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The EU'S FDI proposal

What does it mean and how will it interact with EU merger control?

by **Catriona Hatton, Brian R. Byrne**
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According to the OECD,[1] EU member states are the world's most open countries to foreign direct investments (FDIs).[2] This ranking reflects the EU's commitment to free trade and the free movement of capital. However, the rise in the number of foreign takeovers in critical industries, such as energy and advanced electronics, has caused significant concern in Brussels and certain key member states. So much so that the European Commission (Commission) proposed, in September 2017, a regulation aimed at establishing a framework for the screening of FDIs in the EU (the Proposal).[3]

Member states may adopt national rules to review FDIs in companies established in their jurisdiction that affect public order or security, and several member states have done so. The Proposal provides for a framework for coordination among member states and for coordination between the member states and the Commission. The Proposal also sets minimum procedural standards for national FDI screenings and allows the Commission to issue (non-binding) opinions to member states conducting the review of an FDI. The Commission, however, will not get jurisdiction to block FDIs itself. Nor does the Proposal attempt to harmonise existing national screening regimes from a substantive point of view.

Below, we explain the context in which the Proposal was issued, the way in which the Commission intends to frame the control of FDIs, and how the Proposal interacts with EU merger control. Finally, we discuss the expected timing and next steps necessary for the Proposal to become law.

Background

The EU rules on free movement of capital – in particular Article 63 of the Treaty on the Functioning of the European Union (TFEU) – allow companies established in the EU and in third countries to invest without restrictions within the EU's borders. However, Article 65 TFEU gives member states the right to take measures limiting this investment freedom on grounds of public policy or public security.[4] The EU Courts have held that member states may subject transactions involving FDIs to prior administrative approval, provided that the approval regimes respect strict conditions.[5] Twelve member states (including France, Germany, Italy and Spain) have so far adopted national legislation that provides for the screening of FDIs. These national screening regimes are very diverse: they cover different sectors (for example, gambling activities in France, or the acquisition of land in border areas in Greece); they vary in scope (for example, some cover only FDIs from third countries while others also cover FDIs from other member states); and they follow different procedures (for example, *ex-ante* review in some jurisdictions; *ex-post* review in others). Furthermore, differences exist between the intended objectives of the screening regimes. Germany, for instance, has adopted legislation to protect "the fundamental interests of society" ("*Grundinteressen der Gesellschaft*")[6] while French legislation seeks the "preservation of national interests" ("*garantie des intérêts du pays*"[7]).

In light of increasing investment activities by Chinese State-backed enterprises in Europe, the national screening regimes for FDIs have recently attracted significant attention. Chinese FDIs in the EU reached new heights in 2016, at €35 billion (an increase of 77% from 2015). Notable recent examples include the acquisition of the German cutting-edge robot maker Kuka by Midea and the attempted acquisition of the German semiconductor manufacturer Aixtron by a Chinese-backed investment fund. The latter deal faced major hurdles in Germany (which decided to withdraw its prior authorisation of the transaction, citing security concerns) and was ultimately blocked by President Obama, also on security grounds.[8]

To be able to resist such strategic buyouts, several member states decided to reinforce their existing FDI screening regimes. Germany reinforced its right to veto foreign takeovers on the grounds of public order and public security in July 2017.[9] Three months later, the British government announced its intention to reinforce its right to block takeovers by foreign firms in the military and high-tech sectors.[10]

The extent to which member states can block such deals without violating EU law, however, remains uncertain. It is difficult for member states to know whether a decision to prohibit a transaction is in compliance with the rather vague exceptions provided for in Article 65 TFEU, especially when the assessment involves novel questions linked to recent technological development (such as the importance of the takeover of an industrial robot manufacturer with regard to public order and security). As a result of this uncertainty, numerous voices called for action at the EU level to set clear rules regarding FDI control. The then newly elected French president, Emmanuel Macron, suggested during the June 2017 European Council that screening mechanisms throughout the EU should be reinforced. The proposition was met with mixed reactions. It was frowned upon by some member states, notably those committed to, or dependent on, FDIs (for example, Hungary, Sweden and Greece); others, such as Germany and Italy, welcomed the suggestion. The Commission, which had dedicated a reflection paper to the question of "Harnessing Globalization" one month earlier,[11] also reacted positively.

