy and resources, equipment, infrastructure, transportation, cultural products and services, information technology and Internet products and services, financial services and technologies.

The scope of sectors previously covered has been extended and now includes areas such as key information technology and Internet products and services, financial services and cultural products and services. There is, however, no clear definition of these areas in the measures or any other relevant law or regulation. As a result, we expect that the authorities will enjoy a broad discretion in interpreting the scope of the covered sectors and key terms (such as "equipment" or "technologies").

Notably, as a result of the latest reforms, the filing obligation applies to all "foreign investments" in the relevant sectors – and this now appears to cover foreign-to-foreign transactions too. Previously, China's national security review regime explicitly excluded acquisition of interests held by foreign investors in Chinese companies. These restrictions are removed under the new rules. This is not surprising, given that foreign-to-foreign transactions are generally not exempted from review in other countries (such as the U.S., the UK and Germany) and that the new rules were enacted in the context of the global "arm's race" of new or strengthened foreign investment control/national security review regimes, many of which target Chinese foreign investments. However, we currently expect that this new "weapon" will be used sparingly and target only specific cases.

X. AUSTRALIA

2020 saw major shifts in Australia's foreign investment regime (which is administered by the Foreign Investment Review Board, or "FIRB"). A temporary $0 threshold was introduced in response to COVID-19, followed by the most comprehensive set of reforms to Australia's foreign investment regime this century. Consistent with global trends, these reforms have focused on national security.

Effective January 1, 2021, monetary screening thresholds which previously applied for foreign investments were reinstated. A new category of mandatory transactions was also introduced – "notifiable national security actions" – which have a $0 threshold. Transactions which trigger a "notifiable national security action" are (i) starting a "national security business," (ii) acquiring a direct interest in a "national security business" or (iii) acquiring an interest in "national security land." A national security business is generally one which is involved in, or connected with, a "critical infrastructure asset," telecommunications, defense or the national intelligence community, or their supply chains. For transactions involving sensitive data, conditions relating to the treatment of data have become commonplace, and FIRB has now provided guidance on restrictions that may be imposed.

A new "call-in power" to review a broad range of transactions which raise national security concerns has also been introduced ("reviewable national security actions"). The risk of the call-in power being exercised can be removed by voluntarily applying for FIRB approval. This call-in power will expand the pre-existing voluntary notification regime, with FIRB issuing guidance for 20 sectors indicating circumstances where voluntary filing is recommended.

In terms of timeframes, two to four months for a decision is now typical, and we expect this to persist for a period until filing parties and FIRB adjust to the new regime.

XI. CONCLUSION

The trends highlighted above are indicative of a very significant shift - foreign investment control is here to stay. With ever more jurisdictions introducing rules and an increasingly aggressive enforcement environment, the regulatory landscape is becoming more complicated and time-consuming to navigate. Planning ahead is going to be ever more important in M&A transactions.

In terms of key lessons learnt from recent developments, it is recommended that companies engaged in M&A should:

- continuously monitor the changing foreign investment landscape – rules are changing quickly, in certain instances overnight, and with limited or even no transition phase;
- conduct a thorough analysis of filing requirements and foreign investment control risk profile – since the target and its activities are the prime trigger for more intense scrutiny, investors should be mindful of the potential timeline implications for every single transaction;
- carefully assess whether policy concerns may be raised in the process and how such concerns can be addressed, including whether mitigation measures may be required in an individual case and what the implications of such measures might be on the deal rationale;
- prepare for the review process – foreign investment filings can be complex and formalistic;
- be mindful of more information exchange amongst agencies – a transaction which might previously have flown under the radar may now be uncovered by new tools such as the EU Screening Mechanism and be called in by the regulators;
- be prepared for a process which is, by design, rather untransparent – maintaining a constructive and trustful dialogue with the regulator will be key for navigating the process as swiftly as possible;
- be prepared for a potentially longer timeline – foreign investment proceedings are increasingly becoming the timeline driver on many M&A-deals.

THE FRENCH DILEMMA: PRESERVING FDI IN FRANCE WHILE EXERCISING GREATER CONTROL

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I. INTRODUCTION

It is no mystery that, for some time now, sovereign states have been tempted by protectionism. This is reflected in a general strengthening of foreign investment control regimes, which must be given particular attention by any foreign investor wishing to invest in a so-called "sensitive" activity.

In the EU, this reinforcement has even been encouraged by the European Commission, which not only took the initiative in setting up a new EU filtering framework for foreign direct investment[2] ("FDI"), but also invited Member States that did not have such regimes to set them up, hence putting aside its traditional skepticism towards such measures due to their potential harmfulness to the EU internal market.[3]

France, which had not waited for this call to set up its own regime (its regime was already under periodic scrutiny by the European Commission, and had even inspired others, e.g. Italy), is no exception to this general trend towards a closer control of FDI. Between 2018 and 2020, various amendments to the French foreign direct investment control regime (hereafter, "FDI regime") had been adopted, namely: Decree n°2018-1057, *Loi Pacte* (Law n°2019-486), Decree n°2019-1590 and the related Orders, Decree n°2020-892, and Decree n°2020-1729 and related Orders.

Explicitly or implicitly, these amendments targeted the following main goals, namely:

- Strengthen the Minister of Economy's powers;
- Broaden the scope of his control by including new strategic sectors and investments; and
- Ensure the compatibility of the French regime with the newly introduced EU filtering framework on foreign investments.

However, while following this trend, the French government has not failed to regularly reiterate its concern that France should remain an attractive place for foreign investors.

This raises the question of how to reconcile two seemingly contradictory intentions. This article first offers a brief overview of the strengthened and extended French FDI regime, as well as its practical implications for foreign investors. It then raises the question of the reconciliation of a strengthened FDI regime with the Government's stated objective of preserving France's attractiveness in terms of FDI and suggests possible avenues that could be explored to improve the current situation.

II. A BRIEF OVERVIEW OF THE STRENGTHENED AND EXTENDED FRENCH FDI REGIME

A. Scope of the FDI Regime

In France, the principle of freedom to invest applies. Only certain foreign investments in sectors which are deemed strategic in consideration of the essential interests of the nation are subject to the Ministry of Economy's prior review. While this prior review was traditionally limited to the most obvious strategic sectors (namely, national security, defense (ammunition, weapon-related sector, dual-use materials and technology…), encryption, gambling, private security, sites of vital importance…), the list of sectors has progressively been enlarged along with the categories of investments concerned.

