

European Commission publishes Draft Regulation for Screening of Foreign Direct Investments into the European Union

Basic Requirements and Rules on Information and Cooperation

Background and overview

Only recently, on 18 July, Germany tightened its foreign investment control regulations, widening the scope of foreign investment control, and extending the time limits of examination proceedings. The amended foreign investment control regime of the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung, “**AWV**”) has a focus on the acquisition of certain critical infrastructures, for example in the energy and transport sector, by introducing reporting requirements for foreign investors. For further information on the legal changes in Germany please refer to our [newsletter from July 2017](#).

On 13 September, the European Commission published its proposal for a new regulation for “Investment Screenings”. With this piece of legislation, the Commission aims to establish a framework for EU Member States, and in certain cases for the Commission, to screen foreign direct investments in the European Union. The proposal mainly consists of three elements: (i) a regulatory framework for screening mechanisms of the Member States, (ii) a framework for a Commission screening and (iii) information and cooperation rules. Generally, the draft commits to the EU maintaining an open investment environment. E.g. it does not introduce a reciprocity test for investment conditions and will have less material impact than some of the Member States initially might have hoped. Germany, France and Italy, politically bolstering the European initiative, expressed their approval of the draft in a joint press statement on the day the draft was released.

Regulatory framework for the Member States

The proposed regulation lays down some common rules for the Member States in case they intend to establish or maintain a national screening mechanism (currently, 12 of the 28 Member States have screening mechanisms in place). It addresses only the Member States and not entities involved in a foreign direct investment. A foreign direct investment in the context of the draft regulation means any kind of investments of investors from third countries, i.e. non-Member States.

However, while taking the legal form of a regulation, and being directly applicable, the regulation would, if adopted, not require Member States to introduce or maintain a screening mechanism for foreign direct investments. Moreover, the regulation does not establish a standalone EU-screening

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mechanism directly applicable in the Member States. Rather, the draft regulation links to and builds upon national screening mechanisms established by the Member States. The common rules for screening mechanisms consist of a formal and a substantive part: The formal rules are to ensure that the national screening mechanisms established by the Member States meet some basic requirements, such as the possibility of a judicial review of screening decisions, the principle of non-discrimination between different third countries and the principle of transparency.¹ The substantive part² states that national screening mechanisms are allowed to monitor foreign direct investments on the grounds of security or public order. It then provides a non-exhaustive list of factors that may be taken into consideration in the screening. The most important factor is the potential effect of the investment on sensitive sectors, such as critical infrastructures (e.g. energy, transport, communications etc.), critical technologies (e.g. artificial intelligence, robotics, semiconductors etc.), the security of supply of critical inputs, access to sensitive information and the ability to control sensitive information. The second factor mentioned is whether the foreign investor is controlled by the government of a third country, including through significant funding.

Regarding the newly amended German rules on foreign investment in the AWV, the regulation, if adopted, should not be of material relevance, as the German investment screening in its current form should already meet the requirements introduced by the draft. Especially the substantive factors to be taken into account in the framework of a foreign investment screening³ are framed in very similar terms as the requirements in the amended Section 55 of the AWV. Whereas the draft regulation explicitly allows to take into account whether the foreign investor is controlled by the government of a third country, the AWV does not explicitly refer to this aspect. However, the competent authority in Germany – the German Federal Ministry for Economic Affairs and Energy (Bundeswirtschaftsministerium, “**BMWi**”) – already can take this aspect into account in its assessment on endangerment of the public security or order.

Framework for Commission screening

The proposed regulation also provides that the Commission may carry out a screening on grounds of security and public order, in case where a foreign direct investment may affect projects or programmes of Union interest. Such projects are defined as projects and programmes which involve a substantial amount or a significant share of EU funding, or which are covered by Union legislation regarding critical infrastructure, critical technologies and critical inputs. Where the Commission considers that a foreign direct investment is likely to affect projects or programmes of Union interest on grounds of security or public order, the Commission may issue an opinion addressed to the Member State where the foreign direct investment is planned or has been completed. The Commission has 25 working days after receiving sufficient information on the investment to issue this opinion. Member States shall then

¹ See Article 6 of the draft.

² Mainly Article 3 (1) and Article 4 of the draft.

³ See Article 3 (1) and Article 4 of the draft.

take account of the Commission's opinion and "provide an explanation to the Commission in case its opinion is not followed"⁴. The legal opinion of the Commission is therefore not legally binding for the Member State and the regulation does not include further participation rights of the Commission in the national screening mechanisms. Ultimately, the Commission's screening rights would be monitoring rights rather than actual inspection rights since the Commission would not have the power to prevent a Member State from accepting or halting an investment. Nonetheless, if adopted, the Commission screening mechanism would be completely new and without precedent.

Information and cooperation rules

The other provisions in the regulation aim to establish a cooperation framework as between the Member States and the Commission, with the aim of informing each other of foreign direct investments that may threaten security or public order.

Thus, Member States that are conducting investment control screenings would be under an obligation to inform the Commission and the other Member States within five working days from the start of the screening. The other Member States and the Commission then have 25 working days to issue comments or – in case of the Commission – an opinion whether the foreign direct investment is likely to affect security or public order. In case a Member State does issue a comment, the Commission has an additional 25 working days to give an opinion. The draft regulation has a rather broad understanding of the term "screening", defining it as "a procedure allowing to assess, investigate, authorise, condition, prohibit or unwind foreign direct investments". Thus, the cooperation mechanism might even be triggered by the proceedings of issuing a clearance certificate (cf. Sec. 58 AWW) with the BMWi, which may be granted without opening formal proceedings. In any case, the new cooperation mechanism will lead to more complex proceedings and, in some cases, might cause considerable procedural delays.

In contrast to the screening procedure by the Commission outlined above, the Member State screening the investment is not obliged under the draft regulation to provide an explanation for its decision. It is only required to give due consideration to the comments of the other Member State and/or the opinion of the Commission.

⁴ Article 9 (5) of the draft.

Outlook

It remains to be seen whether the draft regulation will be subject to further amendments during formal adoption. From a German perspective, the proposed regulation will most likely not lead to substantial changes as to how foreign investment control rules under the AWV will be applied in the future. In particular, foreign investors will still face only one screening procedure when it comes to investments in Germany, to be conducted by the BMWi.

Nonetheless, the regulation may still have impact on the German screening mechanism, in particular with regard to the time frame of potential foreign investment control screenings: First, there is a chance that the time limits that have just been extended in the AWV will require further extension since both the cooperation mechanism and the framework for commission screening introduce long time limits for the commission to issue an opinion or the Member States to provide comments. With regard to the cooperation mechanism, the timing implications could further aggravate in cases where both a Member State and the Commission make use of their rights to comment and give opinions, as described above. Especially, the development of the relation between the German clearance certificate (cf. Sec. 58 AWV) and the triggering of the information and cooperation mechanisms under the regulation will remain of interest.

Moreover, it is imaginable that the competent authority in Germany, the BMWi, will apply increased scrutiny to foreign investments if other Member States and/or the Commission raise objections against it.

Linklaters will monitor the legislative process and keep you informed of any relevant further developments.

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