It was against this backdrop that Commission President Juncker, during his September 2017 State of the Union speech,[12] announced the Proposal, which seeks to address two key problems:

- First, it aims to improve legal certainty for member states by giving them a framework within which they can use or establish their own screening mechanisms, so as to ensure the effective protection of national and European interests.
- Second, the EU recognises that it is lagging behind other major jurisdictions who have long afforded great importance to the screening of FDIs. For instance, the US Committee on Foreign Investment (CFIUS) considers national interests and security ramifications of investments by foreign companies. Under the *Investment Canada Act*, direct acquisitions by foreign investors of Canadian businesses exceeding certain enterprise value thresholds may be blocked if they are not of "net benefit" to Canada. Japan also undertakes FDI reviews: the Japanese Ministry of Finance must give approval before a foreign company buys more than 10% of the shares of companies in designated sectors (for example, aerospace and telecommunication). China, through its *Catalogue for the Guidance of Foreign Investment Industries*, also explicitly prohibits or restricts investment by foreign businesses in numerous sectors (for example, energy, water, and telecommunications).

Content and implications of the Proposal

The Proposal does not define the terms "security and public order". It does provide, however, a non-exhaustive list of factors that may be taken into consideration when determining whether a FDI may affect these two concepts. These factors include the effects of the investment on "critical infrastructure" (for example, energy, transport, data storage), "critical technologies" (for example, artificial intelligence, cybersecurity, space technology), "the security of supply of critical inputs",[13] and "access to sensitive information". Another relevant factor is whether the foreign investor is a state owned or controlled enterprise. Investments stemming from another EU member state do not fall within the framework,[14] although the Proposal does not forbid member states from screening such transactions under their national rules if they wish to do so.

The Proposal has three main aspects: an enabling framework, a cooperation mechanism, and Commission screening.

- ***Enabling framework***. The Proposal creates an "enabling framework" within which member states can provide for the screening of FDIs on the grounds of public order and security. The Proposal does not establish specific rules regarding the substantive assessment; however, member states must respect minimum standards for certain procedural aspects of the review. In particular, review mechanisms must be transparent and non-discriminatory (in line with the jurisprudence of the EU Courts[15]), they must set a timeframe to issue decisions, they must respect the right to confidentiality of investors, and must provide the right to judicial redress. Importantly, the Proposal only enables member states to adopt screening provisions; it does not oblige them to do so.
- ***Cooperation mechanism***. The Proposal provides for a cooperation mechanism between member states and the Commission in order to ensure coherent and informed enforcement of screening mechanisms across the EU. Member states must notify the Commission of their existing and new screening mechanisms. They must also advise the Commission and the other member states of FDIs undergoing review within the framework of their review mechanisms. If a member state considers that its public order and security are "likely to be affected" by an FDI happening in another member state, it can request information regarding the transaction and address a comment to the latter. The Commission can likewise request information and issue an opinion if it considers that a particular FDI affects public order and security in one or more member states. These comments and opinions are not binding on the member state carrying out the review but must be given "due consideration".
- ***Commission screening***. Finally, the Proposal allows the Commission to issue opinions on FDIs affecting "projects or programmes of Union interest" on grounds of security and public order. These are defined as projects or programmes involving significant EU funding or covered by EU legislation regarding critical infrastructures, critical technologies or critical inputs. An indicative list of seven such projects, all of them EU-funded, is annexed to the Proposal. This list of projects includes for instance Galileo (the European satellite-based navigation system) and Horizon 2020 (the EU Framework Program for research

and innovation). These opinions carry more weight than those under the cooperation mechanism: member states on whose territory the FDI takes place must "take utmost account" of the Commission's opinion and provide an explanation if they reach a final decision contrary to the opinion. Nonetheless, the Commission will not itself have decision-making power in the field of FDI screening.

Importantly, the right of potentially affected member states and of the Commission to issue comments/opinions is not dependent on the fact that the member state where the FDI occurs is reviewing the FDI, or even that it has a screening regime at all.[16] Businesses investing in the EU will therefore need to be mindful that member states, and the Commission, will be able to issue comments/opinions on a transaction, even if it is taking place in a country that does not screen FDIs.

As regards the effects of member state comments or Commission opinions, it is difficult to predict the practical impact that they will have on particular transactions. While they will carry little weight from a legal perspective, they may nonetheless carry significant political weight. Thus, assuming the member state where the transaction is taking place has an FDI screening regime, comments or an opinion which opposes the transaction might convince the member state to block the deal. In cases where the member state does not have an FDI screening regime, it may – according to the Commission – still consider comments and opinions in its "broader policy making".[17] This not only means that it may be encouraged to adopt legislation of its own, but also that comments and opinions could influence informal/unofficial FDI screening mechanisms, such as negotiations between the investor and relevant government authorities.

Interaction with EU merger control

Status quo

Currently, member states applying their national screening regimes must ensure that they do so in compliance with Article 65 TFEU. This means that an FDI prohibition must still be justified on grounds of "public security" or "public policy".

