

European Commission proposes a Regulation establishing a framework for the review of foreign direct investments into the EU

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Key Takeaways

- Regulation introduces an EU review process with screening rights for the Commission, but without enforcement powers
- Impact of Regulation expected to be largely procedural; practical consequences will depend on actual involvement of the Commission and other Member States
- Review strictly on the grounds of “public order and security”; reciprocity or economic net benefit considerations not part of review
- Regulation does not require Member States to adopt or maintain a national security review mechanism
- Proposal expected to come into force towards the end of 2018 at the earliest, following completion of the legislative process

On September 13, 2017, Jean-Claude Juncker, President of the European Commission (“Commission”), delivered his State of the Union address to the European Parliament. Juncker announced the proposal of an EU Regulation establishing a framework for the review of foreign direct investments into the EU. The proposal seeks to establish minimum harmonization of national security reviews within Member States and grants certain screening and consultation rights to the Commission.

Largely prompted by increased foreign investment into European technology companies over the past 18 months (in particular from the PRC), there has been an increased call for the EU to take a more active role in scrutinizing such investments. Some Member States such as Germany have recently tightened their national security regimes, in line with an international trend towards strengthening foreign investment controls. The initial proposals, put forward by Italy, France and Germany, revolved, *inter alia*, around introducing a “reciprocity test” that would take into consideration the investment environment of the home state of the respective investor. The proposed Regulation does not pick up on such proposals, but maintains a narrower review approach focusing on national security. Based on the proposal, the role of the Commission will be limited to an “opinion-based” second-layer review that can neither dictate nor overrule decisions made at Member State level.

By coincidence, the Commission's proposal was published the same day President Trump blocked the acquisition of Lattice Semiconductor by Canyon Bridge in the US, only the fourth transaction blocked by a US president under the CFIUS statute, though it is the second in the past ten months. This again demonstrates how national security reviews can become a "gating item" to foreign direct investment.

1. Scope of National Security Reviews

The proposed Regulation would provide a framework for Member States and their existing or future review mechanisms. Today, only 12¹ out of 28 Member States have established national security review mechanisms, and they differ widely. The proposed Regulation would not introduce an obligation for the remaining Member States to establish such a regime.

The potential scope of screening of foreign direct investments will be based on the criteria of "security and public order" only. Such terms are not alien to European law, but are vaguely defined by the European Court of Justice. The proposed Regulation would specify the criteria of security and public order with a non-exhaustive list of considerations to be taken into account. Accordingly, Member States will have to consider potential effects of an acquisition on, *inter alia*:

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

Such scope specifically addresses increased concerns relative to transactions in the technology sector, in particular, where the acquirer is "*controlled by the government of a third party, including through significant funding*". The Commission and Member States are also entitled to screen transactions involving an EU-based investor, so as to avoid circumvention by non-EU investors.

By focusing on "national security", the Proposal prompts comparison to the practice by the Committee on Foreign Investments in the United States (CFIUS), which reviews foreign investments from a national security perspective as well. Given "national security" is not defined under the CFIUS regulations, the Committee has substantial leeway in its reviews. As a matter of practice, however, the above-mentioned criteria are frequently considered by CFIUS as well.

2. New role of the Commission in National Security Reviews

If the proposed Regulation comes into effect, the Commission will take on a new role vis-à-vis reviews conducted by Member States, namely:

- The respective Member States would be required to inform the Commission, as well as other Member States, of any foreign direct investment undergoing review. Should the Commission consider the investment likely to affect security or public order it may issue an "opinion" to the respective Member State, which then has to give due consideration to the Commission's views (the "cooperation mechanism").

Other Member States may issue comments as well, if they consider their security or public order likely to be affected by the investment in question. However, the Commission's opinion and the Member States' comments would not be binding, leaving the ultimate decision on the clearance of the relevant investment to the reviewing Member State.

- The Commission's opinion would be considered to have more weight if foreign investment is likely to affect projects or programs with significant EU funding or that are covered by EU legislation regarding critical infrastructure (e.g. Galileo, Copernicus, trans-European Networks, etc.). In this case, the reviewing

¹ Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain and the United Kingdom.

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*”. However, within this context as well, the ultimate decision-making power will remain with the Member State.

The rights granted to the Commission differ significantly from the authority vested in CFIUS. While CFIUS is in charge of the review process, the role of the Commission is limited to an advisory status. Even taking into account that CFIUS has to leave the ultimate blocking decision to the US President, its role is significantly more robust.

3. Procedural Implications

New parallel review processes for the Commission and Member States are likely to expand the time period needed for reviews conducted at the level of the Member State performing the primary review, as the proposed Regulation stipulates that the national review process give due consideration to the Commission’s opinion or other Member States’ comments.

Going forward, Member States would have to inform the Commission and other Member States of foreign direct investments undergoing review within five working days from the start of the review. Opinions and comments from the Commission and other Member States would then be required to be delivered within 25 working days. However, should the Commission require additional information, it may request such information from the reviewing Member State, with the receipt of such information by the Commission triggering the restart of the 25-working-day period. While the Commission may only address such information request to the reviewing Member State (not the parties to the transaction), it may protract the overall review period at the Member State level. The restart of the Commission’s 25-day-review-period would also be triggered, if another Member State were to voice its comments before the Commission issued its opinion.

4. Conclusion/Outlook

By expanding the role of the Commission and all Member States in the review of foreign direct investments into the EU, the proposed Regulation would introduce another layer of complexity. This would continue the trend of national security reviews playing an increasingly important role in international M&A, and could be a critical factor for successful completion of a transaction. The cooperation mechanism and annual reporting obligations are steps towards aligning European investment controls and making them more transparent. It remains to be seen whether the current proposal is an interim or more definitive step in the course of harmonizing European investment controls.

Once the Regulation enters into force, investors should be prepared to include the new procedural requirements for investment control reviews when planning the timeline of M&A transactions.

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