Global Counsel

Screen Tests: the EU's proposed new framework for foreign investment

20 November 2017 | Author: Stephen Adams

Summary

A few months ago, we looked at the evolution of the debate on foreign investment screening in Europe and the joint French-German-Italian call for a new regime in the EU. In mid-September this year, the European Commission published a draft regulation for such a system which is now being considered by EU member states and the European Parliament. This is an important development, in the sense that it ends a long period in which the critics of foreign investment screening in Europe have successfully resisted EU action. However, the Commission's proposed approach makes it clear that for now this is a partial change of approach at most, albeit one with new questions for investors attached. But the Commission's chosen approach also raises the question of how far it is likely to go to satisfy political demands for a tougher EU approach to Chinese capital in particular.

A few months ago, we looked at the evolution of the debate on foreign investment screening in Europe and the joint French-German-Italian call for a new regime in the EU. In mid-September this year, the European Commission published a draft regulation for such a system which is now being considered by EU member states and the European Parliament. This is an important development, in the sense that it ends a long period in which the critics of foreign investment screening in Europe have successfully resisted EU action. However, the Commission's proposed approach makes it clear that, for now, this is a partial change of approach at most, albeit one with new questions for investors attached. But the Commission's chosen approach also raises the question of how far it is likely to go to satisfy political demands for a tougher EU approach to Chinese capital in particular.

The Commission's proposal does not in fact create a new screening regime at the EU level, at least not one with the power to block investments on the CFIUS model. This will disappoint advocates of an EU version of the US or Australian approaches, but it reflects objections by a number of member states to a regime that would remove too much discretion from national capitals. Rather, the proposed system creates a harmonised framework for EU member states wishing to operate screening regimes, although it contains no requirement for them to do so. 15 EU member states already operate regimes of various kinds. This will broadly standardise their approaches, although within a loose framework.

Screen tests

The Commission's proposed framework establishes a set of tests for member states determining whether a foreign-backed acquisition presents an unacceptable threat to the broadly established concepts of national security and public order. The first is that it must be 'lasting and direct' investment, aimed at managerial participation in, or control of, an asset. The framework thus excludes portfolio investment that does not trigger the defined control tests. This is both a practical test of control similar to that used in CFIUS, and a definition designed to stay inside the ECJ description of FDI that gives the EU competence to set policy for it.

The second is that it should relate to an asset that can be characterised as, or linked to, critical infrastructure, critical technologies, the control of sensitive information or access to critical inputs. This is a deliberately wide and non-exhaustive list, which potentially covers swathes of key EU infrastructure and advanced manufacturing, at least where it can be shown to underpin EU security or resilience. Finally, the proposals

endorse the idea that investment by state entities or state-financed entities should be treated as a particular prompt for scrutiny.

So the framework leaves the operation of screening regimes to EU member states, and does not make them mandatory. While this includes responsibility for consulting with other member states and the European Commission, it leaves final judgements to national capitals, along with the duty to provide judicial recourse for investors affected.

However, it does propose to create a parallel EU process for acquisitions that touch on Union interests. This would allow the European Commission to review transactions that impacted EU-funded projects or programmes, or shared EU infrastructure assets. The Commission would not have the power to block acquisitions. But a Commission opinion supporting an intervention - whether delivered to a member state carrying out its own review or not - would place the onus on that member state to intervene or explain publicly why they were rejecting the Commission's advice – a gauntlet investors may not wish to run.

This is clearly an evolution for inward investors in the EU in sensitive sectors, especially when they are state-owned or state-backed. However, most large EU member states already have screening regimes close to the framework described by the Commission proposal, with much the same scope for review. Whether member states will feel empowered to use them more, or more robustly, by this framework will only be clear with time. Some states may revise their frameworks. Some may feel impelled to create new systems of their own. The biggest material change is the prospect of European Commission commentary shaping the calculus of national capitals in the cases where the Commission believes it has locus and wants to use it.

