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Foreign investment monitor

Q2 2021

The road to tougher FDI controls in Europe: how the EU's screening regulation is playing out on the ground

Freshfields Bruckhaus Deringer

Welcome to the second edition of foreign investment monitor

In our latest quarterly review of the fast-changing world of FDI screening, we take a closer look at developments in Europe, nine months on from the EU's screening regulation coming into force.

Our teams explore the background to the regulation, explain how it's being applied on the ground, highlight the main takeaways for business and take a deeper dive into key regulatory and case law updates across nine important member states. Elsewhere, we explore the UK's new national security regime and what it means for international companies, ask whether the EU's investment agreement with China will ever be signed into law, and bring you the latest on the Biden administration's approach to CFIUS and Chinese capital. If you want to discuss any of the themes in more detail, please reach out to your usual Freshfields contact.

The EU's screening regulation came into force in October 2020

Nine months on, what does the EU's FDI screening regulation mean for business?

In October 2020, the EU's foreign investment screening regulation came into force. Here, we explain the background to the new regime, look at how it's being applied on the ground – and explore the key takeaways for business.

Background

In March 2019, the EU adopted a regulation establishing a framework for screening foreign direct investments (FDI) into the union. It aims to preserve Europe's strategic interests while keeping the EU market open to investment, and became fully operational on 11 October 2020.

Given the high degree of integration between the markets of EU member states – which results in (for instance) businesses having interconnected supply chains and common infrastructure – there was concern in Brussels that a foreign investment could pose a security risk beyond the specific member state in which it is made.

The regulation obliges EU countries to notify other member states and the European Commission of FDIs they are screening under their national regimes. Once notified, the member states can provide comments and the Commission can issue an opinion on the proposed investment, usually within 35 calendar days. Although these comments and opinions aren't binding on the authority carrying out the review (which remains solely competent to review and approve/veto the notified transaction), it should take them into account in the spirit of co-operation.

Soaring number of mandatory FDI filings

In the wake of the COVID-19 pandemic and as a result of a general push towards tighter (and harmonised) foreign investment controls stemming from the new regulation, several member states have either introduced new FDI regimes or updated/tightened their existing rules. In particular, the number and types of sectors that national laws consider to be sensitive have increased markedly and now include most areas of the healthcare sector and advanced technologies such as artificial intelligence, robotics and nanotechnology, as well as critical inputs and raw materials.

Alongside this widened scope, FDI regulators in a number of countries (including Austria, Italy and Spain) have taken a broad interpretative approach, generally considering transactions that touch on a sensitive sector to trigger mandatory FDI filings, even where there is only a limited nexus to the jurisdiction in question.

Today, 18 EU countries have an FDI screening mechanism in place and a senior EU trade official declared that '… dozens of foreign-investment vetting requests have been notified to the European Commission through the new EU screening mechanism since it came into force last October. The number of vetting requests is comparable to the number of merger notifications.'

COVID-19 has seen several member states bring healthcare into their 'sensitive sector' list

> Since the regulation came into force some member states issue requests for information... with a view to extending the deadline as they feel they are in a time-squeeze compared to other EU countries.

Practical impact of the new EU regulation: some initial impressions

One consequence of the new regulation is that formal requirements for the notification of FDI have increased considerably. In some cases, notification forms have been changed almost overnight, and to facilitate information-sharing between countries, national authorities now require either bilingual notifications and/or specific forms that can be shared with other member states and the Commission.

On top of this, regulators have de facto increased the number of post-notification questions they are asking of applicants, and in general reviews are even more thorough than previously.

In many cases, the co-operation mechanism has led to longer review timelines, despite the Commission stressing that the new regulation has not been a delaying factor, and the fact that most cases have been resolved within 15 days. In reality, since the regulation came into force we have seen some member states issue requests for information (or indicate they are minded to issue an opinion) not because of substantive concerns but with a view to extending the deadline as they feel they are in a time-squeeze compared to other EU countries.

