Media Scope Group

Overview of the draft of the EU Screening Regulation

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Introduction

On January 24, 2024, the European Commission unveiled its European Economic Security Package (EESP). This package included a proposal to revamp the EU Regulation that provides a framework for Foreign Direct Investment (FDI) screening. This proposed regulation is one of five initiatives within the EESP aimed at implementing the European Security Strategy, which was published in June 2023.

The proposed regulation aims to enhance the legal structure for FDI screening within the European Union. It is based on feedback received by the Commission during its 2023 public consultation. If enacted as proposed, it will bring about significant changes to FDI screening procedures throughout the EU.

This article outlines the primary modifications suggested in the reform and examines their potential impact on international deal-making. It also offers a forecast on the forthcoming steps for these proposals.

Main points and observations

The proposed regulation extends its reach to include indirect foreign investments via EU subsidiaries and greenfield investments. It sets minimum standards and promotes greater uniformity across the EU. The proposal introduces call-in powers to review all transactions for a minimum of 15 months post-completion. It encourages coordinated submission of foreign investment filings in transactions involving multiple countries. The focus is on fostering cooperation between Member States and the Commission on cases that are likely to be sensitive. The proposal provides more detailed guidance on substantive assessments and remedies, including a formal obligation for national screening authorities to prohibit or impose conditions on transactions they conclude could negatively impact security or public order in one or more Member States. It calls for increased reporting while safeguarding confidential information.

The Proposed Regulation represents a significant overhaul of the screening framework, introducing a more comprehensive and consistent set of rules and procedures for the screening of foreign investments across the EU. The emphasis on increased harmonisation of filing requirements and substantive assessment, as well as initiatives to enhance transparency, is particularly commendable.

However, several key terms and concepts in the Proposed Regulation remain overly broad or lack clear definitions. For instance, the Proposed Regulation does not specify the standards to be used to define ‘control’ or what ‘effective participation in the management’ means within the context of the legislation. These terms are used in key concepts of the framework, including the definition of “foreign investment” itself. Given the existing national screening regimes with low filing thresholds, where share acquisitions of 10% (and sometimes even less) may trigger a filing obligation, it is unclear whether the Proposed Regulation would also encompass such transactions or how the framework’s requirements apply to these aspects of national regimes.

The adoption of the Proposed Regulation may therefore necessitate further revisions to national foreign investment screening legislation.

Much wider scope of investments and structures

The Proposed Regulation aims to broaden the scope of the EU FDI Regulation to include foreign investments made indirectly through EU-established entities that are ultimately under the control of a non-EU investor. Many national foreign investment screening regimes within the EU already have the capacity to scrutinise such investments. However, the European Court of Justice ruled in C-106/22 Xella (2023) that indirect investments via EU entities (even those under foreign control) are outside the current EU FDI Regulation's purview, unless they constitute "artificial arrangements" designed to evade the concerned screening mechanism.

The Proposed Regulation plans to expand the EU's foreign investment screening scope further to encompass greenfield foreign investments that establish a durable and direct connection between a foreign investor and the European Union. Applicable greenfield investments would involve the creation of new facilities or enterprises in the European Union by foreign investors or their EU subsidiaries.

Standardisation and greater consistency for foreign investment screening regimes

Under the existing framework, the decision to introduce a Foreign Direct Investment (FDI) screening regime is left to the discretion of each Member State. Currently, 22 Member States have implemented a screening mechanism, while the remaining five (Bulgaria, Greece, Croatia, Ireland and Cyprus) have legislation in progress at various stages. The new regulation would mandate these Member States to establish a foreign investment screening regime before the end of the transition period from the current framework, provided they haven't already done so.

The Proposed Regulation aims to foster greater consistency across the EU by setting minimum standards for Member States to screen specific foreign investments. Specifically, it would necessitate national foreign investment screening regimes to conduct ex-ante (i.e., pre-closing) screenings of investments in EU companies that:

- participate in the 'projects or programmes of Union interest' outlined in Annex I of the Proposed Regulation, such as the Digital Europe Programme and the EU4Health Programme; or
- are engaged in specified sectors of the economy 'of particular importance' as detailed in Annex II of the Proposed Regulation.

Moreover, for the military and dual-use items, critical medicines, and certain segments of the financial system, the Annex II list includes ten areas of 'critical technology' identified by the Commission for further risk assessment (such as advanced semiconductors, artificial intelligence and autonomous systems, and advanced materials and manufacturing

technologies). Furthermore, the Proposed Regulation mandates Member States to ensure national screening regimes adhere to certain procedural requirements, including:

- providing judicial recourse against screening decisions made by the national authority;
- authorising authorities to retrospectively review transactions not subject to an authorisation requirement for at least 15 months post-completion; and
- ensuring effective measures are in place to address non-compliance (including the power to impose mitigating measures on, prohibit, or unwind investments that were not filed).

