

# NEW EU RULES ON THE SCREENING OF FOREIGN DIRECT INVESTMENTS

## WHAT WILL CHANGE AND HOW SHOULD INVESTORS PREPARE?

Investors into the EU should be aware that the EU has recently adopted its first EU-wide FDI screening mechanism. This article sets out the key elements of such FDI screening mechanism and will identify some attention points for future investments. If you have further questions, don't hesitate to contact our investment advisory specialists at Philippe.Billiet@billiet-co.be or konstantinos.adamantopoulos@billiet-co.be

### 1. EXECUTIVE SUMMARY

Regulation (EU) No. 2019/452 of 19 March 2019 of the European Parliament and the Council "establishing a framework for the screening of foreign direct investment into the Union" was published in the Official Journal of the EU on 21 March 2019 ("the EU FDI Regulation").

The EU FDI Regulation entered into force on 10 April 2019 and will apply throughout the EU as from 11 October 2020. It may cover completed FDI projects in the EU up to 15 months prior to its application, i.e. FDI projects completed as from 11 July 2019 onwards. The EU FDI Regulation will also apply to UK originating new investments after Brexit.

The EU FDI screening mechanism will be advisory / consultative in nature. EU Member States where FDI projects take place will "keep the last word" whether such investment projects should be allowed or not in their respective territories. In reality, however, we expect that political pressure from the EU and other EU Member States will make it very difficult for an EU Member State not to follow the comments received from other EU Member States and the Commission.

The EU FDI Regulation will target investments whereby the investor would acquire effective control over the day-to-day management of companies or assets in the EU, be it directly or through investor group-controlled EU subsidiaries. Mere "portfolio investments" are not covered by the new rules.

The outcome of an FDI screening process may be the adoption, by the EU Member State where the FDI takes place or has been completed, of a Decision to authorise, condition, prohibit or unwind the FDI project at issue.

In light of the EU FDI screening mechanism, we recommend future investors to include in Sale and Purchase Agreements ("SPAs") relating to EU companies or assets proper Conditions Precedent ("CPs") on the outcome of the EU FDI screening mechanism, in addition to the usual antitrust clearance and other regulatory approval CPs.

### 2. GENERAL OVERVIEW

The EU FDI Regulation intends to ensure that the EU and the EU Member States are equipped to protect their essential interests while remaining one of the most open investment regimes in the world. Recitals (1) - (3) of the EU FDI Regulation demonstrate this with the following wording:

- (1) Foreign direct investment contributes to the Union's growth by enhancing its competitiveness, creating jobs and economies of scale, bringing in capital, technologies, innovation, expertise, and by opening new markets for the Union's exports. It supports the

- objectives of the Investment Plan for Europe and contributes to other Union projects and programmes.
- (2) ... the Union and the Member States have an open investment environment...
- (3) Pursuant to the international commitments ... it is possible for the Union and the Members States to adopt restrictive measures relating to foreign direct investment on the grounds of security or public order, subject to certain requirements. The framework established by this Regulation relates to foreign direct investments into the Union."

The President of the Commission, Jean-Claude Juncker, stated on 5 March 2019:

"Today's decision is a proof the EU is able to act quickly when strategic interests of our citizens and economy are at stake. With the new investment screening framework, we are now much better equipped to ensure that investments coming from countries outside the EU actually benefit our interests. I committed to work for a Europe that protects, in trade as in other areas; with this new legislation in place we are delivering on a crucial part of our promise."

European Commissioner for Trade, Cecilia Malmström, stated on 5 March 2019:

"I'm very pleased with the Council's decision today. The EU gains a lot from foreign investment and it plays a vital role in our economies. However, we have seen a recent increase in investment in our strategic sectors and this has led to a healthy public debate on the issue. With this new framework we are in a much better position to monitor foreign investments and safeguard our interests. I now look forward to working closely with Member States to implement this new legislation effectively."

