**Notes from webinar with DG Trade’s Carlo Pettinato on foreign direct investment controls**

**Topic**: foreign direct investment (“**FDI**”) screening mechanisms and the approach of the European Commission (the “**Commission**”) during the COVID-19 crisis.

**Chair**: Oliver Bretz, Founding Partner—Euclid Law.

**Speakers**:

* Carlo Pettinato, Head of Investment Policy Unit—DG Trade, European Commission;
* Manuel Vélez Fraga, Partner—Uria; and
* Alan Riley, Senior Fellow—Atlantic Council.

**Discussion:**

**CARLO PETTINATO (the EU FDI guidelines issued with the COVID-19 crisis communication)**

* On 25 March 2020 the European Commission issued [Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe’s strategic assets](https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf) (the “**Guidelines**”), ahead of the application of [Regulation (EU) 2019/452](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0452&from=EN) (the “**FDI Screening Regulation**”) in October 2020. This was addressed to Member States setting out what they can do in advance of the FDI Screening Regulation mechanism coming into force. The document was part of the overall Commission response to the COVID-19 crisis.
* The Guidelines aim to tackle two main issues in relation to the COVID-19 crisis:
  + IMMEDIATE CONCERN: The preservation of European health care capacities, namely the production of medical PPE and vaccines (preventing attempts to buy exclusive rights to EU production capabilities of essential products during the crisis).
  + BROADER CONCERN: The economic vulnerability or the undervaluation of companies which could result in the selloff of infrastructure critical either during the crisis, or essential for the future post-crisis recovery.
* The Guidelines do not create any new rules; however they:
  + clarify how national screening mechanisms should be used in the current COVID-19 crisis and how to interpret the Commission screening capacity, giving an overview of the process to follow;
  + put on record the scope of the EU screening framework mechanism;
  + highlight concerns regarding capital movements in addition to FDI (although this goes beyond this webinar’s discussion);
  + stress that in order for the FDI mechanism to be triggered, **Member States should always establish a link between national security and public order** (the COVID-19 healthcare crisis comes under these headings).
* The Guidelines also wanted to be a call from the Commission to Member States to implement full national FDI mechanisms to work alongside the EU framework and, in the meantime, to consider what can be done with the instruments currently available.
* Finally, the Guidelines wanted to signal to investors that:
  + **any FDI completed after 19 April 2019 could be subject to ex-post scrutiny from 11 October 2020** (when the FDI Screening Regulation comes into force). However, the general rule applies mandating that **(i)** **Member States comment up to; and (ii) the Commission issue an opinion by, the end of the 15th month from completion of an FDI**; AND
  + **any ex-post investigations may not result in binding order, including for the divestment or the unwinding of the transaction**. However, they can still give recommendations, for instance for refining and tuning the FDI in a way to mitigate security risks.

**Prof. ALAN RILEY (the long-term consequences of fast-tracked measures)**

* The nature of this emergency will fast forward processes which would organically take much longer to be carried through. One example of a sped-up process that organically would take longer to complete is the establishment of national FDI screening mechanisms. It is now likely most Member States will adopt such mechanisms by the end of the crisis.

* Given the potential for the crisis to impact across a number of industries, for example knock on effects across the chemical sector on sourcing and supply in the health care sector it is likely that the screening mechanisms will be deployed in a broader range of market sectors. Screening mechanisms may also be deployed in industries, not directly related to the COVID-19 crisis, which are considered as critical, and potentially under threat from external predation.
  + Mr Petinato stressed in response that any FDI screening powers should be exercised with the view that foreign investments will be necessary element for the post-crisis recovery and, therefore, not in a protectionist fashion.

* In light of this, it is unclear what will be temporary and what will become permanent. Temporary solutions lasting for longer than expected could lead to structural problems. The coexistence of EU and Member State antitrust merger controls with EU and Member State FDI controls could be troublesome, as transactions caught by both mechanisms will be scrutinised twice from different perspectives.

