

# Foreign Direct Investments

## A Future EU Regulation That Matters !

***The press reported recently that Chinese investments plummeted in the EU and the US throughout 2018 (See Neue Zürcher Zeitung, 15/01/19). The stricter screening over foreign investments in the EU appears to be one of the reasons of this fall .***

***And, it is not going to stop. Today, some EU Member States only have such a control mechanism over foreign direct investments (FDI). Very soon, a new EU Regulation will impact the screening of foreign direct investment throughout the EU via joint screening between the EU Commission and national authorities within the Member States.***

***This Regulation will impact on trade policy, competition/merger rules enforcement as well as merger and acquisition in the EU. We briefly explain why and how.***

### A Stricter Control Worldwide Over FDIs

As it has been widely publicized, a new foreign direct investment screening mechanism will soon be enacted in the European Union ("EU"). This new mechanism should be understood in the wider protectionist context deployed by large economic blocs. Lately, the USA's stricter stance on several investment projects (particularly Chinese ones) has made the front page of economic newspapers. Also, the FDI laws of the People's Republic of China have been subject to many reforms and debates over the last years.

In the EU, several developments have taken place at the national level. For instance, Germany has again tightened its foreign direct investment regime by lowering its thresholds in certain sensitive sectors from 25 to 10 per cent shareholding in a German company, allowing the Federal Ministry for Economic Affairs and Energy to review a larger number of transactions on security and public order grounds (19 December 2018). Earlier in the year, the German government had decided for the first time to prohibit a FDI on its territory. In that case, a French company, *Manoir Industries*, controlled by the Chinese group Yantai Taihai, attempted to acquire the German company *Leifeld* active in the manufacturing components for the aviation and aerospace industry that can be used in the defense and nuclear industries. Even though *Manoir Industries* decided to withdraw its bid for *Leifeld* at the very last minute, this case illustrates the strengthening of FDI control in Germany.

***"Europe must always defend its strategic interests and that is precisely what this new framework will help us to do. This is what I mean when I say that we are not naïve free traders. We need scrutiny over purchases by foreign companies that target Europe's strategic assets." (Jean-Claude Juncker President EU Commission 20.11.2018)***

See also how the German government used its political influence to prevent the State Grid Corporation of China (SGCC) from buying a 20 percent share in *50Hertz*, a leading German power grid operator.



In France, the government adopted the Decree 2018-1057 of 29 November 2018 and the adoption of the “PACTE” legislation is expected soon.

Other Member States have put in place FDI review mechanisms such as: Austria, Denmark, Finland, Italy, Latvia, Lithuania, Poland, Portugal, Spain and the United Kingdom.

In this context where several Member States take initiatives to regulate FDIs on their own territories, there is a risk of fragmentation of the EU Single Market, which bolsters the relevance of the new EU Regulation on FDI.

## The Future EU Regulation

On 10 December 2018, the Committee on International Trade of the European Parliament (INTA) voted in favor of the *Proposal for a Regulation establishing a framework for screening of foreign direct investments into the European Union* (“the Regulation”). The plenary session of the European Parliament is expected to vote on the Regulation in early 2019. Some say that the new rules are expected to enter into force in April – May 2019 and fully apply as early as November 2020.

*"This is an important milestone in the process we initiated only a year ago to protect critical technology and infrastructure in Europe. (...) In an increasingly interconnected and interdependent world, we need means to protect our collective security while keeping Europe open for business." (EU Commissioner Cecilia Malmström, 20.11.2018).*

## The key takeaways of the draft Regulation

- ◇ The Regulation includes *no condition based on the size of the deal* for triggering the review mechanism. It is up to Member States to set out the circumstances triggering screening, the potential mandatory character of the notification, and the sanctions for its circumvention.
- ◇ Member States have jurisdiction to screen and take the final decision on FDI in their territory. Yet, the Regulation establishes *a cooperation mechanism* with the EU Commission (“**Commission**”) and the other Member States.
- ◇ This cooperation mechanism will materialize through an *exchange of information* with the Commission and the other Member States that will have the opportunity to issue *opinions and comments* on FDI taking place elsewhere in the EU. The Member State where the FDI is planned or has been completed will have to reason its decision in light of those opinions and comments. The Commission will be at the center of this mechanism to coordinate the review of FDI in the EU, and, hopefully, to ensure a consistent policy throughout the EU.
- ◇ The draft Regulation does *not require Member States to adopt* a screening mechanism if they do not have one. Yet, the cooperation mechanism with the Commission and the Member States will apply even in cases where the FDI takes place in a Member State that does not have such a screening mechanism.
- ◇ *Third parties* will have an increased role in FDI screening since the Regulation expressly provides that both the EU Commission and Member States might consider relevant information received from economic operators, civil society organizations, or social partners such as trade unions.
- ◇ The draft Regulation stresses that the Commission and Member States should take into account whether a foreign investor is controlled directly or indirectly (e.g. through significant funding, including subsidies) by the *government of a third country* or is pursuing *State-led outward projects* or programs.



