Foreign Direct Investment, Screening on the Rise in Europe and Chinese answer: A Difficult Balance from Olivia Lê Horovitz, partner M&A, Private Equity, Simon Associés

The European Regulation establishing an EU foreign investment screening came into force on 10 April 2019. Its rules are aimed at strengthening control over foreign investments from investors in countries such as China that affect security or public policy sectors of EU member States. The Commission made a list of FDI screening mechanisms created by Member States publicly available and updates it regularly. In France, the list of strategic sectors where prior government approval is necessary for investment has been extended. In tandem with these new EU regulations, the "Pacte law" was passed, aimed at strengthening control over foreign investments. In response to this increase of control by the European Union and several of its member states, China has implemented a radically different strategy. In its recently created Foreign Investment Law adopted on the 15th of March 2019, the Chinese government advocates greater openness of the Chinese market to foreign investors and adds provisions aimed at increasing investor protection. Both the French and Chinese laws will take effect in January 2020. In this context, what will be the implications of these recent changes?

I. EU Foreign investment screening framework

On 13 September 2017, the European Commission published a proposal for a regulation establishing a legal framework for the screening of foreign direct investment ("FDI") inflows into the EU. On 13 June 2018, permanent representatives of the EU Member States (COREPER) agreed on the Council's position. The trialogue phase started on 10 July 2018 and ended on 20 November 2018 with an agreement on a provisional text. After the text's approval by COREPER, INTA (EU Parliament's Committee on international trade) endorsed it by 30 votes to 4 with 5 abstentions on 10 December 2018. The European Parliament Plenary approved the text on 14 February 2019.[1] On 5 March 2019, the European Council approved the text. On 10 April 2019, the new EU framework for the screening of foreign direct investments has officially entered into force.

The Regulation[2] proposes to create an enabling legal framework which embraces the diversity of Member States' approaches to FDI screening and their exclusive responsibility for national security, while taking into account the EU's competence for FDI. More precisely, under this document, Member States may maintain, amend or adopt FDI screening mechanisms on grounds of security or public order but they would not be obliged to create an FDI screening mechanism and they retain their final decision-making power on FDI.

In general terms, the most significant aspects of the Regulation are:

- to introduce a new Commission competence of screening FDI and issuance of a non-binding opinion, if

    i) an FDI in a Member State may affect the security or public order of projects or programs of "Union interest";

[1] Framework for screening of foreign direct investments into the European Union // http://www.europarl.europa.eu/doceo/document/TA-8-2019-0121_EN.html?redirect

[2] Regulation (EU) 2019/452 of the European Parliament and of the Council as of 19 March 2019.establishing a framework for the screening of foreign direct investments into the Union // https://eur-lex.europa.eu/eli/reg/2019/452/oj

ii) an FDI in a Member State may affect the security or public order of other Member States;

iii) to create a cooperation mechanism between Member State(s) and the Commission which aims to enhance the coordination of screening decisions taken by the Member State/s concerned and to increase the awareness of Member States and the Commission about planned or completed FDI that may affect security or public order by way of exchanges of information;

iv) to introduce transparency and information requirements for screening and non-screening Member States linked to this new cooperation mechanism.

A series of factors could be taken into account by Member States or the Commission in order to determine if a FDI may affect the Union on the grounds of security or public order:

- possible effects of an investment on critical infrastructures and technologies as well as dual use items, including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum and nuclear technologies, along with nanotechnologies and biotechnologies;
- supply of crucial inputs and food security;
- access to sensitive information, such as personal data, and the ability of controlling said data; media freedom and diversity;
- shareholding structure of foreign investors, whether they are directly or indirectly controlled by a foreign government.

In order to increase FDI screening regimes visibility, on 24 June 2019 the Commission published a list of FDI screening mechanisms notified by Member States.[3] As part of the Framework Regulation, Member States with an FDI screening mechanism in place are obliged to notify the Commission on its implementation.[4] Under Art. 3.8 of the EU Regulation 2019/452, the Commission is responsible for making a list of Member States' screening mechanisms publicly available and keeping this list up to date.[5] The recently published list is the first consolidated list of FDI screening mechanisms in the EU and is likely to spur the debate about introducing such a system in those EU Member States which have not yet done so.