The new EU framework for FDI screening:

- Creates a cooperation mechanism where EU Member States and the Commission will be able to exchange information and raise specific concerns (Article 1 (1) of the EU FDI Regulation);
- Allows the Commission to issue opinions in cases where an investment poses a threat to the security or public order of more than one EU Member State, or when an investment could affect a project or programme of interest to the whole EU, such as the Trans-European Networks ("TENs", Article 1 (1) of the EU FDI Regulation);

- Encourages international cooperation on investment screening policies, including sharing experience, best practices and information regarding investment trends;
- Reaffirms that national security interests are the responsibility of EU Member States (Article 1 (2) of the EU FDI Regulation). EU Member States will "keep the last word" whether a specific investment project should be allowed or not in their respective territories (see also, Recitals (7), (17) and (19) of the EU FDI Regulation); and
- Imposes on those EU Member States that have in place national FDI screening legislation the obligation to (1) comply with the principles of transparency and non-discrimination; (2) adopt short FDI approval time-frames; (3) ensure strict confidentiality of information exchanged in the course of FDI screening procedures; and (4) grant private parties the right to effectively challenge national FDI screening decisions before national courts (Article 3 (2) - (5) of the EU FDI Regulation).

The EU Member States that presently have national FDI screening mechanisms in place are Austria, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, the Netherlands, Poland, Portugal, Spain and the United Kingdom. Thus, all large EU Member States already have national FDI screening mechanisms in place. Such mechanisms are not homogenous and large differences exist regarding their legal or purely consultative / political nature and binding effects.

The EU Member States that do not have national FDI screening rules are Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Estonia, Greece, Ireland, Luxemburg, Malta, Romania, Slovakia, Slovenia and Sweden. The EU FDI Regulation does not impose a legally binding obligation on these EU Member States to adopt FDI screening mechanisms at a national level.

The EU Member States that have FDI screening mechanisms in place, such as France and Germany, are expected to actively use the EU FDI cooperation mechanism and ensure that FDI Projects that take place in EU Member States that do not have national FDI legislation are also screened at an EU-wide level. The EU FDI Regulation will serve to "close a loophole" that exists in the EU with regard to EU Member States such as Italy, Portugal, Greece, Poland etc. that rely on FDI more than other EU Member States.

### 3. ACQUISITION OF EFFECTIVE MANAGEMENT CONTROL ON A LASTING BASIS

Recital (9) of the EU FDI Regulation defines the term “FDI” by reference to the existence of direct and lasting investment links between foreign entities and the EU, excluding portfolio investments. It provides that:

“A broad range of investments which establish or maintain lasting and direct links between investors from third countries including State entities, and undertakings carrying out an economic activity in a Member State should be covered by this Regulation. It should however not cover portfolio investment.”

Article 2 of the EU FDI Regulation defines the terms FDI, foreign investors and third country undertakings as follows:

“‘foreign direct investment’ means 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 entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity in a Member State, including investments which enable effective participation in the management or control of a company carrying out an economic activity;

‘foreign investor’ means a natural person of a third country or an undertaking of a third country, intending to make or having made a foreign direct investment;

‘undertaking of a third country’ means an undertaking constituted or otherwise organised under the laws of a third country.”

The EU FDI Regulation requires, therefore, the acquisition of effective management control over EU undertakings or assets as a result of the investment. If an investment does not render to the investor decisive influence, including veto rights, over the day-to-day management of EU undertakings or assets, the EU FDI Regulation will not apply.

Veto rights of minority shareholders that protect the investment of such minority shareholders, relating, for example, to substantially large investments, the change of the activities of a company, the acquisition or the disposal of major assets, are not considered as conferring effective management control over a company. Such veto rights do not affect the day-to-day management of a company.

The FDI Regulation draws attention to the risks of circumvention of the EU FDI screening mechanism from investments made by EU entities owned by third country entities as well as the ownership of such third country entities (Article 3 (6) of the FDI Regulation). Recitals (10) and (11) of the EU FDI Regulation clarify the term “circumvention” and state as follows:

“(10) Member States that have a screening mechanism in place should provide for the necessary measures, in compliance with Union law, to prevent circumvention of their screening mechanisms and screening decisions. This should cover investments from within the Union by means of artificial arrangements that do not reflect economic reality and circumvent the screening mechanisms and screening decisions, where the investor is ultimately owned or controlled by a natural person or an undertaking of a third country. This is without prejudice to the freedom of establishment and the free movement of capital enshrined in the TFEU.

