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+ ADD 2 (SWD(2017) 297 final)

EXPLANATORY MEMORANDUM FOR EUROPEAN UNION LEGISLATION AND DOCUMENTS

COMMUNICATION FROM THE Commission Welcoming Foreign Direct Investment while Protecting Essential Interests

Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL establishing a framework for screening of foreign direct investments into the European Union

ANNEX to the PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL establishing a framework for screening of foreign direct investments into the European Union

COMMISSION STAFF WORKING DOCUMENT Accompanying the document Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union

Submitted by the Department for International Trade on 5 October 2017

This Explanatory Memorandum was drafted in collaboration with the Department for Business, Energy, and Industrial Strategy.

SUBJECT MATTER

1. The EU Commission has proposed an EU-wide Foreign Direct Investment (FDI) screening framework to mitigate against perceived security risks. This proposal was highlighted in Commission President Juncker's annual State of the Union address on 13 September 2017 and also referred to in the accompanying package of written material stemming from the speech. The proposals are made in line with the EU's trade principles and objectives set out in the EU's "Reflection Paper on Harnessing Globalisation" published on 10 May 2017 (EU document no 9075/17).

2. The EU Commission's Communication document "Welcoming Foreign Direct Investment while Protecting Essential Interests" and also the Commission Staff Working Document (Annex ADD 2) give the context for the EU taking action in this policy area. It explains that the EU is open to foreign investment with one of the most open investment regimes in the world. This document makes the case for action. Whilst the Commission fully acknowledges the need to maintain the necessary flexibility of Member States to screen foreign direct investments, it considers that foreign direct investment falls under the EU's Common Commercial Policy.
3. The proposed Regulation itself includes a framework to allow the European Commission to carry out screening of foreign investment into the EU and a mechanism for mandatory information sharing about the operation of Member States' national regimes, including provision for the Commission to give non-binding opinions. These proposals, if introduced, will have implications for the UK both as a current Member State and as a third country following exit from the EU.
4. In summary the Commission proposes:
 - i. A framework for investment screening that, while it does not mandate Member States to screen investments, promotes convergence of policies by putting in place 'basic requirements' for those who have, or wish to have, a screening mechanism, such as the possibility of judicial redress of decisions, non-discrimination between third countries and transparency.
 - ii. A mechanism for cooperation that would compel Member States to share information on their screening activity, including live cases, in order that other Member States could provide comments and the Commission could provide non-binding opinions over a combined ten-week period. Member States that do not have a screening mechanism would still be required to provide an annual report to the Commission detailing Foreign Direct Investment (FDI) in their territory.
 - iii. A means for the Commission to issue an opinion to a Member State in which FDI is planned in relation to projects and programmes that have Union interest such as Galileo¹, Copernicus², Eurocontrol³, energy transmission networks and some cybersecurity functions. A full list of the projects of programmes of Union interest which are referred to in Article 3(3) of the proposal are listed in the Annex document ADD 1.

¹ Galileo is a global satellite navigation system

² Copernicus is a programme providing satellite earth observation for environmental purposes

³ Eurocontrol coordinates air traffic control across Europe

5. The proposals do not:
 - i. restrict Member States from establishing, or continuing to operate, their own screening regimes as this is already permitted under the EU Treaties;
 - ii. enable the EU to intervene directly in FDI at national level; or
 - iii. cover portfolio investment.⁴
6. This Explanatory Memorandum was drafted in collaboration with the Department for Business, Energy, and Industrial Strategy.

SCRUTINY HISTORY

7. Not applicable. This is a newly proposed Regulation.

MINISTERIAL RESPONSIBILITY

8. This proposal falls within the responsibilities of two Ministers, the Secretary of State for International Trade and the Secretary of State for Business, Energy and Industrial Strategy. The Department for International Trade has responsibility for ongoing trade business with the EU and the UK's independent international trade policy post-exit, and the Department for Business, Energy and Industrial Strategy has responsibility for the development and implementation of the UK's domestic FDI screening policy, to which the additional EU process could foreseeably need to be added should the Regulation be implemented before the UK departs from the EU.