When applying their screening regimes, member states must also take into account the Commission's competence, in the field of competition law, to block or authorise mergers with an EU dimension (EU Mergers). An FDI will be an EU Merger if it fulfils the conditions set out in the EU Merger Regulation (EUMR)[18] (i.e., the FDI leads to a change of control of an enterprise on a lasting basis resulting from a merger, an acquisition or a joint venture, and the parties' turnover exceeds certain thresholds). In the case of an EU Merger, member states can still apply their national screening regimes but only under the specific conditions laid out in Article 21(4) EUMR.

Article 21(4) EUMR provides that member states can only block or impose conditions on an EU Merger in order to protect two classes of "legitimate interest". The first is an enumerated category of interests, namely: public security, plurality of the media and prudential rules. The second is an open-ended category of "other public interest[s]"; however, if a member state wishes to invoke an interest falling into that category, it must first gain approval from the Commission. Importantly, even when Article 21(4) EUMR is triggered, member states are still limited by Article 65 TFEU (i.e., the interests at stake must be matters of "public policy" and "public security") and the related case-law.

The Commission has adopted several decisions that offer guidance on the scope of legitimate interests under Article 21(4) EUMR. For instance, in its *E.ON/Endesa* decision, the Commission stated that member states can only rely on public security as a legitimate interest to hinder an EU Merger if there is a genuine and sufficiently serious threat to a fundamental interest of society, such as ensuring a minimum level of energy supply in a crisis situation.[19] In *BSCH/A. Champalimaud*, the Commission held that the protection of national interests and strategic sectors for the national economy – as such – did not constitute a legitimate interest under Article 21(4).[20] The EU Courts have confirmed that member states must not pursue purely economic ends when applying restrictions to the free movement of capital (i.e., a decision to prohibit a transaction based on the application of FDI screening legislation cannot be purely protectionist in nature).[21]

If the Commission considers that a member state has gone beyond what is permitted under Article 21(4) EUMR and/or Article 65 TFEU, it can bring an infringement proceeding against the member state before the EU Courts and it has done so in the past.[22]

The Proposal

The Proposal interacts with EU Merger Control in two important ways. First, it is possible for a transaction to be regarded as both an EU Merger and an FDI within the meaning of the Proposal. In that case, a member state that is reviewing the merger on the basis of its national screening legislation must take into consideration two important factors. On the one hand, it must respect Article 21(4) of the EUMR (i.e., if it wishes to block the transaction, it must do so on the basis of public security, plurality of the media or prudential rules, or alternatively it must ask for the Commission's approval.) On the other hand, under the Proposal, the member state may receive comments from other member states related to the transaction or opinions from the Commission itself. This last point is significant because it gives the Commission an opportunity to intervene in situations where, currently, it has no basis for intervention (i.e., situations where a member state invokes public security, the plurality of the media or prudential rules under Article 21(4) EUMR).

Second, the Commission's practice of issuing opinions under the Proposal is likely to be influenced by – and to influence – its practice under Article 21(4) EUMR. This is because the Commission has announced that it will apply the Proposal and the EUMR in a consistent manner as far as the two legal frameworks overlap, in particular with regard to the interpretation of security and public order, and of the notion of legitimate interests within the meaning of Article 21(4) EUMR.[23] Thus, for instance, since the Commission found that the protection of strategic sectors for the national economy as such did not constitute a legitimate interest under Article 21(4),[24] its opinions issued under the Proposal regarding non-EU Merger FDIs should, in theory, follow a consistent approach. There is an important caveat, however, to the expectation of consistency across these two regimes. The Proposal applies only to FDIs stemming from third countries. The EU Courts have endorsed the notion that capital movements stemming from outside the EU may be treated differently than those stemming from inside the EU.[25] Although this distinction is not yet reflected in the Commission's decisional practice under Article 21(4) EUMR,[26] the Commission might seek to rely on this case-law to issue opinions under the Proposal that deviate from its existing decisional practice under Article 21(4) EUMR.

Timing and next steps

The Proposal will next be discussed by the European Parliament and the Council of the EU, both of which can amend the text to a substantial extent. A simple majority is sufficient for the legislation to pass the European Parliament; however, a qualified majority (i.e., 55% of member states in favour representing 65% of the EU population) is required for the legislation to pass the Council of the EU.

Whether the Proposal can go through the procedure unscathed is questionable. It is well known that some member states are strongly opposed to the Proposal and it has further been reported that 21 member states voiced their common concern to the Commission by raising numerous questions left unanswered by the Proposal. In this context, it might be difficult for the Council to reach the necessary "qualified majority" in spite of strong support from some member states.

