Global Counsel

Covid-19 and foreign investment: temporary pause or closure for good?

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Summary

A growing preoccupation with the impact of foreign acquisitions on European security and autonomy has in recent years fuelled the steady growth of investment screening mechanisms, with 14 out of the EU's 27 member states (and the UK) now having such regimes in place. The economic impact of the covid-19 pandemic has further accentuated these concerns and led to a further wave of investment screening measures in Europe, including proposals for new EU powers in this area. As the continent begins its long recovery from the crisis, important questions persist around the permanence and evolution of the new mechanisms, their role in screening acquisitions from countries other than China, and their likely impact on the UK's attempts to strike new trade deals as it leaves the EU.

Background

Concerns around national security and industrial sovereignty have in recent years led to an increase in foreign investment screening mechanisms in the UK, the EU and its member states, and other advanced economies. This has been largely driven by growing wariness of China both as an economic competitor and a security threat. More specifically, policymakers see Chinese investment in sectors such as technology and energy as an attempt to accelerate its economic development and embed itself in national infrastructure. The strengthening of screening mechanisms is therefore a means of protecting domestic assets and businesses deemed critical or strategic in either of these areas.

The covid-19 pandemic has accelerated this dynamic, prompting European countries to introduce new measures or bring forward planned changes. The severe economic impact of the pandemic and related lockdown measures have raised fears that depressed asset valuations will lead to a wave of opportunistic foreign takeovers. The origins of the virus in China, and its relatively rapid economic recovery in comparison to European states, have concentrated these fears on China and brought about a further series of measures strengthening investment screening.

Investment screening measures introduced during covid-19

The new investment screening measures introduced by European governments during the crisis range from the temporary to the permanent, and touch on both sectors and threshold and notification requirements. Both Germany and France have permanently expanded their existing screening frameworks to cover certain health-related investments, while France has also temporarily lowered the investment threshold triggering intervention. Italy has greatly expanded the list of sectors subject to its "Golden Power" screening regime until the end of 2020, while Spain has, largely from scratch, introduced a new permanent investment screening regime comparable to those of its neighbours. The UK has yet to adjust its rules in light of the crisis, but the government has accelerated its pre-pandemic plans to tighten investment screening on national security grounds (for a more detailed summary of recent measures, see table).

The European Union has been supportive of these developments, both introducing its own regulation and encouraging member states to bolster national-level measures. The EU's Foreign Investment Screening Regulation, which comes into force this October, while not creating an EU-level

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mechanism for blocking investments or compelling member states to introduce them, will establish new procedures for coordination and information sharing between governments. Since the outbreak of the crisis, the Commission has also published non-binding guidelines on FDI screening during the pandemic, which calls on member states to avoid a "sell-off of Europe's business and industrial sectors" and to protect "critical health infrastructures" and "supply of critical inputs". It also strongly encourages the 13 member states that lack screening mechanisms to put them in place.

Going one step further, the Commission has published proposals – the White Paper on "levelling the playing field as regards foreign subsidies" – which, if passed into law, would give it direct powers to investigate and potentially block acquisitions of EU assets facilitated by foreign subsidies. Even if used infrequently, such powers would represent a significant expansion of the EU's investment screening capabilities given that currently only national governments can veto acquisitions. The proposals are a response to the Commission's acknowledgement that the issue of foreign subsidies is not adequately covered by its existing competition and trade defence instruments, and concerns – particularly within France and Germany – around the distorting influence of state-backed Chinese, Russian and American firms within the single market.

To date the new measures have not been tested to a significant degree, though this may be due to the chilling effect they are already having on investment. Nonetheless, several recent cases, while not dependent on the new measures, illustrate the increasingly unfavourable environment for foreign investment. In April, the French government moved to block the acquisition of photosensor technology firm Photonis by US firm Teledyne, demonstrating both its willingness to proactively scrutinise (and if necessary halt) transactions and the application of screening measures to US, as well as Chinese, investment. In the UK, heightened sensitivities towards foreign investment led to government intervention in relation to (Chinese-owned) private equity firm Canyon Bridge's attempt to place new members on the board of UK semiconductor firm Imagination Technologies, which it acquired in 2017.

