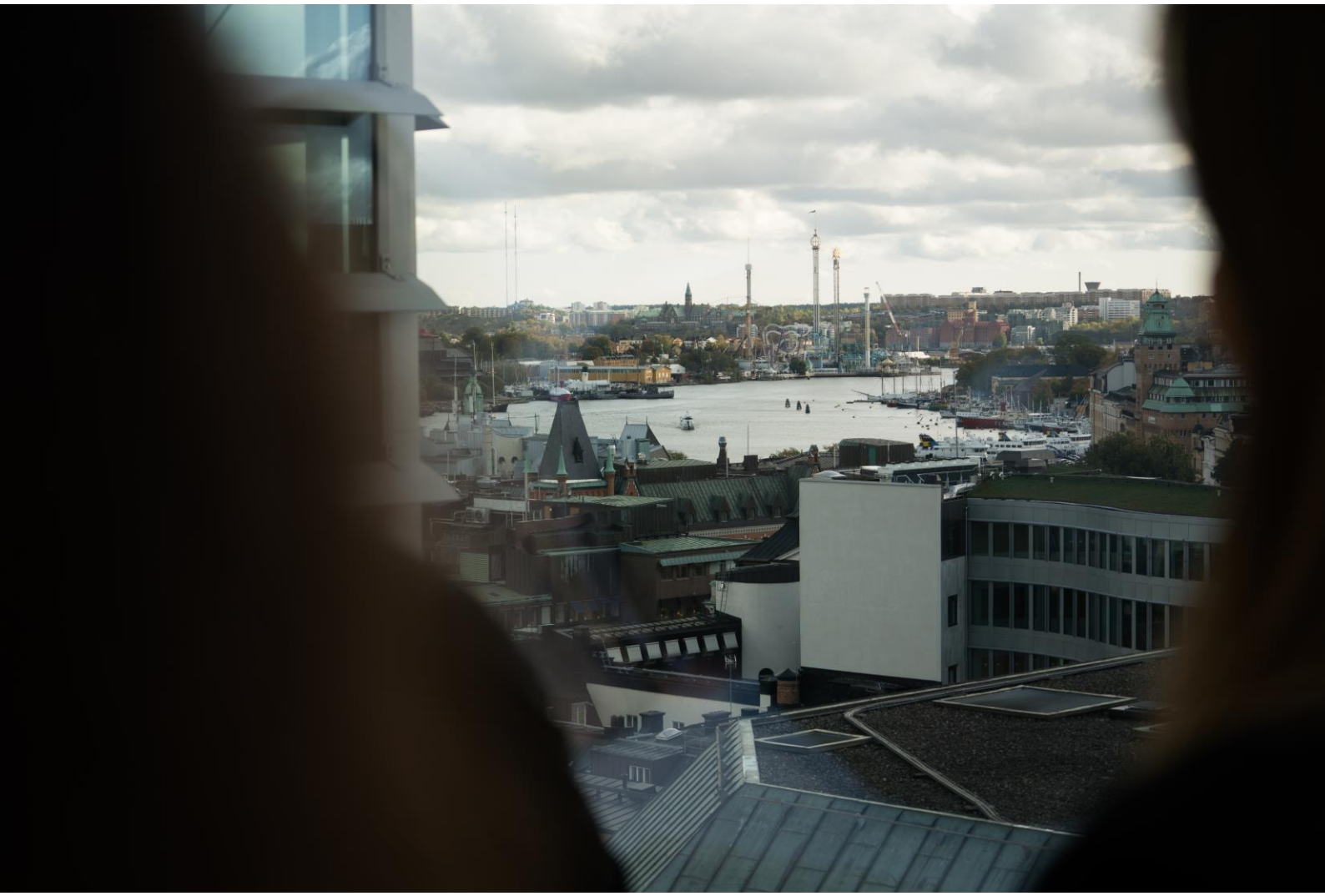
New Swedish rules on investment screening

20 December 2023



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On 1 December 2023, a new law on a Swedish foreign direct investment review mechanism (the "**FDI Act**") entered into force, SFS 2023:560. The new FDI Act allows foreign direct investments to be screened for security risks and, if necessary, restricted or prohibited. The Inspectorate for Strategic Products (the "**ISP**") is the competent review authority. The law applies to both Swedish and foreign investors, despite the title suggesting that there must be a foreign element.