(11) It should be possible for Member States to assess risks to security or public order arising from significant changes to the ownership structure or key characteristics of a foreign investor.”

Future investments in the EU relating to the acquisition of controlling interests in EU companies and assets (including investments of its EU subsidiaries) should therefore be based on strong and sound commercial business plans and reflect prevailing EU and global market conditions.

On the other hand, the acquisition of minority non-controlling shareholding interests will not be covered by the FDI Regulation. This will also be the case where an investor obtains veto rights over certain matters relating to the activities of target companies, as long as such veto rights do not relate to day-to-day management.

### 4. NATIONAL SECURITY AND PUBLIC ORDER

The EU FDI Regulation provides that EU FDI screening is necessary on the grounds of security and public order. However, it does not further define the terms “security and public order” which thus remain too vague and broad and, as a result, susceptible to wide interpretation. They can encompass anything that endangers society or an EU Member State’s interests.

Recitals (13) and (14) of the new EU FDI Regulation attempt to shed light in the meaning of the terms “public order and national security”. The European Parliament, society members such as Non-Governmental Organisations (“NGOs”) and Trade Unions will also be able to offer comments on the meaning of these terms in future cases. Accordingly:

“(13) In determining whether a foreign direct investment may affect security or public order, it should be possible for Member States and the Commission to consider all relevant factors, including the effects on critical infrastructure, technologies (including key enabling technologies) and inputs which are essential for security or the maintenance of public order, the disruption, failure, loss or destruction of which would have a significant impact in a Member State or in the Union. In that regard, it should also be possible for Member States and the Commission to take into account the context and circumstances of the foreign direct investment, in particular whether a foreign investor is controlled directly or indirectly, for example through significant funding, including subsidies, by the government of a third country or is pursuing State-led outward projects or programmes.

(14) Member States or the Commission, as appropriate, might consider relevant information received from economic operators, civil society organisations, or social partners such as trade unions, in relation to a foreign direct investment likely to affect security or public order.”

The Commission stated in the past that the EU FDI Regulation avoided defining these terms on purpose. According to the Commission, it is very difficult to estimate what kind of developments can affect public order and security in the future.

In light of this, it may be particularly important to reflect on e.g.

- whether foreign state aid/funding programs enabled the investment and whether such aid would have been compatible with the limits of support that are allowed under EU state aid rules;
- whether EU GDPR rules are being complied with (also regarding the transfer of data into and out of the EU);
- the extent to which practices of the investor may be allowed outside the EU that would not be allowed within the EU and whether the EU investment could support those practices (e.g. restrictions on direct selling, online sales, consumer protection, etc.)

It would also appear prudent for an investor to keep a complete and up-to-date record of all its major success stories in the EU as well as positive comments and feedback received from EU Governments Authorities for future reference, if necessary.

### 5. THE EU FDI SCREENING MECHANISM

Article 2 of the EU FDI Regulation defines the various aspects of the screening mechanism as follows:

‘screening’ means a procedure allowing to assess, investigate, authorise, condition, prohibit or unwind foreign direct investments;

‘screening mechanism’ means an instrument of general application, such as a law or regulation, and accompanying administrative requirements, implementing rules or guidelines, setting out the terms, conditions and procedures to assess, investigate, authorise, condition, prohibit or unwind foreign direct investments on grounds of security or public order;

‘foreign direct investment undergoing screening’ means a foreign direct investment undergoing a formal assessment or investigation pursuant to a screening mechanism;

‘screening decision’ means a measure adopted in application of a screening mechanism;”

The FDI Regulation introduces 3 types of FDI screening cooperation processes as follows:

- FDI projects already undergoing screening in one or more EU Member States;
- Completed FDI projects or FDI projects not subject to a screening process in one or more EU Member States; and
- FDI in projects and programmes involving substantial EU funding or set up by EU law on critical infrastructure, critical technologies or critical inputs.