For the FDI regime to apply, three cumulative conditions must be met:

- <u>The investment concerned must involve a foreign investor</u>. This condition is met by non-EU/EEA and EU/EEA (non-French) investors, it being specified that a French citizen, who is domiciled abroad for tax purposes, is deemed a foreign investor. More surprisingly, the condition is also met by an ultimate French based investor, to the extent the latter performs its investment through a chain of companies, including a foreign registered company.

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.

3 Communication from the European Commission - 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 (C(2020) 1981 final).

- The investment concerned must fall within the categories of the so-called "foreign investments." Not all types of transactions are indeed caught. Three categories of investments are subject to the Minister of Economy's review (NB: one less for EU/EEA investors): 1° acquisition of (direct or indirect) control, within the meaning of Article L. 233-3 of the French Commercial Code, of an entity governed by French law; 2° acquisition of all or part of a branch of activity of an entity governed by French law; 3° crossing, directly or indirectly, alone or in concert, of the threshold of 25 percent of the voting rights of an entity governed by French law (instead of the former threshold set at 33 1/3 percent of the share capital or voting rights applicable until early 2020).[4] This is the latter category which does not apply to EU/EEA investors.

- The investment concerned must pertain to a French target engaged in a so-called strategic sector. The enlarged list of sectors now includes the following sectors (from the oldest to the most recently introduced ones):

  - Strategic activities as per Article R.151-3, I°, of the French Monetary and Financial Code: activities relating to products for military use, dual-use products and technology, national defense, encryption, including contractors and subcontractors of the French Ministry of Defence in these areas, devices for interception or remote detection of conversation or data, assessment and certification of IT security by approved assessment centers, gambling (other than casinos), measures to address the use of biological or chemical threats or to prevent the health consequences of such use;

  - Strategic activities as per Article R.151-3, II°, of the French Monetary and Financial Code: (*introduced 2014, enlarged in 2018 and 2019*): activities relating to infrastructures, goods or services that are vital to guarantee the integrity, security and continuity of energy supply, water supply, transport networks and services, space operations, electronic communications networks and services, public health; activities relating to infrastructures, goods or services that are vital to guarantee the integrity, security and continuity of public safety missions carried out by police, gendarmerie, customs, and other approved providers of security services the operation of a building, installation or of a key infrastructure (*ouvrage d'importance vitale*) within meaning of French Code of Defense, food safety, print and digital press, IT security services in relation to the operation of a building, installation or of a key infrastructure (*ouvrage d'importance vitale*) within meaning of French Code of Defense;

  - Strategic activities as per Article R.151-3, III°, of the French Monetary and Financial Code (*introduced in 2018, enlarged in 2019 and 2020*): activities relating to R&D on applications for the aforementioned activities, regarding: dual-use goods and technologies, cybersecurity, artificial intelligence, robotics, additive manufacturing, semiconductors, quantum technology, energy storage and biotechnologies.

Of these conditions, the third is undoubtedly the most challenging for foreign investors and practitioners when it comes to determining whether a contemplated investment falls within the scope of the French definition of an FDI. Indeed, absent any guidelines or publicly available decisions in that regard, the definition of certain sectors (in particular the recently introduced ones) remains rather vague and what may qualify as a "strategic" activity is subject to interpretation.

B. Implications for Foreign Investors and Powers of the Minister of Economy

When a contemplated investment is subject to the Minister of Economy's prior review, the foreign investor shall notify and obtain his prior approval before completing it.

A failure to comply with the obligation to notify and/or the standstill obligation can have serious consequences. Firstly, any agreement, any contractual documentation, by virtue of which the investment concerned is materialized is deemed null and void. Secondly, since the *Loi Pacte*, the Minister of Economy enjoys an important toolkit of burdensome injunctions *vis-à-vis* the foreign investor, with the possibility to impose penalty payments in case of non-compliance. Thirdly, the Minister of Economy may impose financial sanctions against the foreign investor, the amount of which is at most the highest of the following sums: double the amount of the irregular investment, 10 percent of the annual turnover excluding tax of the French target, five million euros for legal persons and one million euros for natural persons. Lastly, the foreign investor may also be exposed to criminal prosecution and criminal sanctions.

Once a notification is received, the matter is being handled by a special and dedicated division of the Treasury, the bureau in charge of foreign investments, which is part of the Ministry of Economy, and the ministries or agencies competent in the sector concerned (e.g. if the defense sector is concerned by the investment, the Ministry of Defense is involved in the process, if encryption activities are at stake, the ANSSI is generally involved).

4 NB: this threshold has temporarily been lowered to 10 percent (until the end of 2021) for investments concerning French listed companies.

The Minister of Economy may render a decision either in phase I, after a 30-working-day period after filing, or in phase II, after an additional 45-working-day period after the opening of the said phase II. Admittedly, the duration of the initial review period is shorter than before 2019 where a single two-month review period applied. But, at the same time, the potential additional review period, which applies in particular where the Minister intends to subject his approval to conditions, can render the overall review period significantly longer than before.

Decisions which may be taken by the Minister of Economy are the following: non-applicability decision (i.e. decision whereby the Minister eventually finds that the foreign investment is not subject to review); authorization without conditions; authorization with conditions; rejection and withdrawal of authorization. Silence kept after the expiry of the review periods amounts to rejection.

As for the conditions which may be imposed by the Minister of Economy and which have been specified in more detail by Decree n°2019-1590, they may be far-reaching, although in principle subject to the proportionality test. Four main categories of conditions are provided for: (i) those necessary to preserve, on the national territory, the security and sustainability of the strategic activity concerned; (ii) those designed to ensure that knowledge and know-how of the French target are protected and not subject to a "foreign capture"; (iii) those relating to the internal organization of the French target and its governance (including the way voting rights are being exercised); and (iv) those pertaining to the reporting *vis-à-vis* the Treasury. The aforementioned Decree also provides that the Minister's authorization may be subject to the sale, by the foreign investor, of shares or interests in the French target, or of whole or part of a branch of the French target, to a third party approved by the Minister.

When it remains unclear whether a contemplated investment is subject to prior review (in most cases, due to the vagueness of the definition of certain sectors), the foreign investor (or the target) has the possibility to formally request an opinion from the Ministry of Economy who has two months to respond.

For those familiar with pre-merger control procedures, the FDI review process may present, to some extent, some similarities, although the substantive assessment that is being performed in the FDI review is obviously very different. Like pre-merger requirements, FDI requirements shall also, when applicable, be duly considered in the transactional documentation and in the indicative timeframe of the transaction.

C. Control Over the Minister of Economy

Admittedly, the Minister of Economy enjoys a wide margin of maneuver when it comes to FDI review.

