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Screening of foreign direct investments by the European Union

Regulation (EU) 2019/452 of the European Parliament and of the Council of March 19, 2019 establishing a framework for the screening of foreign direct investments into the European Union (the "Regulation") entered into force on April 10, 2019. It will automatically apply in EU Member States from October 11, 2020.

The objective of this new Regulation is to create cooperation mechanisms between Member States on the one hand, and between Member States and the European Commission on the other hand, in order to control foreign direct investments in sensible European business sectors.

Foreign direct investments in the European Union

First and foremost, what is a foreign direct investment ("FDI")? According to the French Ministry of Economy, direct investment is a category of cross-border investment made by a resident in one economy with the objective of establishing a lasting interest in a company that is resident in another economy. By convention, the "lasting interest" is evidenced when a company owns at least 10% of the share capital or voting rights in a company that is resident in another country.[1]

The European Union is the world's most attractive zone for FDI: in 2017, FDI in the European Union amounted to 6.295 billion euros. As such, FDIs have a significant economic impact and the European Union is concerned about maintaining its attractiveness.

Yet, in response to increased FDIs in strategic sectors, notably by China, Russia and Brazil, the European Union, which until now had one of the most open investment regimes in the world according to the OECD, has decided to establish a common supervisory and screening framework to protect its strategic assets and ensure security and public order.

In 2018, Jean-Claude Juncker, President of the European Commission, declared:

"*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.*"

The issue of FDI has been integrated into the EU common commercial policy following the adoption of the Treaty of Lisbon of December 13, 2007. The new Regulation has been prepared under Article 207 §2 of the Treaty on the Functioning of the European Union ("TFEU") that stipulates as follows: "*The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall adopt the measures defining the framework for implementing the common commercial policy."*

What does the new Regulation provide for?

The fundamental screening criterion laid down by the Regulation is based on the potential effect that a FDI may have on security or public order. Article 4 of the Regulation includes a precise list of factors that may be taken into consideration in determining whether a foreign direct investment is likely to affect security or public order:

"*1. In determining whether a foreign direct investment is likely to affect security or public order, Member States and the Commission may consider its potential effects on, inter alia:*

(a) critical infrastructure, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure;

(b) critical technologies and dual use items as defined in point 1 of Article 2 of Council Regulation (EC) No 428/2009 (15), including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies;

(c) supply of critical inputs, including energy or raw materials, as well as food security;

(d) access to sensitive information, including personal data, or the ability to control such information; or

(e) the freedom and pluralism of the media.

2. In determining whether a foreign direct investment is likely to affect security or public order, Member States and the Commission may also take into account, in particular:

(a) whether the foreign investor is directly or indirectly controlled by the government, including state bodies or armed forces, of a third country, including through ownership structure or significant funding;

(b) whether the foreign investor has already been involved in activities affecting security or public order in a

Member State; or

(c) whether there is a serious risk that the foreign investor engages in illegal or criminal activities."

The targeted strategic sectors are high technologies (including artificial intelligence and robotics), energy and defense. Special attention is also paid to fundamental rights, such as the protection of personal data or the freedom and pluralism of the media. Enhanced scrutiny is recommended wherever the foreign investor is directly or indirectly controlled by the government of a third country.

According to Article 8 of the Regulation, a specific protection is granted to projects and programs of Union interest, such as Galileo (for the implementation of the European satellite navigation systems), Horizon 2020 (for innovation in high technologies) or trans-European networks for transport (RTE-T) and for energy (RT-E).[2]

The cooperation mechanism is based on Member States' domestic screening methods, wherever such methods exist. On the date hereof, 14 Member States have implemented schemes to this end: Austria, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, the Netherlands, Poland, Portugal, Spain and the United Kingdom.

Specifically, Article 6 of the Regulation provides that:

- Each Member State shall notify the European Commission and the other Member States of any FDI in its territory that is undergoing screening;
- The other Member States may provide comments on the FDI to the Member State undertaking the screening and said comments must be sent to the European Commission simultaneously;
- The European Commission may issue an opinion on the relevant FDI once it has been notified thereof or after having received the comments provided by other Member States. Opinions may be issued by the European Commission at its own initiative or at the request of a Member State;
- The other Member States and the European Commission may request additional information from the Member State where the FDI is contemplated;
- The Member State undertaking the screening must give due consideration to the comments and opinions that have been issued. It remains, however, free to make its own final screening decision.