Moreover, to enhance clarity in the review process and improve due process, the Proposed Regulation instructs Member States to inform the investor applying for clearance prior to making a decision that would impose mitigating measures or prohibit the investment, and to provide the reasons for that decision.

Coordination element on submission of foreign investment fillings

The Proposed Regulation aims to streamline the submission of foreign investment filings across the EU. For transactions involving multiple countries, applicants would be required to submit their authorisation requests simultaneously in all relevant Member States, referencing the other submissions. Considering the stringent filing deadlines currently enforced by some Member States, the Proposed Regulation could significantly influence the planning and timing of transactions.

Streamlining procedural requirements

The Proposed Regulation aims to streamline procedural requirements for investments that are less likely to raise concerns. This is achieved by narrowing the scope of transactions that require notification under the cooperation mechanism, compared to the broader range of transactions covered by the minimum scope of national screening regimes. Specifically, transactions involving targets active within the sectors listed in Annex II would only be automatically included in the cooperation mechanism if the acquirer fulfills certain criteria.

With this refined scope, Member States are only required to report investments to the Commission and other Member States under the coordination mechanism if:

- the target is involved in one of the Union-interest projects or programmes listed in Annex I, or
- the target operates in one of the areas specified in Annex II and the foreign investor (or its EU subsidiary making the investment) is:
    - directly or indirectly governed by a third-country government,
    - subject to EU sanctions (restrictive measures), or

- has participated in a transaction previously screened by a Member State that was either not authorised or authorised with conditions; or
- the Member State initiates a comprehensive investigation (or plans to prohibit or impose conditions on a transaction without a comprehensive investigation).

The objective of this approach is to exclude a substantial number of low-risk cases from being circulated among Member States and the Commission, thereby allowing Member States to more efficiently screen these cases under their national regimes.

Self-initiated procedure

The Proposed Regulation also proposes a mechanism that enables Member States and the Commission to collaborate on foreign investments that were not reported under the cooperation mechanism by the Member State where the foreign investment is intended or has occurred. This allows Member States and the Commission to initiate a 'self-initiated procedure' under the cooperation mechanism, starting 15 months after the completion date of the foreign investment.

Evaluating impact and implementing measures

The Proposed Regulation outlines factors to consider when assessing the potential impact of a foreign investment on security or public order. These factors include the effect on the security, integrity, and operation of critical infrastructure, the accessibility of critical technologies (including key enabling technologies), the sustained provision of critical inputs, the safeguarding of sensitive information (including personal data), and the preservation of media freedom and diversity.

Significantly, the Proposed Regulation mandates that if the screening authority of the Member State where the foreign investment is to occur determines that the transaction is likely to adversely impact security or public order in any Member State, the authority is obliged to either prohibit the transaction or implement mitigating measures, in accordance with the principle of proportionality and the specific circumstances of the investment.

Conversely, if the potential impact on security and public order can be addressed by suitable measures under other Union or national laws, the authority is required to approve the transaction unconditionally.

Confidentiality of information

The Proposed Regulation stipulates that all information shared within the cooperation mechanism should be treated as confidential. This information should only be used for the purpose it was requested for unless the originator of the information consents otherwise or if EU courts require such information for legal proceedings. Confidential information cannot be

downgraded or declassified without the prior written approval of the originator. Additionally, the Commission would establish a secure and encrypted system for exchanging information.

While the Proposed Regulation would establish a legal framework for Member States and the Commission to collaborate with third countries regarding investment screening, the Commission indicates that this is not intended to permit the sharing of information about transactions under review within the cooperation mechanism.

Transparency, disclosure and accountability

The ongoing discussion about the suitable degree of transparency in foreign investment review processes and the disclosure of the reasoning behind substantive assessments continues. This includes both the decisions and reports made public by authorities and the Commission, as well as the interactions between screening authorities and the parties involved in a transaction. Although the Proposed Regulation introduces few new measures in this area, it mandates Member States to submit annual reports on their screening activities and decisions to the Commission by March 31 each year. The Commission would then use these reports to publish an annual report at the Union level.

Furthermore, each Member State is required to annually publish aggregated and anonymized data on the transactions screened, the results of screening procedures, the nationalities of parties involved in screened, authorised, or prohibited foreign investments, and the economic sectors of activity of the target.

What next?

The Proposed Regulation will undergo the standard legislative process and requires approval from both the European Parliament and the Council. Member States will participate in the discussions during this process. Although there may be differing views among Member States on some of the obligations outlined in the Proposed Regulation, there seems to be a general consensus on the overall direction of the legislation. Given the upcoming European Parliament elections this summer and the subsequent formation of a new College of Commissioners, the legislative process may experience delays and extended discussions.

If ratified, the new regulation would replace the existing EU FDI Regulation and would come into effect after a 15-month transitional period.

The policy and regulatory specialists at Media Scope Group are actively monitoring these developments. Our experts are ideally positioned to enable stakeholders to shape policymaking and guide clients on how to manage the regulatory implications that alterations to foreign investment screening frameworks across Europe may have on their operations.

About Media Scope Group

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