Notifications under the FDI Act must be filed before a transaction or investment is made. In practice, authorisation under the FDI Act will be treated as a condition to completion, in the same way as for competition or financial regulatory approvals.

Although the FDI Act contains extensive notification requirements, we anticipate that only a small number of cases will ultimately be considered problematic. Thus, for the vast majority of transactions, it will simply be an additional workstream to manage.

SCOPE OF THE FDI ACT

For the FDI Act to apply: (i) the target company must be engaged in a so-called "*protected activity*"; and (ii) it must concern a covered investment.

Protected activities – what types of activities are covered?

The purpose of the FDI Act is to prevent foreign direct investment in Swedish activities worthy of protection where they could have a detrimental effect on Sweden's security or on public order or public safety in Sweden. What constitutes activities worthy of protection is divided into the following categories:

Essential services. The concept of essential services is set out in a regulation from the Swedish Civil Contingencies Agency (the "**MSB**"), MSBFS 2023:4. The regulation is comprehensive and covers various activities. However, there is a general rule that the target entity must have either: (i) at least five employees; or (ii) an average annual turnover of SEK 5 million (based on the last three years or, if the entity has been in operation for less than three years, an annual turnover of at least SEK 5 million during the previous financial year). The regulation on essential services is categorised as follows (with each category having its own more detailed regulations):

- Extraction of minerals, etc.
- Manufacturing
- Supply of electricity, gas, heating, cooling and fuels
- Water supply, wastewater treatment, waste management and sanitation
- Construction, installation and maintenance
- Trade
- Transport and storage
- The hotel and restaurant sector
- Information and communications sector
- Finance and insurance
- Property management
- Science and technology
- Rental, property services, travel services and other support services
- Education and training
- Healthcare and social care

Security-sensitive activities are defined in the Protective Security Act (2018:585) and include activities that are of importance to Sweden's security or that are covered by an international commitment to security protection that is binding on Sweden.

Critical raw materials and other metals and minerals. This covers the exploration, extraction, enrichment or sale of the materials listed in the Ordinance on the Examination of Foreign Direct Investments (SFS 2023:624), Annex 1.

Large scale processing of sensitive personal or location data. Sensitive personal data means data referred to in Article 9(1) of the GDPR. Location data means data processed in a public mobile electronic communications network which indicates the geographical position of an end-user, or data in a public fixed electronic communications network which indicates the physical address of the network connection point.

Military Equipment. This includes the manufacture, development, research, or supply of military equipment in accordance with the Military Equipment Act (1992:1300), as well as the provision of technical support for such equipment.

Dual-use items include the manufacture, development, research, or supply of dual-use items (as defined under the EU Dual-Use Regulation), as well as the provision of technical assistance for such items.

Emerging technologies and other strategically important technologies. This covers the research or supply of products or technology within emerging technologies or other strategically protectable technology. It also includes activities that have the ability to manufacture or develop such products or technology. The technologies are set out in the Ordinance on Review of Foreign Direct Investments (SFS 2023:624), Appendix 2.

Which types of investments trigger a notification?

The FDI Act applies to investments in limited liability companies, European companies (Societas Europaea), partnerships, economic associations, foundations, unincorporated partnerships or sole trader undertakings. The notification thresholds, discussed below, relate to limited liability companies. Investments include both ordinary acquisitions and other forms of investment, such as venture capital. An obligation to notify arises if:

(a) the investor would hold, directly or indirectly, voting rights equal to or exceeding 10, 20, 30, 50, 65 or 90 % in the target company (whereby notification must be made whenever such threshold is exceeded, regardless of whether a lower percentage has previously been authorised); or

(b) the investor would otherwise obtain direct or indirect influence over the target's management (e.g. through board representation or extensive veto rights).

The FDI Act applies to investments in both private and listed companies, as well as asset transfers and so-called "greenfield" investments, i.e. where the future operations of the target company are to comprise protected activities. Investments by way of private placements are also covered, although rights issues are excluded.

