ALERT MEMORANDUM

Proposed New EU FDI Screening Regulation – 10 Things to Know

March 12, 2024

The European Commission ("EC") has recently adopted five initiatives as part of the European Economic Security Strategy unveiled in June 2023.[1] The initiatives are aimed at bolstering the EU's economic security interests. Their main focus is a proposal for a new EU FDI Screening Regulation,[2] which remains subject to adoption by the European Parliament and the Council, and as proposed would comprise a complete overhaul of the existing EU FDI regime:

(1) All EU Member States would be required to adopt and maintain FDI screening;

(2) Investments in the EU made by investors registered in the EU but controlled by non-EU persons would fall within the scope of the EU screening cooperation mechanism;

(3) The EU screening cooperation mechanism would apply to 'greenfield' investments if they are reportable at the EU Member State level;

(4) All EU Member States would need to screen a minimum set of activities specified in Annex I and Annex II, but would be free to review other activities as well;

(5) The EU screening cooperation mechanism would be reinforced: notifying EU Member States would need to take "*utmost consideration*" of comments/opinion from other EU Member States and the EC and justify any divergence from those comments/opinion;

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

BRUSSELS

François-Charles Laprévote
+32 22872184
fclaprevote@cgsh.com

Vladimir Novak
+32 22872173
vnovak@cgsh.com

Thomas Harbor
+32 2 287 2204
tharbor@cgsh.com

ROME

Francesco Iodice
+39 06 6952 2697
fiodice@cgsh.com

FRANKFURT

Mirko von Bieberstein
+49 69 97103 204
mvonbieberstein@cgsh.com

LONDON

John Messent
+44 20 7614 2377
jmessent@cgsh.com

WASHINGTON

Chase D. Kaniecki
+1 202 974 1792
ckaniecki@cgsh.com

[1] EC proposes new initiatives to strengthen economic security, 24 January 2024, available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_24_363.

[2] The package also includes a white paper on *outbound* investment control (available at: https://circabc.europa.eu/ui/group/aac710a0-4eb3-493e-a12a-e988b442a72a/library/51124c0d-58d8-4cd9-8a22-4779f6647899/details?download=true), launching a debate on whether and how to scrutinize investment outflows from the EU for the first time in the Union's history. See our Alert Memorandum: "EU Takes Time to Ready Outbound Investment Control Toolkit" (available at: https://www.clearygottlieb.com/-/media/files/alert-memos-2024/eu-takes-time-to-ready-outbound-investment-control-toolkit.pdf).

(6) The EC and Member States would be able to initiate ex-officio reviews of deals not notified to the EU screening cooperation mechanism for up to 15 months post-closing;

(7) The EU screening cooperation mechanism would likely take 2-3 months in practice, potentially extending the current duration of national FDI review procedures;

(8) The substantive analysis of transactions would focus on a series of common factors related to the investment and the investor;

(9) EU Member States would have to grant investors certain due process guarantees – notably an opportunity to comment ahead of a prohibition or conditional clearance decision;

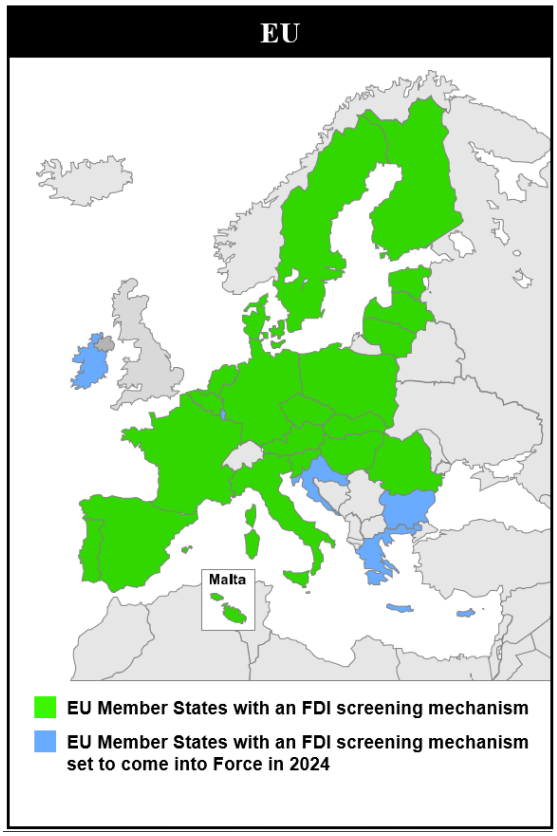
(10) The Commission proposal will be subject to a long legislative process. It is unlikely that the new Regulation will enter into force before 2027.

