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WHITE PAPER

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Screening of Foreign Direct Investments in the EU Under the New FDI Regulation

On 21 March 2019, Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union ("FDI Regulation") was published in the *Official Journal of the European Union*. The FDI Regulation entered into force on 10 April 2019 and will apply to transactions from 11 October 2020 onwards. As explained in more detail below, any transaction that is not undergoing screening in the EU and is completed on or after 11 July 2019 can in principle still be commented on by Member States or be the subject of the opinion of the European Commission ("Commission") when the FDI Regulation becomes applicable (on 11 October 2020).

The FDI Regulation represents a fundamental evolution. It is the first time that the screening of foreign direct investments ("FDI") is regulated at European Union ("EU") level. It has the potential to significantly impact those investors from third countries that consider investing in the EU. Importantly, it can also be of relevance to those EU investors interested in EU target companies that have reason to believe that they compete with third country investors.

TABLE OF CONTENTS

On 21 March 2019, Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union ("FDI Regulation") was published in the *Official Journal of the European Union*.[1] The FDI Regulation entered into force on 10 April 2019 and will apply to transactions from 11 October 2020 onwards. As explained in more detail below, any transaction that is not undergoing screening in the EU and is completed on or after 11 July 2019 can in principle still be commented on by Member States or be the subject of the opinion of the European Commission ("Commission") when the FDI Regulation becomes applicable (on 11 October 2020).

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The FDI Regulation does not impose a robust EU-wide FDI screening mechanism capable of issuing binding decisions. It is distinct from and more liberal than other regimes, such as reviews by the Committee on Foreign Investment in the United State ("CFIUS"). The final decision on FDI screening rests with the EU Member States, which remain sovereign in the area of FDI. The focus is more on "coordination and cooperation" between Member States and sets minimum standards for national regimes. Nevertheless, it is a first step in a direction that is likely to evolve towards an increasingly harmonized and robust screening of FDI in the EU.

This Jones Day *White Paper* discusses the impact of the FDI Regulation and elements that are likely to lead to increased harmonization of the national FDI screening mechanisms. The transitional period of 18 months[2] will give Member States the required time adapt national frameworks where needed and Jones Day will closely monitor developments in this context. We will share some initial comments regarding the consequences of the FDI Regulation on the national FDI screening mechanisms in some of the EU's most important jurisdictions.

Following an overview of the framework established by the FDI Regulation (see Section A below), we will provide some initial comments relating to the interplay between the Regulation and the national FDI screening mechanisms in these jurisdictions going forward (see Sections B to D below).

A. THE FRAMEWORK ESTABLISHED BY THE FDI REGULATION

The FDI Regulation establishes a general framework for the screening of FDI in the EU. This is limited to screening mechanisms[3] on the grounds of "security or public order".[4] Importantly, it does not require EU Member States that currently do not have an FDI screening mechanism to put such a mechanism in place. However, new or existing Member State FDI screening mechanisms must be transparent and non-discriminatory.[5] Moreover, it requires Member States with FDI screening mechanisms in place to ensure that these mechanisms include the necessary measures to identify and prevent circumvention.[6] This could, for instance, extend the application in certain circumstances to foreign-owned EU entities wishing to acquire other EU entities.

The FDI Regulation also lays down a non-exhaustive list of factors that may be taken into account by Member States or the Commission in determining whether FDI is likely to affect security or public order. This list is very broad and ranges from critical infrastructure, whether physical or virtual, to access to sensitive information or the freedom and pluralism of the media.[7] In addition, other elements to be taken into account include whether the foreign investor is directly or indirectly controlled by the government of a third country, including through ownership structure or significant funding.[8] This could target otherwise private companies that receive significant subsidies from the government of a third country.

The FDI Regulation also establishes three different sets of cooperation and review mechanisms: A cooperation mechanism for FDI undergoing screening (Article 6, see sub 1. below), a cooperation mechanism for FDI not undergoing screening (Article 7, see sub 2. below), and a mechanism for FDI likely to affect projects or programs of Union interest (Article 8, see sub 3. below). Finally, we will discuss whether the FDI Regulation establishes an EU FDI screening mechanism through the back door for transactions that are not already undergoing screening (see sub 4. below), and we will also discuss some general considerations.