#### 5.1 FDI PROJECTS UNDERGOING SCREENING IN AN EU MEMBER STATE

Article 6 of the EU FDI Regulation sets out the screening cooperation mechanism between the EU Member States and the Commission regarding FDI Projects that undergo screening in the EU Member State where they are expected to take place. Accordingly, the relevant FDI screening Authorities of EU Member States must report on all FDI

projects in their territory covered by the EU FDI Regulation that are subject to their national screening procedures. In order to improve the quality and comparability of information provided by EU Member States as well as to facilitate compliance with the notification and reporting obligations, the Commission will provide standardised forms for the reporting of EU FDI projects.

## 5.2 FDI PROJECTS NOT SUBJECT TO SCREENING IN AN EU MEMBER STATE OR ALREADY COMPLETED

Article 7 of the EU FDI Regulation provides for a screening cooperation mechanism for FDI projects that do not undergo screening in the EU Member State where they take place. In such cases, any interested EU Member State and the Commission may address a duly reasoned and justified request for information to the EU Member State where the FDI takes place. The request must set out the national security and public order concerns arising from the FDI project at issue.

National interest also includes situations where an investor of an EU Member State competes with investors of third countries for making an investment in another EU Member State such as acquiring companies and/or assets.

This mechanism will also apply to FDI Projects up to 15 months after their completion (Article 7 (8) of the EU FDI Regulation).

## 5.3 FDI PROJECTS IN AREAS OF EU INTEREST OR EU FUNDED PROGRAMMES

According to Article 8 of the EU FDI Regulation, the Commission may also provide an opinion regarding foreign direct investments likely to affect projects and programmes of EU interest on grounds of security or public order.

Such opinions would concern projects and programmes involving substantial EU funding or established by EU law.

## 6. INFORMATION REQUESTS FOR FDI PROJECTS

According to Article 9 of the EU FDI Regulation, the FDI Project information provided by EU Member States shall include:

- the ownership structure of the foreign investor and of the undertaking in which the foreign direct investment

- is planned or has been completed, including information on the ultimate investor and participation in the capital;
- the approximate value of the foreign direct investment;
- the products, services and business operations of the foreign investor and of the undertaking in which the foreign direct investment is planned or has been completed;
- the EU Member States in which the foreign investor and the undertaking in which the foreign direct investment is planned or has been completed conduct relevant business operations;
- the funding of the investment and its source, on the basis of the best information available to the Member State; and
- the date when the foreign direct investment is planned to be completed or has been completed.

EU Member State FDI Screening Authorities should provide accurate, comprehensive and reliable information. For this purpose, the EU Member State Authorities where an FDI is planned or has been completed may request the foreign investor or the undertaking concerned to provide all relevant information. In cases where no detailed information is available, any comment issued by another EU Member State or any opinion issued by the Commission in the framework of the cooperation mechanism may be made on the basis of the information available to them.

## 7. EU FDI SCREENING COOPERATION PROCEDURE AND TIME LIMITS

Following an FDI notification, any EU Member State may provide duly reasoned comments to the EU Member State in which the FDI is planned or has been completed, regardless whether such an investment is undergoing screening in that EU Member State. Requests for information, replies and comments of EU Member States will also be forwarded to the Commission.

The Commission may issue an opinion to the EU Member State in which the investment is planned or has been completed, in particular, in cases where the national interest of more than one EU Member States is affected by the FDI project at issue.

Such comments and opinions must be sent to the EU Member State within 35 calendar days from the notification of the FDI Project by that EU Member State to the other EU Member States and the Commission. This period may be extended

by another 20 calendar days, if in the meantime additional questions and clarification requests were raised by EU Member States or the Commission. The 20-day period starts from the receipt of the requested clarifications or information. Both time periods are extended by 5 calendar days with regard to opinions of the Commission.

Similarly, in cases of FDI projects that are not subject to screening in the EU Member State where they take place or have been completed, EU Member States may submit their comments within 35 calendar days from receipt of the information they requested from the relevant EU Member State where the FDI project takes place or has been completed. The Commission has additional 15 calendar days to issue an opinion following the submission of the comments of the EU Member States.

