FDI Screening Laws of EU Countries to have significant implications on Investors and Transactions

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Introduction

The European Union (EU) has always been a popular destination for Chinese investors. According to the Business Environment of the European Union 2019/2020 released by the China Council for the Promotion of International Trade, by the end of 2018 more than 3,200 Chinese-invested firms had been established in the EU across all Member States employing almost 260,000 local employees. [1] But in recent years, the EU and its Member States have been calling for the adoption of FDI screening laws which are likely to have significant implications for Chinese investments in the EU. This article will briefly introduce some common elements of FDI screening laws adopted by EU Member States, and analyze the potential significant impact on investors, investments and transactions.

Background Information

In recent months a number of EU countries have adopted FDI screening laws. Many invoked the coronavirus pandemic and the increased risk of acquisitions of health care capacities (for example for the productions of medical or protective equipment) and related industries such as research establishments (for instance developing vaccines) via FDI as the reason for their adoption.

However, the decision to introduce FDI screening laws in the EU predates Covid-19. Following a study conducted for the European Commission by E&A Law and Millieu from 2016 to June 2018 [2], the EU adopted Regulation 2019/452 establishing a framework for the screening of FDI ("Regulation") on 19 March 2019. This Regulation will enter into force on 11 October this year.

In anticipation of the Regulation, albeit the Regulation does not oblige EU Member States to adopt foreign screening laws, a number of states have already adopted such laws. The first to do so was Germany, which introduced screening laws in December 2018, even before the Regulation was adopted. On 17 March 2020 Spain followed suit, followed by Hungary on 25 March and Slovenia on 1 June. Poland and France are expected to follow suit shortly.

Screening of investment on grounds of security and public order

Although there are differences between the screening laws adopted by the above-mentioned countries they share the following elements:

They provide for the screening of foreign investments on the grounds of security and public order. Some countries have provided for screening also on public health grounds.

In determining whether a foreign investment is likely to affect security or public order its potential effects on:

operating ‘critical infrastructure’, 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;

using ‘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;

supplying ‘critical inputs’, including energy or raw materials, as well as food security;

having access to sensitive information, including personal data, or the ability to control such information; or

affecting the freedom and pluralism of the media

will in particular be assessed.

Some countries have also provided that foreign investments will be screened if they affect projects or programmes of Union interest as defined in the Annex to the Regulation which include programmes concerning satellite navigation, space programme, trans-European transport energy infrastructure and telecommunication networks.

Definition of foreign investor

In all countries that have adopted screening laws, the term “foreign investor” is defined as natural or legal persons who is resident/ has its seat in a country (“third country”) which is outside of the European Union (“EU”), the European Economic Area (“EEA”) or Switzerland. Some countries, such as Slovenia, have adopted an even broader definition of foreign investor which includes all non-Slovenian natural and legal persons. In other countries like Hungary, EU, EEA and Swiss companies which are majority owned by third countries are also regarded as foreign investors. In Spain, EU, EEA and Swiss companies where investors from third countries own 25% of the company are also regarded as foreign investors.

Trigger for screening

The trigger for screening in most countries is low so that an acquisition of 10% or more of the voting rights in a company will trigger notification obligations. Additional triggers for screening are imposed including in Slovenia in case of the establishment of a new branch, the production of new products and the establishment of a new company in which foreign investor will have more than 10% voting rights. and in Hungary in case of the transfer of use or operational rights in infrastructure or assets that are indispensable for the operation of strategic companies.

Screening procedure

The above-mentioned investments have to be notified to the relevant screening body (in some cases the Ministry in others the Competition Authority). A failure to notify in most countries can result in a fine for the company up to 1% of its annual turnover and imprisonment from 6 months to 5 years for persons responsible.

Depending on the country a standstill period of between 45 and 120 days is required to enable the relevant bodies to undertake the screening. Most countries provide for a certification of non-objection to be deemed to have been given upon the expiry of this time period. However, the Slovenian and Hungarian law do not contain such a provision. In fact, Slovenia reserve itself the right to review all foreign investments for 5 years after they were made even the ones which it had previously reviewed and not objected to.

Potential significant impact on investors, investments and transactions

The potential implications on investors, investments and transactions are significant.

- Introduction of new condition precedents to completion.
- Need to prepare more complex documentation and increased transactional costs.
- Simultaneous signing and completion of transactions is no longer possible.

- Already progressing or signed deals need to be reviewed and completion is likely to be delayed.

- Lack of deemed approval and reservation of right to review foreign investment for 5 years after completion generates significant uncertainty.

- Uncertainty damages deal environment and may impact deal pricing.

- Creating and enforcing security may be not work (e.g. share pledge).

- Potential events of default may be triggered.

- Typical shareholders' agreements provisions may be impacted (e.g. provisions covering control rights, call options, anti-dilution etc.)

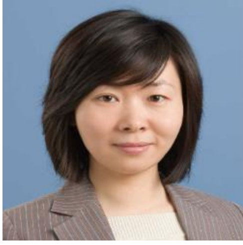
Conclusion

The EU and its Member States, which are the important destinations for Chinese overseas investment, continue to tighten the FDI screening policy through the adoption of the FDI screening laws. As of 28 February 2020, 14 EU Member States had adopted FDI screening mechanisms. [3] These laws are likely to have adverse effects on existing and new investments by Chinese investors in the EU. Chinese investors should pay more attention to whether the transaction falls within the scope of the FDI screening laws of the investment destination country. In addition, the possible adverse effects of the FDI screening law on transactions should be considered before entering into a transaction and the transaction structure should be designed to minimise potential adverse effects.

[1] China Council for the Promotion of International Trade, European Union Investment Environment Report, P1.

[2]http://www.ealaw.eu/static/pdf/final_report_on_study_on_national_rules_for_protection_of_infrastructure_relevant_for_security_of_supply.pdf

[3] Austria, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Netherlands, Poland, Portugal, Romania and Spain.



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Ms. Gao has practiced in the areas of energy & natural resources, mergers & acquisitions and foreign investment in China for more than 15 years. Currently, she focuses on representing foreign and domestic clients, from multinational companies, large state-owned enterprises to private companies, including Fortune 500 companies, in dealing with their cross-border transactions in China and all over the world.

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Ana Stanič, an English Solicitor Advocate, is the founder of E&A Law. Ana has over 25 years of experience advising States, companies and international institutions such as World Bank on matters of EU law including liaising with the European Commission. She is on the CIETAC's list of arbitrators and is a member of the Permanent Court of Arbitration in The Hague. Ana has advised the Chinese government on questions of EU law and is a visiting professor at UIBE.

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