However, when exerting his powers, he may be subject to two types of control:

- The first type of control is the one exerted through the judicial review of his decisions. Indeed, as with any other administrative decisions, a foreign investor, addressee of an adverse decision, has a right to legal challenge. One must however admit that, in practice, this means of control is seldom used by foreign investors. Only a handful of judgments have been rendered since the FDI regime is in force.

- The second type of control is the one exerted by the French Parliament, although it shall be specified that it is only exerted *ex post* and is of purely political nature. The Government shall indeed report on its activities relating to the FDI review on a yearly basis. The designated representants of the National Assembly and the Senate may request hearings of the Minister of Economy and civil servants and launch investigations on the Government's actions. They may also make observations and issue recommendations to the Government.

D. The Relationships with the European Commission and the EU Member States

While the FDI review had long been a topic of purely national interest, arousing as it has been said above the European Commission's skeptiscim, things can be said to have slightly changed since the entry into force, on April 10, 2019, of the EU filtering framework on foreign investments.

With the political announcements and the terms used ("filtering"), one could have expected a new and quite developed arsenal at the EU level regarding FDIs.

But, in the end, this initiative only led to a mere cooperation mechanism, far from a control regime at EU level, which would have added up with the existing national FDI regimes.

Although it is undoubtedly disappointing for the European Commission, which is relegated to a subordinate role of simple commentator (it can, like the Member States, issue an opinion to the Member State competent to review the FDI in question), one can think that this mechanism, which allows an exchange of information and of views between the competent Member State, the other Member States and the European Commission, put some additional risks and add some more uncertainty for the foreign investor, even if in this area there is no doubt that the competent Member States retain a very largely predominant role.

III. HOW TO RECONCILE THE OBJECTIVE OF PRESERVING FRANCE'S ATTRACTIVENESS WITH THIS STRENGTHENED AND EXTENDED FDI REVIEW?

While many factors contribute to a country's attractiveness to foreign investments, one cannot deny that the scrutiny facing such investments may constitute an important one.

In light of the current framework presented above, the question arises of how to reconcile the concern to preserve France's attractiveness to foreign investments with this strengthened and extended FDI review.

While boasting of its (renewed) first place at the top of the ranking of attractive European countries from the point of view of foreign direct investment,[5] France has indeed recently been singled out for two foreign investment "bans" that have been voluntarily made public by the French Government itself and largely advertised by the press.

The first ban concerned the offer to buy Photonis, a French SME specialized in optronic technologies, in particular for night vision binoculars for the French armed forces, by Teledyne, a US company specialized in electronics and engineering. According to the Ministry of armed force's press release,[6] the State's decision was "*motivated by the French government's strong desire to protect and guarantee French economic and industrial defense sovereignty*" and "*[i]n this case, the conditions for the takeover of Photonis did not meet these requirements*." From the press reports, it seems that the ban could have been the result of the refusal by Teledyne to adhere to the far-reaching conditions which might have been proposed to them by the Minister of Economy.[7] It is admittedly very difficult to give an informed opinion without knowing the details of the case, even more when the defense space, probably the most sensitive sector, is concerned. But, while bearing in mind this reservation, an outside observer might think that the Minister's stance was a bit harsh. Teledyne indeed has a strong presence in France and is moreover already a partner of the Ministry of the Armed Forces. It cannot be ruled out that this position took Teledyne a little by surprise.

The second ban, which is not technically a ban (because it is highly unlikely that the FDI review process has even begun), concerns a very different sector, that of food retail. It concerns the contemplated takeover of the French food retailer Carrefour by the Canadian Couche-Tard, also engaged in the food retail sector. Very quickly after the announcement of the opening of discussions between the two groups, the Minister of the Economy expressed strong opposition to the project on the grounds of national food security and did not hesitate to say that should the parties proceed with it, he would use his power to prohibit it in the context of the FDI review. Although it is permissible to question the legal robustness of the reasoning which would have enabled him to take such decision, this simple political statement had the desired impact since the parties quickly made it known that they were abandoning their project.

If it is true that those sensationalist bans may potentially have sent some bad signals to foreign investors, they are not (because of their political sensitiveness) the most representative and thus not the most detrimental in terms of image.

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5 See the Minister of Economy's press release dated June 7, 2021 "International investments: France remains the most attractive country in Europe," available at https://www.economie.gouv.fr/investissements-internationaux-france-reste-pays-plus-attractif-europe#.

6 Press release dated December 18, 2020 and entitled "Sovereignty of strategic companies: Florence Parly announces that the French government is working on an alternative solution for the takeover of Photonis."

7 According to the press, on the initial attempt by Teledyne to purchase Photonis, the following commitments would have been proposed by the Minister to Teledyne: allow for a minority stake in Photonis of the State-owned institution, Bpifrance (up to 10 percent) and grant veto rights regarding the operations and management of Photonis' European businesses in France and the Netherlands (see e.g. the press article dated October 27, 2010, published in Challenges and entitled "*Incroyable, l'américain Teledyne repart à l'assaut de la pépite française Photonis*" by Vincent Lamigeon).

What is more detrimental is the increased uncertainty surrounding the current FDI regime, which also affects transactions that are less spectacular. This uncertainty has three faces:

- The uncertainty pertaining to the material scope of the FDI review which admittedly did exist to a certain extent in the past but has been worsened with the introduction of the new sectors. Their rather vague definition unquestionably leaves more room to interpretation. As a result, there is a multiplication of cases where a foreign investor must, to pre-empt any risk of failure to request a prior approval, request at minimum a prior opinion from the Minister.

- The uncertainty pertaining to the timeframe of a given transaction because of the potential implications of the FDI review. While timeframe is admittedly crucial for all transactions, it is even more crucial where the target is of a relatively small size and engaged in fast-moving technology markets where competition is fierce (including competition for tech talents). This time-related uncertainty arises in two types of situations: the first situation (which, as indicated above, has tended to become more and more frequent) is when there is doubt as to whether a given investment shall be deemed subject to the Minister's review as, depending on the latter's opinion, the Phase I review period (and potentially also the Phase II review period) may turn out to apply and delay completion of the transaction ; the second situation comes fromthe difficulty to anticipate from the outset, in particular in new sectors, whether the Minister will consider that conditions will be required and hence if the transaction will only be subject to a Phase I review period or also to a Phase II review period.

- The uncertainty pertaining to the potential conditions that may be requested from the foreign investor. As said above, those conditions may be very far-reaching and may be difficult to anticipate from the outset, in particular, in the new sectors. If it is true that the foreign investor can still pre-empt the risk of far-reaching conditions by providing for an outright exit right in the contractual documentation, he will have lost time and money in the process, not to mention the potentially adverse consequences for the target, which may find itself eventually worse off after this failure.