In addition, while member states are expected to reply to requests from other countries and the Commission without undue delay, we have seen individual cases where authorities have taken weeks or even months to respond where the questions related to factual information that was not in the possession of the parties. This may result in a protracted suspension of the deadline for clearance, and as a result it is essential for the notifying parties to plan ahead and be alert to the practical implications of the new rules.

REGULATORY ROUNDUP

How member states are responding to the new EU rules

In the first of a regular series of snapshots on FDI developments around the world, we summarise how the screening regulation is being applied by policymakers and authorities in the EU.

AUSTRIA

Austrian FDI filings at all-time high

The new Austrian FDI regime, which came into force in July 2020, has significantly extended the scope of the country's mandatory screening mechanism to cover the acquisition of businesses with activities in a broad range of sensitive sectors.

The Austrian regulator has also taken a very active role in the new EU-wide consultation mechanism as well as in the broad interpretation of critical sectors, leading to a significant increase in FDI filings over the past 12 months. By May the number of pending Austrian FDI cases had reached an all-time high, and while the authority is making efforts to provide approvals in time it remains to be seen how this increased workload will impact the timing of FDI filing procedures.

CZECH REPUBLIC

New foreign investment regime comes into force

The Czech Republic's new foreign investment screening law came into force on 1 May. The regime applies to non-EU investors (i) acquiring the ability to dispose of a stake equal to or greater than 10 per cent of voting rights in a Czech target; (ii) acquiring the ability to dispose of ownership rights to an asset through which the target's business activity is carried out; (iii) acquiring control, which results in the ability of the foreign investor to obtain access to information, systems or technologies that are important to safeguard the national interests of the Czech Republic; or (iv) becoming a member in the corporate bodies of the target. The FIC Act distinguishes two regimes depending on the sector concerned. The mandatory regime applies to sensitive investments and requires a prior approval from the Ministry of Trade and Industry, with the following sectors considered 'sensitive': military industry, critical infrastructure (media, energy, water management, food and agriculture, healthcare, transportation, communication and IT systems, financial markets, emergency services or public administration) and manufacturing or development of dual-use items. The voluntary regime includes the remaining transactions, which can be implemented without prior notification.

DENMARK

Scope of new laws still unclear

Denmark's new foreign investment screening regulation entered into force on 1 July and will apply to investments completed on or after 1 September. The acquisition by foreign investors (ie non-EU or non-EFTA) of at least 10 per cent of voting rights, shares or control in a Danish company active in a sensitive sector (such as defence, IT security or processing of classified information, dual-use item production, critical technologies and critical infrastructures) will be subject to the prior approval of the Danish Business Authority. In addition, the new regime allows non-EU/non-EFTA investors to submit voluntary notifications of acquisitions of more than 25 per cent of a Danish company in any sector if the investment could pose a threat to national security or public order. The FDI regime is still in its early stages, and with the executive orders delineating the scope of application, the process and the information to be provided for a filing not yet final, there is still some uncertainty regarding the exact scope of application.

| FRANCE

France and Italy welcome decision to abort of sale of Iveco unit

On 17 April, CNH Industrial, the parent company of Iveco, announced it had ended discussions with China's FAW Group over the sale of a unit of Iveco SpA comprising the Iveco, Iveco Bus and Heuliez Bus brands. The decision was welcomed by both France and Italy, with CNH announcing that it would instead aim to spin off its trucks, coaches and commercial vehicles businesses by early next year.

