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First Year's Experiences with EU Regulation on Foreign Direct Investment Screening

Jay Modrall (Norton Rose Fulbright, Belgium) · Tuesday, January 11th, 2022

Regulation 2019/452 (as amended, the FDI Regulation) inserted the European Commission (the Commission) into a hitherto jealously guarded area of EU Member State authority – screening of foreign direct investment (FDI) for threats to security and public order. The FDI Regulation set out minimum requirements for Member States' FDI screening mechanisms and a mechanism for coordinating Member States' FDI reviews. As in other areas, notably consumer protection, the FDI Regulation expanded the EU's power by giving the Commission a new coordinating role rather than direct enforcement powers.

In late 2021, the Commission published its first annual report on experience with the FDI Regulation (the Report), providing valuable insights into the regulation's practical impact and likely next steps. One striking effect is the proliferation of FDI screening mechanisms in the EU. In 2019, when the regulation was adopted, 11 EU Member States had such mechanisms. According to the Report, 24 (out of 27) now have or are in the process of adopting FDI screening laws.

The FDI Regulation was the first to create a general EU framework for reviewing private transactions since the EU Merger Regulation (the EUMR) in 1989, but it is unlikely to be the last. Another new screening mechanism will likely be created under the EU's anti-subsidy regulation proposed in May 2021. Meanwhile, a new approach to EUMR referrals adopted in March 2021 gave the Commission effectively unlimited jurisdiction to review M&A transactions whether or not they met the EUMR's "Union dimension" thresholds. The anti-subsidy regime will likely be enforced solely by the Commission, while the new EUMR referral policy abandons the EUMR's (formerly) fundamental one-stop-shop principle.

The FDI Regulation: Hybrid enforcement, EU style

Scope. The FDI Regulation applies to screening mechanisms for FDI. "Screening" and "screening mechanisms" are defined as procedures for assessing, investigating, authorizing, conditioning, prohibiting or unwinding FDI on grounds of security or public order. "FDI" are defined as investments of any kind by a "foreign investor" aiming to establish or to maintain lasting and direct links to an economic activity in a Member State, including investments enabling "effective participation" in management or control of the target. The concept of "effective participation in

management" is much broader than "control" under the EUMR and presumably includes the power to appoint representatives to the board of an EU company, even without strategic veto rights. The new mechanism is not subject to any minimum turnover or other size-based test.

The FDI Regulation sets out a uniform set of factors for FDI screening, including potential effects on:

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

In response to the COVID-19 crisis, the Commission also published guidance calling for particular attention to the healthcare sector.

In determining whether a FDI is likely to affect security or public order, Member States and the Commission may take into account all relevant factors, including the effects on critical infrastructure, technologies (including key enabling technologies) and inputs that are essential for security or the maintenance of public order. Additionally, they may consider whether the foreign investor is controlled by the government of a third country, including through its ownership structure or significant funding.

Minimum requirements. As noted, the FDI Regulation sets out minimum criteria for Member States' screening mechanisms. National mechanisms must be transparent and not discriminate against third countries. Member States must set out the circumstances triggering screening, the grounds for screening and detailed procedural rules. Member States must establish timeframes for issuing screening decisions that allow them to take into account the comments and opinions of Member States and the Commission. Confidential information must be protected, and foreign investors and other parties concerned must have the possibility to seek judicial redress against screening decisions.

EU coordination. The FDI Regulation creates an elaborate cooperation mechanism for FDI undergoing screening. Member States must notify the Commission and other Member States of any FDI that is undergoing screening. Where a Member State considers that an FDI planned or completed in another Member State is likely to affect its security or public order, or otherwise has relevant information, it may provide comments to the host Member State, with a copy to the Commission. The Commission must then notify the other Member States and may issue an opinion itself. A Member State may request the Commission to issue an opinion or other Member States to provide comments, and the Commission must deliver such an opinion if requested by at least one-third of Member States.

Upon receipt of an initial notification that an FDI is undergoing screening, the Commission and Member States have 15 calendar days to notify the Member State concerned that they intend to provide comments or an opinion and to request additional information. Opinions and comments

should be delivered within 35 calendar days of the original notice, or 20 calendar days from receipt of any additional information requested. The Commission may issue an opinion following comments from other Member States no later than 40 calendar days from the original notification.

The final decision-making power on proposed FDI rests with the host Member State, although it must give "due consideration" to comments and opinions from other Member States and the Commission. In cases of "Union interest," host Member States must take "utmost account" of Commission opinions and explain any non-compliance, a "comply or explain" approach common in EU legislation.

The Report: Lessons from the first year

The Regulation requires Member States to notify the Commission of any new or existing screening mechanism, as well as any changes. Member States also submit annual reports including a list of FDIs screened and undergoing screening; screening decisions prohibiting investments or submitting them to conditions; the sectors, origin, and value of the investments; and whether an investment undergoing screening is likely to be caught by the EUMR.

