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Status report on newly implemented FDI regimes

Lessons learned in CEE/SEE

September 2021

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FDI restrictions in Central and Eastern Europe

In the context of the global pandemic which exposed the vulnerabilities of 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 into certain critical infrastructure and critical technologies in their respective countries.

Investors can avoid penalties by preparing

A survey of the legislative and procedural changes 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, it is critical that investors obtain the best legal advice "on the ground" before proceeding with their investments in these countries.

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 EU attempted to establish a framework to legislate the growing trend among Member States towards screening and restricting of foreign direct investment 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".[1] 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"

Bryan Jardine
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1 Article 6, clause 9 of the FDI Regulation

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Czech Republic

The liberal FDI regime changed significantly as the very first Czech FDI Act came into force in May 2021

Mandatory FDI approval introduced for investments made by non-EU investors in sensitive areas

Since 1 May 2021, non-EU investors have been required to comply with the new Czech Act on the Screening of Foreign Direct Investment (the "**FDI Act**"), which introduced two categories of FDI screening regimes.

The first regime relates to investment in specific "sensitive" areas, which must be approved in advance. The second is for all other investments, which require no such prior approval, but which may be screened ex-post within five years if they are likely to affect the security or the public or internal order of the state. Previously, investments had only been regulated for certain areas of business (such as military or banking and insurance), irrespective of where the investor was from.

The authority competent for conducting the screening and other administrative proceedings under the FDI Act, including proceedings for offences committed, is the Ministry of Industry and Trade (the "Ministry").

Identifying whether the mandatory FDI filing is required may be challenging

The FDI Act presents foreign investors with new challenges, as certain matters have yet to be settled or clarified through application in practice. Therefore, when advising on FDI matters, we have discussed the regulations with the Ministry and assessed the issues at hand by taking into account *inter alia* both the views of the Ministry and the practices in foreign countries where FDI rules have been introduced before.

The first major concern which investors face is identifying which is the applicable regime under the FDI Act. The FDI Act stipulates that an application for approval is mandatory for investments into, *inter alia*, the operation of critical infrastructure and services. However, critical infrastructure is defined by its registration in a specific registry which is not publicly available and only very general criteria are set out in Czech law.

The Ministry has suggested that the target must itself know whether it operates critical infrastructure and could communicate this to the buyer. However, the target may be bound by a confidentiality obligation that prevents it from disclosing this information to any party. Hence, any response from the target may not be conclusive. Furthermore, it may be difficult for a foreign investor to draw any decisive conclusions when conducting a preliminary assessment or being engaged in transactions in which there is no prior communication with the target (such as acquisition of a minority share or a highly sensitive transaction).

Given the above, an investor's assessment of the FDI regime may not provide definitive answers.

Therefore, we advise investors to make an FDI filing in all cases where the requirement for a mandatory FDI approval may apply and to join the filing with a proposal for a voluntary consultation process.

That way, if the Ministry ultimately decides that the mandatory procedure does not apply, the consultation process will be initiated. Given that the investment cannot

be reviewed again after the consultation process has concluded (except for in very limited circumstances), this approach protects the investment from any ex-post screening.

Investors need to assess carefully whether they qualify as "foreign investors"

Furthermore, investors must take care when assessing whether they fall under the definition of a foreign investor. It is currently unclear whether the FDI obligations apply to acquisitions of Czech targets by an EU investor if a) that investor is directly owned by a non-EU investor but b) the ultimate owner is from the EU. The wording of the FDI Act allows for more than one interpretation and no prevailing opinion has been established in this regard.

When compared with the approaches taken in other countries (for example, Austria and Germany), the structure described above (i.e. intermediate non-EU holding with EU UBO) may indeed fall within the scope of those countries' FDI laws. As the Ministry has admitted that screening cannot be ruled out in such a case, a careful approach is recommended.

Filing early is the advisable course of action

The stage at which applications for the FDI approval must be filed presents a further unresolved matter. The FDI Act does not define whether submissions can be made at any time before closing, or whether they should be made strictly between signing and closing or even before signing.

Although it appears sufficient under the FDI Act for the mandatory filing to be made and the approval to be obtained any time before the closing of the transaction, the Ministry's preliminary views expressed informally do not fully support this approach. They rather indicate that the Ministry would prefer the FDI filing to be made before the signing of the transaction. It is therefore recommendable to file the FDI application at an early stage of the transaction.

Nevertheless, we believe that in the long run, a different practice may prevail, and investors will be able to wait with the mandatory FDI filings until the transaction documentation has been signed and obtain the FDI approval any time before closing (similarly as is the case for merger clearance). Such an approach can be observed in some foreign countries (such as Austria, where, however, submission of the filing immediately after signing is required) and in our view, it is also fully compliant with the FDI Act.