Taking Stock of the existing EU FDI Screening Regulation – Ripe for a Reform

The past few years have shown a growing concern regarding the scope and nature of inbound investments by foreign actors, leading to a proliferation of new FDI regimes globally. The Covid-19 pandemic further accelerated this trend, primarily driven by fear of both jeopardizing the survival of strategic businesses and exposing them to predatory takeovers by foreign investors. The EU followed this trend by adopting, in 2019, a regulation establishing a new framework to facilitate cooperation among Member States in screening foreign investments within their jurisdictions and, to a limited extent, to coordinate their domestic FDI control regimes ("FDI Screening Regulation"),[3] which entered into force in October 2020.

Unlike well-established FDI regimes in the United States, Canada, and Australia, the EU does not have the power to review and authorize foreign investments nor, more generally, to act as an overarching regulator. Instead, the EC facilitates cooperation among Member States in screening foreign investments under their national FDI screening processes, and provides its views for the Member States' consideration where relevant.

The number of Member States with an FDI screening regime has increased markedly—22 out of 27 EU members have an active FDI regime. Ireland is already planning to join that group,[4] and the remaining countries in South-East Europe—Bulgaria, Croatia, Cyprus, and Greece—are expected to do so as well in the foreseeable future.



In June 2023, the EC launched a public consultation on whether the FDI Screening Regulation ought to be amended. The consultation highlighted various shortcomings of the existing regime—notably regulatory divergence, lack of cooperation, and the fact that some Member States do not screen FDI at all—confirming that the FDI Screening Regulation was ripe for reform. The EC decided to do so through a new proposed EU FDI Screening Regulation that would repeal and replace the existing regulation.

[3] European Parliament and Council regulation establishing a framework for the screening of foreign direct investments into the Union, OJ L 791.

Key Aspects of the Proposed New EU FDI Screening Regulation

The Draft EU FDI Screening Regulation proposes to: (i) make investment screening compulsory in the EU; (ii) harmonize procedural rules and expand the scope of investment screening; (iii) reaffirm and clarify substantive analysis guidelines; and, (iv) reinforce cooperation between enforcement authorities. It does so through various changes to the existing regime. The following 10 are most notable:

(1) Compulsory FDI Screening across the EU

Under the existing EU FDI framework, EU Member States are encouraged, but not obliged, to put a screening mechanism in place. That lack of obligation has led to security "loopholes" within the Union. Between 2019 and 2023, around 23% of FDI in the EU occurred in Member States with no FDI screening regime in place.[5]

Article 3(1) of the Draft EU FDI Screening Regulation makes pre-closing[6] FDI screening a requirement for all EU Member States, to be implemented within a 15-month transitional period after the entry into force of the new FDI regime.[7] It may well be that the four remaining countries that do not yet have sufficiently concrete plans to introduce screening regimes will do so ahead of the new regulation's entry into force, such that the real effect of Article 3(1) would be an unequivocal requirement for all EU member States to maintain the FDI regimes in place.

(2) The EU screening cooperation mechanism will apply to all non-EU controlled investors

The CJEU judgment in *Xella*[8] highlighted a loophole in the current EU FDI screening regime: investments in the EU made by EU-based investors fall outside the scope of the existing EU FDI Screening Regulation even if those investors are ultimately controlled by non-EU persons (unless the investors try to circumvent the current regime, by, for example, undertaking the investment through an EU SPV vehicle). Such investments could still be caught by FDI screening regimes in Member States that also control intra-EU FDI flows, but the EU Member State agencies would not be permitted to notify the investment to the EU screening cooperation mechanism.

The Draft EU FDI Screening Regulation corrects this—non-EU persons will fall within the Regulation's scope whether they invest in the EU directly or indirectly via a controlled EU-based company.

