COVID-19 – Commission issues guidelines to protect European critical assets from foreign investment

1 April 2020

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On 25 March 2020, the European Commission issued guidelines to coordinate the EU's approach to investment screening in light of the COVID-19 crisis and to protect the EU's critical assets and technologies from potential hostile takeovers and investments by non-EU companies.

For many years, the European Commission ("Commission") has been concerned about companies in European strategic industries that are being acquired by non-European companies, in particular, but not exclusively by State-owned enterprises. In an attempt to curb this trend, a mechanism of cooperation and coordination of national screening procedures for new foreign direct investments ("FDI") has been established at the level of the European Union ("EU") under the so-called 'FDI Screening Regulation'. These new rules will start to apply on 11 October 2020.[1]

In light of the current COVID-19 crisis and its severe implications for the EU economy, the Commission stepped up efforts to strengthen the protection of EU companies even more quickly and more effectively through guidelines ("Guidelines")[2] issued on 25 March 2020.

In its guidelines, the Commission notes that "[a]mong the possible consequences of the current economic shock is an increased potential risk to strategic industries, in particular but by no means limited to healthcare-related industries." In particular, the Commission warns "there could be an increased risk of attempts to acquire healthcare capacities (for example for the productions of medical or protective equipment) or related industries such as research establishments (for instance developing vaccines) via foreign direct investment."

Generally, the Guidelines seek to, at least partly, anticipate the application of the FDI Regulation by recalling its scope and explaining the role of FDI screening in the case of a public health emergency. More importantly, the Commission calls for increased investment screening by EU Member States, as well as actions to protect European companies and aid the economic recovery of the EU as a whole.

To that end, the Commission points at two crucial tools to protect the EU's critical sectors.

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1 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 [2019] OJ LI79/1 (available at: https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf)

2 Guidance for Member States concerning FDI and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 ('FDI Screening Regulation'), available at: https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf.

1. Increased use of (new) FDI screening mechanisms

First, the Commission calls upon EU Member States that already have an FDI screening mechanism in place to make "full use already now" of their FDI screening mechanisms and, for those EU Member States that do not have such a screening mechanism yet,[3] to move fast towards establishing a mechanism and, in the meantime, to "use all other available options". The Commission: "[t]he resilience of these industries and their capacity to continue to respond to the needs of EU citizens should be at the forefront of the combined efforts both at European Union and at Member States level."

In fact, even where a foreign investment is undertaken in the months before the FDI Regulation comes into effect on 11 October 2020, but does not undergo a national screening process, the FDI Regulation provides that the Commission and EU Member States other than the one where the investment takes place can provide ex post comments and opinions as from 11 October 2020 and within 15 months after the foreign investment has been completed. Such opinions may potentially still lead to the prohibition of the investment by the EU Member State where the investment took place or, alternatively, to the adoption of so-called 'necessary mitigating measures', both at the Member State's discretion and provided national law so allows. Such mitigating measures may include certain supply commitments to meet national and even EU vital needs (e.g., conditions guaranteeing the supply of medical products and/or devices in a respective EU Member State or the EU). Although this *ex-post* mechanism is not binding, it will serve as a relevant tool for the Commission to encourage the use of FDI screening review by certain reluctant Member States that are traditionally more favourable to foreign investments.

2. Enhanced screening of non-FDI capital under free movement of capital rules

Second, the Commission encourages EU Member States to look carefully at acquisitions that do not constitute FDI, and therefore, fall outside the scope of the FDI Screening Regulation[4], under the free movement of capital rules. Notably, the free movement of capital rules apply to capital entering the EU from third countries, on which restrictions may be imposed in order to attain a legitimate public policy objective.

According to the Commission, "portfolio investments, which do not confer the investor effective influence over management and control of a company, are generally less likely than FDI to pose issues in terms of security or public order." However, "where they represent an acquisition of at least qualified shareholding that confers *certain rights* to the shareholder or connected shareholders under the national company law (e.g., 5%), they might be of relevance in terms of security or public order."

In other words, while small portfolio investments into EU companies seem less problematic to the Commission, but it may be relevant to screen (and potentially block) even minority acquisitions (e.g., 5%) when certain rights are attached. In addition, the Commission encourages Member States to acquire so-called 'golden shares', enabling them to block or set limits to certain types of investments in a certain company.

The Commission recalls well-established case-law that any restrictions to capital movements may be allowed if necessary and proportionate to achieve a legitimate public policy objective. According to the case-law of the CJEU, "[g]rounds of public policy, public security and public health can be relied on if there is a genuine and sufficiently serious threat to a fundamental interest of society".[5] The Commission points out that in situations "of 'predatory buying' of strategic assets by foreign investors (e.g. with a view to limit supply to the EU market of a certain good/service)", these grounds could justify, for instance, "restrictive measures necessary to ensure security of supply (for instance in the energy field) or the provision of essential public services if less restrictive measures (e.g. regulatory measures imposing public service obligations on all companies operating in certain sectors) are insufficient to address a genuine and sufficiently serious threat to a fundamental interest of society". Interestingly, the Commission stresses that "[r]estrictive measures may also be taken to address threats to financial stability."

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[3] Currently, only 14 out of 27 EU Member States have a national screening mechanism in place (see list at http://trade.ec.europa.eu/doclib/html/157946.htm).

[4] Article 2(1) of the the FDI Screening Regulation defines FDI as an "*investment of any kind by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity in a Member State, including investments which enable effective participation in the management or control of a company carrying out an economic activity*."

[5] See Case C-54/99 Église de Scientologie, para 17; Case C-503/99 Commission v Belgium, para 47; Case C-463/00 Commission v Spain, para 72.

In relation to stock-quoted companies with valuations that are deemed too low, the Commission specifically comments that capital restrictions could be considered, taking into account the true value of these companies to society and the risk dependence if they fall into foreign hands.

The Commission also notes that, under the Treaty, in case of restricting transactions involving investments from a non-EU country, EU Member States could rely on additional grounds of justification for restrictions beyond "public policy, public security and public health", which may be interpreted more broadly.[6] In this regard, it should be noted, however, that the CJEU has traditionally taken a restrictive view of the derogations to the free movement principles, whether the investment is intra-EU or from a non-EU country. If the public policy can be achieved through other means (e.g., regulatory measures imposing public service obligations), then under the case law, a restriction on the specific foreign investment would be deemed disproportionate.

It remains to be seen whether the Commission will be taking any additional measures in order to safeguard the EU's assets and technology. Clearly, non-EU investors and EU targets active in strategic sectors have to pay increasing attention to any new legal developments and the political sensitivities of EU Member States to this end.

Certain EU countries amended their foreign investment control regime even before the publication of the EU Commission guidelines. In this regard, Spain was the first EU member to take rather stringent measures in the context of the COVID 19 outbreak in order to protect its national economy by suspending its liberalized regime in certain sectors (notably critical infrastructures and technologies) h) for investors originating from outside the EU/EFTA. This echoed measures adopted in Australia, which announced that all proposed foreign investments subject to the Foreign Acquisitions and Takeovers Act 1975 will require prior approval, regardless of value (the monetary screening thresholds being reduced to $0) or the nature of the foreign investor.

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[6] See C-446/04, Test claimants in FII, Group litigation, para. 171.