A narrow view of a wide political problem

However, the Commission's narrow lens in defining both the problem and the solution is likely to be an issue for many of the more vocal advocates for this kind of proposal. This is true not least in the European Parliament, where it is now headed. The Commission has been careful to stay within the conventional boundaries of investment screening as defined by WTO and OECD rules in linking it to national security and public order. While the supporting documentation for the Commission's proposals reference the EU's 'technological edge' and the problem that the EU has in securing reciprocity and a level playing field for EU FDI in markets such as China, the Commission does not ultimately pretend that this proposal is targeted at those problems. Arguably, it could not be targeted this way without raising questions about the legal basis for intervention.

The way the Commission has positioned the question of state subsidy for acquirers captures the issue well. The Commission proposals are clear that sovereign financial backing for a buyer is a potential cause for concern. However, the Commission is careful not to suggest that subsidy in itself is grounds for intervention. Rather, it implies that subsidy creates locus for a foreign state in a firm acquiring sensitive EU assets, and thus a potential threat to EU public security or public order. But for many advocates of a screening regime in the European Parliament and elsewhere, the simple distortion of subsidy itself should be treated as grounds for intervention.

The same question arises on the question of the EU's technological competitive advantages. Advocates of investment screening in the EU routinely invoke the risk posed to the EU's long-term competitiveness by the acquisition of such technological competences via FDI. The EU's Digital Single Market review last year explicitly flagged it as an area of concern. However, although the new framework borrows from US practice in using the concept of critical technologies (and defines that technology as covering areas such as robotics, artificial intelligence, semi-conductors and cyber resilience) it only does so in so far as these technologies can be linked to national security interests.

Both of these issues show the challenge for the Commission of designing a proposal that stays inside established boundaries for investment screening regimes but which also satisfies the political appetite for a more robust line with state capitalism and investment protectionism. Especially from actors like China that target European intellectual property through acquisition and technology transfer as part of an industrial development strategy. As now, the only way for member states to actually invoke the 'new' defences set out in this system will be to invoke a strategic and even military rivalry with China that, unlike their US counterparts, most EU policymakers have generally been quite reluctant to describe. German officials only reversed their authorisation of the Aixtron acquisition by Fujian Grand Chip Investment Fund in 2016 after US officials intervened with Berlin.

One of the things that this is likely to mean is that a key role of screening mechanisms is likely to remain 'soft blocking': the creation of a process for slowing down transactions, providing locus for government officials and politicians to probe them and shape them, and time for the rallying of alternative and more politically acceptable 'European' buyers where desired. This is what the German state tried and failed to do with KUKA Robotics in 2016.

As the Commission proposal heads into trialogue, we can predict that this will be the area where member states and MEPs alike focus on the merits of the Commission's careful navigation of the legal basis for intervention. It will certainly be seen as insufficiently ambitious by many MEPs who want a new tool for enforcing a commercial level playing field. Member states are likely, in general, to back the Commission's more restrictive reading of what can and cannot be done to manage FDI in the name of industrial competitiveness and reciprocity.

The Commission will argue that the appropriate channel for attacking Chinese subsidy regimes is through the maintenance of a strong anti-dumping and anti-subsidy system of investigations and corrective duties, which it is doing in parallel by refusing to grant China Market Economy Status and toughening its general approach to trade defence. The Commission is likely to fight to keep the trade defence and investment screening files separate, and both separate from the wider question of pushing for a more level playing field for investment through trade agreements and commercial diplomacy. Politicians may not see it this way.

This Global Counsel Insight note was written by Stephen Adams, Senior Director at Global Counsel.

To contact the author, email:
s.adams@global-counsel.co.uk

The views expressed in this note can be attributed to the named authors only.

A: 5 Welbeck Street, London, W1G 9YQ
T: +44 (0)203 667 6500
E: info@global-counsel.co.uk
www.global-counsel.co.uk
@global_counsel