INTEREST OF THE DEVOLVED ADMINISTRATIONS

9. International trade policy is a reserved matter under the UK's devolution settlements and no devolved administration interests arise. The devolved administrations have therefore not been consulted in the preparation of this EM.

LEGAL AND PROCEDURAL ISSUES

Legal basis

10. The legal basis for this proposed Regulation is Article 207(2) of the Treaty on the Functioning of the European Union (TFEU).

⁴ Portfolio investment is the purchase of assets such as stocks, bonds and cash equivalents, or the depositing of money into a country's banks, often on the basis of speculating for profit.

European Parliament Legislative Procedure

11. The proposal is subject to the Ordinary Legislative Procedure.

Voting procedure

12. The proposed Regulation will be subject to Qualified Majority Voting.

Impact on United Kingdom Law

13. Depending on the contents of the final Regulation, it is possible that procedural requirements would need to be added to the Enterprise Act 2002 and potentially additional amendments to that Act and other legislation would be required regarding information gathering and sharing on live cases. However the extent of the Regulation is not clear in regard of the latter.

Application to Gibraltar

14. This proposal is not applicable to Gibraltar.

Fundamental rights analysis

15. No fundamental rights issues arise from this proposal.

APPLICATION TO THE EUROPEAN ECONOMIC AREA

16. This proposal does not have relevance under the EEA agreement.

SUBSIDIARITY

17. The proposal relates to the common commercial policy which is an area of exclusive European Union competence.

POLICY IMPLICATIONS

18. On 23 June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. The Government respected the result and triggered Article 50 of the Treaty on European Union on 29th March 2017 to begin the process of exit. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will also continue to negotiate, implement and apply EU legislation.

19. The main policy implications of the proposed Regulation are threefold.
20. First, it could add additional process to the UK's own limited investment screening activity before EU exit, constraining the ability of the UK to act swiftly in cases of genuine national security concern, and place additional burden and uncertainty on prospective investors, which is at odds with the UK's stance as an open and liberal investment destination.
21. Second, the Regulation as drafted would compel Member States to provide information to other Member States and the Commission on live cases in order that they may provide opinions. While the UK already shares information on security risks with other Member States through appropriate channels on a voluntary basis, the compulsory sharing of information that is likely to be highly sensitive both for security and commercial reasons, would not be acceptable to the UK.
22. Third, allowing the Commission to encroach upon Member States' ability to act on a national basis to protect their security interests sets an unhelpful precedent both in relation to security matters and in respect of other areas of Member State competence. Should even a small overstep be accepted in this case, it is possible that this could be taken as precedent to expand further in future.
23. The EU's announcement comes at a time when the Government is planning to bring forward its own proposals for an enhanced investment screening regime, as announced in the Queen's Speech prior to the 2017/18 session. This will be security focused, and we will be consulting on how to ensure any reforms are targeted and proportionate and do not damage inward investment.
24. Beyond the impact on the UK whilst still a member of the EU, as a third country, the UK will be subject to these provisions following our exit.

CONSULTATION

25. The Commission has not conducted a formal consultation on this matter.

IMPACT ASSESSMENT

26. The Commission has not yet produced an impact assessment for these proposals.

FINANCIAL IMPLICATIONS

27. There are no budgetary implications other than administrative costs.

TIMETABLE

28. The Commission has not provided a clear timetable for concluding the negotiations. We expect this matter to be discussed at official-level EU working groups on a regular basis from October onwards. However, it is not clear that the Regulation will come into force before the United Kingdom leaves the European Union

Yours ever,

A handwritten signature in black ink, appearing to be 'GH', with a long horizontal line extending to the right.

**Rt Hon Greg Hands MP
Minister of State for Trade Policy and Minister for London
Department for International Trade**