

The EU Framework for Screening of Foreign Direct Investment Receives Informal Approval by the European Parliament and Council

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On 20 November 2018, the European Parliament, the Council and the Commission reached a [political agreement](#) on the proposed EU framework for screening of foreign direct investments (FDIs). The proposal, put forward by the Commission in September 2017, aims at protecting key strategic industries and assets in Europe whilst maintaining the EU's appeal to foreign investors.

While other countries such as Australia, Canada, China, India, Japan and the US, as well as 12 of the 28 EU Member States^[1] already have FDI screening mechanisms in place, it is the first time that such a mechanism is introduced at the EU level.

The proposal is a response to growing concerns in the EU – especially from France, Germany and Italy – that state-owned or state-controlled foreign investors, notably from China, are increasingly acquiring control over high-tech companies and critical infrastructure in Europe.

The EU framework will not impose an obligation on Member States to establish FDI screening mechanisms but rather sets out common rules for Member States that already have such mechanisms in place or that are willing to create them. In any case, the prohibition of FDIs on security or public order grounds will still be decided at the national level.

Formal approval of the proposed Regulation by the European Parliament and the Council is expected by March 2019, ahead of the upcoming EU elections in May 2019.

1. What Triggered the Creation of the EU Framework for Screening of FDIs?

The EU has greatly benefitted from FDIs over the years and the Commission is clear in acknowledging their importance as a source of growth, jobs and innovation. In its 2017 Communication 'Welcoming Foreign Direct Investment' the Commission pointed out that the EU is the world's leading source and destination of FDIs with an inward flux of foreign investment of over EUR 5.7 trillion, compared to the EUR 5.1 trillion in the US and EUR 1.1 trillion in China.

However, a recent increase in foreign investments by state-owned or state-controlled companies or private firms with governmental links in companies with cutting-edge technologies – such as artificial intelligence, robotics and nanotechnologies – or in 'critical infrastructure' led to the realisation that a common EU-wide screening mechanism of FDIs was necessary in order to safeguard the EU's key interests.

In particular, some Member States raised concerns about the growing number of FDIs from China – which spiked from EUR 6 billion in 2015 to EUR 37 billion in 2016 – in what are considered as 'strategic sectors'. In February 2017, the Economy Ministers of Germany, France and Italy submitted a joint letter to the European Commission asking for a change in the EU's approach towards FDIs. The three Member States raised concerns that foreign investors are increasingly acquiring European technology companies to satisfy their own strategic objectives and at the same time imposing barriers for EU companies to invest in their home jurisdiction.

At the national level, some EU Member States like Germany are increasingly protecting their national champions against FDIs. For example, in July 2017 the German Government amended its foreign trade regulations introducing the term 'critical infrastructure' – which has now been picked up at the EU level – as a response to an attempt by Chinese investors to take over the German technology companies Aixtron SE and Kuka AG.

2. How Will the EU Framework for Screening of FDIs Work?

The Main Objective

The main objective of the proposed Regulation is to establish a framework for Member States and in some cases the Commission, to screen FDIs into the EU on the basis of security or public order concerns, while allowing Member States to take account of their individual situations and national circumstances.

However, the proposed EU framework does not oblige Member States to create such mechanisms but it only imposes certain criteria – such as transparency and non-discrimination requirements between third countries – on Member States that already have such mechanisms in place or that intend to implement them.

In addition, the proposed Regulation does not regulate the criteria and procedure for Member States to prohibit FDIs; it only establishes a screening process on the basis of the EU's exclusive competence over the common trade policy. Member States will therefore remain free to authorise or prohibit FDIs on security or public order grounds.

The Conditions for the Screening of FDIs

The proposed Regulation establishes that Member States and the Commission may screen FDIs on security or public order grounds and it sets out the conditions under which they can do so.

In particular, the **Member States'** screening mechanisms must:

- Be transparent and non-discriminatory vis-à-vis third countries;
- Set out the circumstances that trigger the screening, for example, the volume of FDIs or the percentage of shares; and
- They must set out the grounds for screening – basically security and public order – as well as contain detailed procedural rules and timeframes.