1. The Mechanism for FDI Undergoing Screening

A Member State screening any FDI under its national rules ("Screening Member State") must provide detailed information on the transaction to the other Member States and the Commission as soon as possible.[9] This information includes the ownership structure of the buyer and the target, the value of the transaction, the business activities of both buyer and target, the Member States in which the buyer and target are active, the funding of the transaction, and the date of the transaction's scheduled or completed closing.[10]

Other Member States may make a comment on the transaction to the Screening Member State in case they determine that the FDI is likely to affect its security or public order, or that it has relevant information in relation to that FDI. The Commission may issue an opinion on the transaction to the Screening Member State, in case it considers that the FDI is likely to affect security or public order in more than one Member State, or that it has relevant information in relation to that FDI.[11] It is required to issue such an opinion where justified, if at least one third of EU Member States have raised concerns.[12]

The Screening Member State may also request for the Commission to issue an opinion or for other Member States to provide comments.[13] The comments and the opinions need to be "*duly justified*".[14] The FDI Regulation lays down specific rules regarding the procedure and timing.

There is no explicit obligation on the Screening Member to reflect any opinion or comment received, but it is required to give "due consideration" to any such comment or opinion. Ultimately however, the FDI review decision remains with the Screening Member and is not delegated to the Commission or any other supra-national body.[15]

2. The Mechanism for FDI Not Undergoing Screening

The Regulation establishes an additional type of review outside a formal screening process for FDI that are not screened by the Member State in which the transaction takes place ("Affected Member State").

In such cases, a Member State that believes that the planned or completed FDI in a Member State that is not undergoing screening is likely to impact its security or public order, or that it has relevant information in relation to that FDI, may provide comments to the Affected Member State.[16]

The Commission may also issue an opinion to the Affected Member State if it believes that the transaction is likely to affect security or public order in more than one Member State or that it has relevant information in relation to that FDI. It is required to issue such an opinion where justified, if at least one third of EU Member States have raised concerns.[17]

The Affected Member State that does not perform a screening may also request the Commission to issue an opinion or other Member States to provide comments.[18] This provision appears to be designed to cover a situation in which the Affected Member State is unable to perform a screening either because it does not have an FDI review mechanism, because its FDI review mechanism does not apply to the FDI in question or because it has already completed its screening.

If the Commission or a Member State consider that an FDI not undergoing screening is likely to affect security or public order, it may request information from the Affected Member State.[19] Also here the FDI Regulation lays down specific rules regarding the procedure and timing.

The Affected Member State must give "due consideration" to the comments of other Member States or the opinion of the Commission.[20]

In case the FDI is not undergoing screening, Member States may provide comments and the Commission may issue an opinion within 15 months after completion of the FDI.[21] This time limit does not apply to Affected Member States requesting the Commission to issue an opinion or to request other Member States to provide comments. While the FDI Regulation will only apply as from 11 October 2020, it can still be very relevant to transactions that are completed in the 15 months prior to that date. Indeed, any transaction that is not undergoing screening in the EU and is completed on or after 11 July 2019[22] can in principle still be commented on by Member States or be the subject of opinion by the Commission as soon as the FDI Regulation becomes applicable.

3. The Mechanism for FDI Likely to Affect Projects or Programs of Union Interest

The FDI Regulation establishes additional rules in case an FDI is likely to affect projects or programs of Union interest.[23] This mechanism provides the Commission with a tool to protect projects and programs "which serve the Union as a whole and

represent an important contribution to its economic growth, jobs and competitiveness. This should include in particular projects and programs involving a substantial EU funding or established by Union legislation regarding critical infrastructure, critical technologies or critical inputs."[24]

The projects and programs of Union interest are exhaustively listed in an annex to the Regulation. In broad terms, they cover EU-wide science and technology research projects, certain European space industry projects and certain Europe-wide defense, transport, telecoms and energy projects. These are quite wide, since they also include the EU's flagship program, Horizon 2020. The Commission has the power to amend the list.[25]

If the Commission believes that an FDI is likely to impact such projects or programs of Union interest, it may issue an opinion to the Member State in which the transaction is taking place, irrespective of whether such transaction is screened by that Member State or not.[26] The procedures set out under the two other mechanisms[27] shall apply *mutatis mutandis*, subject to some modifications.[28] An important modification relates to the relevance of the Commission's opinion. Specifically, the Member State where the FDI is planned or has been completed must take "utmost account" of the Commission's opinion and provide an explanation to the Commission in case its opinion is not followed.