However, investments made by EU-based companies (whether ultimately owned by EU persons or not) still benefit from the freedom of establishment (and free movement of capital) protections under Articles 49–55 TFEU. As noted by CJEU in *Xella*, this means that EU Member State FDI agencies essentially cannot intervene against investments made by EU investors unless there is "*a genuine and sufficiently serious threat to a fundamental interest of society*".[9]

The Explanatory Memorandum to the Draft EU FDI Screening Regulation seeks to preserve the possibility of intervening against EU-based investors that are foreign-controlled by highlighting that "*the existence of a clear link with a foreign investor*" and "*public presence in the ownership structure of the foreign investor, as well as the fact that the foreign investor may be screened because it is subject to EU sanctions all highlight specific characteristics of the investment which may translate into specific concerns for security and public order*".[10] On this basis, the Explanatory Memorandum reasons, "*it is possible, to*

---

5 European Court of Auditors, "Foreign direct investment screening in the EU: time to address weaknesses", Special Report 27/2023, available at: https://www.eca.europa.eu/en/news/NEWS-SR-2023-27#:~:text=ECA%20special%20report%20No%2027,available%20on%20the%20ECA%20website.

6 Article 4(4) states that an "authorisation requirement" should apply to notifiable transactions. Article 4(2)(g) makes it clear that such the authorisation requirement shall be filed and screened "before the investment is completed".

7 See Article 3(1).

8 Court of Justice of the EU, Case C-106/22, *Xella Magyarország*, ECLI:EU:C:2023:568, 13 July 2023.

9 Draft EU FDI Screening Regulation, p.3.

10 Draft EU FDI Screening Regulation, p.3.

make a distinction between the application of internal market freedoms to investments within the EU where the EU entity is controlled by a non-EU-country investor and pure intra-EU situations."[11] Accordingly, the Draft EU FDI Screening Regulation sends a signal to non-EU investors that they will likely face similar scrutiny whether they invest in the EU directly or indirectly via a controlled EU-based company. It remains to be seen, however, whether the Court of Justice will agree with such differentiated application of the single market rules depending on the nationality of the ultimate owner of an EU-based entity.

(3) The EU screening cooperation mechanism would apply to Greenfield investments if they are reportable at the EU Member State level

The Draft EU FDI Screening Regulation does not explicitly mandate EU Member States to screen greenfield investments, but provides that "*to the extent they are considered relevant by a Member State for the purpose of the screening of foreign investment*", then such investments would likewise fall within the scope of the new EU FDI Screening Regulation.[12] Accordingly, if a greenfield investment is reportable at a Member State level, that Member State would be obliged to notify it to the EU screening cooperation mechanism. As a practical matter, this means that even if a Member State where the new greenfield investment is to be made is amenable to approve it as it represents a new inflow of capital, its FDI review would need to take "utmost" consideration of comments from the EC and other EU Member States as part of a reinforced screening cooperation mechanism (see point (5) below).

(4) Setting a 'floor' for activities to be screened by all EU Member States

The existing EU FDI Screening Regulation contains a list of broadly-phrased activities that EU Member States are encouraged to screen. This has led to a wide divergence in the sectoral scope of the national FDI regimes within the EU and was flagged as a major deficiency during the recent public consultation. The Draft EU FDI Screening Regulation mandates that, at a minimum, all EU Member States must screen investments in EU-based companies that:

— (A) participate in programmes of Union interest, listed in Annex I (*e.g.*, Horizon Europe, Galileo, Trans-European Networks for Transport, European Defence Fund, *etc*.); or

— (B) are economically active or intend to be active in technologies, assets, facilities, equipment, networks, systems, services, and economic activities of particular importance for the security or public order of the EU, listed in Annex II:

- dual-use items;
- military technology and equipment;
- advanced semiconductors;
- artificial intelligence;
- quantum;
- biotechnologies;
- advanced connectivity (including 6G, Internet of Things);
- advanced sensing technologies;
- space and propulsion technologies;
- energy technologies (*e.g.*, nuclear fusion, hydrogen, batteries);
- robotics and autonomous systems;
- advanced materials and recycling technologies;
- critical medicines;
- critical financial services (*e.g.*, payment systems, large financial institutions).

Annex II provides useful clarifications on the scope of activities that are of real interest. For instance, rather than only referring to artificial intelligence, which includes a plethora of activities, Annex II specifies that artificial intelligence is liable to review insofar as it concerns: (i) high performance

[11] Draft EU FDI Screening Regulation, p.3.

