Foreign Direct Investment Alert

As Foreign Direct Investment Screening Regimes Spread Throughout Europe, European Commission Releases Its First Annual Report

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To read the EU Foreign Direct Investment (FDI) Screening Regulation, please click here.

To read the European Commission Annual Report, please click here.

On November 23, 2021, the European Commission issued its first annual report on foreign direct investment screening in the European Union (the "Report") since the implementation of the EU Foreign Direct Investment Screening Regulation (the "Regulation") on October 11, 2020. Many EU Member States have in recent years implemented varying forms of national security-related foreign investment screening procedures that draw comparisons to the long-standing Committee on Foreign Investment in the United States ("CFIUS"). However, it was not until late last year that the European Commission adopted the Regulation that implemented a formal coordination process among Member States with respect to the review of these filings. The Report provides a summary of the trends, developments, activities and perceived benefits of the Regulation's cooperation mechanism since its implementation.

The Report also hints at a future where Member States may begin to align their regimes, such that investors could one day face a more uniform process in Europe instead of the disparate patchwork of rules we see today.

Below we discuss noteworthy takeaways from the Report and offer recent first-hand observations from filings in Member States. In short, the EU has experienced a rapid adoption of new or expanded regimes over the last two years, and while FDI filings are on the rise, most are approved relatively quickly. The Report also hints at a future where Member States may begin to align their regimes, such that investors could one day face a more uniform process in Europe instead of the disparate patchwork of rules we see today—a change that would likely be welcomed by many strategic investors, private equity firms and acquisitive international corporations that regularly invest in Europe.

Member State Screening Mechanisms Continue to Increase in Number and Scope

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Our Firm continuously monitors these legislative developments across the globe and we have indeed seen a dramatic shift in this regulatory landscape over the last two years. Some of these FDI-related changes have been driven or were accelerated by the global pandemic, with many jurisdictions quickly imposing heightened foreign investment restrictions on domestic resources necessary for their COVID response, including those operating in the healthcare industry, pharmaceutical manufacturing and development, medical device and technology innovators, diagnostic laboratories and related suppliers. Beyond these sector-specific regulations, some jurisdictions around the world have also imposed interim measures to prevent foreign acquirers from snapping up local enterprises at deflated valuations after suffering from the economic shocks of lockdowns and other pandemic measures.

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The rapid adoption and alteration of these regimes has for many global M&A transactions inserted heightened deal uncertainty and regulatory risk. The rules applicable to a particular deal can in some cases change between the date of signing and the date of closing and often are retroactive in effect, meaning that additional filing obligations can sometimes arise late in a closing period causing a delay or preventing consummation at the last hour if a transaction target maintains subsidiaries or operations in a number of countries. For example, Denmark implemented a new FDI regime this year, which was particularly broad in scope and application, and introduced additional regulatory approvals for a number of pending transactions. We expect to see similar issues in 2022 once the long-anticipated FDI regimes in the Netherlands and the United Kingdom come into effect. Navigating the many moving parts presented by these updates to FDI regimes in the EU and elsewhere has proved challenging, but manageable if the parties' respective regulatory counsel are cognizant of the forthcoming changes and are able to anticipate the impact on the transaction timeline.

In 2020, Member States performed 1,793 foreign investment reviews. Of these, approximately 80 percent were not formally screened because the proposed transaction was determined to not impact security or public order, or fell outside the scope of the national screening mechanism.

A Majority of EU Investments Have Been Approved Without Conditions

In 2020, Member States performed 1,793 foreign investment reviews. Of these, approximately 80 percent were not formally screened because the proposed transaction was determined to not impact security or public order, or fell outside the scope of the national screening mechanism. Of the remaining 20 percent that were formally screened, 91 percent were approved, only 2 percent were prohibited and 7 percent were aborted by the parties and no decision rendered. Of the 91 percent that were formally screened and approved, only 12 percent of those transactions were approved subject to conditions on the parties. These numbers indicate that foreign investment regimes in the EU are still open to foreign investors, and that only those transactions presenting a clear risk to security or public order are receiving added scrutiny.