This may have a substantial impact on FDI originating from countries such as China where FDI may often be linked with the State or with state-led industrial policies such as “Made in China 2025”. Yet, the Regulation also specifies that rules and procedures related to screening mechanisms should be transparent and should not discriminate between third countries.

- ◇ The draft Regulation only provides for a vague and non-exhaustive **list of criteria** that **may** be taken into consideration by screening authorities in order to assess the potential threat to security and public order of FDI. It appears that the call of several stakeholders, such as the powerful BDI (Federation of German Industries), for increased legal certainty has had a limited impact on the EU Legislator.
- ◇ Interestingly, the draft Regulation may also apply to **intra-EU investments** when the acquiring entity established in the EU is controlled by third country nationals and the intra-EU investment aims at circumventing the FDI screening rules through artificial arrangements that do not reflect economic reality.
- ◇ The relevant stakeholders and screening authorities might have to **monitor the market** even after the deal is implemented since the proposed Regulation provides an ongoing monitoring resulting from change of in the ownership structure or characteristics of the foreign investor.

## A Number of Outstanding Issues

Still, the draft Regulation raises a number of issues, among which:

- ◇ The Regulation needs to provide better legal certainty. There is a need for clear definitions of the situations that can lead a screening authority to prohibit a FDI. Absent such definitions, the risk is to leave too much discretion to Member States unless the Commission overcomes national interests and ensures a consistent enforcement of those criteria.
- ◇ How to take these new FDI rules into account in M&A transactions, including at the due diligence level?
- ◇ How will third parties and/or competitors use these new rules to prevent what they consider an adverse deal?
- ◇ To what extent those new screening mechanisms will further delay the implementation of M&A deals?
- ◇ What will be the impact of the case law of the Court of Justice of the European Union (“**Court of Justice**”) regarding the free movement of capital and the freedom of establishment to the screening of FDI? Those two freedoms apply to intra-EU FDI (See for instance: C-54/99, *Eglise de Scientologie*, para. 14; C-284/16, *Achmea*, para. 42) such as in *Leifeld* where we understand that a French company (owned by a third country investor) attempted to acquire a German company. The Court of Justice strictly assesses the compliance with the EU Treaties of any restriction to those freedoms, even on grounds of public security and public order. (See for instance C-187/16 *Commission v. Austria*, para. 76 to 78) Further, to the extent that FDI fall within the free movement of capital, this freedom will also apply to FDI originating from third countries since the free movement of capital applies to relation *vis-à-vis* third countries.



- ◇ Another question relates to the creation and protection of EU champions. The relationship between FDI screening, on the one hand, and other EU policies such as merger control, trade and anti-dumping, on the other hand, calls for some consistency.

On this point, the much debated Siemens/Alstom merger brings to light the tensions between some national governments and the Directorate-General for Competition. While Bruno Lemaire (the France's Minister of the Economy and Finance), largely supported by the German government, backed the merger and insisted on the necessity for the merger control review in a global economy to take specific account of the economic power of China, Margrethe Vestager (EU Competition Commissioner) answered that addressing the growing power of Chinese companies and the lack of level playing-field should be done through a range of other tools such as trade, anti-dumping policies and investment screening. That is correct and reinforces the need for the adoption of the proposed Regulation on FDI screening, but does not resolve the need for consistency between the various EU policies in a global economy.

This new Regulation is likely to cause a wave of questions and uncertainties that reflects the need for the EU to adjust its policies to a changing global environment currently driven by the increased protectionism of the large economic blocs.

For more information :

- Bruno Lebrun : [b.lebrun@janson.be](mailto:b.lebrun@janson.be)

- Ulysse Bertouille: [u.bertouille@janson.be](mailto:u.bertouille@janson.be)



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