Client Alert

Foreign Investments: the EU takes the lead to harmonise screening initiatives

26 September 2017

The European Commission issued a proposal for a regulation establishing a common framework for screening of foreign investments.

It confirms that Member States may maintain or adopt new measures to control foreign investments that may affect security or public order under certain conditions but does not require them to do so.

The main goal of the Commission is to answer a strong political demand and to ensure fair competitive conditions between EU and foreign investors based on market rules.

The core of the Proposed Regulation is to establish a cooperation mechanism between the Member States and with the Commission.

It now has to follow the normal legislative procedure that may take more than one year.

On 13 September 2017, the European Commission (the "**Commission**") issued a proposal for a Regulation "*establishing a framework for screening of foreign direct investments into the European Union* (the "**EU**")" (the "**Proposed Regulation**").

"Let me say once and for all: we are not naïve free traders."

Jean-Claude Juncker, President of the European Commission
State of the Union speech 2017

Where does the Proposed Regulation come from?

The Proposed Regulation is the response to a request made in February 2017 by France, Germany and Italy for a common approach, at the EU level, of foreign investments control. These governments asked for the implementation of a "principle of reciprocity", meaning a possibility by Member States to go as far as prohibiting investments originating from a third country that discriminates against European investors.

This request was the result of a recent "*series of take-overs of European companies [that] involved foreign investors with strong ties to their home governments which strategy focus on the purchase of European companies that develop technologies or maintain infrastructures that are essential to perform critical functions in society and the economy*".

These take-overs were perceived as not being justified by economic reasons, but rather by the desire of some foreign governments to control European industry icons. Such comments were made, most notably, regarding the acquisitions by Chinese companies of France's Toulouse Airport in 2015 (the first French airport to be privatised by the State and a symbolic location as it houses the headquarters of the European multi-national Airbus) and the Port of Piraeus (one of the oldest and a major European port located in Athens, Greece) in 2016. In the same way, the take-over of Germany's robotics maker Kuka by Chinese appliances maker Midea in 2017 raised concerns of a transfer of cutting-edge technology from Germany to China.

These instances led to a strong political demand for a tightening of the control of foreign investments in the EU. Some were concerned that this demand could lead to the creation by Member States of foreign investments control mechanisms with strong protectionist undertones.

What are the main provisions of the Proposed Regulation?

Scope and control mechanisms adopted by Member States

The Proposed Regulation confirms that foreign investment may be screened by the Member States on the grounds of security or public order. As a reminder, foreign investments control mechanisms exist in 12 Member States (ie nearly half of them).

The Proposed Regulation provides a non-exhaustive list of factors that may be taken into consideration when screening foreign investment. This list of factors also intends to provide clarity to investors considering making foreign investments in the EU.

In determining whether a foreign investment may affect security or public order, Member States may consider all relevant factors. Examples of factors which may be taken into consideration in the screening include the potential effects on:

> critical infrastructure (eg energy, transport, communications, data storage…)

> critical technologies (eg artificial intelligence, robotics, space or nuclear technology…)

> the security of supply of critical inputs

> the access to sensitive information

> the ability to control sensitive information

Member States should also be able to consider whether a foreign investor is controlled directly or indirectly by the government of a third country, including through significant funding.

Member States should be able to maintain, amend or adopt measures necessary to prevent the circumvention of their screening mechanisms and decisions. Such measures may include the screening of investments carried out by an undertaking formed in accordance with the law of a Member State and owned or controlled by a foreign investor, when the investment is made through artificial arrangements within the EU that do not reflect economic reality and circumvent the screening mechanisms.

The Proposed Regulation reiterates the essential elements of the procedural framework that were already defined by the European Court of Justice: it will notably ensure that investments are screened in a transparent manner and that there will be no discrimination between different third countries. Those elements include, notably, establishment of timeframes for the screening and the possibility for investors to seek judicial review of screening decisions.

The new cooperation mechanism

The Proposed Regulation creates a "*cooperation mechanism*". Each Member State must inform the Commission and the other Member States of foreign investments that are undergoing screening in the concerned Member State. The Commission and other Member States may offer "*opinions*" and "*comments*" that need to be given "*due consideration*" by the concerned Member State.

This cooperation should allow Member States to exchange information and co-ordinate, where possible, their response to the foreign investment. The screening Member State should allow other Member States to provide comments within 25 working days.

The Commission should also be informed of foreign investments undergoing screening under a Member State's screening mechanism and have the possibility to provide comments to take account of the comments made by Member States, the Commission proposes to have an additional period of 25 days to determine whether to issue such an opinion to the Member States in which the investment is planned or has taken place.

A new mechanism for screening by the Commission

Where the Commission considers that a foreign investment is likely to affect the "*security or public order*" of the EU, it may offer an opinion to the concerned Member State. The Member State must take "*utmost account*" of the Commission's opinion and provide an explanation in case said opinion is not followed.

What is not in the Proposed Regulation?

Although the request issued by France, Germany and Italy asked the Commission to provide for a possibility by Member States to go as far as prohibiting investments originating from a third country that discriminated against European investors, the Proposed Regulation does not contain any provision regarding such a "principle of reciprocity".

What are the next steps?

The Proposed Regulation will now follow the Ordinary Legislative Procedure. This means that the proposal will be examined and, very likely, amended by the Parliament (representing the people of the Member States) and the Council (representing the governments of the Member States). The Parliament and the Council will each discuss their positions on the proposals before entering trilogue negotiations.

There is no mandatory deadline for the examination of the Proposed Regulation. It takes an average of 18 months for legislation to be adopted in first reading. However, considering the potential controversial nature of foreign investment screening amongst Members States, we cannot exclude a delay in the adoption process. We cannot also exclude that the Proposed Regulation will not be enacted.

What can you expect?

The Proposed Regulation is a response to a very strong political need, by European States, to establish a better screening of foreign investments from third countries. This response may also be seen as a desire of the Commission to avoid the risk of Member States adopting protectionist policies. The Commission hopes to pre-empt any uncoordinated response from the Member States and to assuage concerns regarding the motivation of foreign investments.

The Commission also hopes that a rational and transparent screening mechanism at the EU level could encourage foreign investors to continue investing in Europe while always remaining motivated by economic and not political motives.

The overall goal is to ensure fair competitive conditions between EU and foreign investors based on market rules.

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