EU and Germany Move to Further Tighten FDI Screening Process

DECEMBER 20, 2018

The past two weeks have seen two major developments in relation to the screening of foreign direct investment in the European Union ("EU") for national security or public order reasons. First, on December 10, 2018, the EU Parliament's Committee on International Trade ("INTA") approved a proposed regulation establishing a framework for screening foreign direct investment ("FDI") in the European Union (the "Proposal" or "Proposed Regulation"). INTA's vote followed the prior political agreement on December 5 among representatives of the Parliament, the Council (representing the EU Member States) and the European Commission on a final text. This means that formal approval of the Proposed Regulation can now take place by March 2019, before next year's Parliamentary elections. (See also our prior client alert here.) Second, on December 19, the German Foreign Trade and Payments Ordinance was amended to enlarge the range of transactions that can be reviewed for national security and related concerns. (See also our prior client alert on German developments here.)

These developments in Europe come at the same time that the United States is further strengthening its national security-based FDI review process and related export control rules (see our prior client alerts, here and here), including in response to increasing concerns about supply chain vulnerability, and national security and geo-economic threats. Unlike in the United States, where the Committee on Foreign Investment in the United States ("CFIUS") reviews the national security implications of transactions that could result in control of a U.S. business by a foreign entity, the EU does not currently have legislation in place on the review of foreign investments although certain individual Member States have their own mechanisms.[1] The developments discussed in this alert are part of a broader push to strengthen the controls that are in place and to add an EU-wide mechanism on top.

Below, we provide general background on the proposed EU mechanism, an overview of the proposed procedure and scope of review, and an overview of the next steps in the legislative process and the implications of the Proposed Regulation for future investments in the EU. We also discuss the forthcoming German legal changes.

EU Parliament Approval of the Proposed EU Investment Review Mechanism

General Background on the Proposed Regulation

INTA's decision to approve the Proposed Regulation, and the process leading up to it, is largely a response to concerns over a series of takeovers of European companies by (state-controlled) foreign investors — particularly but not exclusively Chinese investors — in 2016-2017, and the perceived lack of appropriate tools for the EU and many of the EU's Member States to review such transactions in a meaningful way.[2] The Regulation was also made possible by the further extension of the Commission's competence over investment issues that resulted from the EU's Lisbon Treaty which gave the EU exclusive competence over FDI as part of its common commercial policy.

Scope of the Proposed Regulation

As discussed in further detail in a prior client alert, the Proposed EU Regulation seeks to establish a framework for EU-wide screening and review of FDI on the basis of public policy or security concerns although it continues to leave significant discretion to individual Member States in this regard. Specifically, while Member States will still have the final say over the approval or rejection of proposed transactions, the Regulation creates a right for the Commission to issue non-binding opinions on transactions that may affect the security or public order of projects or programmes "of Union interest" in the areas of research, space, transport, energy and telecommunications, to which the EU's cooperation in defense has been added, or that may affect the security or public order of other Member States. In addition, the Regulation sets out a (non-exhaustive) list of key security or public order interests that may be considered when investments are reviewed and authorizes the Commission to update that list periodically.

The Proposed Regulation's stated objective is to "provide legal certainty for Member States' screening mechanisms on the grounds of security and public order and ensure EU wide coordination and cooperation" on the screening of FDIs. However, the Proposed Regulation does not require that Member States implement an FDI screening mechanism; rather, Member States retain the competence to approve or reject incoming investments based on "their individual situations and national circumstances."[3] More and more Member States have, however, begun implementing or are considering such mechanisms and we expect others to do the same going forward.

Article 4(1) of the Proposed Regulation provides what is effectively a definition of the types of concerns that Member States and the Commission *may* consider when screening FDIs on the basis of security or public order. As reflected in the text provisionally agreed on 6 December, these factors include whether the investment relates to the following:

- Critical and strategic infrastructure, whether physical or virtual, including energy, water, transport, communications, media, data storage or processing, aerospace, health, defense, electoral or financial infrastructure, as well as sensitive facilities and investments in land and real estate, crucial for the use of such infrastructure;
- Critical and dual-use items, including artificial intelligence, robotics, semiconductors, quantum, aerospace, nanotechnologies, biotechnologies, energy storage, cybersecurity,

aerospace, defense, or nuclear technology;

- Security of supply of critical inputs, including energy or raw materials, as well as food security;
- Access to sensitive information, including personal data, or the ability to control such information; or
- The freedom and pluralism of the media.

Article 4(2) of the Proposed Regulation, moreover, provides that Member States and the Commission *may* take into account whether a foreign investor is controlled by a government of a third country, including state bodies or armed forces. INTA approved modification of the original proposal to add an additional consideration involving instances where there is a "serious risk that the foreign investor engages in illegal or criminal activities."

INTA's modifications to the original proposal, now agreed in the provisional text of the Proposed Regulation, also include providing the Commission an even greater role in issuing opinions on contemplated investments and strengthening the obligation for cooperation between the Commission and the Member States. For example, Article 6(1) of the Proposed Regulation requires Member States to notify the Commission of any FDI in their territory that is undergoing screening. Article 6(3) states that the Commission "shall" issue an opinion "where justified," in cases where at least one third of Members think that an FDI undergoing screening is likely to affect their security and public order. A Member State that thinks an FDI on its territory is likely to affect its security or public order may also take the initiative to request an opinion from the Commission and comments from other Member States (Article 6(4)). This possibility is also open to Member States without a domestic screening process, giving them a way to trigger the mechanisms available under the Proposed Regulation for FDIs of concern (Article 7(3)).

