September 27, 2017

Screening of Foreign Investments in the EU

On September 13, 2017, the European Commission issued a proposed Regulation establishing a framework for screening foreign investments into the European Union.[1] The Commission also issued an explanatory memorandum and a communication to the European Parliament and other relevant EU bodies providing background about the proposed Regulation and suggesting a number of complementary measures.[2]

The Regulation, if adopted in its proposed form, would authorize (not require) EU member states to maintain mechanisms to screen foreign direct investments on the grounds of security or public order, and would also authorize the Commission itself to screen foreign direct investments that are likely to affect projects or programs of Union interest on the grounds of security or public order. Matters of Union interest are those which involve substantial EU funding or are established by EU legislation regarding critical infrastructure, critical technologies or critical input.

The Regulation clarifies that the "screening" of non-EU investments would include procedures to assess, investigate, authorize, condition, prohibit or unwind foreign direct investments.

The draft Regulation does not attempt to define either "security" or "public order," but it does specify that member states and the Commission may consider the potential effects of a proposed or completed investment on, inter alia:

- critical infrastructure, including energy, transport, communications, data storage space or financial infrastructure, as well as sensitive facilities;

---

1 European Commission Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union, Brussels 13.9.2017 COM (2017) 487, available at: https://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-487-F1-EN-MAIN-PART-1.PDF.

2 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, "Welcoming Foreign Direct Investment while Protecting Essential Interests," Brussels 13.9.2017 COM(2017) 494, available at: http://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-494-F1-EN-MAIN-PART-1.PDF.

- critical technologies, including artificial intelligence, robotics, semiconductors, technologies with potential dual use applications, cybersecurity, space or nuclear technology;
- the security of supply of critical inputs; or
- access to sensitive information or the ability to control sensitive information.

The Regulation contemplates that, in determining whether a foreign direct investor is likely to affect security or public order, member states and the Commission may take into account whether the foreign investor is controlled by the government of a third country, including through significant funding.

In announcing the proposals, EU President Jean-Claude Juncker explained the Commission's intent with three examples:

> If a foreign, state-owned, company wants to purchase a European harbor, part of our energy infrastructure or a defense technology firm, this should only happen in transparency, with scrutiny and debate. It is a political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed.

The Proposed Regulation and Commission communication are a response to pressure from France, Germany and Italy for an EU-wide foreign investment review system, similar to the system that exists under the so-called Exon-Florio Amendment administered by the Committee of Foreign Investment in the United States (CFIUS). Many EU member states[3] already have some mechanism in place to screen foreign direct investment, but there is a desire both among these states and others to strengthen these protections and harmonize them across the EU.

While the proposed Regulation speaks in terms of "foreign" investment, national restrictions on intra-EU investments are permitted only on very narrow grounds, as they will otherwise fun afoul of the basic EU principle of the free movement of capital.[4] If adopted, however, the Regulation and any national legislation adopted by member states reflecting its guidance is likely to be applicable to foreign direct investments by U.S. companies and U.S.-controlled investment funds.

---

[3] Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain and the United Kingdom. Existing screening mechanisms vary widely among these jurisdictions.

[4] *See* Treaty on the Functioning of the European Union (TFEU), Articles 63 and 49.

EU Proposals for Screening of Foreign Investment

Although there is an EU-wide merger control regime, there is currently no EU-wide foreign investment review system. In February 2017, EU member states Germany, France and Italy sent a joint proposal to the European Trade Commissioner calling for the introduction of an EU-wide regime to be added to the Commission's agenda for discussion. This advocacy reportedly reflected growing concerns regarding the exponential increase in Chinese investment in EU companies in recent years and proposed that there be an additional layer of control for investments by non-EU investors in European companies.

In response to these pressures, the Commission communication highlights that EU openness to foreign investment must be accompanied by policies to protect assets in the EU against takeovers that could be detrimental to the essential interests of the EU or its member states.

The draft Regulation establishes essential elements of the procedural framework for the screening of such foreign direct investments by member states, including that:

- screening mechanisms should be transparent and not discriminate between third countries;
- timeframes should be established for issuing screening decisions;
- confidential information, including commercially sensitive information made available by foreign investors, should be protected; and
- it should be possible for foreign investors and undertakings to seek judicial redress against screening decisions of the national authorities.

Experience with the CFIUS procedures in the United States, and comparable screening mechanisms in other countries,[5] suggests that achieving some of these stated objectives may be more difficult than the draft Regulation implies. To cite two examples, the objective of "transparency" will often be in conflict with the desire of the parties to a transaction to maintain confidentiality around transaction and ownership structure, and may also conflict with legitimate governmental interest in maintaining secrecy around matters affecting national security. Non-discrimination may be difficult to achieve in a process where the nature of the investor (e.g., state ownership) and its government's policies (e.g., in relation to political-military matters, or the protection of intellectual property) may be central to an evaluation of the risk to security or public order that may arise as a result of the proposed foreign investment.

---

[5] *See, e.g.*, the Investment Canada Act, *available at:* http://laws-lois.justice.gc.ca/eng/acts/I-21.8/index.html; and the [Australian] Foreign Acquisitions and Takeovers Act 1975, *.available at:* http://laws-lois.justice.gc.ca/eng/acts/I-21.8/index.html.

