COVINGTON

European Commission issues guidance on Foreign Direct Investment enforcement during the Covid-19 crisis

March 26, 2020

FDI

On March 25, 2020, the European Commission ("Commission") published a policy paper to provide guidance to the EU Member States regarding takeovers by non-EU ("foreign") investors of EU companies and assets in "strategic industries" during the Covid-19 crisis (the "Guidance Paper" or the "Guidelines"). The Commission emphasizes the importance of vigorously deploying the Foreign Direct Investments ("FDI") screening mechanisms in place at the Member State level. Such screening mechanisms have been developed for governments to observe foreign investments in strategic industries including infrastructure, critical technology or raw materials on grounds of security and public order. According to the Commission, the current crisis caused by the Covid-19 pandemic has made such FDI screenings particularly urgent and important.

While the focus of the Guidance Paper is clearly on healthcare-related industries, it is "by no means limited" to this sector but paves the way for a much broader application, as it specifically refers to "*potential risk to strategic industries*" generally. It states that "[t]*he resilience of these industries and their capacity to continue to respond to the needs of EU citizens should be at the forefront of the combined efforts both at European Union and at Member States level*".

There are strong indications that some of the main reasons for the Commission to issue the Guidelines at this stage are (i) the heavy stock market declines as a consequence of the Covid-19 crisis, which have created many opportunities for foreign investors to secure control over strategic assets in Europe, and (ii) recent attempts to secure significant volumes of healthcare-related products such as masks, gloves, etc., and by extension potentially establishing control over strategic European manufacturing companies. These discussions were inter alia initiated by (meanwhile disproved) rumours regarding a possible takeover offer from "the United States" regarding the German biotech company CureVac in order to gain access to information on the development of a coronavirus vaccine.

Against this background, the Commission identifies "*an 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 foreign direct investment."* It further states that *"Vigilance is required to ensure that any such FDI does not have a harmful impact on the EU's capacity to cover the health needs of its citizens.*" This emphasis is in line with the approach of nine European state leaders set out in a joint letter of March 25, 2020, asking for the EU "*to make sure that essential value chains can fully function within the EU borders and that no strategic assets fall prey of hostile takeovers during this phase of economic difficulties*."

The Commission points to certain measures which Member States have available to combat any possible medical supplies shortages they may face as a result of the Covid-19 emergency. The Commission indicates that, as part of the screening procedures, Member States may impose measures to mitigate the potential impact that foreign investment on healthcare capabilities may have. For instance, Member States may impose conditions on the investment to ensure continuity in the supply of medical products and devices.

In addition, the Commission reminds Member States of their powers outside of screening mechanisms. In particular, the Commission highlights that Member States may in certain cases, such as a pandemic, intervene by for example imposing compulsory licences on patented medicines.

With the new Guidelines, the Commission mainly addresses four audiences:

- Potential foreign investors that - from the Commission's perspective - may attempt to use the current crisis to acquire strategic EU companies and assets at very low price;
- The EU Member States – both those which have FDI screening mechanisms in place and are implored to use them where appropriate, and those which can use the Covid-19 crisis as the political impetus necessary to newly adopt such FDI screening mechanisms;
- Potential EU target companies whose acquisition might trigger FDI screening – these may be companies seeking protection from potentially hostile bids, as well as owners seeking to sell assets of strategic importance for the wider economy; and
- Foreign governments which may be eyeing to use their own funds, or coordinate with the private sector, to acquire strategic assets in the European Union.

The Guidance Paper emphasises that "**at present**" the Commission itself has no effective FDI screening measures at hand and therefore urges the Member States to act. The EU Regulation establishing a framework for the screening of foreign direct investments into the Union (Regulation 2019/452/EU), adopted in March 2019, enters into force only on 11 October 2020, and only provides for an obligation to exchange information between Member States and the Commission, and a possibility for the Commission and Member States to issue opinions and comments on specific transactions. However, it does not grant the Commission own powers to intervene in transactions.

In this context the Guidance Paper emphasizes several times that FDI screenings, although currently under the responsibility of single Member States, may have effects well beyond any one Member State. The Guidance is very clear on this topic stating that "*[i]n the European internal market, risks created by an investment do not necessarily stop at the borders of the Member State where the investment happens*" and *"[t]he Commission also reminds Member States of the interdependencies that exist in an integrated market like the European one",* claiming that coordination in these cases within the framework of the EU Regulation will be important.

Such statements appear to be linked to the export restrictions on medical supplies such as masks and other personal protective equipment recently imposed by certain Member States. In this sense, the Commission uses the Guidance Paper to remind Member States that *"[t]he Union interest may dictate that such supply commitments extend beyond the predicted needs of the host Member State*".

In sum, the Guidance Paper endorses two main messages. First, it requests those Member States which have established FDI screening measures to apply them vigorously. It should be noted that some Member States, such as Germany, have already begun to tighten their existing rules. Second, as currently only 14 Member States have national FDI screening mechanisms in place, the Commission urges those Member States who have not yet implemented FDI screening measures to set up appropriate screening mechanism and "*in the meantime to use all other available options to address cases where the acquisition or control* *of a particular business, infrastructure or technology would create a risk to security or public order in the EU, including a risk to critical health infrastructures and supply of critical inputs*".

As an additional mechanism beyond FDI screenings conducted by the Member States, the Guidance Paper also refers to the specific circumstances under which the free movement of capital, notably from third countries and linked to the acquisition of significant stakes, may be restricted. For example, the Commission mentions the possibility for Member States to take "golden shares" in strategic companies. Through such "golden shares" a state entity can acquire special rights in certain undertakings, which enables it to block or limit certain types of investments in the companies concerned. Since these "golden shares" amount to a restriction of capital movements, they have to be justified. The most relevant exception to the principle of free movement of capital, enshrined in Article 63 TFEU, is "public policy or public security", as set out in Article 65 (1) (b) TFEU. The Commission explicitly refers to the possibility of relying on "grounds of public policy, public security and public health" if there is a genuine and sufficiently serious threat to a fundamental interest in society. The Court of Justice of the European Union has, however, applied a proportionality test to any restrictions on the free movement of capital.

Covington will continue to monitor the situation and will provide regular updates on new developments.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our CFIUS/FDI practice:

Peter Camesasca	+32 2 549 52 38	pcamesasca@cov.com
Horst Henschen	+49 69 768063 365	hhenschen@cov.com
Sarah Hachmeister	+49 69 768063 357	shachmeister@cov.com