[12] *See* Recital 17, Draft EU FDI Screening Regulation.

computing; (ii) cloud and edge computing; (iii) data analytics technologies; or, (iv) computer vision, language processing, object recognition. Similarly, rather than only referring to energy infrastructure and storage, Annex II specifies that reviewable energy technologies are those that concern: (i) nuclear fusion, reactors and power generation, radiological conversion / enrichment / recycling technologies; (ii) hydrogen and new fuels; (iii) net-zero technologies, including photovoltaics; or, (iv) smart grids and energy storage, batteries.

Setting a floor for activities to be screened by all EU Member States should, to some degree, facilitate harmonization of the scope of the Regulation across the EU. However, the list set out in the Draft Screening Regulation is very broad and could result in an expansion of the scope of mandatory FDI review even in the most interventionist Member States. Moreover, to the extent Member States remain free to review sectors beyond those proposed in the EU list—and several would likely avail of this opportunity—sectoral divergence in FDI review would likely persist within the EU.

(5) Reinforced cooperation mechanism

EU Member State practices diverge in relation to notifying investments to the EU cooperation mechanism—another major deficiency flagged during the recent public consultation. As such, the Draft EU FDI Screening Regulation harmonizes the cases that must be notified to the EU cooperation mechanism:[13]

— (A) The target EU company participates in programmes of Union interest, listed in Annex I;

— (B) The target EU company is active in areas listed in Annex II and one of the following applies to the foreign investor:

  • (i) it is directly/indirectly controlled by the government;[14]

  • (ii) it is subject to EU sanctions; or,

  • (iii) it had an investment prohibited or made subject to conditions within the EU.

— (C) The EU Member State launches an in-depth Phase II review or intends to prohibit the investment or impose conditions in Phase I.

In addition, EU Member states are permitted, but not obliged, to notify investments that do not fall under (A) – (C) above to the EU screening cooperation mechanism: "*if the Member State where the Union target is established considers that a foreign investment could be of interest to the other Member States and the Commission from a security or public order perspective, including where the Union target has significant operations in other Member States, or belongs to a corporate group that has several companies in different Member States which are economically active in one of the areas listed in Annex II*".

Moreover, the Draft EU FDI Screening Regulation fundamentally changes the internal accountability loop within the screening cooperation mechanism by mandating a specific regulatory dialogue and feedback process among the concerned authorities:

— All EU Member States and the EC can submit comments/opinions to the notifying Member States.

— The notifying Member States will need to "*give utmost consideration*" to the received comments/opinions.[15] While the comments/opinions would remain non-binding so as not to encroach on the Member States' jurisdiction in the national security arena, the provision nonetheless increases the level of influence non-notifying Member States would be able to exert in practice. This is further reinforced through the following procedural steps:

  • Upon receipt of comments/opinions, the notifying Member State shall set up a meeting with other notifying Member States, the EC, and Member States that submitted comments to discuss the input provided.

13 See Article 5.

14 Including state bodies, regional or local authorities or armed forces, of a third country, including through ownership structure, significant funding, special rights or state-appointed directors or managers.

15 Article 7(5), Draft EU FDI Screening Regulation.

- If the notifying Member State disagrees with the comments or proposed measures, it shall "*aim to identify alternative solutions*".
- Where the EC issues a reasoned opinion, the notifying Member State shall notify its screening decision to all Member States and the EC and provide a written explanation of the extent to which it took utmost account of comments and (if applicable) the reasons for its disagreements. EU Member States or the EC can then request additional information from the notifying Member State.
- If the EC or Member States consider that the screening decision did not take utmost account of the comments/opinions provided, a meeting shall be organized to identify the disagreements and identify solutions for future cases.

(6)) Ex-officio review of investments not notified to the EU screening cooperation mechanism

Article 9 of the Draft EU FDI Screening Regulation grants national authorities (and the EC) the power to initiate an ex-officio review of investments up to 15 months post-closing if two cumulative conditions are met:[16]

— (1) There are grounds to consider that the investment is likely to negatively impact security or public order of the Member State to which a notification was not made (the EC can only intervene in FDIs that impact two or more EU Member States or projects/programmes of Union interest listed in Annex I, or in cases where the EC has "relevant information" about the investment); and

— (2) The investment was not notified to the EU screening cooperation mechanism.