We were not surprised to see these figures, and in particular, the significant number of transactions that EU FDI regulators declined to review through formal procedures. Many of these regimes throughout the EU are sector-specific, but the categories of covered sectors are often broad and sometimes have an ambiguous scope. Regulators have explained that this approach is in fact purposeful so that parties are inclined to take a conservative approach and offer the government an opportunity to review and weigh in on the need for formal approval. What this means is that many investors, particularly those with a risk-averse regulatory posture, have filed more frequently and in more circumstances than in other parts of the world where jurisdictional assessments can be more clear-cut on when a filing is required. Nevertheless, one positive effect of the many transactions that have been filed out of an abundance of caution is that practitioners—particularly those in jurisdictions with nascent screening regimes like Spain and Italy—have been able to gather experience and establish some guideposts on how regulators will perceive a particular transaction. Over time, we expect that local practitioners in these jurisdictions with newer regimes will be in a position to draw upon their past experience and rule out the need for some of these cautionary filings despite the broad language currently employed in implementing regulations.

Many Transactions Are Receiving Quick Approval With Certain Exceptions

As noted above, 80 percent of transactions submitted to EU Member States for investment screening did not result in a formal review, meaning that these transactions, by and large, received quick approval. In our experience, submissions in many jurisdictions with established regimes like France and Germany have been approved very quickly—often in just several weeks. With that said, there are a few jurisdictions that have resulted in longer than

expected review times. For example, some of the newly-implemented regimes like Spain and Italy have served as the final laggard approvals for a number of major transactions, delaying closing by several weeks or months after all other conditions have been satisfied. Whether a transaction is approved quickly or not will of course depend on the unique facts and circumstances of each investment, but some of the recently-implemented regimes are certainly seeing some growing pains as internal procedures mature.

Inbound Investments in the EU Have Risen Since 2020 But Not to Pre-COVID-19 Levels

The Report tracks the volume of foreign investment in EU Member States from 2019 to the first quarter of 2021. Through the first quarter of 2021, EU inbound foreign investment was up 4.5 percent from the same period in 2020, but remained a substantial 30 percent below 2019 levels. Based on merger and acquisition activity in the second and third quarters, we believe this number has continued to rise throughout 2021. In 2020, over 65 percent of EU foreign investment came from investors in the U.S., Canada and the U.K., while an additional 12.1 percent belonged to investors from European Free Trade Association states (Iceland, Liechtenstein, Norway and Switzerland).

Looking Forward to the Future of FDI in Europe

The Report acknowledges the issues presented by multi-jurisdiction foreign investment transactions (*i.e.*, those instances where the target has a presence in multiple Member States via subsidiaries in more than one Member State, or through providing goods or services in more than one Member State). The Report notes that these cases "raise a number of challenges, including differing timelines under different national legislation which may prevent synchronisation of notifications and assessment under the Regulation." The Report acknowledges the Regulation does not currently address this issue, but notes that "given the significant share (29%) of such multi-jurisdictional FDI transactions and related challenges, the European Commission believes that it warrants careful consideration in the future."

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Indeed, the rapid adoption of FDI regimes in a number of jurisdictions throughout Europe has resulted in a patchwork of regulations and jurisdictional thresholds that differ from one Member State to the next. Many of these regimes cover the same general sectors, but use varying definitions or interpretations, meaning that a transaction target with similar operations throughout Europe will require unique interpretation and analysis in each jurisdiction, and will be subject to a variety of varying review procedures and timelines. Yet the information required for filings themselves across EU jurisdictions is fairly similar

—a trend that has only continued with the standardization of the EU cooperation mechanism form that is ordinarily required with the submission of an FDI filing to a Member State.

It is clear from the Report that the European Commission is already looking to the future and how it can position itself to streamline the foreign investment screening process across Member States.

The Report recognizes that the Regulation and the cooperation mechanism established therein are still in their early days, and acknowledges that there is room for improvement. One of the key items that the Report mentions as an area for further consideration is the possible issuance of EU-wide foreign investment guidelines for the benefit of Member State screening authorities and investors. The Report recognizes that similar guidelines have proven valuable in other areas of regulation and enforcement, and specifically makes reference to competition policy in the EU. The Report goes on to explain that with the rise in FDI regimes and filings, the European Commission will consider ways to streamline the cooperation procedures by focusing on transactions that are more likely to pose a risk to the security of more than one Member State or to projects of EU interest. As the Report explains, "[t]his will include consideration of how, given the current Regulation, multi-jurisdiction FDI transactions are best handled, including possible alignment of notifications by two or more Member States."

How the FDI landscape unfolds throughout Europe will be the subject of much discussion over the coming years, but it is clear from the Report that the European Commission is already looking to the future and how it can position itself to streamline the foreign investment screening process across Member States.

Simpson Thacher & Bartlett LLP routinely oversees worldwide multi-jurisdictional FDI analyses and filings for global M&A transactions and investments. For further information, please contact one of the following members of the Firm.

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