Despite the fact that the screening mechanism is not binding, 15 out of the 28 Member States (with Sweden about to follow suit)[6] have already established such mechanisms, ranging from screening procedures to partial or total prohibition of FDI in specific sectors.[7] Albeit diversity in their nature and procedures, these mechanisms aim to address challenges raised by FDI into sectors that are deemed

[3] List of screening mechanisms notified by Member States (Last update: 22 July) // 2019 https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf.

[4] Focus on Regulation. Foreign Investment Control on the Rise – New List of EU Member States' FDI Screening Mechanisms // https://www.hlregulation.com/2019/06/26/foreign-investment-control-on-the-rise-new-list-of-eu-member-states-fdi-screening-mechanisms/.

[5] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union // https://eur-lex.europa.eu/eli/reg/2019/452/oj.

[6] Joshua Kirschenbaum, Etienne Soula, Meaghan Clohessy. EU Foreign Investment Screening – At Last, a Start // https://securingdemocracy.gmfus.org/eu-foreign-investment-screening-at-last-a-start/

[7] Foreign Investment Control on the Rise – New List of EU Member States' FDI Screening Mechanisms. 26 June 2019. Focus on Regulation // https://www.hoganlovells.com/en/blogs/focus-on-regulation/foreign-investment-control-on-the-rise-new-list-of-eu-member-states-fdi-screening-mechanisms.

sensitive or strategic to their economy and national security.[8] Legal experts expect that other states will soon implement similar FDI legislation, as it was the case of Hungary who did so in January 2019.[9]

In general, the current trend is the expansion of existing FDI screening mechanisms– especially in developed countries such as Germany, Austria, France, the UK, and – outside the EU – in the US. At the same time, new FDI regimes are being added or considered in countries which have not screened FDI previously (such as in the Netherlands).

According to the European Commission's report[10], growing inflows of FDI in the EU, their ever-evolving nature, as well as the rise of new investors from emerging markets and offshore financial centers, all support a policy reflection around investment screening. In fact, EU is keen to welcome FDI while also eager to protect essential interests, but some foreign investors, for example, the China State Owned Enterprises (SOEs) may be considered both as opportunities and as threats. The newly adopted Regulation seeks therefore to create a legal framework for cooperation among Member States, helping them to screen direct foreign investments made in the Union's strategic sectors that could affect security or public order within the European territory.

II. French Legislation relating to Foreign Investments

In the context of strengthening the control of foreign investments, particularly at the European level, the French Parliament intended to deepen control procedures and broaden the scope of authorization of foreign investments in France.

On June 18, 2018, the French government presented draft legislation aiming, among others, to reform French foreign investment rules – the "Pacte Law".[11] On 10 October 2018, the draft "Pacte Law" was voted at first reading by the National Assembly. On 11 February 2019, the senators adopted this Law but have significantly revised the text. On 16 March 2019, the Committee of The National Assembly re-modified the Senate version. On 11 April 2019, the "Pacte Law" final text was adopted by the National Assembly. It was published in the Official Journal on 23 May 2019 and will enter into force on 1 January 2020.

The recent legislation has implemented significant changes to French foreign investment rules:

- **Extension of the Scope of the French Prior Authorization Regime.** As a reminder, the Montebourg Decree as of May 14, 2014[12] had already extended the scope of French foreign investment control to certain strategic sectors (energy, transports, telecommunications, critical infrastructures, water and public health). From then on, foreign investments in these sectors are subject to authorization of the French Ministry of Economy. In 2018, the Decree

[8] *Ibid.*

[9] Dr. Tobias Heinrich. Update: New EU Foreign Direct Investment Regulation goes live. 2 April 2019 // https://www.whitecase.com/publications/alert/update-new-eu-foreign-direct-investment-regulation-goes-live.

[10] Commission staff working document on Foreign direct investment in the EU, European Commission, 13 September 2017.

[11] Loi n° 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises. JORF n°0119 du 23 mai 2019.

[12] Décret n° 2014-479 du 14 mai 2014 relatif aux investissements étrangers soumis à autorisation préalable // JORF n°0112 du 15 mai 2014. P. 8062.