It cannot be denied that repeated attempts have been made by France to otherwise ensure that the FDI review process be quicker, smoother, and more straightforward.

Yet, the least that can be said is that there is still room for improvement.

What could be done to better address this uncertainty and hence better reconcile the strengthened and extended review with the quest for attractiveness?

Some possible avenues that could be explored are suggested below:

- Issue guidelines to clarify the scope of the most recent strategic sectors. As the decisional practice has developed over the last three years, the administration may have acquired sufficient experience to be able to give more precise indications as to what may be deemed "strategic." It would be even more important since, as said before, decisions are not publicly available, and the rare case-law is irrelevant for that matter.

- Shorten the two-month-period to issue an opinion as to whether a given investment is subject to review. In practice, this period is generally not fully used by the administration, which is more pragmatic and responsive, but this depends on its goodwill. For better predictability, a quicker response should not merely rely on the administration's goodwill but rather on texts.

- Issue "best practices" on the FDI review. Those "best practices," which constitutes a tool used by the European Commission in various fields (state aid, merger control, antitrust proceedings…), provide a useful insight on the administrative practice in a given field. They would ensure a better stability in the administrative practice despite the natural turnover of civil servants in charge of the FDI review as changes in approach are often noticeable when teams are renewed.

While it is fully understandable that the protection of national interests may require the preservation of some margin of maneuver for the Minister of Economy in the context of the FDI review, it shall be no excuse not to go the extra mile to try to better tackle this lack of predictability. It may not entirely solve the dilemma facing France, but it is undoubtedly part of the solution.

CANADA'S EXPANDING APPROACH TO NATIONAL SECURITY IN FOREIGN INVESTMENT REVIEWS

BY NEIL CAMPBELL & JOSHUA CHAD[1]

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I. INTRODUCTION

Canada has been reviewing foreign investments for half a century, but its focus over the past decade has shifted from an economic assessment of benefits to Canada towards national security issues. The range of potential national security concerns continues to expand, but an improved process is needed for the potential review of non-notifiable transactions.

II. CANADA'S FOREIGN INVESTMENT REVIEW REGIME

Canada's primary legislation regulating foreign investment is the *Investment Canada Act* ("ICA").[2] It sets out notification and review/approval requirements governing investments by non-Canadians to acquire existing Canadian businesses or to establish new Canadian businesses.

The ICA replaced Canada's *Foreign Investment Review Act*[3] ("FIRA") in 1985. FIRA was enacted in response to nationalist fears about foreign investment in the early 1970s and had a strong protectionist orientation.[4] It subjected investments to acquire Canadian businesses above relatively low financial thresholds to pre-closing reviews in order to confirm that the transactions were of "significant benefit" to Canada.

The enactment of the ICA by a new Conservative Government in 1985 represented a major policy shift, signaling that Canada was "open for business" and wanted to encourage additional investment from non-Canadians.[5] It was followed by negotiation of the *Canada-United States Free Trade Agreement* and numerous other deregulation and trade liberalization initiatives.

The ICA raised the pre-closing review thresholds significantly, with the Government estimating that only 10 percent of investments previously reviewed under FIRA would be reviewed under the ICA.[6] A post-closing notification requirement allowed the Government to maintain visibility on smaller transactions that would not longer be reviewable. In addition, the "significant benefit to Canada" test was replaced with a less demanding "net benefit to Canada" test.

After an in-depth study in 2008,[7] Canada proceeded with further modernization and liberalization. Since 2009, the review thresholds for investors from countries with which Canada has bilateral or regional trade agreements, as well as those from WTO member countries, have been raised to the point that there are now only a handful of "net benefit" reviews annually.[8] However, the trade agreement commitments all contain exceptions that preserve Canada's ability to take action to review and block or remedy investments that give rise to national security concerns.

The ICA was amended in 2009 to establish a formal national security regime.[9] It enables the Government to review most types of foreign investment on national security grounds - including minority shareholding investments (which currently are not subject to net benefit review or the regular post-closing notification requirement) as well as any acquisitions or establishments of Canadian businesses that are not subject to net benefit review.

2 RSC 1985, c 28 (1st Supp). There are also foreign ownership limitations in a variety of regulated sectors including financial services, telecommunications/broadcasting and aviation. For more detailed descriptions, see N. Campbell and R. Wisner*, International Protection of Foreign Investment*, 2nd ed. (2019, looseleaf).

3 SC 1973-74, c 46 at s 2.

4 See, for example, Barry J O'Sullivan, "*Canada's Foreign Investment Review Act Revisited*," Fordham International Law Journal, Vol 4, Issue 1 (1980); Article 8.

5 See, for example, John L. Ross and David A. Rubin, Q.C., "*Investment Canada Act: A New Regime for Foreign Investment in Canada*," Commercial Law Journal, Vol 91, Issue 1 (1986) 141 at pp 141-142.

6 George Glover, Douglas New and Marc Lacourciere, "*The Investment Canada Act: A New Approach to the Regulation of Foreign Investment in Canada, Business Law*, Vol. 41 (1985) 83 at 98.

7 Competition Policy Review Panel, Compete to Win: Final Report (2008).

8 ICA, ss 14, 14.1. The threshold for direct acquisitions by trade agreement investors in 2021 is C$1.565 billion (enterprise value or asset value of the Canadian business being acquired), and the threshold for WTO investors is C$1.043 billion. Indirect acquisitions of control (i.e. acquisition of a foreign corporation with a Canadian subsidiary) by such investors are not reviewable. A lower threshold of C$415 million applies if the investor is a state-owned enterprise and the investment is a direct acquisition (indirect acquisitions by state-owned Enterprises from WTO member countries are not reviewable). For investments in the cultural sector, as well as investments by investors that are not controlled by citizens or governments of WTO member countries, the pre-2009 thresholds of C$5 million (direct acquisitions) and C$50 million (indirect acquisitions) continue to apply.

9 ICA, Part IV.1.

III. THE RISE TO PROMINENCE OF NATIONAL SECURITY REVIEWS

Unlike the mandatory "significant benefit" reviews under FIRA and "net benefit" reviews under the ICA, national security reviews are discretionary. They can occur either before or after an investment is implemented.

When national security reviews were first introduced, there was limited guidance about the situations that would likely raise national security concerns, how the review process would play out, and how the risks related to a national security review could be managed by transaction parties and their advisors.