Non-exhaustive list of recent investment screening measures introduced by the EU Commission and member states

Jurisdiction	Measure	Description
European Commission	Foreign Investment Screening Regulation	A new framework for coordinating investment screening across the EU that will: ▪ Create a cooperation mechanism enabling member states and the Commission to exchange information and raise concerns on specific transactions ▪ Allow the Commission to "issue opinions" where a transaction threatens the security or public order of more than one member state, or projects and programmes of European interest ▪ Set basic requirements for member states introducing or maintaining national investment screening mechanisms
European Commission	Guidelines for member states on investment screening during covid-19	Non-binding guidance for member states on protecting critical assets during the covid-19 emergency, which calls on them to: ▪ Make full use of existing FDI screening mechanisms to ensure "critical health infrastructures, supply of critical inputs, and other critical sectors as envisaged in the EU legal framework" are protected ▪ Set up a "full-fledged" screening mechanism where one is not already in place or does not cover "all relevant transactions", and in the meantime use "all other available options" to protect critical assets.

European Commission	Proposals on preventing takeovers enabled by non-EU state aid	The Commission is seeking new powers to limit the influence of foreign subsidies within the Single Market, including on acquisitions. In terms of investment screening (Module 2), the key proposals are that: ▪ The Commission would have new powers to investigate acquisitions facilitated by foreign subsidies, either because these fund the acquisition itself or strengthen the financial health of the acquirer more generally. ▪ Entities benefitting from foreign subsidies would need to notify their acquisitions of EU companies above a given threshold (to be determined) to the Commission, with transactions paused during the Commission's review. If it found that the acquisition was facilitated by foreign subsidies, the Commission could either accept commitments by the acquirer to remedy the distortion or block the acquisition.
France	Strengthening of screening regime in response to covid-19	The French government has implemented an emergency expansion of its investment screening in response to covid-19. This consists of two key measures: ▪ The addition of biotechnology to the list of critical technologies subject to investment screening ▪ In sensitive sectors, the share of voting rights in a French company a non-EU entity needs to acquire before triggering investment screening has been decreased from 25% to 10%. This measure is set to expire on December 31st 2020
Germany	Draft legislation tightening FDI regime	The German government has approved draft legislation, predating the covid-19 crisis, which significantly tightens the country's screening regime. The key elements of the bill are as follows: ▪ Acquisitions will no longer need to constitute an actual threat to national security and public order, but will only need to be a likely threat to merit screening ▪ Standstill obligations requiring the suspension of transactions subject to investment screening will be extended to apply to "critical infrastructure" as well as "sensitive security areas" ▪ Greater consideration of how transactions may affect public order and national security in other EU member states, as well as projects and programmes of EU interest
Germany	Amendment to Foreign Trade and Payments Ordinance	The amendment is a direct response to the current pandemic. Its main provisions are: ▪ The addition of vaccine and antibiotic makers, manufacturers of medical protective equipment and producers of medical goods used to treat highly infectious diseases to the list of critical sectors subject to investment screening ▪ Screening will also take into account whether investors are controlled by governments and whether they have been involved in economic crimes or activities that have had an adverse effect on public order and national security in Germany or other EU member states