French Minister of the Economy Bruno Le Maire tweeted that the announcement was good news since the proposed takeover raised important issues of industrial sovereignty, highlighting that France and Italy had worked hand in hand to maintain industrial capacity in Europe. Italy also welcomed CNH Industrial's decision, stressing that the production of heavy road vehicles is of strategic national interest. The Italian government, under widespread political and media pressure, had threatened to use its golden power last March to block the deal, with certain 'dual' technologies held by Iveco's Defence division raising particular concerns.

| GERMANY

Germany tightens rules on FDI in technology and beyond

After recent reforms in response to the COVID-19 pandemic (focusing in particular on the health sector), new FDI screening rules entered into force on 1 May that significantly extend the scope of Germany's mandatory and suspensory screening mechanism to cover acquisitions of businesses involved in so-called critical technologies and critical inputs (including artificial intelligence and autonomous vehicles). Another core element of the new rules is the extension of the types of transaction that fall within scope. For example, the acquisition of 'atypical control' in the form of board seats, veto rights or information rights now carries the risk of a call-in by the German authorities even if the relevant voting rights thresholds (now 10, 20 or 25 per cent) are not met. The new regulation also extends the concept to cover the cross-attribution of voting rights between several different investors (eg in case two state-controlled investors from the same jurisdiction invest in the same German target company). Finally, the new regulation clarifies that the acquisition of additional voting shares above the applicable thresholds can trigger a new filing requirement.

| ITALY

Italy uses golden power to block Chinese acquisition of semiconductor company

In April 2020, the Italian government blocked Shenzhen Investment Holdings (a Chinese state-owned investment company) from acquiring a 70 per cent stake in Lpe SpA. Lpe specialises in the production of epitaxial reactors, which are used to manufacture semiconductors. With a turnover of €27.9m it is the only Italian company involved in this type of technology and is a world leader in the sector, not least through its own patents. Italian Prime Minister Mario Draghi commented on the intervention as 'a judicious use of golden power' given that 'the shortage of semiconductors forced many car manufacturers to slow down production last year, so it has become a strategic sector'. Since its introduction in 2012, Italy's golden power regime (which has over time significantly increased in scope) has led to prohibitions in just a few cases. In the case of Lpe, it appears the conditions of the sale were deemed 'unsuitable to assure security and continuity of supply' in Italy and Europe, with Sweden, the Netherlands and the European Commission intervening in the proceedings.

| NETHERLANDS

Further FDI legislation remains on government's radar

Last year, the Dutch government announced two legislative proposals introducing stricter investment screening rules. It presented for consultation a draft bill that foresees a general national security regime covering investments in providers of 'vital processes' and 'sensitive technology' that could result in social disruption in the Netherlands, as well as announcing a sector-specific regime applicable to the defence industry. Further information on the latter has not yet been released.

The bill introducing the national security regime has been approved by the government and will soon be presented to parliament. It remains uncertain when the new FDI regimes will come into effect. However, investors currently involved in deals that could raise national security concerns are advised to evaluate the implications of the new regime on deal certainty and timing. Although it's expected to be used rarely, the minister will be able to retrospectively call in transactions that complete between 2 June 2020 and the date the national security regime begins, give rise to national security concerns and have not been subject to a public interest intervention under the current sector-specific regimes.

If called in, transactions will have to be notified and will be subject to substantive review.

SLOVAKIA

FDI regime scheduled for January 2022

From 1 March, an amendment to the Slovak Act on Critical Infrastructure requires the owner or operator of critical infrastructure in the energy, metallurgy, pharmaceutical and chemical industries to notify the government in the event of a change of more than 10 per cent direct or indirect share or voting rights, or a change of persons having the possibility to exercise influence over management. The new rules apply irrespective of whether the critical infrastructure involved is acquired by a foreign or Slovak entity.

In parallel, the government is currently preparing legislation that would introduce an FDI screening mechanism in response to the EU regulation. The draft is still being discussed, although according to its current version, the new regime is scheduled to take effect from 1 January 2022.

SPAIN

Suspension of FDI liberalisation extended to European investors

In November 2020, Spain extended a law suspending the liberalisation of certain foreign direct investments to cover deals involving residents of other EU and EFTA countries. The measures – which ran until the end of June this year – applied to companies carrying out certain strategic activities that are listed in Spain as well as those that are unlisted if the investment exceeded €500m. Any deals that fell within scope required a prior authorisation from the government (for further details, read our briefing).

