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Second Commission FDI Report Reflects Consolidation of EU Framework

Jay Modrall (Norton Rose Fulbright, Belgium) · Tuesday, September 6th, 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 sets out minimum requirements for Member States’ FDI screening regimes and a mechanism for coordinating Member States’ FDI reviews.

On September 2, 2022, the Commission published its second [annual report](#) on experience with the FDI Regulation (the Report) in 2021, together with a [staff working document](#). The Report is the first covering a full calendar year (since the FDI Regulation entered into force in October 2020) and overlaps with the first [annual report](#), which covered the period through June 30, 2021. The Report provides valuable insights into the FDI Regulation’s practical impact and reflects the consolidation of the EU framework.

One striking effect of the FDI Regulation 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, 25 (out of 27) now have or are in the process of adopting FDI screening laws. In 2021, nine Member States introduced FDI screening mechanisms or amended existing ones, mainly to upgrade screening procedures, expand covered sectors, and prolong the validity of national mechanisms. Although two (Bulgaria and Cyprus) are not currently working on such a mechanism, the Commission expects all 27 Member States to adopt FDI screening mechanisms.

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 EU Merger Regulation (EUMR) and presumably includes the power to appoint representatives to the board of an EU company, even without strategic veto rights.

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 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. (The staff working document published together with the Report includes a detailed analysis of public ownership in foreign direct investors.)

The Commission has published two sets of guidelines on application of the FDI Regulation, one in response to the [COVID-19](#) crisis and another relating to sanctions imposed on [Russia and Belarus](#) following Russia's invasion of the Ukraine. In April 2021, the Commission published a [notification template](#) designed to upgrade the information submitted and speed up reviews.

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: FDI trends

The Regulation requires Member States to notify the Commission of any new or existing screening mechanisms, 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.

According to the Report, global direct investment flows rebounded +52% with respect to 2020 and +11% with respect to the pre-COVID-19 levels of 2019. The most important sectors for inward EU FDI were information, communications and technology (ICT) and manufacturing. The U.S. and UK were the EU’s top foreign investors, while China accounted for only 2.3% of foreign acquisitions and 6% of greenfield investments. Germany was the top destination country for foreign acquisitions (followed by Spain, France and the Netherlands), while Spain was the top destination for greenfield investments (followed by France and Germany).

The EU accounted for only 8% of global FDI (compared to 27% in 2019), driven by decreases of inward FDI in Ireland, Germany and Luxembourg and by disinvestments in the Netherlands. The Commission expects inward investment levels to remain depressed through 2022 due to uncertainty caused by the Russian invasion of Ukraine.

The Report: FDI screening

In 2021, 13 Member States submitted a total of 414 notifications pursuant to the FDI Regulation’s cooperation mechanism. Five Member States — Austria, France, Germany, Italy and Spain — accounted for more than 85% of those notifications. The sectors with the highest number of transactions were ICT, manufacturing, financial activities, wholesale and retail, and construction. The main sectors and origin of the ultimate investor (USA, UK, China, Cayman Islands and Canada) largely reflected overall investment trends. Notified transactions ranged in value from EUR 1 to approximately EUR 29-31 billion. 28% concerned multi-jurisdictional transactions notified by several Member States, confirming the need for EU-level coordination.

Of the 414 cases notified, 86% were closed by the Commission in Phase 1, with 11% proceeding to Phase 2, with additional information being requested from the notifying Member State(s). (3%

were still ongoing on the Report's cut-off date). About 71% of all applications were deemed ineligible or did not require formal screening because of an evident lack of impact on security and public order.

The time required for Member States to provide requested information in Phase 2 cases ranged from 3 to 101 days, with an average of 22 days. The information requested included data on products and/or services of the target company; possible dual-use classification of products involved; customers, alternative suppliers and market shares; the investor's influence on the target post-transaction; and the target's IP portfolio and R&D activities.

Manufacturing and ICT accounted for a significant majority of Phase 2 cases (44% and 32%, respectively). Defense and aerospace accounted for almost half of the manufacturing sector cases. A significant number of notified cases involved one or more of the factors for consideration listed in Article 4 of the FDI Regulation, notably critical infrastructure, technology and dual use items, and access to sensitive information, as well as possible government ownership or control of, or influence over, the foreign investor.

Where a decision was reported, 73% were approved without conditions. 23% of decided cases entailed mitigating measures (a significant increase compared to 12% in the first report). 1% of decided transactions were blocked. Unfortunately, the Report does not provide further information on the transactions that were subject to mitigating measures or blocked. Information on the types of mitigating measures accepted and the sectors in which they required would provide useful guidance for potential investors.

The FDI Study and next steps

The Commission will soon conclude a study, launched in 2021, including (i) an overview of relevant Member State legislation; (ii) how this legislation and the FDI Regulation regulate the interaction between national authorities and the Commission; (iii) problems that may lead to less effective and/or less efficient outcomes; and (iv) the proportionality of the administrative burden for investors and other stakeholders. The study responded to concerns raised by Member States and described in the 2021 report and will feed into the Commission's decision whether to propose amendments to the FDI Regulation in 2023.

Conclusion

Despite still-reduced levels of inward FDI, the first full year of experience under the FDI Regulation generated 414 notifications to the Commission. FDI notifications – and the resulting workload – will no doubt increase as more Member States adopt screening mechanisms and inward FDI levels recover from the depressed levels caused by the COVID-19 crisis and the Russian invasion of the Ukraine.

The high percentage of cases cleared without a request 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. For example, introduction of a simplified procedure, as under the EUMR,

could reduce the administrative burden associated with notifying the majority of cases considered ineligible or self-evidently raising no concerns.

The Commission's openness to changes to streamline FDI screening procedures is welcome, and its study will be eagerly awaited this fall. However, any changes requiring an amendment to the FDI Regulation would likely come into effect only around 2025.

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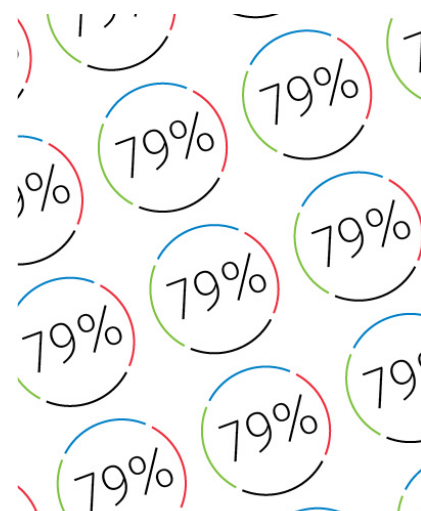
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