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One Year of Luxembourg's Foreign Direct Investment Screening Mechanism: Managing Uncertainties

Foreign direct investment ("FDI") is essential for the development of the European Union's economy. However, FDI can pose a threat to security and public order in the EU and its Member States if a foreign investor wishes to acquire control over a critical infrastructure or access to sensitive data. Luxembourg's FDI screening regime has been in force for one year.

The EU legislator has provided a framework for the screening of FDIs into the Union on the grounds of security or public order via Regulation (EU) 2019/452 establishing a framework for the screening of foreign direct investments into the Union ("Regulation").[1] It does not limit the right of each Member State to decide whether or not to screen a particular investment but it creates a cooperation mechanism between Member States and the European Commission.

The Luxembourg Law of 14 July 2023 establishing a mechanism for the screening of FDIs likely to affect security or public order ("Law") obliges foreign investors to notify in-scope FDIs to the Minister for the Economy prior to completion and provides for sanctions in the event of non-compliance. The mechanism enables the Minister to assess whether a given investment could undermine security or public order based on certain screening factors.

Since the entry into force of the Law in September 2023, its defining criteria and the screening procedure have been put to the test, in particular for Private Equity transactions involving Luxembourg legal entities. As described below, it is fair to say that the Law contains shortcomings in terms of the definition of an in-scope FDI and certain procedural aspects, which are partly undergoing reform at European level.

An evolving approach to indirect investment

The national mechanism applies to FDIs, with the exception of portfolio investments, likely to affect security or public order, in a Luxembourg-registered entity carrying out critical activities in Luxembourg.[2]

An FDI is an investment of any kind by a foreign investor aiming to establish or maintain lasting and direct links with a Luxembourg entity, thus enabling the investor to participate, alone, together with or through an intermediary, in the control of this entity.[3]

"Control" is notably defined as the fact of, directly or indirectly, having the right to appoint or dismiss the majority of the members of such entity's governing bodies, or exceeding the threshold of more than 25% of the voting rights in such an entity.[4] In particular, the role of the 25% threshold may raise questions.

Although the Law explicitly only applies to investments made by investors from outside the European Economic Area ("EEA"), the Council of State indicated that "control" must be interpreted in view of a possible circumvention of the screening mechanism "with regard to the foreign investor acting alone, together with or through a company, even one established in another Member State of the European Union or the European Economic Area".[5]

As part of an overhaul of the Regulation, the Commission wishes to ensure greater consistency by treating investments made directly by a foreign investor in the same way as those made through an entity located in the EEA since they can have the same effect.[6] Thus, investments made through an EEA entity will also have to be notified even if there is no intention to circumvent the screening mechanism. One can expect the Law to be amended to reflect this explicitly.

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Broad definition of critical activities

Critical activities include, for example, certain activities in the energy, health, aerospace, media and agri-food sectors. These are often defined so broadly that it can be difficult to exclude a certain activity from the scope of the Law. For example, a taxi service, arguably not an activity relating to Luxembourg's strategic interests, security or public order, could fall within the scope of the Law, which defines land transport as critical. In addition, the Law also defines as critical research or production activities directly linked to a critical activity or related activities that provide access to sensitive information or to premises where a critical activity is carried out. Therefore, would an app that collects data on customer journeys for the taxi service also fall within the scope of the Law?

Also giving rise to debate are FDIs involving Luxembourg holding companies that have no genuine activity, i.e. no income or employees, where related target entities outside Luxembourg may exercise critical activities. A common sense approach should be adopted in our view when applying the Law.

Bridging procedural gaps

When a notification is required, the notification form notably requests information on the ownership structure of the foreign investor and of the Luxembourg entity before the FDI was made, including information on the beneficial owner, the products, services and commercial operations of the foreign investor and the Luxembourg entity, and the financing of the FDI.[7]

Upon receipt of the notification, the Minister has two months to decide whether the FDI will be subject to the screening procedure (Phase 1). If the information provided is deemed insufficient, the Minister may request additional information, which will suspend the review period.

When launched, the screening procedure may not exceed 60 calendar days (Phase 2). The FDI is then examined in accordance with the screening factors set out in the Law, such as the possibility for the foreign investor to control a critical infrastructure or sensitive information, or the fact that it has close links with the government of a third country, or is involved in illegal activities. Here again, suspension is possible if further information requests are launched.

Therefore, in theory, the review period is of – minimum – two months if no screening procedure is triggered and of – minimum – four months if there is a screening procedure.

If the screening procedure is launched, the Law does not require that decision to be reasoned. In its proposal for a regulation, the Commission provides that, before taking a screening decision subject to conditions or blocking a transaction, the competent authority should inform the foreign investor of its intentions, explaining its reasons and giving the foreign investor the opportunity to state its position.[8] However, given the sensitivity of the field and Member States' duty of confidentiality, it remains to be seen to what extent meaningful statements of reasons will be provided.

The Minister, who decides whether to authorise, authorise with conditions or refuse the FDI, concludes the screening procedure. The Law does not indicate what happens if the Minister has not made a decision after the deadline expires, which adds a further degree of legal uncertainty that should be addressed as part of a future reform of the Law.

Looking ahead

Many practical scenarios encountered over the last year have shown the impact of the Luxembourg FDI screening regime. In view of the proposal for a regulation, amendments at Luxembourg level could be expected. They would offer an opportunity to clarify certain areas of uncertainty. In addition, although the responsible ministry addresses some helpful questions in an online FAQ, the latter has not been updated and, in our view, could be completed to take account of its practical experience with the review mechanism. ●

1. 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, OJ L 079I 21.3.2019, p. 1, as amended, Article 1(1).
2. Article 2(1) of the Law.
3. Article 1(6) of the Law.
4. Article 1(1) of the Law.
5. Opinion of the Council of State, parliamentary document No 7885/01, 22 March 2022, page 3.
6. European Commission, Proposal for a Regulation of the European Parliament and of the Council on the screening of foreign investments in the Union and repealing Regulation (EU) 2019/452 of the European Parliament and of the Council, COM(2024) 23 final, 24 January 2024, recitals 7 and 11.
7. Article 4 of the Law.
8. European Commission (footnote n 6), Art. 4(3).