A new provision that was put forward by the Council and agreed with Parliament and the Commission gives both Member States and the Commission the opportunity to provide comments/an opinion even after an FDI has been completed, for up to 15 months (Article 7(8)). However, this would apply only to FDIs that did not undergo a screening process at the time they took place and would not apply to FDIs that have been completed before the Proposed Regulation enters into force.

To define the scope of FDIs that may affect projects of EU interest, the Proposed Regulation now provides authority to the Commission, through delegated acts, to update the annex listing such projects of EU interest (Article 8(4)).

The Proposed Regulation specifies that a new expert group on the screening of FDIs into the EU that was set up by the Commission at the end of last year should advise the Commission. This expert group is also charged with exchanging information on best practices and trends and issues of common concern as well as providing input to the Commission where requested on systemic issues concerning implementation of the Regulation.

Next Steps and Implications

Now that the Parliament's INTA Committee has approved the political agreement reached among the European institutions on the final text of the Proposed Regulation, formal adoption of the Regulation by the European Parliament and the Council can take place as currently scheduled in March 2019. This is now a legislative formality - the text as agreed and approved by INTA is subject only to lawyer/linguist revision by the institutions.

The Proposed Regulation's approval confirms a general direction towards more protection over strategic assets in the EU that certain Member States had already initiated at the national level. Those contemplating future investments in EU companies active in the sensitive sectors listed in the Regulation will need to deal with this additional review mechanism on top of existing antitrust-focused merger and acquisitions reviews, and any relevant Member State screening. Investors will henceforth have to deal not just with DG Competition and/or Member State competition and investment screening processes, but also with DG Trade, the European Commission's Directorate General in charge of all EU trade and investment policy issues, as well as potentially with other affected Directorates General and Member States. For investments that have not undergone screening at the time they were made, the new provisions under the Proposed Regulation that give the Commission and the Member States up to 15 months after the investment has been completed to issue comments or an opinion mean potential added uncertainty, even after all formally required approvals have been obtained.

Upcoming Amendment of the German Foreign Trade and Payments Ordinance

On December 19, 2018, the German Federal Government amended the Foreign Trade and Payments Ordinance, which is the key framework for the control of foreign investments in Germany. The Ordinance provides two different regimes depending on the characteristics of the company to be acquired: one for the acquisition of any German company ("cross-sectoral examination"), the other for the acquisition of companies in defined military sectors ("sector-specific examination").

The German Government already tightened the Ordinance in 2017: it introduced, *inter alia*, a list of civil areas (*i.e.*, non-military products or areas) with special security relevance (including a number of "critical infrastructure", *i.e.*, areas of energy, information technology, telecommunications, transport, traffic, healthcare, water, food, finance and insurance where a failure could endanger public security). Acquiring companies operating in these areas may "in particular" call for a cross-sectoral examination.

Yesterday's amendment provides for a further tightening. Specifically:

- The list of civil areas with special security relevance will include "companies in the media industry which contribute to the formation of public opinion by means of broadcasting, telemedia or printed products and is characterized by its topicality and broad impact". The exact meaning and scope of this additional area of coverage is not yet known but at least by its plain terms could be interpreted quite broadly.
- Any acquisition (directly or indirectly) of 10 percent of the shares or more in a company operating in any of the listed civil areas with special security relevance will allow the Federal Ministry for Economic Affairs and Energy to review the transaction for potential

concerns of public order or security and, potentially, to block it or impose conditions. Previously, the threshold was at 25 percent. For acquisitions involving companies in non-listed civil areas, the threshold will remain at 25 percent.

- Similarly, the acquisition (directly or indirectly) of 10 percent or more of the shares of a company in any specified "military areas" will also trigger the Ministry's competence to review and, potentially, block a transaction or impose conditions. The previous threshold for these transactions was 25 percent as well.[4]

Conclusions

The recent EU-wide and German developments described above are the latest steps in a further tightening of national security and public order-based review of foreign direct investment in the EU. We anticipate these developments to continue over the next months and years. Investors and companies considering acquisitions or related transactions in the EU should make sure they are up to speed on these developments and take them into account both in their investment and M&A decisions, and in implementing such transactions in the years to come. By their nature, and given the way the EU and Member State frameworks are structured, the review processes are a mix of legal-regulatory and more discretionary policy-focused assessments. As such they are quite different from existing antitrust merger reviews or other existing processes and require careful handling and advice.

1. 14 EU Member States currently have domestic FDI screening mechanisms, though these vary in scope.

2. Notably, in February 2017, the Economy Ministers of Germany, France and Italy submitted a joint letter to the European Commission to request a change in the EU's approach towards FDI, citing concerns that foreign investors were acquiring interests in the EU technology sector to satisfy their own strategic objectives. Chinese direct investment in the EU, for example, reportedly increased from about EUR 20 billion in 2015, to EUR 35.9 billion in 2016.

3. Recital 8, Proposed Regulation.

4. The effect of lowering both of the thresholds mentioned will be evaluated for an 18-month-period starting with the amendments entering into force.

Authors

Martin Seyfarth

PARTNER

Partner-in-Charge, Berlin Office

martin.seyfarth@wilmerhale.com

+49 30 20 22 64 30

Christian Duvernoy

RETIRED PARTNER

christian.duvernoy@wilmerhale.com

+32 2 285 49 06

Geoffroy Barthet

COUNSEL

geoffroy.barthet@wilmerhale.com

+32 2 285 49 22