Over time, the Government has provided more extensive guidance on what types of investments and situations might trigger national security issues. While the initial focus of the regime was on military/defense, terrorism and organized crime concerns, the potential for state-enterprises to engage in activities that do not reflect ordinary commercial operations soon emerged as another area of significant scrutiny. Guidelines were issued to indicate how such issues would be addressed in an application for review under the net benefit test,[10] but in some circumstances SOE activities and relationships may generate national security reviews irrespective of whether or not a net benefit review is under way.

More recently, the Government issued a policy statement in April 2020 expanding the use of national security reviews in response to the coronavirus pandemic.[11] The policy statement indicated that controlling as well as non-controlling investments in the health sector and in critical supply chains would potentially be scrutinized, regardless of the source of the investment.

This policy change remains in effect, and was reinforced and further extended by a March 2021 update to the Government's *Guidelines on the National Security Review of Investments*. The expanded guidance identified artificial intelligence and several other advanced "sensitive technologies," critical minerals and mineral supply chains, and access to sensitive personal data as additional areas of focus.[12]

IV. THE CONNECTION BETWEEN NOTIFICATIONS AND NATIONAL SECURITY

The ICA notification requirement for non-reviewable investments to acquire or establish a Canadian business provided a simple and convenient mechanism to enable the Government to conduct initial screening for transactions that might warrant a national security review.[13] The ICA regulations and notification forms were amended to require provision of various information that is useful for initial screening, including more details about investors, their officers and directors, persons controlling the investors, and possible involvement of state-owned enterprises.

Procedurally, the existence of the notification requirement allowed the national security regime to utilize a 45-day limitation period (after receipt of a complete notification) in which the Government may either commence a national security review or issue a notice indicating that it needs an additional 45 day period to determine whether to do so.[14] These are reasonable and clear time periods that reduce uncertainty for transaction parties while incentivizing the Government to complete the initial screening processes expeditiously.

According to the most recent annual report on the operation of the ICA, for the year ended March 31, 2019, the power to extend the initial screening period by 45 days was exercised 9 times. National security reviews were commenced for less than 1 percent (7 / 962 investment filings) of foreign investments.[15] While data for the years ending March 2020 and 2021 may be expected to show some increases, the Government has exercised the power to conduct lengthy and in-depth reviews sparingly.

10 Innovation, Science and Economic Development Canada, *Guidelines - Investment by State-Owned Enterprises - Net Benefit Assessment*, https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2.

11 Innovation, Science and Economic Development Canada, *Policy Statement Regarding Foreign Investment Review and Covid-19*, April 18, 2020, https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81224.html.

12 Innovation, Science and Economic Development Canada, *Guidelines on the National Security Review of Investments,* March 24, 2021, https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81190.html.

13 It is assumed that parties will comply with the notification requirement, although there are no penalties for failure to do so unless and until the authorities have issued a demand that non-compliance be remedied and the investor has not responded with the requisite filing.

14 ICA, ss 25.2, 25.3.

15 Innovation, Science and Economic Development Canada, *Investment Canada Act – Annual Report for 2018-19*, https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk81126.html#Toc528931168.

Notifications under the ICA normally are filed within the 30-day period after closing of an acquisition or the establishment of a new business. This results in any national security review being undertaken post-closing, with the investor bearing the possible risks of divestiture or mitigation orders.[16]

To address such risks, an investor may decide to submit its ICA notification pre-closing (assuming the acquiree/vendor agree to allow such a step). The Government has encouraged this approach for pre-closing determination of whether national security concerns exist. As long as the investor allows more than 45 days between the notification date and the proposed closing date, and as long as the Government does not issue an extension notice or commence a national security review within the 45-day limitation period, the national security review risk is eliminated. However, if the Government does issue an extension or commence a review, the parties cannot complete the transaction until approval is obtained. This no-close review period may run for up to 200 days or more for a full national security review process.

The practical solution developed by foreign investment review lawyers and the Government works reasonably well for notifiable transactions. The transaction parties can choose whether to shift from post-closing to pre-closing review risks and manage their transaction timelines and risk allocations accordingly.

V. NATIONAL SECURITY REVIEWS OF NON-NOTIFIABLE TRANSACTIONS

In addition to notifiable acquisitions of control or the establishment of Canadian businesses, the ICA allows the Government to conduct a national security review of investments "to acquire, in whole or in part, or to establish an entity carrying on all or any part of its operations in Canada," as long as the entity has a place of operations in Canada, any individuals in Canada who are employed or self-employed in connection with its operations, or assets used to carry operations in Canada.[17] The submission of a notification form does not provide a trigger for the initial screening of such transactions for possible national security issues. Nor does it provide a starting point for the limitation period in which such decisions must be made. Instead, the 45-day period runs from the transaction closing date.

This regime is sub-optimal for the Government because it does not ensure that the investment review and national security authorities have awareness about transactions, or it may leave them with insufficient time to conduct screening in situations where they only become aware of a potential transaction towards the end of the 45-day period after closing. In either case, they do not have the information that would be contained in a completed notification form as a starting point for their screening activities.

This regime is also sub-optimal for private parties. They do not have the ability to trigger the start and end of the limitation period in which a pre-closing national security review would be initiated. The inability to obtain such certainty also reduces the incentive for voluntary engagement with the Government regarding potential issues that could be addressed pre-closing.

The latter concern might be addressable by way of changes to the *National Security Review of Investments Regulations*.[18] However, an amendment to the ICA would be needed if the Government wants to ensure that it has full visibility regarding the types of foreign investment activity that currently are not subject to notification requirements.

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16 ICA, s 25.4.

17 ICA, s 25.1(c).

18 SOR/2009-271. Even though there is no statutory obligation to file notifications for these types of transactions, the limitation period could be structured as the earlier of; the date on which the investor voluntarily provides the complete and certified information that would be contained in a notification, or 45 days after closing.

THE IMPORTANCE OF COMPETITIVE NEUTRALITY IN PROMOTING FDI AND SUSTAINABLE RECOVERY

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I. INTRODUCTION

The COVID-19 crisis has increased concerns over the risks of inward foreign investment. Before the pandemic, governments were already showing signs of increased caution, with foreign direct investment ("FDI") screening mechanisms gaining momentum. The current health and economic crisis has fast-tracked this trend. Unlike the 2008 economic crisis where many countries became more open to foreign investment, the COVID-19 crisis has instead encouraged greater economic protectionism and with this, the adoption and reform of investment screens.[2] Host countries are more and more concerned about foreign acquisition of critical infrastructure and strategic technology, and screening mechanisms can be used to block such FDI on, for example, national security and public order grounds.[3]

The OECD Investment Division has explained that one of the reasons for the different approach could be the increased role of State-Owned Enterprises ("SOEs") as foreign investors.[4] Indeed, "the share of OECD countries that single out state-owned acquirers in the context of FDI screening has grown from eight to fourteen since the beginning of 2020."[5] As previously explained by the OECD, FDI concerns are "exacerbated by the unique characteristics of SOEs" including "their proximity to the sovereign powers of individual nations."[6] Screening mechanisms tend to concentrate on their potential "pursuit of non-commercial objectives,"[7] but in addition, FDI by SOEs may raise competitive neutrality concerns. Failure to adhere to competitive neutrality principles can distort the domestic and international competitive landscape and affect FDI.

