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COVID-19 Affects European Foreign Direct Investment Reviews: New EU Guidance Potentially Heralds Increased Protectionism

FDI Regulation of March 2019

European foreign direct investment (FDI) had previously been solely regulated at the national level, with some governments more or less activist in this regard. While this largely remains the case, legislators felt a need to coordinate regulation at a European level. Then-European Commission President Juncker proposed the creation of a European FDI regime in his 2017 "State of the European Union" speech, which ultimately led to new legislation in March 2019. This came at a time of reforms to corresponding regimes in the U.S. such as the Committee on Foreign Investment in the United States (CFIUS) and Foreign Investment Risk Review Modernization Act (FIRRMA), as well as changes to various national regimes across Europe, e.g., in the UK.

In March 2019, a new European regulation was passed, creating a framework for the screening of FDI in the EU (Regulation 2019/452). That regulation will come into force on October 11, 2020. The new framework was designed as a cooperation mechanism so that EU Member States can monitor FDI, especially from countries such as China, and in particular from state-owned enterprises, in strategic industries across all sectors of the economy, including infrastructure, critical technology, raw materials, and most pertinently now, health. It covers the full range of companies from small startups and small to mid-size enterprises (SMEs) right up to the largest firms.

Regulation 2019/452 grants Member States the right to block or impose restrictions on certain transactions. It also gives the European Commission the right to comment on such transactions during the course of any such FDI proceedings. One key point is that, pursuant to Recital 21 and Article 7(8), Member States and the European Commission are able to comment on any given transaction up to 15 months after it has completed, affecting potential transaction timelines and purchaser risk. Citing provisions of the Treaty on the Functioning of the European Union, Regulation 2019/452 establishes that relevant legal grounds for state intervention include public policy, public security, and public health.

European Commission Guidance of March 25, 2020

Effective March 25, 2020, ahead of Regulation 2019/452 coming into force in October 2020, the European Commission published further guidance on FDI amid the current public health crisis (the "FDI Guidance"). This came 10 days after the U.S. government reportedly tried to buy a German biotech company developing a vaccine against the coronavirus. Taken as a whole (combined with ongoing nationalizations and numerous European Commission decisions approving new state aid schemes by Member

States), and although it builds on existing powers, rather than introducing brand-new measures, the FDI Guidance suggests a potential turn toward a more "protectionist" approach to FDI. The robust tone of the language used by the European Commission in the FDI Guidance and its subsequent public statements is also quite striking.

Screening Mechanisms

The FDI Guidance addresses concerns about "increased risk of attempts to acquire healthcare capacities (for example for the productions of medical or protective equipment) or related industries such as research establishments (for instance developing vaccines)" via FDI.

Since responsibility for screening FDI rests with EU Member States, the FDI Guidance calls upon them to use the full extent of existing screening mechanisms in 14 Member States and to set up fully fledged screening mechanisms where they do not yet exist in the other 13 Member States.[1]

The European Commission urged "Member States to be particularly vigilant to avoid that the current health crisis does not result in a sell-off of Europe's business and industrial actors, including SMEs."

The FDI Guidance also used strong language to refer to cases of "'predatory buying' of strategic assets by foreign investors (e.g. with a view to limit supply to the EU market of a certain good/service)."

Reinforcing the message, on March 25, 2020, Ursula von der Leyen, president of the European Commission, tweeted out a video addressed to EU Member States, stating "You should use all options to protect critical European companies from foreign takeovers or influence that could undermine our security and public order."

In addition, on April 16, 2020, Phil Hogan, the European Commission's trade commissioner, addressed a meeting of European trade ministers in Brussels. Ahead of Regulation 2019/452 coming into force in October 2020, Hogan said that "in light of the current extraordinary circumstances, the Commission is ready to start an informal cooperation with Member States on FDI screening."

At least one European association of manufacturers has strongly welcomed such measures, and publicly called for further protection. While in this particular case the association did not refer directly to Chinese M&A activity, it is clear that those manufacturers remain concerned about the competitive threat posed by Chinese industry.

