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Covid-19 and Foreign Direct Investment: EU Sees Stricter Controls

27 March 2020

The President of the European Commission (the "Commission" or "EC"), Ursula von der Leyen, warned this week of the need to protect European companies struggling due to the Covid-19 pandemic from hostile takeovers and called on EU governments to either adopt or vigorously enforce investment screening mechanisms to protect sensitive assets during the crisis.

"*If we want Europe to emerge from this crisis as strong as we entered it, then we must take precautionary measures now. As in any crisis, when our industrial and corporate assets can be under stress, we need to protect our security and economic sovereignty. We have the tools to deal with this situation under European and national law and I want to urge Member States to make full use of them. The EU is and will remain an open market for foreign direct investment. But this openness is not unconditional.*"

The Commission's paper of 25 March 2020 refers to the threat posed by the current economic shock to key healthcare and research-related industries, noting that "*The resilience of these industries and their capacity to continue to respond to the needs of EU citizens should be at the forefront of the combined efforts both at European Union and Member State level.*" The concern is clearly that the crisis could result in opportunistic acquisitions of strategic assets via foreign direct investment ("FDI") as more companies suffer from the effects of the pandemic, a situation exacerbated by market volatility and associated uncertainty around company valuation.

To protect the bloc's interests, the Commission has called on those 14 Member States that already have FDI screening mechanisms in place to make full use of them to "*take fully into account the risks to critical healthcare infrastructures, supply of critical inputs, and other critical sectors.*" For Member States that either do not have controls or whose controls do not cover the relevant sectors, the EC asks them to set up "*fully-fledged*"

screening mechanisms and, in the meantime, use whatever other powers they have to scrutinise investments and protect strategic assets, including taking “golden shares” in companies in order to block or limit certain investments.

This is the Commission’s strongest statement yet with regards to FDI and its policy wish to ensure cooperation between Member States to protect EU interests. A year ago, a new EU framework for the monitoring of inbound investment in the Union came into force. Regulation (EU) 2019/452 (the “FDI Screening Regulation”)—which applies from 11 October 2020—aims to align the scope and approach to review between Member States. The FDI Screening Regulation does not establish a centralised EU-wide screening mechanism (unlike CFIUS in the United States) or require Member States to harmonise their existing national regimes (or introduce regimes where there are not yet any). Nor does it introduce an independent body capable of issuing binding decisions. It does, however, set out a clear dual-track system of merger control and FDI which is focused on encouraging information sharing and promoting cooperation between Member States.

With regards to Covid-19, the Commission’s policy paper reminds Member States that the FDI Screening Regulation explicitly refers to critical health infrastructure when screening a foreign investment. The paper also refers to the ability, introduced by the FDI Screening Regulation, of the Commission and other Member States to provide comments and opinions within 15 months of a foreign investment being completed, even where it has not undergone a national screening process.

As a result of the crisis, some Member States have already reformed their FDI controls. Spain, for example, has greatly enhanced its existing screening mechanism to mirror the list of sectors set out in the FDI Screening Regulation and has prohibited acquisitions by foreign investors of 10% or more in the share capital of companies active in sectors related to public order, public security or public health.

Although brought back into the spotlight by the Covid-19 outbreak, these changes form part of a wider global movement towards state interventionism and national protectionism. With an increasing amount of FDI from non-western countries (in particular investments from China or investments *perceived* to be influenced by China) in an ever-widening list of sectors such as emerging technologies, infrastructure and advanced technology and data, as well as concerns that the current rules are not fit for purpose in this fast-evolving digital era, many countries are tightening their regimes and lowering the thresholds for review so as to better protect their interests. Nowhere is this debate more lively than the EU, where the EC has come under increasing pressure to involve Member States and support the creation of “EU champions”. Whilst the EC has fought back against political influence in the merger process, the FDI Screening

Regulation and now the guidelines show its appetite for strengthening FDI controls and encouraging cooperation between Member States to protect the bloc's interests.

Even before the outbreak, several Member States had chosen to further strengthen their own regimes this year. In February 2020, the German BMWi presented its plans to (i) extend the list of areas subject to notification requirement to include artificial intelligence, biotechnology, quantum technology, robotics and semi-conductors; (ii) introduce an implementation prohibition (meaning that all notifiable investments will be provisionally invalid until the BMWi has cleared them in writing or the review period has lapsed); and (iii) lower the prohibition criteria to an "anticipated impairment of public order and security."

Similarly, in France, for filings submitted from April 1, 2020, the list of sectors subject to prior authorisation has been extended to include, e.g., food security, print and online publishing, energy storage and quantum technology. Additionally, the threshold of minority investments by non-EU/EEA investors is to be lowered from 33% of the share capital or voting rights in a French entity to 25% of the voting rights only. The new rules apply to targets active in one of the listed strategic sectors, regardless of whether the shares are held directly or indirectly or whether the investor is acting alone or in concert.

As for the United Kingdom, the government has put forward far-reaching proposals for a regime—separate to merger control and outside the remit of the CMA—to review a much broader range of transactions (or "trigger events") which might raise national security concerns. Marking a significant increase to the CMA's current workload, it is estimated that the new regime will result in around 200 notifications per year, with half of those requiring an in-depth assessment and half of those case (i.e., 50) requiring conditions in order to be cleared.

Whilst introduced as a response to the current health crisis to ensure that important technologies do not fall into the wrong hands, the EC's guidelines are yet another example of the gradual tightening of FDI regimes globally. The above sets out just a handful of the examples we are seeing of countries making a wider range of acquisitions potentially subject to review and adopting an increasingly interventionist approach. As a result, understanding the process and anticipating potential considerations and concerns early on can avoid unexpected hurdles and allow parties to better assess deal certainty and timing. Particularly in the coming months (if not years) parties should take care to factor in the possibility of in-depth (and potentially time consuming) review(s) where the transaction falls—or even might fall—into one of the relevant sectors.

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Please do not hesitate to contact us with any questions.

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