As FDI is essential in ensuring sustainable recovery from the current crisis, governments should pursue measures that ensure effective competition in their home economies and that encourage the implementation of international competitive neutrality standards. This article will therefore focus on the importance of competitive neutrality in encouraging FDI and will discuss how competition law and policy can address these concerns.

II. THE IMPORTANCE OF COMPETITIVE NEUTRALITY FOR FDI

Competitive neutrality principles aim to promote a level playing field among competitors by requiring firms to be subject to the same set of rules irrespective of factors such as their ownership or nationality.[8] Competition may be distorted when certain market players, such as SOEs,[9] or selected private firms,[10] are granted unfair advantages or are subject to different rules. This can affect FDI into the domestic market and raise concerns for host countries when such firms expand abroad.

States can give preferential access to markets to some firms (SOEs or domestic firms, for example) by imposing entry restrictions. Leaving aside foreign equity limitations, states can distort market access creating a statutory monopoly, imposing licensing restrictions or technical and capital requirements on some market players or by implementing qualification rules in public procurement that treat market players differently. States can also enhance the performance of certain firms by providing cost or revenue advantages, for example, subsidies, favorable loan rates and government guarantees. Finally, states can make it easier for specific firms to operate in a market by granting exemptions from the regulatory framework or by applying more favorable rules to certain firms.

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2 See OECD, *Investment screening in times of COVID – and beyond*, June 23, 2020.

3 See for example, Regulation (EU) 2019/452 of the European Parliament and of the Council of March 19, 2019 establishing a framework for the screening of foreign direct investments into the Union. The German *IMST/Addsino* merger prohibition is a recent example where state ownership was key to security concerns.

4 OECD, *Investment screening in times of COVID – and beyond*, June 23, 2020, page 6.

5 OECD, *Investment screening in times of COVID – and beyond*, June 23, 2020, page 6.

6 OECD, St*ate owned enterprises as global competitors: a challenge or an opportunity*? 2016, p.150.

7 OECD, St*ate owned enterprises as global competitors: a challenge or an opportunity*? 2016, p.150.

8 See OECD, Recommendation of the Council on Competitive Neutrality [OECD/LEGAL/2021].

9 See the work by both the Competition Committee and the Corporate Governance Committee's Working Party on State-Ownership and Privatisation Practices. A State owned enterprise is defined in the OECD SOE Guidelines and the OECD Recommendation on Competitive Neutrality as "any corporate entity recognised by national law as an enterprise, and in which the state exercises ownership or control, should be considered as an SOE. This includes joint stock companies, limited liability companies and partnerships limited by shares. Moreover statutory corporations, with their legal personality established through specific legislation, should be considered as SOEs if their purpose and activities, or parts of their activities, are of a largely economic nature."

10 For example, foreign firms with close government ties. See e.g. Government of Canada, *Policy Statement on Foreign Investment Review and COVID-19*, April 18, 2020, https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81224.html. China's Digital Silk Road initiative, for example, is said to be largely driven by private firms but heavily supported by government policies. See, for example, SupChina, Paul Triolo and Robert Greene, *Will China control the global internet via its Digital Silk Road?* May 8, 2020, https://supchina.com/2020/05/08/will-china-control-the-global-internet-via-its-digital-silk-road/

The political rationale for different treatment of certain firms varies. The role of SOEs in the economy, for example, differs worldwide. In some countries, SOEs are primarily used to address specific market failures while in other countries SOEs are key to carrying out a wide range of policy objectives. The justification for special treatment may be to compensate the SOE for its public policy obligations and special duties. However, if these advantages extend to or are used to cross-subsidize the provision of goods or services in markets where SOEs compete or could potentially compete with private firms, the SOE will have an unfair advantage in the market.[11]

This can distort the competitive landscape, both in the country where the advantage is given and in foreign markets, where the SOE is active. First, such advantages may prevent or make it more difficult for both domestic and foreign firms to enter the local market and to compete with the SOEs. This may limit the number or range of suppliers in the market and reduce FDI. Second, it may give SOEs competing abroad unfair advantages in foreign markets, reducing competition in those markets. Such advantages can also decrease allocative efficiency, supporting inefficient firms that may have exited the market if subject to normal competitive conditions. Less competition in the market may result in reduced consumer welfare, with less innovation, lower quality goods and services and higher prices.

While SOEs are often the most obvious example, private firms may also enjoy special treatment, for example, as former SOEs, firms with close government ties or as "strategic" firms. It is therefore important to implement best practices to ensure competitive neutrality in competitive markets, both between SOEs and private firms and between different private firms.[12] Adherence to such principles encourages a level playing field and thus FDI. This does not mean that selected firms cannot be supported, but when doing so states should ensure the least harmful approach and should seek to uphold competitive neutrality principles.[13] States should, for example, "limit compensation for any public service obligation" ensuring "that it is appropriate and proportionate to the value of the services." In doing so, states should clearly define public service obligations, separate regulatory and commercial functions and ensure transparency and accountability. In relation to SOEs, states should adopt best practices for corporate governance and structural separation. [14]

III. EXAMPLES OF THE USE OF COMPETITION LAW AND POLICY TO ADDRESS THESE CONCERNS

A. EU State Aid Regime

The EU has a state aid regime that prevents Member States granting subsidies that may distort the EU single market.[15] Foreign subsidies are not subject to EU State Aid rules. However, research has suggested that if certain foreign subsidies had been granted by Member States, they would have amounted to state aid and so "this difference in treatment can distort competition in the EU's internal market" and "makes it difficult to achieve a level playing field" with the relevant non-EU countries.[16] Following an EU *white paper on levelling the playing field as regards foreign subsidies*,[17] on May 5, 2021, the EU published a proposal for a regulation *on foreign subsidies distorting the internal market*.[18]

11 The opposite can also occur, if the SOE is not adequately compensated for its public service obligations and special duties.

12 See for example OECD, *Competitive Neutrality – A compendium of OECD recommendations, Guidelines and Best practices*, https://www.oecd.org/daf/ca/50250955.pdf and OECD, Recommendation of the Council on Competitive Neutrality [OECD/LEGAL/2021].