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Italy	Expansion of "Golden Power"	In response to the covid-19 crisis, Italy has temporarily expanded the scope of its so-called "Golden Power" law, which underpins its investment screening regime. The main provisions of the Decree, which applies up to December 31st 2020, are to: ▪ Expand the list of sectors subject to screening to include companies involved in critical infrastructure, supply of critical inputs, critical technologies, the financial sector, food security, access to sensitive information and media ▪ Apply the expanded screening rules to EU entities acquiring a controlling interest in an Italian business, and to non-EU entities acquiring at least 10% of voting rights
Spain	New system for screening FDI investment in certain sectors	In response to covid-19, the Spanish government has permanently overhauled its notably liberal investment regime to introduce a screening mechanism similar to those of other major European economies. The key provisions of the new regime are as follows: ▪ Acquisitions by non-EU entities of more than 10% of a Spanish company's equity, or any investment that allows for effective participation in the management or control of the company, will be subject to screening ▪ This will apply to acquisitions of companies involved in critical infrastructure, critical technology, supply of critical inputs, access to sensitive information and media ▪ Screening will also take into account whether investors are controlled by governments and whether they have been involved in economic crimes or activities that have had an adverse effect on public order and national security in Spain or other EU member states
UK	National Security and Investment Bill	The UK government is planning to publish legislation in the current Parliamentary session that would significantly strengthen its powers to block acquisitions due to national security concerns. While the bill has not yet been published, based on details announced in the most recent Queen's Speech, it is likely to contain the following: ▪ Creation of a separate review mechanism outside of the existing competition framework giving ministers greater powers to review transactions based on a broadly defined notion national security, and without limitations in terms of turnover or share of supply ▪ Ministers would be able to intervene in the event of: (i) the acquisition of more than 25% of the votes or shares in an entity; (ii) the acquisition of significant influence or control over an entity; (iii) the acquisition of further significant influence or control over an entity beyond the above thresholds; (iv) the acquisition of more than 50% of an asset; and (v) the acquisition of significant influence or control over an asset ▪ Parties would be encouraged to make voluntary notifications to the Department for Business, Energy and Industrial Strategy, where a transaction could give rise to national security issues. Ministers would also be given the power to call in transactions for further scrutiny for a prescribed period

A temporary remedy or the new normal?

The proliferation of investment screening measures highlights the growing politicisation of foreign investment in Europe, accelerated by the severe economic disruption caused by covid-19. But while the pandemic has clearly contributed to shifting policymaker priorities away from openness and towards national autonomy, security and resilience, it remains to be seen how far the pendulum will swing. As Europe begins its economic recovery, policymakers will need to balance the protection of strategic sectors and assets with pro-growth policies including remaining attractive to foreign investment.

A key question is the extent to which supposedly temporary restrictions on foreign investment will remain in place in some shape or form. A number of the measures introduced during the pandemic - including France's threshold reduction and Italy's expansion of its "Golden Power" - are time-limited, in most cases expiring at the end of the year. But with the economic vulnerabilities that led to the introduction of the measures likely to persist beyond 2020, and growing political appetite for stricter investment screening across Europe, the temptation to make them permanent will be substantial.

Although still at the stage of proposals, the new powers being sought by the Commission to block acquisitions facilitated by foreign subsidies would have significant implications for the EU's trading relationships and internal cohesion. Such new powers would give the EU additional leverage in its negotiations with China on bilateral investment and with the US on tariffs and digital taxation, but are likely to be criticised by its trading partners at a time when the EU is significantly loosening its own internal state aid rules. Within the EU itself, member states in Southern and Eastern Europe that have welcomed foreign infrastructure investment – particularly Chinese - may also be less supportive than their Northern and Western neighbours. On a more general level, the proposed powers would set a major precedent in terms of enabling the EU to directly veto foreign acquisitions under certain conditions, conditions that would be likely to grow over time.

Wider implications

The application of the new regimes will demonstrate the extent to which they are designed to specifically prevent Chinese, as opposed to other non-EU, investment. While countries' strengthened screening mechanisms are clearly to a large degree motivated by worries about Chinese influence, they do not explicitly single out China and could theoretically be used to block investment by any non-EU country. Whether or not this takes place will reveal where policymakers' intentions lie. The recent decisions by the French and German governments to block the acquisitions of Photonis and CureVac by American companies are early indications that tougher screening, while focused on China, will have a wider application. While not yet widespread, restrictions in intra-EU investment, such as those introduced in Italy, raise questions around the future of frictionless investment within the single market.

A less liberal approach to foreign investment will hamper the UK's efforts to position itself as "Global Britain" following its departure from the EU. While strengthened investment screening measures among the EU's member states are not targeted at the UK per se, the recent moves by France and Germany to prevent US acquisitions demonstrate that European governments are willing to protect sensitive national assets even with regards to countries traditionally seen as allies. The UK government is also set to table legislation significantly increasing its powers to block foreign takeovers based on a broad definition of national security. This will make foreign investment in the UK less attractive just as it leaves the single market and the free movement of capital it facilitates.

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