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Proposal to Revise EU FDI Screening Regulation — Revolution or Gradual Evolution?

The proposed revision is ambitious in scope and aims for a greater harmonization of national FDI regimes.

On January 24, 2024, the European Commission (EC) adopted five initiatives to strengthen the EU's economic security, in order to deal with new geopolitical tensions and profound technological shifts in the economy. One of these initiatives is the long-awaited proposal for a revised EU Foreign Direct Investment (FDI) Screening Regulation (Regulation).

The current Regulation, which acts as a framework regulation for national FDI regimes, has been in place for more than three years (fully applicable since October 11, 2020) and was therefore due for evaluation by the EC by the end of 2023. Based on the findings of that evaluation, the EC considered it necessary to amend the existing Regulation. These amendments not only aim to address issues identified by various stakeholders, including the Member States and private investors, but they also build on the experience of the last three years (with more than 1,200 transactions being notified via the EU FDI Cooperation Mechanism).

This Client Alert highlights the key proposals of the revised Regulation. While the proposal still needs to progress through the European Parliament and the Council of the EU, the key changes could, if adopted, raise the regulatory hurdles for a number of transactions.

Requiring All Member States to Establish a Screening Mechanism

Under the current Regulation, Member States are free to decide whether or not to set up a screening mechanism. However, pursuant to the proposal, all Member States would have to adopt FDI screening mechanisms.

Following calls by the EC over recent years for Member States to adopt screening mechanism in response to the COVID-19 crisis or the Russian invasion of Ukraine, the majority of Member States have already adopted regimes. Twenty-three out of the 27 Member States already have screening mechanisms in place, with Bulgaria being the latest Member State to introduce a regime and Ireland's regime set to enter into force in the coming months. In the three remaining Member States (Croatia, Cyprus, and Greece), work on the necessary legislation has already begun.

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The main reason for the shift from "encouragement" to a requirement is to close a perceived loophole for foreign investors trying to enter the EU for the first time via countries without a regime. Based on reports by the Organisation for Economic Co-operation and Development (OECD) and the EU, this applies to more than 20% of investments into the EU.

Extended Scope

A notable change relates to the widening of the Regulation's scope to investments from EU entities whose ultimate owners are non-EU investors. The proposal responds to the Court of Justice's judgment (see Latham's Client Alert) in which the court found an investment made by an EU company, which was owned by a non-EU entity, did not fall within the scope of the Regulation.

However, the proposal does not explicitly capture investments made by EU entities with non-controlling, minority non-EU owners. The proposal therefore falls short of what many national regimes have already implemented, including in Austria, France, Germany, and Italy where indirect non-controlling minority investments of ex-EU investors can be screened for national security concerns.

Increased Harmonization of National Screening Mechanisms

The change that will likely have the biggest practical impact on transactions is the requirement for increased harmonization between the FDI regimes of individual Member States. While most Member States have already implemented screening mechanisms and the EU Cooperation Mechanism has led to an increased exchange of information between national authorities, the regimes still vary significantly in terms of scope and procedural rules (including review timelines).

According to the proposal, all Member States would have to introduce mandatory and suspensory filing requirements for investments in domestic target companies that:

- participate in projects or programs of EU interest listed in Annex I (e.g., Space Programme, Horizon Europe, Trans-European Networks, and European Defence Fund); or
- are active in relation to certain technologies, assets, facilities, equipment, networks, systems, services, or economic activities of particular importance for the security or public order interests of the EU listed in Annex II (e.g., dual-use, defense, semiconductors, artificial intelligence, robotics, biotechnologies, space technologies, and the financial system).

While one may welcome the more prescriptive nature of relevant business activities, the proposal would result in a significant widening of the scope of some existing screening mechanisms (e.g., the Netherlands or Czechia which are currently quite narrow in application) and lead to an increased number of notifications. What activities specifically would be caught by a mandatory filing requirement also remains unclear — the Regulation may cover only "core" activities such as research and development (R&D), production, or also mere sales activities in relation to the listed technologies and assets.

Other proposed changes relate to (1) the ability to review non-notified transactions for up to 15 months post-closing (which would significantly increase legal uncertainty), (2) ensuring that national review timelines allow for a full participation in the EU Cooperation Mechanism (i.e., national authorities must have time and be able to take Member State comments and EC opinions into account), (3) the possibility for effective judicial review, and (4) the requirement for national screening authorities to publish an annual report regarding their screening activities and anonymized data on cases reviewed and outcomes.

Addressing Transactions Involving Multiple Jurisdictions

An issue that investors frequently face in transactions requiring multiple FDI filings in the EU (multi-country transactions) is that national review timelines can differ significantly.

To address this issue, the proposal requires parties in multi-country transactions to (1) submit their filings in all Member States on the same day; while (2) setting out deadlines for the Member States and the EC to initiate key steps in the review process, such as notifications to the Cooperation Mechanism, providing comments/opinions, responding to information requests, or indicating the outcome of their reviews.

The rules on multi-country transactions also push for the EC's role to become much more active. The EC may therefore participate in meetings to address cross-border concerns in response to Member States' comments, or to align mitigation measures.

While these measures may lead to more coordination between the national screening authorities and the EC, therefore lowering the risk of diverging outcomes, they are insufficient for ensuring a uniform timeline. Uniformity would require Member States to amend their national review periods and to align on timing for initiating the Cooperation Mechanism. In Austria, for instance, the national review period only starts after the Cooperation Mechanism has run its course, while in other countries the two run in parallel.

Own Initiative Procedure

The proposal that may have received the most media coverage is that Member States and the EC would be able to open their "own initiative" procedure and review transactions which have not been notified to the Cooperation Mechanism, if they consider that transaction to negatively affect their security or public order. This right shall be available for 15 months after the transaction has closed.

While the proposal aims at ensuring that transactions do not "fall through the cracks," it fails to provide Member States with additional screening power. Even if Member States or the EC identify national security concerns on their "own initiative," all they can do under the proposal is to issue comments or an opinion to those Member States where the investment takes place. That Member State would then still be able to disagree and refrain from opening an ex-officio review (which it would have to justify). The fact that a transaction does not trigger a mandatory filing in that Member State would, however, no longer be considered reasonable as Member States would have to ensure their ability to review any investment in their territory. The question therefore remains how this proposal will be implemented in practice. Investors will need to be aware that, if a transaction is not notified, different routes exist through which it could be called in. Assessing the likelihood and risk of such a call-in will become a consideration in deal planning.

Next Steps

The proposal will now have to progress through the ordinary legislative procedure and may be amended by both the European Parliament and the Council of the EU. Given the upcoming elections for the EU Parliament, this process will likely be delayed until the second half of 2024.

If you have questions about this Client Alert, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Dr. Jana K. Dammann de Chapto
jana.dammann@lw.com
+49.40.4140.3413
Hamburg

Philipp Studt
philipp.studt@lw.com
+32.2.788.6276
Brussels

Dr. Nicolas Jung
nicolas.jung@lw.com
+49.69.6062.6611
Frankfurt

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