Intra-group transactions are also covered by the FDI Act – again, to prevent the risk of circumvention

In relation to corporate groups of investors, ownership and control are to be viewed on a group-wide basis. For instance, an investor proposing to acquire two per cent in a protected company will need to notify the investment if another company in its corporate group already owns or controls nine per cent of the protected company. A notification threshold is triggered since the investment would result in the group's ultimate parent company indirectly controlling over ten per cent of the voting rights.

All investors must notify – regardless of nationality

If it has been established that a transaction must be notified, the investor must file the notification. This obligation also applies to investors established within Sweden or the EU. The reason for including domestic and EU investors is to prevent circumvention of the FDI Act, for instance, where a third country actor uses a Swedish company, which is under its control, to acquire a protected Swedish entity. However, although investments by Swedish and EU investors must be notified (even where there is no ultimate foreign ownership), it is presumed that the ISP will leave such cases without action and not initiate a review. However, the transaction documents of these investments will still need to provide for completion to be conditional on FDI authorisation.

It is worth noting that the Court of Justice of the European Union (CJEU) handed down a judgement earlier this year holding that the prohibition of an acquisition by an EU investor, even when its ultimate owner is non-EU, could in certain circumstances breach the EU principle of freedom of establishment. The CJEU case has generated considerable debate. It remains to be seen whether it will lead to any amendments to the regulatory framework.

ISP can review an investment on its own initiative

Even if an investment does not fall within the scope of the FDI Act, the ISP will be able to commence a review on its own initiative if there is reason to believe that the investment constitutes a security risk for Sweden. The intention here is to prevent circumvention, for example, by several investors with problematic links to third countries each making an investment which, when viewed individually, would not trigger a notification.

Overlap with the Security Protection Act

A company whose activities fall within the scope of the Protective Security Act will automatically also be covered by the FDI Act. The Protective Security Act requires a seller to consult with the relevant supervisory authority when transferring any such activities. Since the Protective Security Act and the FDI Act serve different purposes and areas of protection, the laws will apply in parallel.

NOTIFICATION

The obligation to file a notification lies with the investor. However, the target company has an obligation to provide the investor with information as to the applicability of the FDI Act. In addition, the target company must provide the ISP with information when required to do so for the purposes of the ISP's assessment.

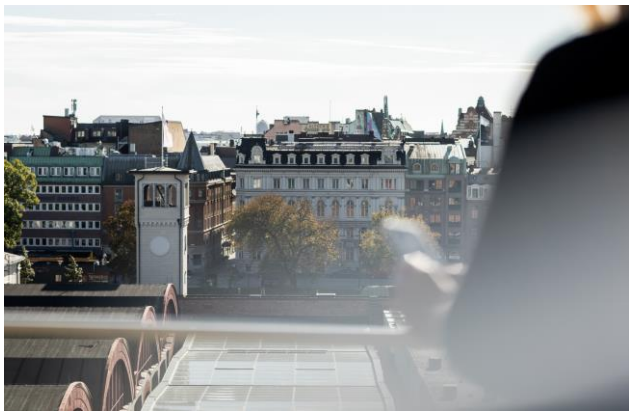
The ISP has 25 working days, from receipt of a complete notification, to decide whether to leave the notification without action, or to initiate an in-depth review. If the ISP initiates an in-depth review, this must be completed within three months (or six months if there are special reasons), after which the ISP must announce its decision to either approve, approve with conditions, or prohibit, the investment. The only way for an investor to appeal the ISP's decision is to the government.

The investment must not be completed before the ISP has announced its decision, even if the ISP is expected to leave the notification without action. If the investment is completed before a decision is announced, a penalty fee may be imposed (see further below), although the investment will not automatically be void.

The notification must be filed on the basis of a form provided by the ISP and must include information about the investor (including its owners) and the target's business. The ISP will also forward the notification to the Swedish Armed Forces and the Swedish Security Service for information purposes. If the ISP decides to initiate a

review of the transaction, it will consult with the EU Commission and other EU Member States in accordance with the EU FDI cooperation mechanism (Regulation (EU) 2019/452) (the "**EU FDI Regulation**"). In such a case, the ISP is also obliged to consult with the Swedish Armed Forces, the Swedish Security Service, the MSB, the National Board of Trade Sweden and The Swedish Defence Materiel Administration.

