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European Commission Proposes Framework to Screen Certain Foreign Direct Investments

Proposal coordinates existing national screening mechanisms, grants the Commission powers to review investments of “Union interest.” European Parliament and Member States’ approval still required.

Key Points: On 13 September 2017, the President of the European Commission introduced the proposal, which includes:

- A European framework for screening of foreign direct investments on grounds of public order or security, including investments in sectors such as technology, cybersecurity, nuclear power, and financial services
- A cooperation mechanism between Member States and the European Commission that can be activated when a foreign direct investment in one Member State may affect the security or public order of another
- European Commission screening on grounds of public order or security for cases in which foreign direct investment may affect projects or programs of Union interest

Introduction

The European Commission's (the Commission's) proposal follows its May 2017 Reflection Paper on Harnessing Globalization in which it voiced concerns about foreign investors, in particular state-controlled enterprises, taking over key EU technologies and investors originating from countries that do not reciprocate the EU's largely open foreign investment regime. The Commission's proposal falls short of incorporating the type of foreign investment controls found in the United States through the Committee on Foreign Investment in the United States (CFIUS). The Commission's proposal largely aims at coordinating and monitoring the relatively open foreign investment control regimes that currently already exist in some EU Member States.

So far, foreign investment has not been subject to EU-level legislation. At the national level, almost half of the Member States do not have a review mechanism in place. The remaining Member States' mechanisms differ in scope and procedure (e.g., ex-ante/ex-post review, voluntary/mandatory notifications, general/sectoral coverage, etc.). Germany, France, Italy, and the UK have well-defined review procedures in place; others, such as Spain, have systems that only exceptionally subject foreign investments to review. Given the current divergence in national screening mechanisms, the Commission believes establishing an EU-wide screening framework is necessary to provide legal certainty and ensure coordination and cooperation among the Member States. The Commission stresses that the proposal will

maintain an “*open investment environment*” and “*provides a policy response to protect legitimate interests with regard to foreign direct investments that raise concerns for security or public order of the Union or its Member States.*”

The key elements of the proposal are the establishment of a general framework for screening mechanisms across the EU, the creation of a coordination mechanism between the Member States and the Commission, and the possibility for the Commission to screen certain foreign investments directly. All of this would be implemented in the form of a regulation directly applicable in each Member State.

The screening mechanism

The framework would give Member States the possibility to “adopt, maintain or amend” screening mechanisms, as well as anti-circumvention clauses. Anti-circumvention clauses are designed to catch investments foreign investors make through EU-established entities to avoid application of foreign investment rules. Nevertheless, Member States are not obligated to adopt a screening mechanism or anti-circumvention clauses.

The framework also requires that national screening mechanisms meet some basic requirements. These include the need of transparency and non-discrimination between third countries, the establishment of adequate timeframes for adopting screening decisions, the protection of confidential information, and the possibility of judicial redress of decisions.

In reviewing foreign direct investments, Member States may take certain factors into account. The non-exhaustive list of factors includes: the potential effects on critical infrastructure (*e.g.*, energy, transport, communication, etc.) or technology (*e.g.*, artificial intelligence, cybersecurity, nuclear technology, etc.), the security of the supply of critical inputs, or “*the access to sensitive information or the ability to control sensitive information.*” Member States may also consider the fact that the “*foreign investor is controlled by the government of a third country, including through significant funding.*”

Coordination between Member States

Pursuant to the proposed Regulation, Member States would need to inform each other and the Commission of the screenings they carry out, and if the review is likely to fall within the scope of EU Merger Control Regulation.

Member States that consider that their security or public order will be affected by the foreign direct investment could provide comments on the screening. Moreover, when a foreign direct investment is likely to affect the security or the public order in one or more Member States, the Commission may also issue opinions concerning the screening. In order to ensure this cooperation mechanism, Member States would need to create specific contact points.

Member States would also be required to report to the Commission the mechanisms and any amendments they implement, and to submit annual reports on the application of screening mechanisms.

The European Commission’s new screening powers

The proposed Regulation introduces new screening powers for the Commission, allowing for a review of certain foreign direct investments that “*are likely to affect projects or programs of Union interest on the grounds of security or public order*” (Art. 3(2) of the draft Regulation). The proposed Regulation further clarifies that these powers would include “*programs which involve a substantial amount or a significant share of EU funding, or which are covered by Union legislation regarding critical infrastructure, critical*

technologies or critical input” (Art. 3(3) of the draft Regulation). An illustrative list of “*projects of Union interest*” includes the European GNSS programs (Galileo & EGNOS), Copernicus, Horizon 2020, the Trans-European Networks for Transport (TEN-T), the Trans-European Networks for Energy (TEN-E), and the Trans-European Networks for Telecommunication.

In these cases, the Commission may issue non-binding opinions and request information from the Member State where the foreign investment is carried out (Art. 9(1) and 9(2) of the draft Regulation). However, the Member State to which the opinions are addressed “*shall take utmost account of the Commission’s opinion and provide an explanation to the Commission in case its opinion is not followed*” (Art. 9(5) of the draft Regulation).

Conclusion and final remarks

The proposal does not implement a new foreign investment screening mechanism, but rather establishes a common framework to unify the existing divergent national systems. Contrary to some press commentary, the EU proposal does not try to replicate the CFIUS model in the United States. The new EU framework would allow Member States the flexibility to keep their own screening mechanisms or not to implement any such mechanisms at all. For those Member States that decide to implement or maintain their screening mechanisms, the proposal presents some minimum requirements that states must respect to ensure legal certainty.

Depending on whether the Regulation is finally adopted or amended, the new coordination mechanism between Member States and the Commission and the possibility for the Commission to review and issue non-binding opinions regarding certain foreign investments could result in an extra hurdle for some transactions involving non-EU investors. Therefore, if the Regulation is ultimately adopted, it should be implemented in a transparent, predictable manner, so as not to create an unnecessary burden that could delay transactions and deter foreign investors.

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