

EU Foreign Direct Investment Regulation Comes Into Force

October 16, 2020

On October 11, 2020, the EU Foreign Direct Investment Regulation—which establishes a European framework for the screening of foreign investments into the European Union—entered into force.

The legislation attempts to address growing concerns (compounded by the COVID-19 pandemic) regarding inbound investments at a European level.

The Regulation does not grant the European Commission (or any other European institution) the ability to veto foreign investments; this power is retained by Member States under national legislation.

Rather, it lays down a common framework for review by Member States and seeks to coordinate national enforcement action, including by enabling the Commission and other Member States to comment on national reviews.

This memorandum provides an overview of the new Regulation and its expected practical impact on foreign investment review in the EU.

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I. Introduction

[Regulation \(EU\) 2019/452](#) (the “[FDI Regulation](#)”) establishes a framework for the screening by Member States of certain types of foreign direct investments (“[FDIs](#)”) into the European Union on the grounds of security or public order.

- **Investments.** The FDI Regulation defines FDIs as those that intend to establish or maintain “*lasting and direct links*” between a foreign investor and a target company. This may “*includ[e] investments which enable effective participation in the management or control of a company carrying out an economic activity,*” though control does not appear to be a pre-requisite to the application of the legislation.
- **Investors.** The FDI Regulation applies to “foreign investors,” which it defines as individuals or entities of a country other than a EU Member State. Intra-EU investments are not caught, though this does not preclude Member States from screening those investments to the extent permissible under the Treaty on the Functioning of the European Union (“[TFEU](#)”).¹

Importantly, the FDI Regulation does not seek to follow the EU Merger Regulation in introducing a “one-stop-shop” review mechanism for FDIs in Europe. Rather, it seeks to (i) increase legal certainty for national screening mechanisms and (ii) increase cooperation on national reviews. It is also likely to result in (iii) increased Commission oversight over national efforts in this area. Each of these areas is discussed in further detail, below.

II. Increased Legal Certainty

The FDI Regulation affirms the ability of Member States to maintain mechanisms to screen FDIs in

¹ Indeed, national legislation in several Member States (including France, Germany, and Italy) already allows for the review of investments that are relevant to defence and public security, even where they are carried out by EU investors, consistent with Article 346 TFEU.

² FDI Regulation, Article 4(1).

³ Dual use items are defined in [Regulation \(EC\) No 428/2009](#) (which sets up a European regime for the

their territories on the grounds of security or public order. It also provides guidance on (i) the sectors and (ii) investors that may be relevant for that purpose.

Sectors. The FDI Regulation sets out a non-exhaustive list of sensitive sectors that Member States (or the Commission) may focus on in reviewing FDIs:²

- **Critical infrastructure**, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure.
- **Critical technologies and “dual use” items** (*i.e.*, which can be used for civil and military purposes),³ including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies.
- **The supply of critical inputs**, including energy or raw materials, as well as food security.
- **Access to sensitive information**, including personal data, or the ability to control such information.
- **The freedom and pluralism of the media.**

Unfortunately, this categorisation is very broad, especially through the use of catch-all industry terms (such as “transportation”, “communication”, “media”, and “data”) without any explicit limitation. It is also intentionally non-exhaustive.

“control of exports, transfer, brokering and transit of dual-use items”) as “*items, including software and technology, which can be used for both civil and military purposes, and shall include all goods which can be used for both non-explosive uses and assisting in any way in the manufacture of nuclear weapons or other nuclear explosive devices.*”

The consequences of this breadth will be magnified by the adoption of the sector list by certain Member States (including Austria, Italy, Slovenia, and Spain) who have incorporated or cross-referenced it in their national legislation.

Nevertheless, as further definitional clarity emerges over time, the list may start to provide a useful and harmonized approach to considerations that can legitimately be taken into account in foreign investment review in the EU.

Categories of investor. The FDI Regulation also provides guidance on the factors that Member States may take into account when scrutinizing FDIs. Specifically, in assessing whether an investment is likely to affect security or public order, Member States may consider whether:⁴

- The investor is controlled by the government (including state bodies or armed forces) of a third country, including through ownership structure or significant funding.
- The investor has already been involved in activities affecting security or public order in a Member State.
- There is a serious risk that the investor engages in illegal or criminal activities.