4. Are Member States Truly Free to Decide Whether or Not to Screen FDI?

The FDI Regulation does not require EU Member States to set up an FDI "screening mechanism", nor does it limit the rights of the Member States to decide whether or not to screen a particular FDI.[29]

Nevertheless, the FDI Regulation introduces a unique procedure through the mechanism for FDI not undergoing screening. A Member State in which an FDI is planned or has been completed, even if it does not have any screening mechanism, is required to provide information on the transaction[30] and to give due consideration to comments from another Member State or an opinion from the Commission. A Member State can also invite other Member States or the Commission to provide comments or an opinion on an investment in its territory that is not subject to screening.

In addition, in case this FDI is likely to affect projects or programs of Union interest, the Commission may issue an opinion of which the Member State must to take utmost account and provide an explanation in case it is not followed. This also applies to Member States that do not have a screening mechanism. The FDI Regulation provides that Member States should take utmost account of the Commission's opinion through, where appropriate, measures available under its national law or in its broader policy-making.

The procedures established by Articles 7 and 8 of the Regulation therefore clearly require a Member State without a screening mechanism to at least to take into account comments by other Member States or the opinion of the Commission in case these are made, as well as provide information to other Member States or the Commission if requested.

In addition, the FDI Regulation refers to a Member State's duty of sincere cooperation laid down in Article 4(3) of the Treaty on European Union in this respect.[31] Therefore, even though the comments and opinions are not binding, a Member State cannot simply ignore them. This is especially the case regarding FDI likely to affect projects and programs of Union interest. The EU may to a certain extent be paying lip service to the independence of Member States by saying that it is ultimately for each of them to decide whether to set up a screening mechanism or screen a particular deal. In practice, the Regulation will force them to look into certain deals to a certain extent whether they wanted to or not. It can be expected that the FDI Regulation will lead to an increase in adoption of FDI screening mechanisms by Member States that currently do not have such systems in place.

5. Does the FDI Regulation Establish an EU-Wide Screening Mechanism Through the Back Door?

Despite not imposing a robust EU-wide FDI screening mechanism, the FDI Regulation may be the first step towards such a system. Indeed, the Regulation lays down an annual reporting obligation on Member States, in which they must include aggregated information on FDI that took place in their territory, as well as aggregated information on the requests received from other Member States regarding FDIs in their territory.[32]

Furthermore, Member States are obliged to set up a dedicated contact point for the implementation of the FDI Regulation.[33]

Moreover, those Member States with screening mechanisms in place must also include aggregated information on the application of their screening mechanisms.

The Regulation also provides that the existing "group of experts on the screening of foreign direct investments into the European Union", composed of representatives of the Member States, must "continue to discuss issues relating to the screening of foreign direct investments, share best practices and lessons learned, and exchange views on trends and issues of common concern relating to foreign direct investments."[34]

Further, while the Regulation is generally addressed only to Member States, it is important to note that it also imposes a direct obligation on the buyer and the target to provide specific information concerning the planned FDI, even outside a formal investigation of the Member State in which the transaction takes place.[35] This means that in such cases the only legal basis that requires the buyer and the target to provide the information is the new FDI Regulation.

These elements, together with the mechanisms under Articles 6, 7, and 8 as discussed above, are likely to result in increasing convergence between the different systems of the EU Member States and an increased importance of EU-wide elements during any screening that takes places within the EU Member States.

