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Change & Recovery
FDI restrictions in CEE/SEE

Developments in the Covid-19 era

April 2021

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In the context of the global pandemic in 2020, which exposed the vulnerabilities with excessive reliance on externalised foreign supply chains, EU Member States (including many in the CEE/SEE region) have accelerated the adoption of local legislation aimed at restricting foreign direct investment ("**FDI**") into certain critical infrastructure[1] and critical technologies[2] in their respective countries.

This article will examine certain of those FDI screening/restriction requirements recently implemented in several CEE/SEE countries and the anticipated impact these requirements may have on inbound FDI in these surveyed countries.

INVESTORS CAN AVOID PENALTIES BY PREPARING

A survey of the legislative and procedural changes implemented/soon to be implemented in the below-referenced countries in the area of FDI screening/restrictions underscores that foreign investors must be well informed and prepared for increased scrutiny and further compliance requirements that will need to be met—particularly if they are investing in critical industries or technologies.

Whereas compliance with these further screening procedures and restrictions will imply additional paperwork, approvals and delays in closing transactions, failure to comply *could result in significant monetary and commercial sanctions for the investors*. And because the local legislation in this area of FDI screening and restriction is not unitary across the EU or CEE/SEE markets, it is critical

[1] Article 4, clause 1(a) of the FDI Regulation defines "critical infrastructure . . .including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure and sensitive facilities as well as land and real estate crucial for the use of such infrastructure."

[2] Article 4, clause 1(b) of the FDI Regulation defines "critical technologies. . .including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technolgies as well as nanotechnologies and biotechnologies."

that investors obtain the best legal advice "on the ground" before proceeding with their investments in these countries.

With offices in thirteen countries in the CEE/SEE region, Wolf Theiss lawyers have the local expertise needed to guide investors through the labyrinth of local legislation, including the fast-evolving area of FDI screening and restriction.

THE EXISTING EU FRAMEWORK ON FDI

Member states retain control of final decisions on FDI

With the adoption of EU Regulation 452/2019 "Establishing a Framework for the Screening of Foreign Direct Investments into the Union" (the "**FDI Regulation**"), the EU attempted to establish a framework to legislate the growing trend among Member States towards screening and restricting of foreign direct investment ("**FDI**") into their countries.

Viewed by many as a necessary tool to protect critical infrastructure and critical technologies, critics argue that FDI restrictions can be misused by Member States as a mechanism to unfairly favour domestic or preferred investors and stifle legitimate foreign investment.

What is important to note is that the FDI Regulation is merely a framework—it leaves the FDI screening and restriction process within the authority of the individual EU member states. The cooperation mechanism under Article 6 of the FDI Regulation does provide that the EU should be notified about any such screening/restrictions and that the Commission may issue an opinion thereon. This opinion should be given "due consideration" by the Member State. However, "the final screening decision shall be taken by the Member State undertaking the screening".[3] Or, as more succinctly stated in clause 17 of the preamble to the FDI Regulation:

> *The final decision in relation to any foreign direct investment undergoing screening or any measure taken in relation to a foreign direct investment not undergoing screening remains the sole responsibility of the Member State where the foreign direct investment is planned or completed.*

[3] Article 6, clause 9 of the FDI Regulation

FDI RESTRICTIONS INTRODUCED IN THE COVID-19 ERA

As previously noted, a number of countries have invoked the vulnerabilities exposed by COVID-19 as the justification to increase FDI screening/restriction requirements in 2020-2021:

- In May 2020, the Investment Control Act (the "**ICA**") entered into force in **Austria,** expanding the Austrian FDI control regime and implementing the EU cooperation mechanism under the FDI Regulation. The main changes introduced by the ICA include a broader scope of applicability, especially with respect to the relevant industry fields, indirect purchases and asset deals. The ICA is generally applicable to direct and indirect acquisition of voting rights in, controlling influence over or substantial assets of an Austrian company.

  If these criteria are met in particularly sensitive sectors (e.g. defence, energy, 5G, medical products and vaccines) then the purchaser must apply for approval from the relevant Austrian authority, which is obliged to initiate the EU cooperation mechanism. This is then followed by a two-stage approval process by the Austrian authorities[4] and this whole process can prolong the closing of the relevant investment transaction for a period of 4-6 months. An investor may also file an application for issuance of a non-objection ruling, claiming that their investment is not subject to the FDI approval requirement. The Austrian authority has two months within which to either issue a non-objection ruling or require that the investor go through the FDI approval process.

- In January 2021, the Parliament in the **Czech Republic** approved the new Act no 34/2021 Coll., On Screening of Foreign Investments (the "**New Act**") which will come into effect on 1 May 2021 but will not apply retroactively. As in Austria, the New Act focuses on those investors achieving effective control in a particular company (e.g. at least 10% of voting rights or corresponding influence in a target and with no monetary threshold). The new Act obliges the investor to seek permission for the investment or file a proposal for consultation with the Czech Ministry of Industry and Trade (the "**Ministry**") if the investment is in a so-called strategic sector or the media industry. Under the New Act, the Ministry may initiate screening proceedings either before the foreign investment is made or within a period of 5 years from the

[4] In Phase 1 the authority must decide within 1 month after the EU cooperation mechanism has been closed (which usually takes between 6-12 weeks) and either grant the approval or request a further, more in-depth Phase 2 assessment. The authority then has another 2 months to further consider and grant or deny approval. If denied, this can be challenged by the investor, which could last another 2 months.

moment the investment is made (but again not retroactive from 1 May 2021). Failure to apply for permission from the Ministry for a transaction that meets the requirements of the New Act could expose the investor to fines of up to 3.7 million EUR or 2% of the total prior financial year turnover.