In June, the government further extended this suspension and the need for prior authorisation until 31 December. According to the explanatory memorandum, this was due to the Spanish economy still being in recovery mode – the same reason that saw the original extension adopted late last year.

A new stand-alone national security regime – the evolving approach to investment screening in the UK

After years of discussion and consultation about reforms, the UK has now aligned itself more closely with its allies by significantly strengthening its powers to intervene in deals that may threaten national security. The National Security and Investment (NS&I) Act 2021 marks a step change in the UK government's power to screen, impose conditions on and block deals that pose unacceptable risks.

Once the new regime commences – expected to be towards the end of 2021 – it will require mandatory notification of investments in 17 strategically sensitive sectors that cross certain share/voting right thresholds. Any mandatory transactions that are not notified will be void, with potential criminal consequences for those completing a notifiable transaction without approval. The regime will also give the government broad and retroactive powers to call in investments it considers could give rise to national security concerns. With no turnover thresholds, the new regime reflects growing disquiet around advanced technologies – often developed by innovative start-ups – and other sensitive assets falling into potentially hostile hands.

The National Security and Investment Act 2021 marks a step change in the UK government's powers to intervene in deals deemed to pose unacceptable risks

We are expecting a significant volume of secondary legislation before the new regime comes into force together with more guidance on what constitutes a threat to national security. Given this is a constantly evolving area, this question has been central in the debate around the NS&I Act to date.

The act is not the only manifestation of the UK's approach to protecting national security. Other recent government initiatives include:

- proposals to allow ministers to block companies listing on the London Stock Exchange on national security grounds (consultation launched on 7 June 2021);
- the proposed Telecommunications (Security) Bill currently passing through the House of Lords, which aims to boost the security standards in UK telecommunications networks; and
- the formation of the Research Collaboration Advice Team within the Department for Business, Energy and Industrial Strategy (BEIS) to offer researchers guidance on how to protect their work from hostile activity, particularly in relation to cyber security, export controls and IP protection.

> "The new regime will require mandatory notification of investments in 17 strategically sensitive sectors.

Despite these developments, the government insists the UK remains 'open for business' and has recently set up the Office of Investment and the Investment Council to continue to encourage capital into the UK – all the more important following the pandemic, Brexit and accusations that the Competition and Markets Authority is now so aggressive that it is proving a deterrent to investment.

> The new NS&I regime is specifically billed as 'national security' and not a foreign investment regime.

The new NS&I regime is specifically billed as 'national security' and not a foreign investment regime – it also applies to British investors – to underline the government's 'Global Britain' messaging and strategy. Although the number of transactions reviewed for national security concerns will increase exponentially compared to interventions under the existing public interest regime (such as the recent national security intervention in Nvidia/Arm), the government expects a small proportion to merit detailed assessment (approximately 5 per cent), with even fewer (approximately 1 per cent) requiring remedies. The UK says it intends the new regime to be a predictable and efficient process for investors, although the real test will be how it works in practice. The new Investment Security Unit, housed within BEIS, has thus far demonstrated a welcome willingness to engage with investors in the transitional period between the existing public interest regime and the NS&I Act coming into force. Such openness will be critical to the success of the new system.

The new UK regime applies equally to British investors as the government seeks to underline its 'Global Britain' strategy

Will the EU/ China trade agreement ever be ratified?

In the last edition of foreign investment monitor, we looked at the potential for the EU–China investment agreement to boost cross-border capital flows between East and West. At the time a diplomatic row had broken out between Europe and Beijing, with the European Parliament freezing the ratification of the deal until China lifts sanctions on European human rights advocates. With many commentators speculating this is unlikely to happen, there are now serious questions about whether the agreement will ever be signed into law.