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Hungary

Recent changes to the FDI regime were intended as temporary and exceptional, but they may be harbingers of a more lasting tightening of the system

For decades the norm has been an investor-friendly approach

Hungary has been advocating a welcoming legal and regulatory environment for foreign investors, successfully attracting significant amount of investments over the past decades. Before 2019, when the Hungarian FDI Act took effect pre-empting the European framework regulation, no investor screening regime had existed in Hungary, except for certain sectorial reviews available in selected regulated industries. These included energy, utilities and banking, in which the acquisition of certain controlling stakes had long been subject to prior approval of the competent national regulator.

Stop-gap changes to previous regime were seen as exceptional and temporary

The introduction of the lasting FDI screening requirements in 2018 and certain temporary FDI screening rules in 2020 in response to COVID-19 were both seen as exceptional tools. Both were intended to supplement the well-established and long-lasting industry-specific regulatory review frameworks. Both FDI regimes have been under constant revision and amendment by the Hungarian lawmakers during the COVID-19 pandemic.

Some changes were very obviously required to tighten the applicable substantive as well as procedural rules, while others appear to carry a connotation in the changing shift of the Hungarian review policy. For instance, bringing under the scope of the FDI screening regime sectors that have not been captured from the outset, such as higher education or even insurance. The temporary FDI regime in Hungary is now expected to expire at the end of 2021 (which is already a date revised from February and then June 2021).

It remains to be seen if any of the temporary FDI regime's different screening requirements will find their place in the lasting FDI rules after their scheduled expiry.

Big shift: EU investors now also covered by the FDI regime

Although FDI screening was designed not to capture any investors from the EU, the EEA or Switzerland, now both Hungarian FDI screening regimes require investors from outside and inside these locations to make a filing for prior Ministerial approval. Furthermore, the industries caught by the Hungarian FDI screening requirements are sweeping in nature and go far beyond what has been captured under the relevant EU framework regulation. Therefore, in quite a number of instances investors find themselves facing an FDI screening requirement in respect of the Hungarian angle of their deals, even if otherwise simultaneous signing and closing would be possible.

Both FDI screening regimes currently applicable in Hungary trigger a mandatory filing obligation with a clear standstill obligation and, furthermore, both relevant laws provide that any transaction implemented without having first obtained the competent Minister's prior acknowledgement would be considered null and void from the Hungarian law perspective.

Furthermore, the review periods are quite lengthy (i.e., 60 calendar days under the lasting regime, whereas 30-business days

under the temporary regime) which, under both regimes can be further extended at the discretion of the acting Minister (with up to another 60 calendar days under the lasting regime and 15 calendar days under the temporary one). Accordingly, investors are advised to carefully consider the Hungarian FDI review proceedings in their completion schedules.

Business community has reacted with raised eyebrows to recent cancelled deals

The competent Ministers under both FDI screening regimes in Hungary enjoy reasonably wide discretion and powers to approve or reject transactions on national security and public order grounds. Practice has shown that they are prepared to step up in the name of protecting Hungarian national interests and hand out prohibition decisions under both FDI regimes, even in respect of the Hungarian parts of significant international transactions. Some of those blocking decisions recently have received controversial reactions from the business community as well as European policymakers, being seen as not genuinely falling within the domain of the prevailing and publicly-asserted policies.

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Poland

The new FDI screening regime in Poland appears investor-friendly thus far, but ambiguities in the rules need clarified

Two decisions in the last year have both cleared the transactions

A new FDI screening regime was introduced in Poland over one year ago, yet enforcement to date shows an investor-friendly approach. Since the introduction of the amendments to the Act on the Control of Certain Investments, we can see that the new requirements do not prevent foreign investors from acquiring Polish targets – it is clear that the Polish M&A market has not suffered from the new FDI regulations.

To date, few FDI proceedings have been initiated under the new regime, and only two decisions have been issued by the President of the Office of Competition and Consumer Protection – both allowing the transactions. The Office's approach is rather positive and investor friendly, but it can of course change in the future.

Big investors (and small startups in effect) not covered by new rules

Excluding investors from EU and OECD countries from the scope of FDI screening regime was a very positive move for investment. This is because the largest investors in Poland have not been limited from investing further.

Core investors, such as private equity funds and VC funds from the USA, European Union, United Kingdom, Japan, remain unaffected by the new regime.

Additionally, financial threshold of EUR 10 million relating to the target's revenues from sales and services in Poland in any of the two financial years preceding the transaction have allowed many startups and small companies to be excluded from the FDI requirements.