2018-1057 as of November 29, 2018[13] enlarged this list of prior-approval sectors adding the so-called "sectors of the future". These "sensitive sectors" are currently set forth in Article R. 153-2 of the French Monetary and Financial Code. Specifically, the new regulations added the research and development activities relating to cybersecurity, artificial intelligence, robotics, additive manufacturing, semiconductors, and dual-use goods.[14] The implementing Decree of the "Pacte Law" further extended the French Prior Authorization Regime to semiconductors, space technology and drones, as long as it relates to national security interests, artificial intelligence, cybersecurity, robotics and big-data storage.[15]

- **Expansion of the Minister's Remedial Powers.** The "Pacte Law" reinforces the ability of the Minister to seek injunctive relief in order to enforce compliance with the French Prior Authorization Regime. For example, the "Pacte Law" also authorizes the Minister to exercise remedial powers in the event that after completion of the investment, the Investor fails to comply with its commitments' vis-a-vis the French government.

- **Reinforcement of Financial Sanctions.** The "Pacte Law" grants the Minister the power to impose fines in the following four situations:
  (i) if an Investor fails to seek prior authorization for a covered investment;
  (ii) if the French authorization was fraudulently obtained;
  (iii) if an Investor does not comply with its commitments vis-à-vis the French state;
  (iv) if an Investor fails to comply with an injunction order from the Minister.

III. China's New Foreign Investment Law

While the EU and its Member States intend to take more control over FDI, China, on the contrary, has elaborated a new Foreign Investment Law ("FIL") aiming to attract more foreign investors, on 23 December 2018. The Law was passed as of 15 March 2019 and is hereby promulgated to take effect on January 1, 2020. The FIL will put an end to the three existing laws on Chinese-foreign equity joint ventures, wholly foreign-owned enterprises, and Chinese-foreign contractual joint ventures.[16]

The main features of the new Chinese Law are as follows:

- **Definition of "foreign investments"**: Article 2 of the new Law defines foreign investments as foreign investors' direct and indirect investment activities in the mainland of the People's Republic of China. Investments in new projects or enterprises; increased investment in existing enterprises; mergers and acquisitions of shares, equity, assets and other similar interests in enterprises in the PRC; and foreign investors' other investments in the PRC made in accordance with laws and regulations are covered by the definition.

[13] Décret n° 2018-1057 du 29 novembre 2018 relatif aux investissements étrangers soumis à autorisation préalable // NOR: ECOT1816712D // ELI: https://www.legifrance.gouv.fr/eli/decret/2018/11/29/ECOT1816712D/jo/texte.

[14] Nicolas Lafont, Stephan de Groër. Foreign Investment Control in France: Strategic Sectors Expansion and Sanctions Reinforcement // McDermott Will & Emery. International News. Issue 2 2019. P. 21.

[15] Loi n° 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises. JORF n°0119 du 23 mai 2019.

[16] Foreign Investment Law of the People's Republic of China // https://www.dezshira.com/library/legal/foreign-investment-law-china.html.

- **Implementation of a “pre-establishment national treatment” mechanism**. Under Article 4 of the FIL, “pre-establishment national treatment” refers to affording foreign investors and their investment treatment, during the investment access stage, no less favorable than that afforded to Chinese domestic investors and their investments.

- **Establishment of a “negative list management” system**. Under Article 4 of the FIL, “negative list” refers to the special administrative measures for foreign investment as prescribed by the State. This “negative list” refers to the special administrative measures for the access of foreign investment in the specific fields, which will be issued or approved for issue by the State Council.[17]

- **Foreign investment promotion.** The FIL emphasizes establishing a stable, transparent and predictable investment environment for foreign investments in China. The new Law sets forth the major principles (not clearly stated in the 2015 consultation draft) for promoting foreign investments which include, among others:

    - Legality or the rule of law[18];
    - Equal protection of foreign investors, consistent application of national policies for developing enterprises to foreign-invested enterprises;
    - Fair and equitable access of foreign-invested enterprises to the state's standardization work and to the government procurement projects;
    - Strengthening of the foreign investments protection.[19]

- **Investment protection.** The FIL also provides for various foreign investments protection mechanisms, specifically:
    - Prohibition of State expropriation of foreign investments. If expropriation is required in the public interest, the State should adhere to procedural fairness standard and pay fair and reasonable compensation;[20]
    - Free transfer of the capital contributions, profits and capital gains of foreign investors into or out of the PRC;[21]
    - Extension of the list of fundraising options available for foreign-invested enterprises (public offering of shares, corporate bonds and other securities);[22]
    - State protection of intellectual property rights of foreign investors and foreign-invested enterprises. Under this principle, administrative means should not be used for forced transfer of technology, this being an important new guarantee not previously provided for;[23]
    - Prohibition of the foreign investment rules that:
        - impair the legitimate rights of, or impose additional obligations on foreign-invested enterprises,