As explained further below, the inclusion of governmental investors is likely to be particularly significant, although the Regulation does give weight to investors' previous experience in activities affecting security or public order in the EU.

III. Increased Cooperation

Each Member State retains full jurisdiction to review FDIs in their territories. Accordingly, the FDI Regulation does not seek to create a centralized "one-stop-shop" for foreign investment review in Europe.

⁴ FDI Regulation, Article 4(2).

⁵ The UK has recently been excluded from this cooperation mechanism due to the uncertainties related to the looming "Brexit". See EC Decision of July 31, 2020: https://trade.ec.europa.eu/doclib/docs/2020/august/tradoc_158921.pdf.

⁶ FDI Regulation, Article 6.

It does, though, take a tentative first step in that direction, by seeking to increase coordination among Member States and with the Commission.⁵ The process differs as between (i) FDIs that are under review; (ii) FDIs that are not under review; and (iii) FDIs likely to affect projects of Union interest.

FDIs under review. Where a Member State is reviewing an investment under its national FDI framework, it is required to notify the Commission and all other Member States.⁶

- Member States may comment on the FDI where they consider their security and public order may be affected, or they have relevant information.
- The Commission may issue an opinion if it considers the FDI is likely to affect security and public order in more than one Member State, or has relevant information. The Commission must issue an opinion where at least one-third of Member States consider it is likely to affect security and public order.
- The notifying Member State may also ask other Member States to comment, or the Commission to issue an opinion.
- Member State comments and Commission opinions do not have binding force, but the relevant Member State is required to give them "*due consideration*".

FDIs not under review. Similar rules⁷ apply even where FDIs are (or were) not undergoing screening (up to 15 months after completion), except that the Member State is of course not required to notify the Commission and other Member States.⁸

It is not yet clear how the relevant Member State will take account of any comments from other Member States or a Commission opinion, where the relevant FDI is not under review (or perhaps even

⁷ Specifically, Member States and EC may comment or issue an opinion on an investment (if they consider the security and public order of Member States may be affected, or they have relevant information) and the Member State in whose territory the FDI is carried out must take them into account.

⁸ FDI Regulation, Article 7.

reviewable) under national law; that issue may be particularly acute for investments that have already completed.

FDIs likely to affect projects of Union interest.

Finally, where the Commission considers that a FDI is likely to affect a defined set of projects or programmes of Union interest on grounds of security or public order, the Commission may issue an opinion addressed to the Member State in whose territory the investment is to be carried out, which must “*take utmost account*” of the opinion and provide an explanation if it is not followed.⁹

IV. Increased Commission Oversight Over National Regimes

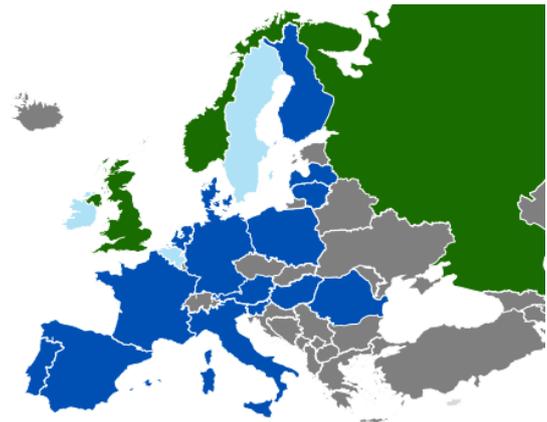
The FDI Regulation obliges the Commission to maintain a list of screening mechanisms under Member States’ respective national laws.¹⁰ This list shows that 15 Member States (in addition to the UK) currently have an FDI review framework in place.¹¹

The list is growing: four Member States introduced new regimes in 2020 (Austria, Hungary, Poland, and Slovenia); others (including Germany, Italy, and Spain) introduced new measures in response to the COVID-19 pandemic following encouragement from the Commission;¹² and several other countries are actively considering new legislation (including Belgium, Ireland, and Sweden).