B. INTERPLAY BETWEEN THE REGULATION AND THE REVIEW OF FDI IN GERMANY

The German system for the review of FDI in Germany pursuant to the German Foreign Trade Ordinance ("AWV") provides for a two-step procedure which distinguishes between a preliminary review (during which, however, even formal clearing decisions can be taken) and a formal investigation by the German Federal Ministry of Economic Affairs and Energy ("BMWi"), which can lead to the conditioning or even blocking of a transaction.

Only a formal investigation, of which the buyer needs to be notified, constitutes a review within the meaning of Article 6 of the Regulation. Thus, the rules provided by Article 6 of the Regulation would govern a formal investigation under the AWV together with the provisions of the AWV.[36] Whether or not the timelines provided by the AWV for its formal investigations need to be adjusted in light of the deadlines stipulated by Article 6 of the Regulation is currently being reviewed by the German Federal government.

The fact that only a formal investigation under the AWV constitutes a screening pursuant to Article 6 also means that a proceeding pursuant to Article 7 and Article 8 can be initiated before, during, and after a preliminary investigation (for instance initiated on the basis of a request for a certificate of non-objection pursuant to § 58 AWV), before the BMWi starts a formal investigation and following the end of such formal investigation. Thus, such proceedings may start even after the BMWi has formally cleared the FDI in question.

On the other hand, it appears to be more likely that Germany would open a formal investigation after another Member State or the Commission became active on the basis of Article 7 or Article 8. The fact that all three mechanisms require the same set of information (see Article 9) should, however, facilitate a switch from Articles 7 or 8 to a formal investigation pursuant to Article 6.

With respect to proceedings pursuant to Articles 7 and 8 of the Regulation, no changes to the AWV appear to be necessary as the Regulation provides the BMWi with the powers required to interact with the other Member States and the Commission. Further, as mentioned above, Article 9(4) of the Regulation, which is expressly addressed to the affected companies, provides the legal basis to obtain the information requested by the Commission or the other Member States.

This obviously raises the question of what the point is of an Article 7 and/or Article 8 proceeding if the BMWi has already cleared the FDI pursuant to the AWV. A second such proceeding may, however, lead to new information that may allow the BMWi to withdraw the positive clearance decision. Further, recital 17 of the Regulation states that the BMWi may wish to consider using legal provisions outside the AWV to address concerns raised by another Member State or the Commission.

The real litmus test for the interplay between the new Regulation and Germany's review of FDI pursuant to the AWV is

going to be the German government's response to comments received from other Member States. Let's assume, for instance, that a Chinese investor wants to acquire a German target company which is a supplier to Airbus. Let's further assume that the German government does not object to that transaction.[37] It will be interesting to see how the German government is going to react in such scenario to critical comments raised, for instance, by the French government. It cannot be excluded at this time that the legal analysis of whether a given transaction may affect Germany's public order and security may be affected by political considerations in such a case.

C. INTERPLAY BETWEEN THE REGULATION AND THE REVIEW OF FDI IN ITALY

Italy has adopted a system of so-called "golden powers" under which the Italian government can, among other things, veto or impose conditions on acquisitions of Italian entities operating in certain industries deemed strategic for Italy.

The new Regulation will likely trigger an amendment of the procedure for the review. At present, the process requires that notice be given to the Italian government regarding the proposed transaction. The government then has 15 business days (which can be extended once by an additional 10 business days) to exercise the 'golden powers,' failing which the transaction may be completed.

Under the FDI Regulation, the Commission and other Member States have 15 calendar days following the receipt of the information regarding the review to notify the Member State undertaking the screening of their intention to provide comments or an opinion.[38] The notification may even include a request for additional information.

Comments or opinions must be sent to the Member State no later than 35 calendar days following receipt of the information or, if additional information was requested, no later than 20 calendar days following receipt of the additional information. The short deadlines provided by Italian law are not compatible with the procedure described above and will need to be amended. This amendment could possibly offer an occasion to further harmonize the Italian system with the Regulation.

D. INTERPLAY BETWEEN THE REGULATION AND THE REVIEW OF FDI IN FRANCE

The French regulations on foreign investment apply either (i) to the acquisition of a controlling interest in a company (in the case of a share deal) or the acquisition of all or part of a branch of activity of a company (in the case of an asset deal), (ii) investments made by a "foreign investor", (iii) in a French company, (iv) operating or involved in a "sensitive sector."