Vague definitions reduce legal certainty

At the same time, there are still many ambiguities in Polish FDI laws, and the Polish regulator is not eager to provide the market with clarifications or binding interpretations. Such clarifications would clearly be very useful for investors and practitioners, and they would contribute to greater legal certainty. For example, the definition of strategic companies and sectors covered by the Act is very general and vague, and it includes not only classic sectors like energy, gas, fuel, telecommunications and military products, but it also applies to many not-easily-definable IT industry entities involved in voice or data transmission systems, and entities providing cloud computing data storage or processing services.

There is also no unified practice relating to the moment when the transaction should be notified to the authorities. The general rule is that the notification shall be made before taking any legal action that leads to acquiring or achieving significant participation or acquiring dominance in a strategic company. This means that the review needs to be obtained prior to the closing, and even prior to the signing.

At the same time, the FDI act states that the agreement (or other legal action) covered by the notification can be conditional upon the authority's approval. These are only two examples of ambiguities – in practice there are also more unclear provisions which require great care when navigating the transaction.

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Despite investor-friendly implementation to date, navigating the rules remains critical for M&A

The FDI screening procedure is undoubtedly one of the key factors that must be taken into account when planning an M&A deal involving Polish targets. FDIs are also becoming more and more important in the tech sector, as technological companies are also widely covered by the Polish Act on the Control of Certain Investments. Despite the fact that the new Polish FDI regulation was intended to be binding for only 2 years, i.e. until June 2022, it is very probable that it will be extended for an indefinite period.

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Romania

After years with a liberal FDI regime, Romania shifts to stricter rules for non-EU investors

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The current mechanism created an investor-friendly environment

Romania has had a positive history with FDI screening since 2012, when the current mechanism was first set up. To date, no transactions have been prohibited from moving forward or conditionally authorised.

Although the scope of the 2012 rules is wide and many sectors are covered, the current regime managed to preserve an investor-friendly environment. Most foreign direct investments essentially ticked the FDI screening box as a mere formality.

It managed to achieve this via a flexible and efficient procedural design:

- the FDI screening mechanism has been embedded in the national merger control procedure. The investor had to file the merger notification before the Competition Council, and it was up to the competition authority to send transactions which could potentially impact sensitive sectors to the Supreme Council for National Defence ("SCND") for scrutiny under FDI rules.
- the Competition Council cleared the mergers upon receiving a green light on national security issues from SCND. The procedure is inter-institutional, with no standalone filling obligations on behalf of investors. In practice, this led to some delays in the merger control clearances processes, but generally the process went smoothly. In a few particular cases (i.e. in the agriculture sector), no formal clearance had been issued by SCND, but the investors moved forward with the transaction anyway, as no concerns were expressed by the authorities in a reasonable time period, and the law provided no standstill obligations / fines for gun-jumping.
- for mergers falling below merger control thresholds or falling under the jurisdiction of the European Commission, SCND moved swiftly in providing clearance (generally below 45 days). For instance, the recent acquisition of Aegon operations in Romania by Vienna Insurance Group was cleared by SCND within a reasonable timeframe.

Tighter rules just around the corner will primarily affect non-EU investors

A new, stricter FDI screening mechanism is on the horizon. Following the wave created in Europe by the EU FDI Screening Regulation, Romania refined the new screening mechanism after several rounds of public consultation. The new mechanism, expected to be adopted after mid-October 2021, will target investors outside of the EU, but the existing flexible mechanism will continue to apply for EU investors.

There is concern that waiting times for investors will rise

This legislative shift is likely to impact significantly the closing timeline of most transactions, as it introduces a standstill obligation and the published procedural deadlines for review are quite long. For instance, a regular phase I review for non-problematic deals may take around 3 or 4 months, instead of the customary 45/60 days, which used to be the norm. This runs against the efforts and enormous progress made by Romania in the field of merger control, where the Competition Council adheres to its ambitious internal merger clearance targets (one month for simplified procedures and two months for regular Phase 1 procedures).

Thus, if the new procedural deadlines set for FDI screening are not improved, the waiting

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period for investors is likely to increase significantly.

The good news is that the Romanian Competition Council will have a key role in FDI national enforcement and coordination with the European Commission, and this should bring significant efficiency gains to the review process.

Foreign investors should be aware that the list of sensitive sectors in Romania is currently extremely broad. It covers sectors such as energy, agriculture, protection of the environment, IT and communication infrastructure. Moreover, the jurisdictional value threshold is set by the draft law at EUR 2 million. In line with the trend in Europe, the most probable beneficial change in the new law will be a clear focus and definition of the sensitive / critical sectors requiring FDI screening and a fast track review procedure for non-problematic deals or greenfield investments.

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