The Regulation does not impose a binding framework since Member States remain free to make their own final screening decision: "*Nothing in this Regulation shall limit the right of each Member State to decide whether or not to screen a particular foreign direct investment within the framework of this Regulation*" (Article 1.3 of the Regulation).

The process is to take place within a limited time frame: 35 days to provide comments and issue opinions from the notification of a FDI, 20 days from the receipt of additional information.

In addition, where a Member State / the European Commission considers that a FDI planned or completed in another Member State which is not undergoing screening in that Member State is likely to affect its security or public order, it may provide comments / issue an opinion to that other Member State[3].

The content of the information notified between Member States and to the European Commission is set forth in Article 9 of the Regulation. It includes:

"a) the ownership structure of the foreign investor and of the undertaking in which the foreign direct investment is planned or has been completed, including information on the ultimate investor and participation in the capital;

b) the approximate value of the foreign direct investment;

c) the products, services and business operations of the foreign investor and of the undertaking in which the foreign direct investment is planned or has been completed;

d) the Member States in which the foreign investor and the undertaking in which the foreign direct investment is planned or has been completed conduct relevant business operations;

e) the funding of the investment and its source, on the basis of the best information available to the Member State;

f) the date when the foreign direct investment is planned to be completed or has been completed."

The magnitude of the information transmitted thus enables Member States and the Commission to concretely assess the contemplated FDI and consider its potential effects.

And how about France?

France has actively participated in the negotiations of this European Regulation. At the national level, several measures have also clarified and enhanced the framework for screening foreign investments.

In France, the FDI screening mechanism is based on a prior authorization procedure with the Minister of Economy, the details of which are specified in Article L151-3 of the French Monetary and Financial Code:

« I. – Prior authorization by the Minister of the Economy is required for any foreign investment in an activity in France which, even on an occasional basis, involves the exercise of public authority or falls within one of the following areas:

a) activities that may undermine public order, public safety or interests of national security;

b) activities of research, production or marketing of weapons, ammunition, explosive powders and substances."

A Decree dated November 29, 2018[4] that became effective on January 1, 2019 has enlarged the list of sectors in which foreign investments must be subject to prior authorization to include aerospace, cybersecurity, artificial intelligence, robotics, additive manufacturing, semi-conductors, hosting of sensitive data. The Decree also provides that the request for prior authorization can now be made not only by the foreign investor but also by the target companies, which constitutes a noteworthy simplification.

Above all, the Law on business growth and transformation, known as the PACTE Law in France, published in the Official Journal on May 23, 2019 has reshaped and expanded the French prior authorization procedure.

In particular, it increases the powers of the Minister of Economy by granting him/her extended injunction powers, detailed in new Article L.151-3-1 of the French Monetary and Financial Code:

« I.- Where a foreign investment has been made without prior authorization, the Minister of Economy may issue three types of injunctions against the investor:

1° Injunction to submit a request for authorization;

2° Injunction to restore the previous situation at its own expense;

3° Modify the investment.

Injunctions referred to in 1° to 3° above may be subject to a penalty per day of non-compliance. The injunction must specify the amount and effective date of this penalty. A Decree of the Council of State shall set the maximum daily amount of the penalty and the terms and conditions in which it will be recovered in case of full or partial non-compliance or delayed compliance."

If the Minister considers that the protection of national interests is or may be compromised, he/she may also take any necessary precautionary measures.

The PACTE Law also introduced a system of financial sanctions[5] which applies in the four following cases:

- foreign investment carried out without prior authorization;
- authorization obtained by fraud;
- infringement of the rules set forth in Article L.151-3 of the French Monetary and Financial Code;
- breach of commitments or partial or full non-compliance with decisions and injunctions made under Article L.151-3 of said Code.

The amount of the financial penalty is capped at the higher of the following:

- twice the amount of the irregular investment;
- 10% of the annual turnover, taxes excl., of the target company;
- 5 million euros for legal entities;
- 1 million euros for natural persons.

Strengthening the screening of FDI is thus a well-established trend, both at the national and European level. In any case, it will be necessary to wait until October 11, 2020, the date of application of the Regulation, to assess the effectiveness of the new mechanism for cooperation between Member States.

[1] https://www.tresor.economie.gouv.fr/Ressources/8235_les-investissements-directs-a-l-etranger-ide

[2] The full list of projects or programs of Union interest in set forth in an annex to the Regulation.

[3] Article 7 of the Regulation

[4] Decree n°2018-1057 of November 29, 2018 on foreign investments subject to prior authorization

[5] Article L151-3-2 of the French Financial and Monetary Code