

EU UNVEILS PROPOSALS FOR TOUGHENED SECURITY SCREENING OF FOREIGN INVESTMENTS

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Legal Briefings

As states race to usher in tighter security controls on foreign takeovers, we assess the EU's new framework for screening FDI

On 13 September 2017 the EU Commission unveiled a set of proposals for the screening of foreign direct investments into the EU.

Whereas the Commission recognises the benefits of foreign direct investment and its importance for growth, jobs and innovation in the EU, it also wants to be in a position to take action where foreign investment may affect security or public order. Announcing the proposals in his annual State of the Union address, Mr Juncker stated that "*We are not naïve free traders. Europe must always defend its strategic interests. This is why we are proposing a new framework for investment screening*". The proposals are set out in a draft Regulation which establishes a framework with which the Member States' national screening mechanisms will need to comply. The Commission will also carry out a detailed analysis of the foreign investment flows into the EU and establish a coordination group with the Member States, in order to identify joint strategic concerns and consider possible solutions in the area of foreign direct investment.

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1. Background to the proposals

The EU does currently not have a comprehensive legal framework in place which addresses the security and public order risks of foreign direct investment into the EU. The EU Merger Regulation (EUMR) does not allow for political considerations to be taken into account as part of the merger review process, but allows Member States to take appropriate measures to protect legitimate interests in respect of a transaction that qualifies under the EUMR (Article 21(4) EUMR). The provision expressly recognises the protection of public security, plurality of the media and prudential rules as legitimate interests, but any other public interests must be communicated to the Commission and must be recognised by the Commission as compatible with the general principles of EU law before the Member State can take any measures.

Calls for specific EU legislation for the control of foreign direct investment into the EU have been made for some time now and the debate has recently been revived in the wake of an increasing level of foreign investment into the EU economy. France, Germany and Italy in particular have been lobbying the Commission to take further action in respect of foreign investment, in light of the wave of purchases of key EU companies by Chinese state-owned enterprises (SOEs). Earlier this year a group of MEPs also asked for more EU action, such as a CFIUS (Committee on Foreign Investment in the US) type vetting regime.

Currently around half of the Member States operate foreign direct investment screening mechanisms and reserve the power to restrict investments posing a threat to their essential interests. These regimes vary in scope and procedure and there is no EU-wide approach or coordination between the Member States. The Commission has now tabled proposals which are aimed at ensuring a more effective coordination of these national regimes.

2. Proposed Regulation

The aim of the proposed Regulation is to establish a framework for Member States to screen foreign direct investments in the EU which maintains the necessary flexibility for Member States to take into account their individual legitimate interests and national circumstances. The proposed Regulation does not require Member States to adopt or maintain a screening mechanism, but aims to ensure that any existing or proposed mechanisms comply with a set of minimum requirements.

Screening factors

When screening foreign direct investment on grounds of security or public order, Member States may consider the potential effects on:

- Critical infrastructure, including energy, transport, communications, data storage, space and financial infrastructure, as well as sensitive facilities
- Critical technologies, including artificial intelligence, robotics, semiconductors, technologies with potential dual use applications, cybersecurity, space and nuclear technology
- Security of supply and critical inputs
- Access to sensitive information and the ability to control sensitive information

The list of screening factors is non-exhaustive and Member States may also take into account issues such as whether the foreign investor is controlled by the Government of a third country, including through significant funding.

General requirements for screening mechanisms

Screening mechanisms operated by Member States will have to be transparent, setting out the circumstances triggering the screening and the grounds for screening. The procedural framework should provide for timeframes for the screening and allow investors to seek judicial redress of screening decisions. Member States must also ensure that there is no discrimination between different third countries.

Reporting obligations

Member States will have to notify the Commission with details of their screening system (and any subsequent changes) and provide the Commission with an annual report on its application, with information on the foreign direct investments screened, any prohibition decisions or decisions imposing conditions and information on the sectors, the origin and the value of the investments screened.

Member States that do not operate a screening system will also need to provide the Commission with an annual report setting out the foreign direct investments that took place in their territory, on the basis of information available to them.

Cooperation with other Member States and with the Commission

The draft Regulation provides for a cooperation mechanism under which other Member States affected by a foreign direct investment can provide comments to the screening Member State (which will also be forwarded to the Commission). Where the Commission considers that a foreign investment is likely to affect security or public order in one or more Member States, it can issue an opinion to the Member State in which the foreign investment is planned or has been completed. The screening Member State retains the final decision-making power regarding the foreign direct investment.

Commission screening powers

The Commission itself will be able to screen foreign direct investments that are likely to affect EU projects and programmes on grounds of security and public order. In these cases, the Commission can issue an opinion to the Member States where the investment is planned or completed, and the Member States concerned must take utmost account of the Commission's opinion and provide an explanation to the Commission in case its opinion is not followed.

3. Other measures

In addition to the proposed Regulation the Commission will carry out a detailed analysis of foreign investment flows into the EU which may raise concerns in the areas of security, public order and/or control of critical assets, in particular where the investor is owned or controlled by a third country or benefits from significant state subsidies. The Commission is also establishing a coordination group dedicated to foreign direct investment, which will be chaired by the Commission and made up of representative of the Member States. The group will be tasked with identifying sectors and assets that have strategic implications, discuss issues of common concern, share best practices and lessons learned for screening foreign direct investment and consider opportunities for cooperation with third countries with shared interests and challenges.

4. Comment

Rather than proposing a centralised EU screening regime, the Commission is proposing a framework which enables Member States to screen foreign direct investments under common criteria and standards. According to the Commission's staff working document accompanying the proposals, *"the objective is to have an EU system that is politically acceptable to all Member States, adequately covers the concerns linked to certain foreign direct investments, stays within the limits of EU international law, does not unduly deter foreign investments and is efficient and credible"*.

The proposed Regulation will need to be adopted by the European Parliament and the Member States, and it remains to be seen whether it will indeed receive sufficient support in its current form. Whereas Germany, France and Italy are keen supporters of an EU-wide intervention scheme, other Member States such as Finland, Sweden and Denmark take a more liberal approach. Estonia, which currently holds the EU's rotating presidency, has also expressed concerns that the proposals could result in China and other third countries retaliating and in turn introducing stricter legislation.

The proposals have been framed in the context of the EU's trade and investment policies and will therefore operate separately from the EU merger control regime. Competition Commissioner Vestager had previously flagged the importance of keeping the two regimes separate. One practical issue that arises from this approach is how the timetables of both regimes will work together.

Following the Brexit vote the UK Government announced that it would introduce a new "cross-cutting national security requirement for continuing Government approval of the ownership and control of critical infrastructure". More detailed proposals have been anticipated for some time now, but the Government has today issued a press release in the context of a Takeover Panel consultation in which it indicates that proposals that address national security concerns arising from foreign investment will be published this autumn.

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