According to Recital (17) of the EU FDI Regulation, when an EU Member State receives comments from other EU Member States or an opinion from the Commission, it should give such comments or opinion due consideration through measures available under its national law, or in its broader policy-making.

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 has been completed (Article 6 (9) of the EU FDI Regulation).

According to Article 8 of the EU FDI Regulation, the Commission may also provide an opinion regarding foreign direct investments likely to affect projects and programmes of EU interest on grounds of security or public order.

The EU Member State concerned should take utmost account of the opinion received from the Commission through 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. Again, the final decision in relation to any FDI project undergoing screening or any measure taken in relation to an FDI project not undergoing screening remains the sole responsibility of the EU Member State where the foreign direct investment is planned or completed.

National FDI screening procedures must be completed within short periods of time to ensure legal certainty. The 35-calendar

day time limit for the cooperation between the EU Member States and the Commission under the EU FDI Regulation may be extended if EU member States submit additional information or clarification requests that in effect “stop the clock”. Eventually longer time limits should, therefore, be taken into account when an investor negotiates time tables for the completion of future projects.

## 8. FDI SCREENING AND ANTITRUST – MERGER CONTROL

The application of the FDI Regulation may interfere with the antitrust assessment of EU Competition Authorities and the Commission itself of mergers and acquisitions (“M&A”). Such assessment presently focuses on the need to avoid the creation of dominant positions as a result of a proposed M&A.

The antitrust assessment concerns the impact on the market of the proposed M&A and the market shares of the various competitors on the products and services affected by the M&A. The analysis is not at all related to the concepts of “national security” and “public order”.

It is therefore conceivable that the Commission Competition Directorate may approve an M&A because such M&A does not have a negative impact on relevant market competition, whilst one or more EU Member States, with the support of the Commission Trade Directorate, block the M&A at issue on national security and/or public order grounds. Indeed, as mentioned earlier, Article 2 (3) and (4) of the new EU FDI Regulations provide that an FDI screening decision may authorise, condition, prohibit or unwind foreign direct investments on grounds of security or public order.

Recital (36) of the EU FDI Regulation seeks to address this issue by providing that the antitrust and FDI screening analyses must take place in a consistent and coherent manner. A consistent and coherent approach in the example mentioned above would mean that the Competition Directorate of the Commission would likely recognise the existence of legitimate national security and/or public order interests of the EU Member State(s) concerned pursuant to the exceptional provisions of Article 21(4) of the EU Merger Control Regulation (EC) No 139/2004.

The need for a coherent and consistent approach likely means that the position of the Commission Competition Directorate will be without prejudice to the FDI screening outcome which may indeed block or unwind the proposed M&A.

Future investor SPAs relating to EU companies or assets will thus need to include CPs on the outcome of the EU FDI screen mechanism, in addition to the usual antitrust clearance and other regulatory approval CPs. Such CPs should be negotiated for SPAs that are completed as from 11 July 2019 onwards.

## 9. CONFIDENTIALITY, DATA PROTECTION AND ENTRY INTO FORCE

The EU FDI Regulation provides for specific procedures in cases of urgency (Articles 6, 7 and 8); the confidential treatment of the information exchanged in the course of the FDI cooperation screening mechanism (Article 10); compliance with the EU Data Protection rules (Article 14); cooperation with third country Governments regarding FDI screening (Article 13); and the establishment of an experts group to assist the Commission in carrying out its tasks under the EU FDI Regulation (Article 12).

The EU FDI Regulation entered into force 20 days following its publication in the Official Journal of the EU, i.e. On 10

April 2019. The EU FDI Regulation will apply 18 months following the day of its entry into force, notably as from 11 October 2020.

Pending the application of the new EU FDI Regulation on 11 October 2020, the Commission will continue to implement an informal FDI screening mechanism at the existing Coordination Group consisting of expert representatives from all EU Member States, on Inward Foreign Direct Investment. This Group looks at identifying sectors and assets that have strategic implications from a security, public order and/or control of critical assets point of view at national level, cross-border level or at European level.

We very much hope that you found this Briefing useful. We remain at your entire disposal for any additional information or clarification.

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