Further to the ex officio review, the Member State may provide comments and the Commission may issue an opinion as set out in the reinforced cooperation mechanism (see section (5) above). It remains to be seen whether such opinion or comments can have a practical implication post-closing. Investors would need to carefully consider whether an investment would fall outside the scope of the EU screening cooperation mechanism and, if so, what would be the practical risk of the investment having an impact on countries to which FDI filings are not made. This might potentially impact the filing calculus in certain sensitive cases and lead investors to make precautionary filings in additional EU Member States to obtain legal clarity prior to closing.

(7) EU Cooperation Mechanism Could Last 2-3 Months

Although the Draft EU FDI Screening Regulation does not harmonize national review timelines (which will continue to diverge), it seeks to align the timeline of the review under the EU screening cooperation mechanism:

— Companies would need to make all FDI filings within the EU on the same day.

— If the investment is subject to a notification to the cooperation mechanism, all Member States concerned shall coordinate to notify the cooperation mechanism on the same day and within 15 calendar days of receiving the FDI filing (or 60 calendar days in the case that the deal is notified to the cooperation mechanism because it is subject to an in-depth Phase II review or intended Phase I prohibition/remedies).

— Other EU Member States and the EC would then have 15 and 20 calendar days respectively from the receipt of the notification to reserve the right to comment/provide opinion.

- If the EU Member States and the EC do not request additional information, they would need to submit their comments/opinions within 35 and 45 calendar days respectively following the receipt of the notification.
- If the EU Member States and the EC request additional information, they would need to submit their comments/opinions within 20 and

[16] Article 9, Draft EU FDI Screening Regulation. The cases where the EC may intervene are listed in Article 7(2).

30 calendar days respectively following the receipt of complete additional information.

The Notifying EU Member States would only be able to make a decision once the periods under the cooperation mechanism expired. Accordingly, the EU cooperation mechanism would likely take around 2-3 months in practice, potentially extending the current duration of national FDI review procedures.

(8) Risk factors related to the investment & investor

Article 13 of the Draft EU FDI Screening Regulation sets out a non-exhaustive list of factors to determine the "*likely negative impact on security and public order*" of foreign investments.

Factors related to the investment are:

— the security, integrity, and functioning of critical infrastructure;

— the availability of critical technologies;

— the continuity of supply of critical inputs;

— the protection of sensitive information (including personal data);

— the freedom and pluralism of media;

Factors related to the investor are:

— the investor's investment screening track record;

— the investor's history of sanctions or involvement in criminal activities, including the circumvention of EU sanctions;

— whether the investor is "*likely to pursue a third country's policy objectives*", including the development of its military capabilities.

(9) Soft due process rights

The Draft EU FDI Screening Regulation delineates general procedural requirements that relate to transparency and non-discrimination. Most notably, investors would have the right to be informed in advance of an intended prohibition or remedies and afforded an opportunity to comment prior to any decision. It remains to be seen whether this would be a *pro forma* opportunity to comment or whether the parties would have a realistic ability to influence a decision late in the process. The Draft EU FDI Screening Regulation also recognizes that decisions must comply with the principle of proportionality and take into consideration all circumstances of the transaction. Similarly, it remains to be seen whether this would have any real impact on the "proportionality" of remedies, which have been imposed in 23% of the cases screened under the EU cooperation mechanism in 2021 (and 9% in 2022).

(10) Next steps - a long road ahead of the adoption

The Draft EU FDI Screening Regulation initiates a long legislative procedure that will see the European Parliament and the Council of the European Union review and potentially amend the EC's initial draft. The precise timeline is not known at this stage, as the number of readings will depend on the potential disagreements between the EU's legislators and significant amendments may be brought to the legislation in light of its sensitive nature in an area that remains closely connected to Member States' sovereignty. If the Regulation were to be adopted two years after the proposal, the obligations would not materialize before the end of 2027. In that case, the current FDI Screening Regulation would continue to apply for the foreseeable future. In the meantime, Member States may pre-emptively adapt their national regimes to some of the anticipated changes before the entry into force of the new FDI Regulation.

…

CLEARY GOTTLIEB