Such sentiments may feed into a wider European debate focused on notions of self-sufficiency, sovereignty, and corporate protection in "strategic" sectors such as health care equipment, pharmaceuticals, food production, and even transport infrastructure. Given the protectionist leanings of France and Germany, it is likely that these sentiments will be boosted under the German presidency of the Council of the European Union from July to December 2020 and France's presidency of the same body from January to June 2022. These political tendencies may lead to changes to the European Union's stated "industrial strategy" or even the European Commission's approach to merger control in sensitive cases under the European Merger Regulation. An early test of regulatory change may come in the review of Alstom's proposed acquisition of Bombardier Transportation's rail business, following the European Commission's controversial prohibition in 2019 of a proposed transaction involving Alstom and Siemens's rail businesses. Investors may wish to take note of relevant European governments again speaking publicly about the alleged need to create "European champions" in defiance of European merger control law. One indicator of such changing policy is that on April 15, 2020, the French economy minister Bruno Le Maire testified to the French financial parliamentary committee that

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[1] Shortly before the publication of this European guidance, on March 17, 2020, the Spanish government approved Royal Decree-Law 8/2020, amending the existing foreign investment regime applied to foreign investors from outside the EU and European Free Trade Association by introducing additional limitations. Spain therefore became one of the first EU Member States to take restrictive measures for FDI during the current health crisis to protect its economy by suspending the existing open regime in certain sectors (e.g., critical infrastructures and technologies). The FDI regime put in place by RDL 8/2020 has since been amended by Royal Decree-Law 11/2020, of March 31, adopting complementary urgent measures to face the social and economic impact of COVID-19. RDL 11/2020 clarifies some important issues related to indirect ownership and procedure. On April 8, 2020, the German government agreed in principle to further restrictions on FDI to be added to its existing Außenwirtschaftsgesetzes.

his government was ready to defend flagship French industrial and technology companies from opportunistic overseas buyers, including large, financially strong foreign technology groups.

There may be further risks for investors interested in FDI—measures that are ostensibly introduced on a "temporary" basis linger on to become something more permanent. Further, merger control scrutiny under European competition law of the same transactions may therefore take place in parallel and lead to the duplication of efforts and/or contradictory outcomes.

While certain European Commission officials do recognize that the European economy will need FDI to recover after the pandemic is over, and might not wish to see FDI powers used in a protectionist or discriminatory way, investors may perceive these measures differently. Further, although these measures seem to have been discussed with the U.S. Treasury Department, there are no reports of similar contacts with the Chinese or various Latin American governments. This lack of coordination may lead to greater fragmentation of global rules on FDI into potentially contradictory regimes. Lastly, the consequences of British FDI into the EU post-Brexit remain unclear, especially in the years following the current transition period.

"Golden Shares"

Harking back to measures previously used by particular Member States to protect certain favored "national champions," in the FDI Guidance, the European Commission reminded Member States that they could use special "golden shares" with extraordinary veto rights to screen out certain FDI. The FDI Guidance states:

> Besides investment screening, Member States may retain special rights in certain undertakings ("golden shares"). In some cases, such rights may enable the State to block or set limits to certain types of investments in the companies concerned. Such measures are company specific, and their scope depend on the powers granted to the State by the golden share. Like other restrictions to capital movements, they must be necessary and proportionate to achieve a legitimate public policy objective.

In line with these sentiments, on April 12, 2020, Margrethe Vestager, the European Commission's executive vice president and competition commissioner, reportedly urged European countries to buy shareholdings in European companies to head off the threat of cut-price Chinese takeovers.

In future deals, investors may therefore need to pay careful attention to the shareholding and capital structure of FDI targets to ensure that any such veto rights are not invoked and official concerns may be allayed.

Key Takeaways

While neither Regulation 2019/452 nor the FDI Guidance refer to any specific countries, investors from certain key jurisdictions may need to pay particular attention to these recent policy changes. Although China is sometimes referred to in this context, Gulf sovereign wealth funds including Saudi Arabia's Public Investment Fund and Abu Dhabi's Mubadala are also reportedly looking to invest in major international assets whose valuations have fallen significantly in recent weeks.

These considerations may have important implications for foreign investors in European entities and the viability of future such transactions, both in the health care sector, but not at all limited to that.

Parties with pending or proposed transactions should therefore consult with antitrust and other specialist counsel for guidance on complying with the new procedures and effectively managing the risk of delay or challenge.

Alston & Bird has formed a multidisciplinary task force to advise clients on the business and legal implications of the coronavirus (COVID-19). You can view all our work on the coronavirus across industries and subscribe to our future webinars and advisories.

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