The Commission may screen FDIs where they are "likely to affect projects or programmes of Union interest" on security or public order grounds. This includes in particular projects and programmes that:

- Involve a substantial amount or a significant share of EU funding; or
- Are covered by Union legislation regarding critical infrastructure, critical technologies or critical inputs.

Where a FDI is likely to affect "projects or programmes of Union interest on grounds of security or public order", the Commission may issue a non binding 'opinion' to the Member State(s) concerned, which will also be communicated to the other Member States.

Factors to Take Into Account When Screening FDIs

The proposed Regulation also establishes a number of **factors** that may be taken into account by the Member States and the Commission when screening FDIs. In particular, when screening FDIs on security or public order grounds, the Member States and the Commission may consider the potential effects of the FDI on:

- 'Critical infrastructure', including energy, transport, communications, data storage, space or financial infrastructure, as well as sensitive facilities;
- 'Critical technologies', including artificial intelligence, robotics, semiconductors, technologies with potential dual use applications, cybersecurity, spare or nuclear technology;
- The security of supply of critical inputs; and
- Access to sensitive information or the ability to control sensitive information.

Additionally, in determining whether a FDI is likely to affect security or public order, Member States and the Commission may take into account whether the foreign investor is controlled by the government of a third country, including whether it is through significant funding.

This list of factors will arguably provide a certain level of clarity not only to Member States but also to foreign investors. However, one concern raised by some commentators is that very broad terms such as 'critical infrastructure' or 'critical technologies' may be used to implement a protectionist agenda by some Member States.

Cooperation Mechanism and Annual Reporting

The proposed Regulation also establishes a cooperation mechanism to ensure transparency of FDI screening between Member States and between Member States and the Commission. In this regard, Member States that initiate a screening procedure must inform the Commission and other Member States within 5 working days from the start of the screening.

Where the Commission considers that a FDI is likely to affect security or public order in one or more Member States, it may issue an 'opinion' addressed to the Member State(s) concerned. In this regard, the Commission (and other Member States) may request information to the Member State(s) where the FDI is planned or completed.

In addition to these cooperation mechanisms, the proposed Regulation sets out notification and reporting requirements. Member States must notify the Commission of their existing screening mechanisms within 30 days of the entry into force of the proposed Regulation and report any amendment or newly created screening mechanisms within 30 days of their entry into force.

3. The Final Text of the Proposed Regulation

While the final text of the proposed Regulation that was politically approved by the European Parliament and the Council on 20 November is not yet publicly available – as it is still being finalised – there are reports about two main changes to the initial Commission proposal:

- **An obligation to screen FDIs:** whereas, as stated above, the proposal indicates that the Commission may screen FDIs that are likely to affect "projects or programmes of Union interest on security or public order" grounds, the approved text reportedly states that the Commission must screen these types of FDIs;
- **A clarification of the factors to take into account when screening FDIs:** the agreed text also reportedly clarifies and expands the factors that should be taken into account when screening FDIs to include sectors such as aerospace, health, nano-technology, the media, electric batteries and the supply of food.

These reported changes – which will be confirmed when the final text becomes publicly available – are in line with a report by the International Trade (INTA) Committee of the European Parliament adopted on 28 May 2018. In this report, the EU Parliament welcomed the Commission's initiative but proposed a series of clarifications concerning key concepts – such as 'foreign direct investments' and 'foreign investor' – as well as the factors that justify the screening of FDIs and the scope of the proposed Regulation.

Interestingly, the European Parliament's report emphasized that this new EU framework for screening of FDI's will not replace the decision-making power of the Member States with regard to investments in their territories but rather will act as an "information transmission belt" between the Commission and Member States.

4. Next Steps

The final text of the proposed EU framework for screening of FDI's will likely be voted in the next Committee of Permanent Representatives (COREPER) meeting on 5 December and in an extraordinary meeting of the INTA Committee at the EU Parliament in Strasbourg on 10 and 13 of December. The final vote by the plenary of the EU Parliament is expected to be in March 2019.

In parallel, the Commission is conducting an in-depth analysis of FDI flows into the EU and has set up a coordinating group with Member States to identify strategic concerns and solutions in the area of FDI's.

[1] These Member States are: Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain and the United Kingdom.