13 See OECD, Recommendation of the Council on Competitive Neutrality [OECD/LEGAL/2021]. It recognizes "that achieving public policy objectives will in certain circumstances require exceptions to competitive neutrality." It considers that "other things being equal, public policies with lesser harm to competition should be preferred over those with greater harm to competition, provided they achieve the identified objectives."

14 OECD, Recommendation of the Council on Competitive Neutrality [OECD/LEGAL/2021], Part II(2)(a-c).

15 See Articles 107 and 108 of the TFEU.

16 European Court of Auditors, 2020, *The EU's response to China's state-driven investment strategy*, pp. 15 and 47, https://www.eca.europa.eu/Lists/ECADocuments/RW20_03/RW_EU_response_to_China_EN.pdf.

17 The *White paper on levelling the playing field as regards foreign subsidies* was adopted on June 17, 2020. https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf.

18 Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.

The proposed regulation aims to ensure a level playing field by identifying and remedying market distortions caused by foreign subsidies and seeks to complement the FDI screening regulation.[19] The regime would be enforced by the EU Commission and would cover subsidies granted by non- EU countries, irrespective of ownership (SOEs and private firms) and sector coverage. If implemented in its current form, it would allow, among other things, *ex ante* review of distortive foreign subsidies (over €50 million) in the case of concentrations above a certain threshold (notifiable transactions) or at the request of the Commission (Chapter 3). This would run in parallel with, but be separate to, any merger review process. The proposal also provides for *ex officio* review powers (Chapter 2) and addresses distortions that may arise in public procurement (Chapter 4).

B. Merger Review

In most jurisdictions, merger review may address competitive neutrality issues indirectly. Where a competition authority is able to consider "public interest" arguments or undertakes a concurrent review under other standards, a merger involving an SOE may be more closely scrutinized yet conflicts may arise between competition and other policy goals.[20] Most governments keep FDI screening mechanisms separate from merger review. The EU Regulation 2019/0452 *establishing a framework for the screening of foreign direct investments into the Union* was created to avoid politicizing merger control and the consideration of non-competition concerns in the merger review process. However, Member States apply their own screening mechanisms and while most have concurrent but separate processes, Poland, for example, has conferred FDI review powers on its national competition authority.[21] As mentioned above, the EU Commission will apply the proposed foreign subsidy regulation in order to ensure uniformity in its implementation and in considering "the role of Member States in competition and State aid instruments."[22]

C. Enforcement Action

Many of the advantages described in this article do not necessarily result in any anti-competitive conduct and so may not be possible to address through enforcement action.[23] Enforcement action can address competitive neutrality concerns indirectly by addressing anti-competitive behavior of SOEs or privileged private firms (for example, predatory pricing by dominant firms). It is therefore important that competition law is competitively neutral.[24] In some jurisdictions, issues may arise if there are statutory exemptions for SOEs in the competition law or there are political or practical challenges (for example, in relation to evidence) in taking action against SOEs.[25]

D. Advocacy

Before seeking to target the behavior of foreign SOEs, countries should ensure the enforcement of competitive neutrality in their own markets. Few countries have a comprehensive competitive neutrality framework, but some countries give their competition authorities or other nominated bodies enforcement powers in relation to competitive neutrality.[26] Competition authorities can also use market studies or investigations to identify distortionary measures in a particular market. More generally, as part of their advocacy functions, competition authorities (or other bodies) can

19 Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, pp. 5,7, 48. https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.

20 OECD, *State owned enterprises as global competitors: a challenge or an opportunity*? 2016, pp.114-115.

21 See Svetlicinii, A, National Competition authorities and FDI screening: the case of Poland, October 8, 2020, http://competitionlawblog.kluwercompetitionlaw.com/2020/10/08/national-competition-authorities-and-fdi-screening-the-case-of-poland/.

22 Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, pp. 21-22, https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.

23 The Swedish competition laws however provide an example where competitive neutrality could be enforced through the competition law, which prohibits SOE conduct that distorts the competitive process. See, OECD, Roundtable on competitive neutrality in competition enforcement, note by Sweden, May 29, 2015.

24 See OECD, Recommendation of the Council on Competitive Neutrality [OECD/LEGAL/2021], Part II (1)(a), which requires adherents to "adopt or maintain, as appropriate, a competitively neutral competition law that addresses anti-competitive conduct and includes merger control."

25 See OECD, *State owned enterprises as global competitors: a challenge or an opportunity?* 2016, p.115. Indonesia, for example, has discretion to exempt SOEs from its competition law. Some countries have trade agreements that include transparency and information provisions in relation to SOEs. For example, the competition chapters of the 2009 Australia-Chile FTA and the 2005 Australia-US FTA contain such provisions (Source: OECD Database on National Practices and Regulations with Respect to State Enterprises, https://qdd.oecd.org/Home/ApplyFilter).

26 OECD, *State owned enterprises as global competitors: a challenge or an opportunity?* 2016, p. 113.

conduct competition assessments[27] or competitive neutrality reviews,[28] of proposed and existing laws and regulations to identify provisions that restrict market access or impose discriminatory requirements.[29]

Authorities can analyze, for example, how SOEs are treated within a specific sector and whether they are given any specific advantages or excluded from regulatory requirements that contribute to an uneven playing field in the domestic market. In carrying out this assessment, they can consider the harm to competition and propose alternative policies in line with the underlying policy objective. This exercise can help inform policymakers of necessary reforms and prevent the introduction of laws and regulations that may be harmful to competition and investment.

IV. THE NECESSITY OF INTERNATIONAL STANDARDS

In order to prevent special rights and privileges granted to certain firms in one market distorting the competitive environment in a host country market, international cooperation is key. There are a few international instruments, for example, through the WTO, which target discriminatory behavior of governments and that can address certain aspects of competitive neutrality. There is however no comprehensive multilateral framework.[30]

Regional mechanisms address aspects of competitive neutrality, such as the EU state aid regime, which addresses distortive subsidies at the EU level and has inspired the new EU proposal addressing foreign subsidies and provisions in certain EU trade agreements. Competitive neutrality principles, notably those targeting distortive behavior of SOEs, may appear in some preferential trade agreements and bilateral investment treaties.[31] However, as noted by the OECD, "considering the very broad set of issues at stake it must be recognized that competitive neutrality is difficult to maintain in the international marketplace unless the participating countries engage in a concurrent commitment to enforcing it at home."[32] International rules and standards on competitive neutrality should therefore be pursued.