The draft Regulation also establishes a mechanism for information sharing and cooperation between member states, notably for cases where foreign direct investment in one or more member states may affect the security or public order of another member state, and between member states and the Commission, where the Commission considers that a foreign direct investment is likely to affect projects or programs of Union interest.

In addition to the proposed Regulation, the Commission also announced that it is immediately proceeding with the following measures:

- carry out (by the end of 2018) a further in-depth analysis of foreign direct investment flows into the EU, especially in strategic sectors (e.g., energy, space, transport) or assets (technologies and inputs linked to strategic sectors, critical infrastructures across sectors, sensitive data) that may raise concerns in the areas of security, public order and/or control of critical assets, in particular when the investor is owned or controlled by a third country or benefits from state subsidies; and

- set up a coordination group dedicated to inward foreign direct investment, including all issues within the scope of the proposed Regulation, to be chaired by the Commission and composed of representatives of member states. The coordination group will identify strategic sectors and assets, exchange information, analysis, best practices and lessons learned among member states for screening foreign direct investments.

The Commission also announced that, in parallel with the negotiation of the Regulation, it would "pay particular attention to foreign direct investments that may threaten security and public order and examine the situation in close cooperation with the member states," presumably signaling that it may play a more active role in this area even before a Regulation is adopted.

Next Steps: EU Legislative Procedure

The draft Regulation now enters the ordinary legislative procedure in the EU. After a series of readings where the draft Regulation will likely be subject to strong debate and scrutiny, it must be adopted by the European Parliament and the member states through the Council of the European Union. The system of qualified majority voting in the Council means that a Regulation will be passed if 55% of member states vote in favor (in practice, this is currently 16 out of 28 member states), and the proposal is supported by member states representing at least 65% of the total EU population.

If adopted in its current form, member states would not have to replace their current national screening procedures, but would have to ensure that they comply with the basic requirements set out in the EU framework. The framework could therefore lead to the creation of new national screening procedures and the amendment of existing procedures.

The Special Case of the UK

The UK has given notice of its intention to withdraw from the European Union, which as a result of that notice will occur on or before March 29, 2019. However, Prime Minister Theresa May has recently proposed a two-year transition period, during which most if not all EU laws and regulations would continue to apply. In addition, even upon the UK's exit from the EU (or "Brexit"), many have suggested that certain aspects of EU law and procedure – including the EU Merger Regulation – should continue to apply. It is thus unclear whether, and, if so, to what extent, the proposed Regulation in relation to the screening of foreign direct investment will apply, or continue to apply after Brexit, to the United Kingdom.

May and her Conservative Party have, however, made a number of statements regarding plans to reform the foreign takeover regime in the UK. In July 2016, in a speech before she was appointed as Prime Minister, May highlighted instances of "great" British companies, such as Cadbury's and AstraZeneca, being targeted by the US companies Kraft and Pfizer, and stated that the UK must be capable of stepping in to defend sectors or companies that are important to Britain.[6]

During the 2017 election campaign, the Conservative Party proposed reforming the rules on takeovers and mergers. Manifesto commitments were made promising updates to the rules that govern mergers and takeovers, including:

- requiring bidders to be clear about their intentions from the outset of the bid process; ensuring that all promises and undertakings made in the course of takeover bids can be legally enforced afterwards; and enabling the government to pause a bid to allow greater scrutiny; and

- taking action to protect the UK's critical national infrastructure by ensuring that foreign ownership of companies controlling important infrastructure does not undermine British security or essential services.[7]

The Department for Business Energy & Industrial Strategy (BEIS) made similar announcements following the decision to approve (subject to specific conditions) the construction of a new nuclear power station in the UK at Hinkley Point C, which had come under additional governmental scrutiny due to the significant level of Chinese investment in the project. BEIS announced that it "will impose a new legal framework for

---

6 Theresa May speech "We can make Britain a country that works for everyone," July 11, 2016, available at: http://press.conservatives.com/post/147947450370/we-can-make-britain-a-country-that-works-for.

7 "Forward Together – Our Plan for a Stronger Britain and a Prosperous Future," The Conservative and Unionist Party Manifesto 2017, pg. 6 & pg. 8, available at: https://cicero-group.com/wp-content/uploads/2017/05/Conservative-manifesto-overview.pdf.

future foreign investment in Britain's critical infrastructure, which will include nuclear energy.[8]" This was expressly stated to include a review of the Enterprise Act 2002. Then, in a press release on 19 September 2017, the BEIS announced that proposals will be published this autumn to address the national security concerns that can *arise* from foreign investment.[9]

At present, there are only limited aspects of UK law that provide for transparency and possible review of foreign direct investment.

The City Code on Takeovers and Mergers (the "Takeover Code") requires bidders to explain the long-term commercial justification for the offer and the bidder's intentions regarding a number of aspects of the future business of the target company. Binding commitments made by bidders during the takeover process ("post offer undertakings") are enforceable by the Takeover Panel.