On November 23, 2021, the Commission published the Report, based on input from the Member States and other sources. Considering that the FDI Regulation was only applied from October 2020, the Report includes data from two periods; data on Member States' reports on "investment dossiers" for the calendar year 2020 and transactions reviewed between the regulation's entry into force and June 2021.

According to the Report, inward FDI into the EU fell 71% between 2019 and 2020, compared to a global reduction of 35%. The U.S., Canada and the UK accounted for over half of foreign investments into the EU, with China accounting for only 2.5% (down from 4% in 2019). This reduced level of inward investment nonetheless generated almost 1,800 notifications under Member State FDI regimes, of which 80% were not formally screened either because of the evident lack of interest or because they did not meet the notification criteria. Of those that were screened, 79% were approved without conditions, 12% were approved with conditions and 2% were prohibited.

Following the implementation of the FDI Regulation, 265 transactions were notified to the Commission by 11 Member States through June 2021, originating mainly from the US (45%), the UK (9%), China (8%), Canada (4%) and the United Arab Emirates (3%). 80% were closed in Phase I and 14% in Phase II, with the Commission requesting additional information (6% were still ongoing at the cut-off date). The Commission issued opinions in less than 3% of notified cases. Six Member States accounted for all 36 Phase 2 cases.

The average delay before the Commission received the requested information was 31 days, but there was a very large range, from 2 to 101 days. The information requested typically included data on products and/or services of the target company; possible dual-use classification of any products involved; customers, competitors and market shares; the target's IP portfolio and R&D activities; and characteristics of the investor. In April 2021, the Commission published a notification template designed to upgrade the information submitted and speed up reviews.

The Report: Member State concerns and Commission next steps

For the Report, Member States were asked to comment on three subjects: (i) the value-added by the FDI Screening Regulation and the cooperation mechanism; (ii) any significant procedural issues encountered; and (iii) possible ways of addressing any such issues. All Member States considered the Regulation and the cooperation mechanism to be valuable tools. However, Member States also reported some issues when applying the FDI Regulation.

In particular, several Member States pointed to resource constraints, as well as tight and inconsistent timelines. Other Member States suggested that too many FDI transactions are notified, including those with no relevance for, or impact on, other EU Member States. Member States welcomed the opportunity to comment on FDI in another host Member States but wanted more information on others' comments. Certain Member States considered some requests for additional information overly burdensome. One Member State suggested additional clarification or articulation of some key aspects of the FDI Regulation, and one suggested introducing the possibility for joint notifications where notification is required in more than one Member State.

The Commission was unsympathetic to many of these concerns. The Commission noted that it had allocated additional resources to FDI screening and encouraged Member States to do the same. It opposed the introduction of filtering criteria, since a transaction that does not seem sensitive to one Member State may be sensitive to another. Timeline inconsistencies, the Commission noted, derive from national legislation, and any change at the EU level would require amendment of the regulation.

On the other hand, the Commission noted that it had already clarified certain key concepts in an updated frequently asked questions document and published the notification template. The Commission signalled openness to discuss ways to clarify the interplay between FDI screening and other tools (e.g. merger and prudential controls). The Commission also supports "careful consideration" of issues arising in multi-jurisdiction FDI notifications.

To address these issues, the Commission has launched a comprehensive study to ensure that the Member States' FDI screening mechanisms, as well as the EU cooperation mechanism, are effective and efficient. This study should be completed by summer 2022. The Commission is also considering issuing guidelines, following public consultation, but the timing of any such initiative is unclear.

Conclusion

Despite significantly reduced inward FDI levels, EU FDI screening mechanisms generated almost 1,800 notifications from 11 Member States in 2020. The first (almost) nine months of experience under the FDI Regulation generated 265 notifications and complaints about the resulting workload from Member State authorities. FDI notifications – and the resulting workload – will no doubt increase dramatically owing to the proliferation of screening mechanisms and post-pandemic increases in FDI levels.

The high percentage of cases cleared without screening (in 2020) or requests for additional information (under the FDI Regulation), the extreme variability in the length of the Phase II process and the high proportion of transactions triggering notifications in multiple Member States

all suggest that there is considerable room for improvement. The Commission's notification template, published in April 2021, should reduce delays caused by Phase II information requests but may also lead to more information being required for non-sensitive transactions.

The Commission's openness to changes to streamline FDI screening procedures is welcome, and its study will be eagerly awaited later this year. As the Report notes, however, significant changes, for example, to harmonize timelines, may require changes to the FDI Regulation. In 2023, the FDI Regulation will require the Commission to report on experience with the regulation and to propose potential changes, though any such changes would likely come into effect only around 2025.

In the meantime, merging parties and reviewing authorities will need to work together to make the EU's unique, hybrid framework for FDI screening as efficient as possible and to adapt to new and evolving M&A review mechanisms under the forthcoming anti-subsidy regulation and EUMR. The EU is an increasingly complex place for M&A, highlighting the need for expert professional guidance.

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