[17] China: Foreign Investment Law Passed. Global Legal Monitor // https://www.loc.gov/law/foreign-news/article/china-foreign-investment-law-passed/.
[18] Explained: China's new Foreign Investment Law // http://www.chinadaily.com.cn/a/201909/18/WS5d818994a310cf3e3556c181.html
[19] *Ibid.*
[20] Article 20. Foreign Investment Law of the People's Republic of China. Promulgation Date : 2019-03-15 Promulgation Number : Order of the President of the People's Republic of China No. 26. Promulgation Department: The National People’s Congress of the People’s Republic of China.
[21] Article 21. *Ibid*.
[22] Article 17. *Ibid*.
[23] Article 21. *Ibid*.

- create unlawful conditions for market access or exit,
- intervene or influence the normal production and operation activities of foreign-invested enterprises[24];

- Strict abidance of local governments and their relevant departments to policy commitments and contracts made according to the legal requirements;[25]
- Protection principles at the local government level (this guarantee had not previously been included in the 2015 consultation draft);[26]
- Improvement of the mechanism for submitting and handling complaints for the protection of the rights of foreign-invested enterprises.

The FIL will have effect on: 1) corporate governance of the existing joint-ventures, 2) the share transfer, dividend distribution schemes, 3) foreign debt quotas, 4) repatriation of profits and minimum shareholding requirements.[27] In these circumstances, it is recommendable that the foreign companies investing in the Chinese economy evaluate both the strong and weak sides of their business strategy, consider how to adapt the old corporate governance structure provided by the old rules to the new FIL governance rules, prepare for a probable round of negotiations with other shareholders of the joint-ventures and also consider more investment opportunities in the restricted sectors in the coming years.[28] Foreign investors can benefit from a 5-year transition period ensuring that the Chinese market participants are ready for the changes.[29]

In general, FIL is designed to open the Chinese market to foreign investments through deregulation and institutional reform. However, the vague wording of the new law could cause loopholes on operational level.[30] Thus, it remains yet unclear how this law will be enforced and handled by local authorities. Since Article 11 of new Law imposes on the Chinese state the obligations to establish and improve the foreign investment service system, to provide counselling and service about new rules and regulations It remains to be seen how the law will be implemented.

Conclusion

In our global world, investing abroad has become a common economic strategy. China has been particularly active in this respect, thus provoking China-US trade war, on the one hand, and appearance of the new European screening mechanisms, on the other hand. The majority of the European countries have already enacted the screening mechanisms, in one form or another. In particular, France has enacted the “Pacte law” relating, inter alia, to strengthening the international investments control. China, in its turn, has responded to criticism of the lack of reciprocity by elaborating a new foreign investment law attempting to remove multiple restrictions on investment outside the negative

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[24] Article 24. *Ibid*.
[25] Article 25. *Ibid*.
[26] Article 26. *Ibid*.
[27] Mark Schaub, Atticus Zhao, Dai Xueyun, Zheng Wei. China Foreign Investment Law: How Will It Impact the Existing FIEs? // https://www.chinalawinsight.com/2019/06/articles/foreign-investment/china-foreign-investment-law-how-will-it-impact-the-existing-fies/
[28] *Ibid.*
[29] Explained: China's new Foreign Investment Law // http://www.chinadaily.com.cn/a/201909/18/WS5d818994a310cf3e3556c181.html
[30] Daisy Cao. China’s New Foreign Investment Law. Highlights, challenges and concerns for foreign investors // https://www.s-ge.com/en/article/news/20193-c3-china-investment-law

list.[31] It is still unclear how particular provisions of this investment law are to be applied in the future. However, it is interesting to note that some of the sectors which have been restricted from foreign investments in the EU and in France are the ones which are being encouraged for investment by China. Meanwhile, there is a probability that the Chinese market will become more attractive to foreign investors who have previously been prohibited to invest in many sectors of the Chinese economy.

[31] Wider, deeper opening-up on the agenda to attract foreign investment // https://www.telegraph.co.uk/china-watch/business/attracting-foreign-investment/