The Enterprise Act 2002 provides that the UK Secretary of State may intervene with regard to the following public interest considerations:

- national security;
- plurality of the media; and
- maintaining the stability of the UK financial system.

To date, these powers have been used only in very limited instances. There have only been seven public interest interventions on national security grounds under the Enterprise Act 2002, the most recent example being that of Hytera Communications' (a Chinese manufacturer of radio systems) proposed acquisition of Sepura in April 2017.

The final category of maintaining the stability of the UK financial system was added to the Enterprise Act in 2008 to allow the Secretary of State to issue an intervention notice in the proposed merger of Lloyds TSB and HBOS on public interest grounds. The power to intervene on this ground has only been used once.

The Commission's publication of the proposed Regulation and related communication to the European Parliament may increase the pressure on the UK government to publish concrete proposals in line with

---

8 Department for Business, Energy & Industrial Strategy Press Release, September 15, 2016, available at: https://www.gov.uk/government/news/government-confirms-hinkley-point-c-project-following-new-agreement-in-principle-with-edf.

9 Department for Business, Energy & Industrial Strategy Press Release, September 19, 2017, available at: https://www.gov.uk/government/news/government-welcomes-proposals-outlined-by-the-takeover-panel.

statements made by the Prime Minister and the BEIS. It remains to be seen, however, whether the UK Government and Parliament have the capacity – in light of the many other legislative challenges posed by the Brexit process – to propose and consider legislative enactments based upon these statements.

Recent Developments in Germany, France and Italy

As noted above, the Commission's recent statement and proposal of a Regulation was at least in part motivated by pressure from Germany, France and Italy. Each of these countries has taken recent action to strengthen its screening mechanisms.

Germany

In July 2017, the German government amended the Foreign Trade and Payments Regulation to strengthen German review of foreign takeovers, particularly in strategic industry sectors. The reforms allow the government to block foreign takeovers if they could endanger "critical infrastructure" (in particular, energy, information technology, telecommunications, transport and traffic, health, water supply, food, finance and insurance). The reforms also broaden the notification requirements and extend the review periods.

Prior to the recent amendment, the German system permitted a general review of foreign takeovers on the grounds of public order and security, as well as a sector-specific review procedure for particularly sensitive industries. Pursuant to the general review provisions, the German Federal Ministry for Economic Affairs and Energy had a three-month window from the signing of transaction documents to initiate a review the transaction. Applicants could either apply for a clearance certificate or wait for the expiry of the three-month period.

The reforms extend the meaning of the term "public order and security" to include critical infrastructure. Any takeovers in critical infrastructure sectors are now subject to a mandatory filing requirement. Moreover, the three-month time period within which the Ministry must open an investigation will now only begin once the Ministry becomes aware of the transaction. If a transaction is not notified to the Ministry and the Ministry is unaware of it, it may commence an investigation up to five years after transaction documents are signed.

Once an investigation has commenced, the review periods have been extended, allowing the Ministry two months to complete its investigation if an application for a clearance certificate was made, and four months to review if no such application was made and the investigation was commenced by the Ministry. The time periods commence upon receipt of a full set of documents and are suspended if negotiations are taking place between the parties and the Ministry. Therefore, the overall review period could extend beyond the stated time periods. The amended rules also clarify that domestic acquisition vehicles cannot be used to circumvent the review procedure.

France

In recent years, France has expanded its domestic procedures in relation to authorizing foreign takeovers. During the proposed acquisition of the energy business of the French company Alstom by US conglomerate General Electric in 2014, the French government issued a decree allowing it to block foreign takeovers of French companies in strategic industries.

The decree (2014-479) expanded the list of sectors in which foreign investors must seek authorization from the French Ministry of Economy. The additional six sectors are energy, transport, water, telecommunications, infrastructure and public health. The decree also extended the list of circumstances under which the Ministry of Economy could refuse to give clearance to a transaction. In line with previous legislation, once the Ministry of Economy has received notification of a proposed foreign investment, it has a two-month period within which to conduct its review, failing which the transaction is deemed authorized.[10]

Italy

In 2012, the Italian government issued Law Decree 21/2012, which gave the government special powers in relation to companies owning or controlling "strategic assets" in specified industries, namely (i) defense and national security, and (ii) energy, transport and telecommunications. The government has special powers (including vetoing resolutions, blocking investments or imposing special terms and conditions) when it determines there is an actual threat to the interests of defense or national security, and more restricted powers in relation an actual threat to the public interest in the energy, transport and communications sectors. Companies operating in these sectors are also subject to notification procedures. Presidential Decrees 35/2014 and 86/2014 regulate the procedure through which the government can exercise its special powers for the defense and national security sectors and the energy transport and communications sectors, respectively.

* * *

---

[10] Some concerns were raised regarding whether this new legislation potentially breached EU law, and the European Commission stated that it would be thoroughly examined and monitored.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

David K. Lakhdhir	Anna L. Christie
+44 20 7367 1602	+44 20 7367 1615
dlakhdhir@paulweiss.com	alchristie@paulweiss.com

Partner David K. Lakhdhir and associate Anna L. Christie contributed to this Client Memorandum.