FDI screening across the EU

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Prof. Massimo Merola

BonelliErede
with LOMBARDI

Content

I. FDI SCREENING IN THE EU

What is FDI screening? (1)

- Slight differences between jurisdictions but also one common denominator: **controlling foreign entities that invest in domestic companies or assets**, based on **national security and public interest** considerations.

- Three factors that trigger control (cumulatively or in different combinations).

- Possible additional quantitative factor: thresholds.

- Some jurisdictions do not require a foreign element for highly strategic sectors (e.g., Spain for the defence sector).
- FDI mechanism in some countries applies only to non-EU/EEA/EFTA investors. In others, FDI screening extends also to EU investors, in line with transitory rules.
- Intra EU investments are not subject to FDI screening (under Regulation (EU) 2019/452 – "**Regulation**").

What is FDI screening? (2)

- **Foreign**: non-EU and EU operators and domestic investors, e.g., when an "in-between entity" in the control chain is a foreign company.

For the EU: the notion of foreign investor includes non-EU operators only → several infringement procedures because some countries have adopted special rules for companies in strategic sectors that also apply to EU investors. But temporary tolerance for wider screening due to the Covid-19 pandemic.

- **Direct**: According to the Regulation: "lasting and direct links" between the investor and the target. However, indirect or portfolio investments (e.g., minority stakes) are also included in some jurisdictions.

How does FDI screening work?

- The rules apply to **specific sectors** or are **sector agnostic**.
- **Screening mechanism** is triggered by:
  - **notification** obligation on the investor, the target or both (if the transaction meets the requirements under national FDI rules); or
  - ***ex officio* investigation** – only in certain jurisdictions (e.g., in Italy, if notification requirements are not complied with, the FDI Authority may also initiate *ex officio* proceedings).
- **Possible outcomes**: clearance, imposition of conditions (e.g., obligation to maintain target's assets within the national territory) and veto power.
- **Contractual implications**: parties to potentially relevant transactions should make provisions for FDI clearance **similar to merger control**, e.g., timetable or risk-shifting provisions (LSD, CP, HOHWC, GFNO, reverse-break up fees, etc.)

Why FDI screening in Europe?

- **New players**: US and Canada traditionally hold the biggest share in terms of investments in Europe. China's share is significantly increasing and EFTA countries' shares are decreasing. Sovereign funds are increasingly active.
- **New challenges**: economic colonialism from emerging superpowers (e.g., Gulf states, state-directed market economies, predatory acquisitions of start-ups/SMEs – battle for IP).
- **Shift in the EU's position because of geopolitical considerations**: MS encouraged to reform – by strengthening or widening – their security screening policy. Similar shift in the EU as in the field of foreign subsidies.

→ Commission 2017 package

→ In-depth study from an expert group on FDI

→ Almost unanimous support for an EU FDI regulation

EU screening regulation (Regulation (EU) 2019/452)

The Regulation sets out a framework for screening FDI into the EU → practical risk of further delaying screening procedures.

No obligation for MSs to set up a screening mechanism

Screening remains national (no EU screening!)

Cooperation mechanism

European mininimum standards:
National rules must:

(a) be transparent and applied in a non-discriminatory way;
(b) include anti-circumvention provisions;
(c) provide timeframes to consider MSs' or the Commission's opinions when issuing a decision;
(d) protect confidential information; and
(e) allow foreign investors to appeal screening decisions.

The Regulation sets out a framework to progressively harmonise national screening mechanisms de facto

What types of transactions are covered? Possible differences with – and among – national screenings

- The Regulation covers FDI, inc. **controlling** and **non-controlling** stakes, if an influence over the company's management exists.

- FDI screening generally covers:

  - ✓ **share and asset deals:** specific thresholds apply to share capital acquisitions:

    - 5%, 10%, 15%, 20% or 50% in Italy and 25% in France for buyers that are non-EU investors; and

    - 10% in Spain and Germany (10% for sensitive sectors and 25% for all other areas), 25%, 50%, 75% or more in the UK; and

  - ✓ **greenfield investments:** this may depend on the strategic nature of the assets.