"Foreign investors" are defined as non-EU investors (companies whose registered offices are not located in EU or individuals who are not nationals of any EU Member States).

France's Financial Monetary Code identifies 14 business sectors for which foreign investments are subject to prior authorization from the French state. These sectors are related to public order and public security (broadly defined, including: dual use, crypto, weapons, ammunition, companies that entered into supply agreements with the French Defense Department, semi-conductors, robotics, data hosting, AI) and regulated activities such as energy, water, telecommunications, transportation, space and public health.

The requirement for prior authorization regarding foreign investments in sensitive sectors depends only the nationality of the ultimate investor, not on the amount of the investment (there is no threshold).

French regulations do not provide for a specific filing date or deadline, but the application must be submitted prior to the closing of the contemplated transaction, clearance being a condition precedent and taking several months. The Minister for the Economy and Finance has a period of two months to review the application. This review period effectively starts from the date on which the Minister will have received a "complete" application (i.e., from the date on which the last required document will have been submitted by the investor). This means that any request by the Minister for supplementary information will trigger a new period of two months to review the application. Consequently, the authorization procedure can in practice be extended well beyond the statutory time frame of two months so that the average timeline is four months. There is no "fast-track" option.

The FDI Regulation processing time will impact the timing of reviews under French law and the closing of transactions. Pursuant to Article 6, Member States' comments and the Commission's opinions should be delivered within 35 days of a Member State notifying other Member States and the Commission that it is screening an investment. Article 6 also provides that Member States and the Commission can request additional information within 15 days of that notification, and that their comments or opinions will then have to be delivered within 20 days of receiving that additional information. This means that, in practice, requests for information can effectively stop the clock until the response is delivered and the Commission and Member States will be able, to some extent, to extend deadlines. These timelines could comply with French ones (two months to review the application), but given the potential lack of clarity around the timelines foreseen, companies may initially experience less certainty than today.

Like in Germany and all EU Member States with FDI regulations, the real test for the interplay between the new FDI Regulation and France's review of FDI is going to be the French government's response to comments received from other Member States.

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ENDNOTES

1 OJ L 79, 21.3.2019, p. 1.

2 I.e. until 11 October 2020.

3 A „screening mechanism" is defined in Article 2(4) of the Regulation as „*an instrument of general application, such as a law or regulation, and accompanying administrative requirements, implementing rules or guidelines, setting out the terms, conditions and procedures to assess, investigate, authorise, condition, prohibit or unwind foreign direct investments on grounds of security or public order*".

4 Article 1(1).

5 Article 3(2).

6 Article 3(6).

7 Article 4.

8 Article 4(2)(a).

9 Article 6(1).

10 Article 9(2).

11 Article 6(2) and (3).

12 Article 6(3).

13 Article 6(4).

14 Article 6(5).

15 Article 6(9).

16 Article 7(1).

17 Article 7(2).

18 Article 7(3).

19 Article 7(5).

20 Article 7(7).

21 Article 7(8).

22 Article 7(10).

23 Article 8(1). This is not the case if completion took place before the Regulation entered into force.

24 Recital 19.

25 Article 8(4), Article 16.

26 Article 8(1).

27 I.e. those laid down in Articles 6 and 7.

28 Article 8(2).

29 See, for instance, Recital 8; Recital 17; Article 1(3); Article 3(1); Article 6(9).

30 Article 7(5) in conjunction with Article 9, Article 8(2) in conjunction with Articles 7(5) and 9.

31 Recital 17.

32 Article 5(1)

33 Article 11(1).

34 Article 12.

35 See Article 9(4). The information that can be requested is listed in Article 9(2).

36 If the BMWi opens a formal investigation, certain information and documents need to be submitted by the buyer. The precise set of information and documents is governed by a General Order („*Allgemeinverfügung*"). The BMWi will have to adjust this information on the basis of Article 9(2) of the Regulation.

37 The German government cleared such a transaction in 2018.

38 Article 6(6).