Harmonization is key and in itself can contribute to increased trade and investment. The OECD has already published several recommendations that relate to competitive neutrality, notably concerning corporate governance of SOEs.[33] In addition, on May 31, 2021, the OECD adopted a recommendation on competitive neutrality.[34] This recommendation hopes to fill the gap in international standards. However, as previously noted by the OECD, adherence of non-members to such standards is vital. In relation to SOEs active in foreign markets, for example, most are owned by non-OECD member countries,[35] and so broad implementation will be key to minimizing distortions caused by FDI and to promoting a level playing field.

V. CONCLUSION

In order to uphold competitive neutrality principles and to avoid distorting the competitive process, regulatory frameworks should be neutral, and states should not grant discriminatory advantages to SOEs or selected private firms. Failure to adhere to competitive neutrality principles can affect FDI and distort the domestic and international competitive landscape. Governments should thus ensure competitive neutrality in their home markets and advocate for international implementation of competitive neutrality principles to encourage FDI, an important driver of sustainable recovery.

27 The OECD *Competition Assessment Toolkit* can help identify different kinds of barriers to FDI. See also, Recommendation of the Council on Regulatory Policy and Governance [OECD/LEGAL/0390]. See, OECD, Recommendation of the Council on Competitive Neutrality [OECD/LEGAL/2021], Part II (1)(c)(iii). The Recommendation of the Council on Competition Assessment [OECD/LEGAL/0455] recommends that adherents should "Carry out competition assessments that identify and revise existing or proposed regulations that unduly restrict competition."

28 See, for example, the OECD Competitive Neutrality Reviews, Towards a Level Playing Field between SOEs and Private Entities in ASEAN, https://www.oecd.org/daf/competition/towards-a-level-playing-field-logistics-sector-asean.htm.

29 In relation to barriers in public procurement, see Recommendation of the Council on Public Procurement [OECD/LEGAL/0411].

30 For example, some WTO instruments address subsidies for trade in goods. See, the SCM Agreement and the GATT. See also, the GATS. There have been several WTO cases, for example, relating to preferential treatment of SOEs. See, Kowalski, P & Perepechay, K, *International Trade and Investment by State Enterprises*, 2015, pp.27-29.

31 For example, Chapter 17 of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

32 OECD, *State owned enterprises as global competitors: a challenge or an opportunity*? 2016, p.126.

33 For example, OECD, Recommendation of the Council on Guidelines on Corporate Governance of State-Owned Enterprises [OECD/LEGAL/0414](OECD Guidelines on Corporate Governance of SOEs), OECD, Recommendation of the Council concerning Structural Separation in Regulated Industries [OECD/LEGAL/0310].

34 OECD, Recommendation of the Council on Competitive Neutrality [OECD/LEGAL/2021].

35 OECD, *State owned enterprises as global competitors: a challenge or an opportunity*? 2016, p. 155.

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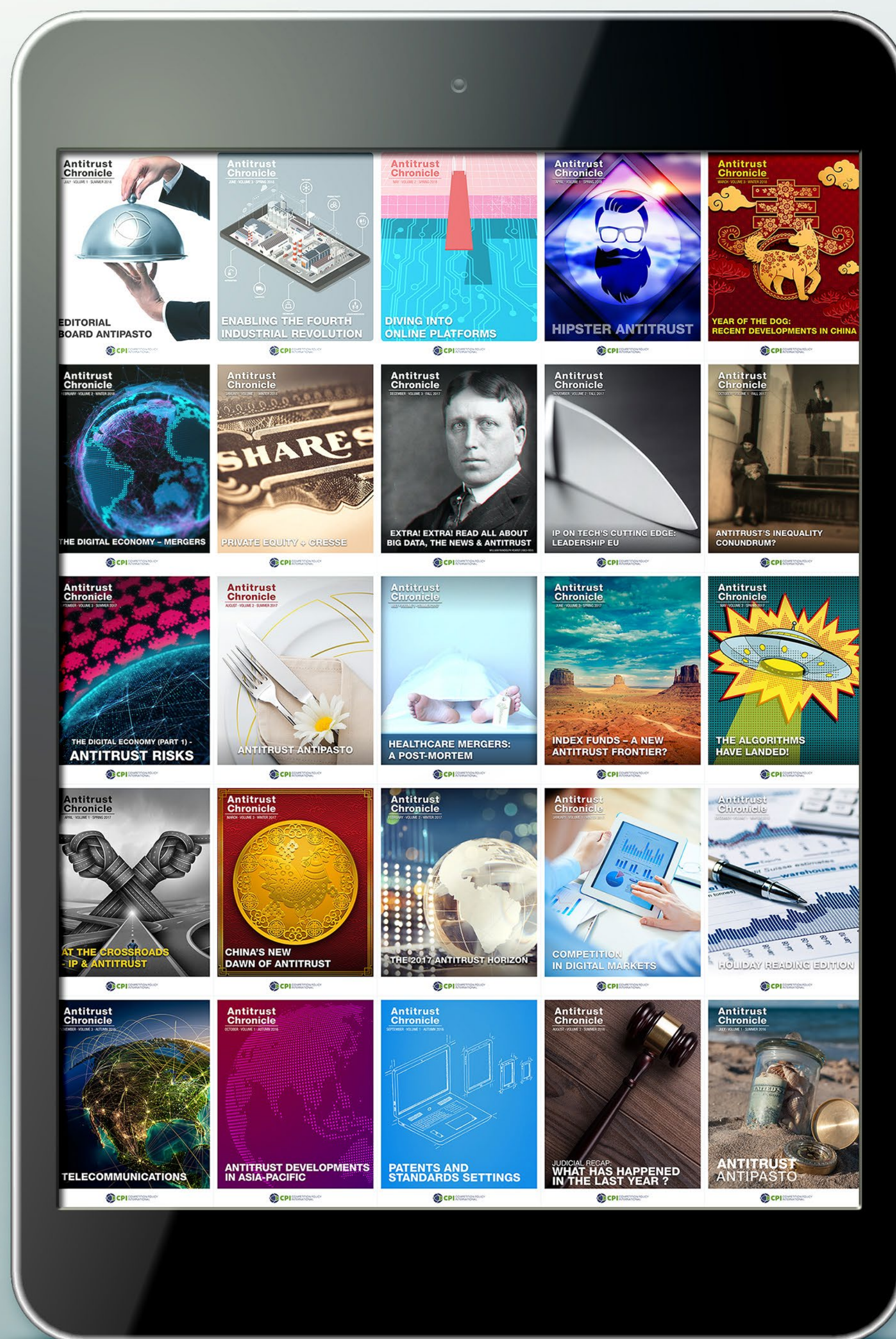

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