Bulgaria, currently holding the rotating presidency of the Council of the EU, has set the Proposal as one of its priorities for trade policy and during an informal meeting of EU Trade Ministers held in Sofia at the end of February 2018, it was agreed that a common position between member states should be reached before June 2018. The Commission's objective, which remains ambitious, is that the Proposal be adopted before the end of the current legislature, in May 2019. There is, however, no time limit on the European Parliament and the Council of the EU to complete their review and voting process.

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Endnotes

1. OECD Global Forum on International Investment, '*Is investment protectionism on the rise ? Evidence from the OECD FDI Regulatory Restrictiveness Index*', 6 March 2017: http://www.oecd.org/investment/globalforum/2017-GFII-Background-Note-Is-investment-protectionism-on-the-rise.pdf.
2. The OECD defines FDIs as cross-border investments made "*with the objective of establishing a lasting interest in an enterprise [abroad]*".
3. The text of the Proposal can be found at https://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-487-F1-EN-MAIN-PART-1.PDF.
4. This rule applies both to movements of capital stemming from within the EU and to those from third countries. The EU Courts have held, however, that member states are permitted to apply stricter rules to the latter than to the former, within the parameters set forth by Article 65 TFEU (See Case C-101/05 *Skatteverket v A*, EU:C:2007:804, paragraph 37).
5. For instance, the regimes must be precise and must respect the principle of legal certainty (Case C-54/99 *Eglise de Scientologie*, EU:C:2000:124, paragraph 22), must be based on objective and non-discriminatory criteria (Case C-463/00 *Commission v Spain*, EU:C:2003:272, paragraph 69) and must respect the principle of proportionality (Case C-423/98 *Albore*, EU:C:2000:401, paragraph 19).
6. Außenwirtschaftsgesetz, section 5.
7. Article R153-2 of the Code Monétaire et Financier.
8. President Obama used the authority granted under the CFIUS regime (Committee on Foreign Investment in the United States).
9. The text of the amendment to the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung) can be found at: http://www.bafa.de/SharedDocs/Downloads/DE/Aussenwirtschaft/afk_neunte_vo_aenderung_awv.pdf?__blob=publicationFile&v=4.
10. The National security and infrastructure investment review of the UK government can be found at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/652505/2017_10_16_NSII_Green_Paper_final.pdf
11. Available at https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-globalisation_en.pdf
12. Available at http://europa.eu/rapid/press-release_SPEECH-17-3165_en.htm.
13. Although the Proposal does not give specific examples of "critical inputs", the EU case law interpreting Article 65 TFEU provides guidance. For instance, with respect to the petroleum, telecommunications and electricity sectors, the EU Courts have stated that "*it is undeniable that the objective of safeguarding supplies of such products or the provision of such services within the Member State concerned in the event of a crisis may constitute a public-security reason [...] and therefore may justify an obstacle to the free movement of capital*." Case C-463/00 *Commission v Spain*, EU:C:2003:272, paragraph 71.
14. Based on the definitions provided in the Proposal, FDIs are investments by a "foreign investor", *i.e.*, a natural person/undertaking of a "third country". While the term "third country" is not defined in the Proposal, the manner in which this term is used in the Treaties (see for instance Article 63 TFEU) confirms that Member States should not be regarded as "third countries".
15. See endnote 5 above.
16. See the Commission's explanation of Article 8 in the Explanatory Memorandum accompanying the Proposal.
17. *Ibid*.
18. Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ (2004) L 24/1.
19. Decision No. COMP/M.4197 – *E.ON/Endesa*, paragraphs 39 and 40.

20. Decision No. IV/M.1616 - *BSCH/A. Champalimaud*, paragraph 28.
21. Case C-54/99 *Eglise de Scientologie*, EU:C:2000:124, paragraph 17.
22. See for instance decisions No. COMP/M.4197 – *E.ON/Endesa* and No. IV/M.1616 – *BSCH/A. Champalimaud*.
23. See Recital 23 of the proposed Regulation.
24. Decision No. IV/M.1616 – *BSCH/A. Champalimaud*, paragraph 28.
25. Cases C-446/04 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue*, EU:C:2006:774, paragraph 171 and C-101/05 *Skatteverket v A*, EU:C:2007:804, paragraph 37.
26. All but one of the Commission's decisions under Article 21(4) EUMR have involved EU-EU transactions. The only decision concerning a non-EU-EU transaction (Decision No. IV/M.2054 – *Secil/Holderbank/Cimpor*), was taken before the EU Courts confirmed the lawfulness of differential treatment for transactions stemming from outside the EU.

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