Talks between the two sides had been rumbling on for close to seven years before Germany assumed the presidency of the European Council in July last year. Then, Chancellor Merkel – with Germany's manufacturing sector keen to further open up the Chinese market – made it a priority to bring the negotiations to a conclusion, which she accomplished just a few days before the change of administration in the US. Now however, as Germany prepares for its own elections in September that will install a new chancellor for the first time since 2005, it is questionable whether her successor – or indeed any other European leader – will have the will (or political capital) to finally get the deal over the line. Chinese officials say Beijing is still open to finalising the agreement but will not tolerate interference from foreign governments in its internal affairs. With US calls for a 'co-ordinated approach' to China among Western powers, the upcoming elections in Germany (2021) and France (2022), and President Xi's likely re-election as general secretary of the Chinese Communist Party, there is currently little to suggest that ratification is around the corner.

Cargo port and harbour, Hong Kong.

Biden's China strategy combines Trump tools with new policy objectives

Joe Biden is pursuing a two-pronged approach to Beijing – spending to boost US competitiveness and aggressively using CFIUS and other authorities to limit China's ambitions. But while the latter borrows from the Trump playbook in some respects, there are important policy differences between the two administrations on foreign investment.

Many of the measures pursued by the Trump administration to address the perceived threat from China focused on limiting Beijing's ability to acquire technology (whether through ordinary trade, buying US companies or surreptitiously) and/or to introduce Chinese technology into critical US supply chains. These included a significant expansion of the reach and resources of the Committee on Foreign Investment in the United States (CFIUS), more aggressive use of export controls and sanctions, and the introduction of new authorities to regulate the US supply chain. There has long been consensus in Washington policy circles, however, that the other critical component to a China strategy involves rebuilding the capacity of US industry to compete.

The current US government (both Congress and the Biden administration) has now largely shifted focus to this 'run faster' approach, precipitated by the healthcare and industrial supply chain challenges that arose during the COVID-19 pandemic. It is also being driven by an unusual alignment of bipartisan interests in Washington, with Democrats eager to build economic strength through federal investment and Republicans elevating concerns about competition with China over their traditional scepticism of government spending.

> "Rebuilding the capacity of US industry to compete is seen as an essential component of China policy.

The Biden investment plan is driven in part by the challenges faced by the US healthcare supply chain during the COVID-19 pandemic

> In a clear departure from the Trump White House, the Biden administration reaffirmed that foreign investment is welcome provided it doesn't threaten national security.

In one of his early high-profile moves, President Biden ordered a 100-day study of critical supply chains. The report, released in early June, focuses heavily on domestic investment as a means to overcome these challenges. Just days afterwards, the Senate overwhelmingly passed legislation that would direct almost $250bn over five years into the development and manufacture of advanced technologies in the US.

Does this mean that aggressive use of CFIUS and other regulatory authorities to target China is likely to subside? Probably not. While the Biden administration has not announced any major new policy initiatives in this regard, it made clear that it intends to take an aggressive and deliberate stance. For example, it allowed rules issued in the last days of the Trump administration to go into effect that give the Commerce Department the authority to review transactions that would place Chinese information and communications technology and services (ICTS) in the US supply chain. While President Biden rescinded President Trump's orders prohibiting transactions with TikTok and WeChat, which had been put on hold by courts, he made clear that connected software applications are to be scrutinised under the new ICTS rules. The White House has also previously confirmed that Trump's CFIUS-related order that ByteDance divest its interest in TikTok is subject to ongoing discussion between CFIUS and the companies.

While CFIUS is unlikely to see any further significant structural changes in the foreseeable future, it can be expected that the concept reflected in the White House supply chain study – and the Senate legislation – that industrial competitiveness is a national security priority will infuse CFIUS deliberations and broaden the type of transactions that could draw CFIUS scrutiny and mitigation. However, in a clear departure from the voices in the Trump White House that expressed scepticism over the value of foreign investment, the Biden administration also in June reaffirmed that it shared the view of numerous Republican and Democratic administrations before Trump that, where a transaction does not raise national security concerns, the US welcomes and values foreign investment. Given his continued strong stance on China security issues, this is a useful clarifying message.