- On 24 July 2020, the **Polish** Act on the Control of Certain Investment was amended to expand coverage of the existing FDI screening regime from nine strategic Polish companies to include various sectors of strategic interest, including among others IT, energy, telecom, medical and pharmaceutical. As in Austria and the Czech Republic, the amended Polish Act applies to certain control thresholds (in Poland, the threshold is 20% share or vote acquisition in target Polish companies in strategic sectors and also includes indirect acquisitions). However, in Poland there is also a monetary threshold--the target company should have revenues over the prior two financial years exceeding EUR 10 million. FDI approval is granted by the President of the Office of Competition and Consumer Protection and the whole approval process (which is divided into a preliminary stage and a controlling stage) can take up to 4 months.

- In **Romania**, the FDI screening procedure is currently embedded within the merger control process and the relevant approval authority is the Supreme National Security Council ("**CSAT**"), while the Romanian Competition Council ("**RCC**") plays the interface role with the investor. Given the currently very broad definition of "sensitive industry sector" in Romania, this effectively means that a high share of all notifiable mergers to the RCC are also reviewed by CSAT. CSAT is not bound by any procedural deadlines to respond on matters referred to them by the RCC, however there is no standstill obligation or fines for the investor proceeding with a transaction prior to CSAT clearance. Under a proposed new standalone FDI approval procedure to be implemented in Romania, which will only apply to non-EU investors (as per the current draft law proposed for publication), specific clearance deadlines and sanctions for non-compliance will be applied.

  The new approval procedure will also update the current broad definition of "sensitive industry sector" to more closely align with the "critical Industry" and "critical technologies" definitions under Article 4 of the FDI Regulation. Under the new procedure, the RCC will retain its role as the primary interface with the foreign investor whereas a newly created FDI Screening Commission will be tasked with obtaining necessary opinions and decisions from the CSAT and Cybersecurity Task Force as required. A standstill obligation will also be imposed under this new procedure which will trigger fines of between 1% and 5% of the investor's global turnover if violated.

- In May 2020, **Hungary** introduced a temporary FDI screening regime in the context of the pandemic, which supplemented an existing screening regime that had already been introduced in January 2019. This temporary regime effectively expanded the requirements for foreign investors to seek prior approval from the appropriate government ministries in certain strategic industry sectors. Specifically, whereas the existing screening regime covered primarily defence, financial/insurance services, energy transmission, water supply and telecommunications, the temporary regime introduced in 2020 also covers manufacturing and chemicals, food and agriculture, health and medical, waste and building materials, transport and logistics and even some retail and wholesale activities.

  The temporary regime also lowers the effective financial thresholds at which foreign investments in these covered sectors must be notified and preapproved by the relevant Hungarian authorities and expands the type of investments[5] that are covered. As in the other surveyed countries in the CEE/SEE region, violation of these FDI screen requirements can lead to substantial fines—indeed these have been increased under the temporary regime from HUF 10 million (roughly EUR 30,000) to an amount of at least 1% of the Hungarian target's annual net turnover.

- An amendment to the **Slovak** Act of Critical Infrastructure (the "**Act**") became effective on 1 March 2021 and prior to this amendment, there was no formal FDI screening procedure in place in Slovakia. The screening mechanism introduced by the amendment to the Act covers "critical infrastructure" under the Ministry of Economy which includes entities[6] operating in industry sectors such as mining, energy/electricity, oil and gas, pharmaceuticals, metallurgy and chemicals. The Act applies to both share deals and asset deals where the foreign investor acquires at least 10% of the shares or voting rights/equity in the target company, and it also covers indirect acquisitions.

  Any transaction which is subject to the Act must be submitted for review by the Ministry of Economy, which (following the review) then provides its recommendation to the Slovak Government as to whether it should consent, conditionally consent or deny the investment transaction. The

[5] For example, besides acquisition of shares in a Hungarian company, the temporary regime also applies to acquisition of convertibles or rights in usufruct as well as corporate transformations, asset acquisitions, capital injections and even in-kind contributions, irrespective of the nature or value of the contribution.

[6] The list of entities covered under the amendment to the Act as comprising "critical infrastructure" is not publicly available but is generally estimated to cover around twenty companies, some of which are already partially owned by foreign investors.

Slovak Government considers this recommendation and if it decides to withhold consent/deny the investment, then the investor has thirty days within which to appeal this decision to the Slovak Supreme Court. During this entire review process, there is an effective standstill period, during which no party to the contemplated transaction may undertake any rights or obligations in relation to that transaction.

About **WOLF THEISS**

Wolf Theiss is one of the leading European law firms in Central, Eastern and South-Eastern Europe with a focus on international business law. With 340 lawyers in 13 countries, over 80% of the firm's work involves cross-border representation of international clients. Combining expertise in law and business, Wolf Theiss develops innovative solutions that integrate legal, financial and business know-how.

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