**MANUEL VÉLEZ FRAGA (the new Spanish FDI screening mechanism)**

* **Spanish national Government’s set up an FDI screening mechanism through an emergency rule accelerated processes**. On 17 March 2020, the Spanish government enacted [Royal Decree – Law no. 8/2020, on urgent and extraordinary measures to face the economic and social impact of COVID-19](https://www.boe.es/boe/dias/2020/03/18/pdfs/BOE-A-2020-3824.pdf). That was further amended two weeks later with [Royal Decree – Law no. 11/2020](https://www.boe.es/boe/dias/2020/04/01/pdfs/BOE-A-2020-4208.pdf) on 1 April 2020.

The most important considerations are:

* + Royal Decree 8 largely copies the EU provisions with very wide, and somewhat vague, interpretations and definitions. FDI will need authorisation by the Spanish Government directly. If a transaction does not fulfil the requirements, it will be declared null and void, although it is possible to obtain an ex-post legalization for it. Fines may be imposed up to the value of the transaction.
  + Royal Decree 11 adds onto the existing FDI mechanism setting up a “look through/lifting the veil” function to identify the ultimate beneficial investor in a transaction. **The FDI mechanism will apply to transactions whose beneficial investor(s) (i.e. more than 25% of capital) is foreign.**
  + Transactions already signed but pending of closing will need to be authorised under the Spanish FDI mechanism, too. However, this will be done through a fast-track procedure by lower officials (not the Spanish Cabinet).
* **There are serious doubts whether this measure will be temporary**. Royal Decrees 8 and 11 are emergency legislation due to last only for one month. However, the mechanisms they put in place has a longer time frame of action. The question inevitably arises as to whether the decrees will be extended or converted into permanent law.
  + Spanish government now legislates using a fast track process, without going through parliamentary debate. It is unclear whether the Spanish Parliament will be given the chance to scrutinise and fine tune this legislation after the crisis.

**CARLO PETTINATO – Q&A (answers only)**

* The Commission’s number one priority is to establish that the EU FDI screening mechanism has very clear rules. The EU needs foreign investment after this crisis is over; therefore, the EU wants to signal that it is not closing. **The Guidelines were issued as a form of clarification to prevent a run on assets during the crisis.** The Commission is interested in preserving the European critical industries and projects throughout the crisis. This endeavour will play a crucial role in the economic recovery.
* Member States can require the parties to the transaction to disclose the ultimate ownership. Equally, Member States are able to screen FDI from other Member States under national law—EU law does not restrict Member States from using national regimes to screen intra-EU FDI.
  + However, Member states cannot take decisions discriminatorily, in a non-transparent way or lacking due process. Procedural minimum requirements have to be part of the FDI mechanism in every Member State.
* The FDI Screening Regulation does not define or limit the industry sectors that can be subject to screening. Potentially **any** sector can be. However, if a Member State’s national regime requires prior authorisation, in order to guarantee legal certainty, the Commission expects the Members State to define the sectors subject to the regime in national law.
* The Commission’s communication regarding the COVID-19 crisis, and the Guidelines, were a political push to encourage Member States to put national FDI screening regimes in place. To that end, further guidance on the matter is not excluded in the future.
* Additionally, the Commission is actively trying to address its “blind spots”, as it sometimes does not have a full picture of the state of FDI in some Member States. That is because often official statistics are late and inconsistent, whereas the Commission is trying to establish a flow of up to date aggregate information.
* **The Commission is in constant contact with the US Department of the Treasury on these matters in a well-established open conversation and dialogue**. Equally, a somewhat similar dialogue is open with other G7 nations. However, **there is no cooperation on the FDI front with other countries such as the People’s Republic of China or Latin American countries**.
* **The UK does not take part in the EU FDI framework because the UK has left the EU on 31 January 2020**, and the FDI Screening Regulation will not apply until October 2020. The Transitional Period does not bridge this gap because it only preserves the *Acquis Communautaire* up to the UK’s withdrawal from the EU. Therefore it does not extend to EU law coming into force after 31 January 2020.
  + However, **as a rule [pending confirmation] British investment would be considered *EU* investment under the FDI Screening Regulation during the Transitional Period** (which could be extended past 31 December 2020).