Key Points

- The European Commission has released a set of documents, including a proposal for an 'FDI Regulation,' which sets out an EU framework for screening foreign direct investments.
- This proposal would grant the European Commission the power to review transactions that are likely to affect projects or programs of European Union interest on security or public order grounds.
- The proposal would also subject EU Member States to notification and information requirements in relation to any foreign direct investments that they choose to review under their national mechanisms, and would impose certain minimum procedural requirements on those national review mechanisms.

New EU Law on the Screening of Foreign Direct Investments in Europe

On Wednesday, September 13, 2017, the European Commission (the EC) published its proposal for a Union-wide response to foreign direct investment screening (the “Proposal”). The Proposal includes a draft Regulation (the “Regulation”) which seeks to introduce an EU-level framework for foreign direct investment (FDI) screening. The EU has no general supranational mechanism for controlling FDI, although there are several EU-level rules on specific industries (for instance, the gas and electricity Directives contain provisions requiring the assessment of security of supply implications where the gas or the electricity transmission system of a Member State is controlled by a third country operator) and national screening mechanisms are in place in nearly half of the Member States.  

Exceptionally, in light of the “rapidly changing economic reality, growing concerns of citizens and Member States,” the Proposal comes with no impact assessment. However the EC has promised an in-depth review of investments flowing into the EU. The Proposal attempts to balance the EU interest in protecting strategic assets, against the diverse views held by the Member States (some of which do not want FDI screening, and others which do not want their national mechanisms to be subordinate to an EC mechanism). As a starting point, only the EU and not the Member States may legislate on FDI, as it is part

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1 Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain, and the United Kingdom
of the Union’s common commercial policy (Article 207 TFEU) and thus falls within the EU’s exclusive competence (Article 3(1)(e) TFEU).

The proposed Regulation applies to “investments of any kind by a foreign investor aiming to establish or to maintain lasting and direct links” with the EU undertaking. This is an imprecise definition that leaves questions as to whether it includes small equity stakes or some forms of debt, although we know that it excludes portfolio investments. The Proposal explicitly allows Member States to retain, amend or adopt their own FDI screening mechanisms. The resulting system could therefore give rise to parallel reviews (by the Member State in which the investment is taking place, and by the EC) with differing outcomes. This and other potential issues will be debated by Members of the European Parliament (MEPs) and European Council (“Council”) working groups over the coming year, as the precise drafting of the Regulation is finalized.

**EC power of review**
The Proposal would introduce a new power for the EC to review FDI that is “likely to affect projects or programmes of Union interest” on the grounds of security or public order only. The EC clarified that these projects or programs include those involving either substantial EU funding, or critical infrastructure. The Regulation includes an indicative list of projects in Annex 1, which includes for instance, the Trans-European Networks for Energy. Even a limited list can result in a broad power to review, if the items listed include e.g., the entire supply chain for the project or program.

The bar for the EC’s power to review investments is set at “likely to affect projects or programmes of Union interest.” ‘Likely to affect’ could be interpreted as ‘on a balance of probabilities,’ or ‘more than 50%.’ Where the EC decides to intervene in an investment, it may address an opinion to the Member State in which the FDI is being made, and may request from the Member State any information it requires to do so, which is to be provided without undue delay. The EC will have 25 days from the receipt of information to issue its opinion (which can be extended by a further 25 days). While the EC’s opinion is not strictly binding on the Member State, the Member State must take “utmost account of the Commission’s opinion and provide an explanation to the Commission in case its opinion is not followed.”

The Proposal attempts to provide further clarity to investors through a non-exhaustive list of factors that Member States and the EC may consider in their FDI reviews. These factors include the involvement of any critical infrastructure, technologies, inputs and sensitive information, as well as any third country government involvement or significant funding. None of them is defined. While the critical infrastructure factor echoes the U.S. foreign investment regime, CFIUS, unlike that U.S. regime, the EC would not have the power to veto investments.

**Notification obligation and cooperation mechanism**
Under the Proposal, Member States would be required to notify the EC of any existing screening mechanisms, and to report annually to the EC on the application of the mechanism. Even Member States with no screening mechanism in place must report to the EC annually on FDI that has taken place within
their territory. Each Member State would also appoint a FDI screening contact point for all communications under the Regulation.

The broader cooperation mechanism obliges Member States to inform the EC and other Member States of its reviews within 5 days of opening any new FDI screening, indicating where possible, the likely outcome of the review. Member States will then have 25 days from the notice to comment on the review if they feel the investment may have an impact on their security or public order. The EC may address an opinion to the Member State undertaking the review within 25 days of receiving the notice or comments from other Member States. The Member State undertaking the review must give "due consideration" to the comments and/or opinions received, but is not bound by them.

**Minimum procedural requirements**

The Proposal has potential implications for current national FDI regimes as it lays down "essential elements of the procedural framework for the screening of foreign direct investment by Member States." The essential elements include transparency, non-discrimination, the possibility for redress and timelines for screening decisions. The Proposal thus includes a certain level of harmonization on FDI screening.

The Proposal will be submitted to the European Parliament and Council under the ordinary legislative procedure, so any definitive legislation is unlikely to be finalized before the end of 2018. We are tracking the Proposal's passage and will be engaging key MEPs and Council working group members. The extent to which FDI in the UK will be affected by any final Regulation depends upon the outcome of the UK-EU BREXIT negotiations. Prior to the Global Financial Crisis, the UK Government had been very open to FDI, with intervention being rare. Minister May has since resurrected UK Industrial Policy and has re-opened the debate on which strategic industries should be protected, as more countries around the world engage in various forms of economic nationalism.
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