It is not possible for an investor to make a voluntary notification to the ISP in respect of a prospective investment. According to the preparatory works, this can partly be remedied by the applicable principles of administrative law, according to which the ISP has a general service obligation. This obligation includes answering questions and providing certain guidance.



ISP'S DECISION

As part of its assessment, the ISP will consider the nature and size of the target company and the circumstances of the investor. With regard to the investor, particular consideration should be given to the following:

(a) whether the investor is directly or indirectly, in whole or in part, controlled by a non-EU state through its ownership structure, significant financing, or otherwise

(b) whether the investor, or anyone in its ownership structure, has previously been involved in activities that have had, or could have had, a detrimental effect on national security, public order or public safety in Sweden or another EU Member State

(c) whether there are other circumstances surrounding the investor which mean that the investment could have a detrimental effect on Sweden's security or on public order or public safety in Sweden

If the ISP's initial review of the notification concludes that there are no grounds for an in-depth review, the ISP will decide to close the notification without taking further action.

If the ISP conducts an in-depth review, the possible outcomes are that the transaction will be: (i) approved; (ii) approved with conditions; or (iii) prohibited. The latter two decisions require the ISP to determine that the transaction constitutes a foreign direct investment and that conditions or prohibitions are necessary to safeguard national security or public order or public safety in Sweden.

The FDI Act is deliberately broad in its scope and notification requirements. Ultimately, however, it is only intended to cover investments by non-EU investors that could undermine Sweden's security, public order or public safety. Prohibition or conditional approval is expected to affect only a limited number of transactions.

CONSEQUENCES OF INFRINGEMENT

The ISP may decide to impose a penalty (of up to SEK 100 million) on an investor who fails to notify an investment when required to do so under the FDI Act. The target company may also face a penalty for failing to provide accurate information, or for failing to respond to an information request from the ISP for the purposes of its review.

COOPERATION STRUCTURE WITH OTHER EU MEMBER STATES

In order for the ISP to commence a review on its own initiative, the investment must first be brought to its attention. The EU FDI Regulation's cooperation mechanism may provide a method for this – requiring Member States to notify the European Commission and other Member States of foreign direct investments subject to review in their territories. In Sweden, the ISP is the responsible contact authority under the EU FDI Regulation. In practice, therefore, the ISP will be informed of investments notified in other Member States, when they could have an effect on Sweden's security, and will have the opportunity to submit comments. Similarly, other Member States will be able to comment on investments in Swedish companies which the ISP has decided to review in accordance with the FDI Act.

HOW DOES THE FDI LAW AFFECT TRANSACTIONS AND INVESTMENTS?

The FDI law will have a significant impact on transactions going forward – both traditional business acquisitions and venture capital investments. While it is not expected that many transactions will ultimately be blocked or conditioned, there are other aspects to consider. For example:

- *Initial analysis*: All transactions will need to be analysed from an FDI perspective (and, in addition to the Swedish FDI Act, equivalent FDI laws in other countries may apply). A seller will therefore want to understand the FDI-related transaction risks of any potential buyer.
- *Transaction planning*: If the FDI Act is applicable, parties will need to allocate time to prepare a notification and await the ISP's decision (and, if FDI laws of other countries are applicable, the decisions of any other relevant FDI authorities).
- *Conditions precedent in SPAs and investment agreements*: If the FDI Act is applicable, the transaction will need to be conditional on ISP authorisation. The parties will also need to allocate the risk of the transaction not being approved, or being approved subject to conditions.
- *Shareholders' agreements, incentive schemes etc*.: Since the FDI Act applies to existing shareholders who increase their shareholding above a certain threshold, many shareholders' agreements will also need to account for the FDI Act.

LOOKING AHEAD

The FDI Act is now in force and the ISP is carrying out initial assessments of the first notifications. Given that this is a completely new law – with no available precedents – there will inevitably be questions about its application that can only be clarified after a notification has been made. The ISP itself has suggested that, in cases of uncertainty, it is better to notify than not to notify. In all likelihood, the legislation will need to undergo a review to address any teething problems that emerge following the first notifications.