

Newly adopted EU FDI screening and its impact on Chinese investments

April 8, 2019

Background

On March 5, 2019, the Council of the EU formally endorsed the agreement with the European Parliament (EP) regarding an EU mechanism for screening foreign direct investments (FDI) and the EU Regulation entered into force on April 1, 2019. Member states and the European Commission (Commission) have 18 months to put in place the necessary arrangements to implement the new mechanism.

Key features of the EU regulation on the screening of FDI

On September 13, 2017, the Commission published a proposal for a new EU regulation that would give it wide-ranging powers to screen foreign acquisitions that may affect security or the public order in the EU.

The Commission, the EP and the Council of the EU concluded negotiations on November 20, 2018, and a provisional agreement on a text for the proposed regulation was released. Although the compromise text mainly follows the European Commission's proposal of September 2017, some noteworthy amendments were made. These amendments include a clearer definition of the roles of the different actors involved, additional screening factors and an enhanced cooperation mechanism.

The provisional agreement thus provides for a "cooperation mechanism" between the Commission and the member states in national review procedures. In such cases, the Commission will be informed promptly and empowered to issue an opinion to the member state to which the latter must give "due consideration." In other words, although the final decisions rests with the member state, the member state will have to "take utmost account" of the Commission's recommendations. If it decides not to follow a recommendation, then it will have to justify its decision not to comply with the issued recommendation.

In determining whether a foreign direct investment is likely to affect security or public order, the text endorsed by the EP provides that EU 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, 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
- e. Freedom and pluralism of the media

In addition, the text provides that EU member states and the Commission may also take into account whether:

- a. The foreign investor is directly or indirectly controlled by the government of a third country, including through ownership structure or significant funding
- b. The foreign investor has already been involved in activities affecting security or public order in an EU member state
- c. There is a serious risk that the foreign investor engages in illegal or criminal activities

As before, the proposed regulation also encourages, but does not require, EU member states to adopt national measures to screen foreign investments involving sensitive sectors. The decision whether to set up such screening mechanism thus remains the sole responsibility of each member state.

Commission (or member state) review would be conducted in parallel to review under the EU Merger Regulation (the EUMR). Coherence would be required in such parallel review but it is likely that the competition law issues and the impact assessment on strategic sectors will be kept separate.

Impact on Chinese investments

Although not really comparable to the Committee on Foreign Investment in the United States (CFIUS), the EU FDI screening framework will have significant impact on third country FDI, particularly those from China.

The first impact we can anticipate will likely be increased sensitivity towards any Chinese takeovers in the EU, especially those touching strategic sectors. For those foreign investors, access to certain strategic sectors will be conditional or may even simply be precluded, especially in sectors relating to critical infrastructure, critical technologies, the security of supply of critical inputs, and the access to sensitive information.

Second, the complexity and uncertainty of FDI deals touching strategic sectors in the EU will certainly increase. In addition to the traditional takeover steps, like market screening, financial advice, DD, negotiation, SPA, deal financing and closing, a complex, uncertain and time consuming FDI screening procedure may be added to the mix. Here in particular we expect that the uncertainty will increase and may continue for a long period after closing.

Lastly, the transaction cost of such deals involving FDI screening procedures will obviously be higher than before.

Advice to Chinese investors

Chinese investors should take into account the likelihood of FDI screening in strategic sectors in the EU and should proceed to a full assessment of risks already at the market screening stage. If they decided to proceed, Chinese investors should also work closely with the member state in which the investment will take place in order to ensure their support for the transaction.

At this stage, the international strategic investment team and the investment advisor may play an important role in determining if the takeover of the EU target might be considered as presenting serious threats to the security or public order in the EU. Comprehensive and objective analysis and evaluation should be undertaken in order to assess such risks.

During the transaction stage, in particular in the drafting of the SPA, a series of clauses and mechanisms could be proposed in the condition precedent chapter. These could be designed to allow one or both parties, to exit without damage, harm and indemnity should the deal be refused by the national authorities or in case of an adverse opinion

issued by the EU.

Lastly, even after the closing, post-closing FDI screening might occur. Thus it is advisable to make preparations now for a worst case scenario in the SPA, including the necessary remedies.

About the authors

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