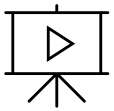
What sectors are covered?

Critical infrastructures, be they physical or virtual, inc. energy, transport, water, health, defence, communications, etc.

Critical technologies and dual use items, as defined in Art. 2, point 1, of (EC) Regulation 428/2009, as amended by the Regulation

Supply of critical inputs, inc. energy, raw materials, and food security

Access to sensitive information, inc. personal data, and the ability to control sensitive information



Freedom and pluralism of the media

Finance/Insurance

Public health

Snapshot of some European screening mechanisms

	FRANCE	GERMANY	ITALY	SPAIN	UK
Target subject to screening	Shares + assets	Shares (exc. non-voting shares) + asset deals	Shares + assets + corp. transactions (inc. pledges)	Shares + corp. transactions + asset deals (strategic)	Shares + assets New FDI screening mechanism introduced by the National Security Investment Act (to be implemented by end of 2021 or Jan 2022)
Thresholds	Change of control, or 25% (non-EU/EFTA), or business division	10% for sensitive sectors (e.g., critical infrastructures), which are subject to mandatory notification requirement, and 25% for all other sectors	Change of control if the buyer is an EU investor; acquisition of 10% (if transaction value > €1m), 15%, 20%, 25% or 50% of the target's share capital for non-EU investor buyers. These rules apply to all sectors	10% or participation in the management	25%, 50%, or 75% or more of votes or shares
What is a foreign investor?	Foreign individuals or entities + not tax-domiciled in France + French entities controlled by the above	Non-EU/EFTA investors for any sector; non-German investors for defence screening	Both EU and non-EU investors	Non-EU/EFTA residents (also EU investors for defence sector)	No specific definition
Look-through	Yes	Yes	Yes	Yes (limited)	Yes
Sectors	Sensitive sectors, critical tech, R&D in cybersecurity, etc.	Any sector + specific defence screening rules	Defence, 5G, energy, transport, TLC and all sectors listed in Art 4.1 of the Regulation	All those listed in Art. 4.1 of the Regulation	17 sectors, inc. energy, defence, transport, communications, etc.
Term	Phase 1: 30 business days Phase 2: 45 business days	Up to 2 months for straightforward cases; up to approx. 6 months for in-depth review (longer in rare cases)	45 calendar days + 10–20 calendar days for RFI	6 months 30 days when fast-track applies (<€5m)	Phase 1: 30 business days + 30 business days (if phase 2 starts) + 45 business days and further potential delays if agreed with the parties
Penalties	Invalidity + fine/criminal penalty + other injunctions	Invalidity (defence and presumably soon other investments) + fines	Invalidity+ fines	FDI invalid + fines	Conditions/criminal penalties/fines

Recent tightening of FDI screening in Europe due to the Covid-19 pandemic

UK

New FDI screening rules are currently being implemented

Switzerland

Legislative chambers are discussing new FDI screening rules

France

Amendments to FDI screening rules (i.e., broadening the scope of sectors subject to mandatory filing with clearance, and extension of enforcement powers)

Italy

Simultaneous amendments and extensions to the government's FDI oversight powers (aka 'golden powers') to block transactions, and specific rules for 5G

Germany

Several amendments to further tighten FDI screening rules (i.e., lowering the review thresholds, and broadening the scope of sectors subject to mandatory filing with clearance)

II. The "European Cooperation Mechanism"

Overview of the European cooperation mechanism

→ MSs must notify the EU and other MSs, provide information on screened investments, and take comments/opinions into consideration.

→ The Commission is obliged to issue an opinion if 1/3 of MSs have commented on a transaction. The Commission may issue an opinion if a screened transaction is considered critical.

Risk factors

- **Sector concerned** (e.g., infrastructure, technologies, and sensitive information).
- **Investor's features**: (a) some countries usually invest through state-owned enterprises, (b) countries targeting specific companies that own critical technologies, or (c) the foreign investor is controlled by state bodies or armed forces of a third country.
- Likelihood of the foreign investor engaging in **illegal or criminal activities** or being from a **blacklisted country** (North Korea, Iran, Iraq, etc.).

How the cooperation mechanism works

- **1st scenario: The foreign investor comes into a country that has a screening mechanism in place:**
  - the transaction falls under the MS' screening mechanism;
  - the national authorities notify the Commission of the transaction; and
  - another MS, if the transaction poses a threat to its national security, issues comments, or the Commission issues an opinion within 35 days.
- **2nd scenario: The foreign investment occurs in a country that has no screening mechanism in place or in a sector that is not screened:**
  - the Commission can ask the MS *ex officio* questions concerning the investor;
  - the Commission can, within the same timeframe, issue comments identifying risks and suggesting ways to overcome those risks; or
  - MSs can, on their own initiative, ask the Commission for an opinion on the foreign investment. This usually occurs when the MS has limited experience with screening.

➡ **What remedies can MSs implement?**

Is the Commission's opinion legally binding?

- The Commission's opinion and comments are **non-binding** – the final decision on whether to authorise the foreign investment remains with each national authority.

- The MS must take the Commission's opinion into "**utmost account**" when a target is involved in projects of EU interest → a strengthened reasoning obligation.
- The Commission's opinions cannot be 'challenged'.

Considerations on the functioning of the European cooperation mechanism

Statistics on Italy:

- Between the end of 2020 and 2021 Italy sent **20** notifications:
  - in **7** cases, MSs/the Commission issued comments or opinions; and
  - in **6** cases, the Commission sent a request for information.
- Italy was informed by other MSs of **34** transactions over the same period.

→ Limited effects of opinions/comments on national decisions so far. However, limited experience.

→ Procedural shortcomings: notifications/enquiries from more than one MS on the same transaction, and parties not involved in discussions on the cooperation mechanism.

What is the scope for improving the functioning of the cooperation mechanism?

What will its fate be?

III. THE NATURE OF EU POWERS

The exclusive competence of the EU vs MSs' national screening systems

- **Art. 207 (6):** "*the exercise of exclusive competence in the field of FDI* ***shall not affect*** *the delimitation of competences between the Union and the MS* [emphasis added]"
- Two sets of rules:
  - **Art. 63 TFEU**: MSs cannot adopt measures in conflict with the free movement of capital between MSs and third countries; and
  - **Art. 65 (1)(b) TFEU** recognises the right of MSs to introduce measures restricting the free movement of capital on the grounds of public security or public policy

- The CJEU accepts the compatibility of national systems with EU law if they comply with the following standards:
  - ✓ protection of a **legitimate interest** and provision of strict time limits to exercise powers of opposition; and
  - ✓ use of **objective criteria** subject to an effective review by the courts.

- Need to strike a balance between the EU's exclusive competence and the MSs' competence regarding national screening systems → The Regulation introduces a form of coordination between national screening systems.

Judicial review by the CJEU if EU law is violated – limited scope

- Lack of predictability about MSs taking action on FDI before the Regulation was introduced - No legal certainty – Commission under a duty to take action as EU exclusive competence
- The Regulation must be interpreted in light of the EU rules (primary law) → investment screening must be **strictly limited** to warning threats to public order and security.
- National FDI screening mechanism might be subject to the CJEU's judicial review: national courts could refer the question of the compatibility of national rules on FDI screening with EU law to the CJEU for a preliminary ruling.

However, the EU's exclusive competence in the FDI field cannot limit the MSs' competence to intervene and restrict the movement of capital

IV. ITALY AND THE JUDICIAL REVIEW OF NATIONAL DECISIONS

The possibility for MSs to appeal screening decisions issued by national authorities

Art. 3(5) of the Regulation: "*Foreign investors and the undertakings concerned shall have the possibility to seek recourse against screening decisions of the national authorities*".

Italy

- The Italian judicial system guarantees individuals and entities the rights to seek recourse against the public administration's decisions before the administrative courts (i.e. Lazio Administrative Court of First Instance – *Tar Lazio,* and the Italian Council of State – *Consiglio di Stato*).
- Even prior to the existing golden power mechanism, decisions concerning the exercise of special powers were subject to the exclusive jurisdiction of the administrative courts: "*disputes concerning the exercise of special powers relating to activities of strategic importance in the fields of defence and national security and in the fields of energy, transport and communications*" (Arts. 133 (1), point z)-*quinquies*), and 135 (1), point h), of Legislative Decree No. 104 of 2 July 2010).
- Scholars classified measures issued by the government in exercising its golden powers as 'acts of high administration' (*atto di alta amministrazione*), and thus subject to judicial control by the administrative courts.

→ **But this provision has remain unchanged - non adapted to FDI rules that broadened the sectors subject to the government's golden powers**

The nature of national jurisdictional control – now and beyond

Common features of judicial control:

- review of **legality** by the administrative courts
- ≠ from competition law decisions → wide high discretionary power of the public administration

Limited judicial review → e.g., in Italy only two appeals were lodged against the decisions issued by the FDI Authority and in both cases the administrative courts annulled the Authority's measures.

➡ However, this might change in the future if the FDI authority's instructions for FDI control become more concrete.

Case study: Retelit

- In 2018 Retelit notified on a "precautionary basis" to the Italian FDI Authority a change of its governance structure.
- According to the Authority the requirements for the application of FDI legislation were met (decision of applicability of the FDI legislation based on the AGCOM's opinion) → it decides to exercise its special powers through the imposition of conditions to ensure the protection of public interests in the field of communications.
- Retelit decided to seek recourse before the administrative court (*Tar Lazio*), which in 2020 annulled the Authority's decision because:
  - AGCOM's opinion on the "classification of assets as strategic assets in the communications sector" was delivered in a manner that did not comply with the rules on the functioning and powers of the AGCOM's secretary-general, the signatory, who lacked the power to issue a decision of that nature (which requires a resolution of the AGCOM's Council as a whole);
  - AGCOM's opinion was decisive for the analysis of the existence of the objective requirement to exercise the special powers.

Case study: TIM/Vivendi

- Vivendi, following progressive share acquisitions, held 23.94% of TIM's share capital (as at 30 June 2017).
- The transaction falls within the scope of application of the Italian FDI legislation only if:
  - Telecom and Tim operate in the communications sector; and
  - Vivendi has **de facto control** over TIM.
- Consob opinion: Vivendi has the power to appoint the majority of directors → it exercises de facto control over TIM.

Violation of Italian FDI legislation because of failure to notify the transaction → opening of proceedings for the potential imposition of a penalty.

- The Council of State annulled the court of first instance's decision and the FDI decision based on the Consob opinion because of a breach of the rules on cross-examinations / right to be heard before a decision is adopted

THANKS FOR JOINING US!

Q&A TIME

Via Barozzi 1, 20122 Milano
+39 02 771131 t.

Via Vittoria Colonna 39, 00193 Roma
+39 06 845511 t.

Via delle Casaccie 1, 16121 Genova
+39 010 84621 t.

Square de Meeûs 40, 1000 Bruxelles
+32 2 5520070 t.

30 Cannon Street, EC4M 6XH London
+44 (0)20 7653 6888 t.

16A, Maamal El Sokkar St., Garden City Cairo
+20 227371195 t.

6th Floor Park LaneTowers, Bole Sub-City, Kebele 03/05 Addis Abeba
+251 0948298345 t.

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