⁹ FDI Regulation, Article 8. The relevant projects are listed in the Annex to the Regulation (as recently updated), which includes: GNSS (the satellite radio-navigation system); Copernicus (the earth observation program); Horizon 2020 (the R&D program on AI, robotics, cybersecurity, and semiconductors); TEN-T (the trans-European transportation project); TEN-E (the trans-European energy infrastructures project) and the project on the trans-European telecom infrastructures; the European program for the development of defence industrial system; PESCO (the defence permanent structured cooperation); EU GOVSATCOM (the government satellite communication program); the Preparatory Action on Defense Research; and the European Joint Undertaking for ITER (the global project to demonstrate fusion as a sustainable source of energy).

¹⁰ FDI Regulation, Article 3(8).

FDI Rules In Europe



15 Member States have regimes in place

Several Member States actively considering legislation

FDI regimes outside of the EU

Finally, Member States are required to report to the Commission each year, including on whether they have applied their FDI review regimes, and whether other Member States made requests under the cooperation mechanism.¹³ In turn, the Commission is obliged to prepare an annual report to the European Parliament on the application of the FDI Regulation.

V. Implications For Businesses

The full implications of the FDI Regulation are not yet clear. There remains considerable uncertainty as to how the rules will operate, and how the Commission will interpret its role. With that caveat,

¹¹ Available at:

https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf. According to this list, the following Member States currently have an FDI review framework in place: Austria, Denmark, Finland, France, Germany, Italy, Latvia, Lithuania, Hungary, the Netherlands, Poland, Portugal, Romania, Slovenia, and Spain.

¹² The Commission issued a Communication on March 25, 2020, encouraging Member States to use their FDI tools (or introduce them where not existing) to protect “*critical health infrastructure, supply of critical inputs, and other critical sectors.*” See https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf.

¹³ FDI Regulation, Article 5.

we set out below some preliminary thoughts on the role the FDI Regulation may have in the coming years.

- **More FDI regimes.** The FDI Regulation has already inspired several Member States to introduce new regimes or expand existing legislation. This trend is likely to continue, resulting in more Member States introducing regimes to scrutinize foreign investments.
- **Longer reviews.** The obligation on Member States to report FDI reviews, the information sharing requirements, and the ability of the Commission and other Member States to intervene, is likely to result in investments being subject to even longer and more complex reviews than they are today.
- **Focus on government-sponsored investors.** The FDI Regulation reflects potential concerns regarding FDIs that are carried out by investors owned or backed by third country governments. This may result in stricter reviews of deals involving governmental investors, consistent with the Commission's recent proposal on investments backed by foreign public subsidies.¹⁴ That said, the Regulation does recognise that previous involvement in activities affecting security or public order may be relevant, which may assist governmental investors with an existing presence in the EU.
- **Greater Commission influence.** The FDI Regulation introduces cooperation mechanisms between the Member States and the Commission. This reflects a compromise between those who had advocated for a more centralized approach, and a purely national review. It remains to be seen how this balance will develop, including as a result of the Commission's powers to comment on national reviews. At a minimum, though, the Commission will have a greater role than it does today.

- **Short term teething issues.** The details of various procedural and substantive issues under the FDI Regulation are still unclear. For example, there is considerable debate over the scope of the industrial sectors covered by the legislation, and the cooperation and coordination mechanisms need to be built out through more granular rules. It will take some time for these issues to bed down; investments that take place in the intervening period will be subject to additional uncertainty.
- **Longer term clarity.** Over time, however, the FDI Regulation should lead to more consistency and predictability, once the parameters of the regime becomes clearer. Likewise, although FDI review inevitably involves more political interference than merger control, a more centralized approach may eventually lead to a more uniform and predictable review system in Europe.

VII. Conclusion

The FDI Regulation is a significant first step towards more harmonized foreign investment review in the EU. In the near term, investors should be aware of greater scope for Member State intervention and Commission oversight. It remains to be seen whether this will lead in the longer term to further harmonization (or even pan-European review), as is already the case for merger control and was recently proposed for acquisitions facilitated by public subsidies.

Our FDI practice will continue to monitor these developments on our webpage (www.clearygottlieb.com/practice-landing/foreign-investment-review) and International Trade and Sanctions Watch Blog (www.clearytradewatch.com) where we write on latest developments.

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¹⁴ See the Commission white paper of June 17, 2019 on "levelling the playing field as regards foreign subsidies":

https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf.