The EU Regulation on Screening of Foreign Direct Investment: A Game Changer?*

WOLF ZWARTKRUIS[1] & BAS DE JONG[2]

Abstract

In March 2019, the EU has adopted a Regulation on the screening of foreign direct investment (FDI) which will apply from 11 October 2020. Member States are allowed to use a national screening mechanism for FDI from outside the EU on grounds of widely defined public order or security, including the protection of key technologies. A cooperation mechanism is established between the Member States and the European Commission. The European Commission is authorized to give a non-binding opinion if the FDI affects Union interests.

The Regulation reflects a new attitude of the EU towards FDI, triggered by geo-political developments especially involving Chinese state-owned enterprises taking over European companies with key technologies. However, the EU's ambitions are faced by legal and practical challenges. From a legal perspective, the Regulation seems to require an extensive interpretation of the grounds for restriction of free movement as developed by the ECJ and codified in the Regulation. From a practical perspective, making coordination work will not be easy. It requires a significant effort from the Member States and the Commission, and success is by no means guaranteed.

Keywords

Foreign direct investment, screening mechanism, public order and public security, free movement of capital, freedom of establishment

1. Introduction

In September 2017, the European Commission launched a proposal[3] for a Regulation on the screening of foreign direct investment (FDI)[4] (hereafter: the Regulation).

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* The research for this paper was completed on 31 October 2019. Later developments were not taken into account, but we do point out the publication of a later volume of articles on the Regulation, see Bourgeois (2019).

[1] Wolf Zwartkruis LLM, PhD Candidate, Leiden University.

[2] Professor of capital markets law, Radboud Business Law Institute, Radboud University Nijmegen.

[3] European Commission, 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 COM(2017) 487 final, 13 September 2017.

[4] "Foreign direct investment" is generally understood as referring to a cross-border investment to

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Although it seemed to be controversial,[5] the Regulation was adopted fairly quickly in March 2019,[6] with relatively few amendments to the proposal. The Regulation will apply from 11 October 2020.[7]

Essential elements of the Regulation are that Member States may have in place a national screening mechanism for FDI from outside the EU on grounds of (widely defined) public order or security, that a cooperation mechanism is established between the Member States and the European Commission, and that the European Commission is authorized to make a non-binding recommendation on cases of Union interest. The Regulation follows a lobbying effort by Germany, France and Italy.

This article will discuss the background and legal context of the Regulation followed by an outline of and comments on some key elements. Our focus will be on clarifying the meaning of core provisions in the Regulation and assessing whether the Regulation effectively protects security and public order. We also make a few comments about the effects of the Regulation on the investment climate, which should be affected by screening as little as possible, but this is not the primary focus.

2. Background: What Is The Issue at Stake?

2.1. Shift in EU Thinking About the Advantages and Risks of FDI

The traditional EU approach to FDI is based on a positive view on the free movement of capital and freedom to enter into FDI transactions as an element thereof. Referring to the doctrines of mainstream economists, Hindelang summarizes the orthodox legal-economic view on the benefits of free movement of capital:

> *"(...) optimal allocation of capital furthers prosperity: if the flow of capital is unrestricted, capital can be directed to the places where it can be used most efficiently to generate the best returns, and it is thereby capable of contributing to an efficient squaring of demand and supply of capital within the Community."*[8]

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acquire a lasting interest in an enterprise operating outside of the investor's home state. See: OECD, *Benchmark Definition of Foreign Direct Investment* (2008), p 17; IMF, *Balance of Payments Manual* (2009), para. 6.12. FDI is distinguished from portfolio investment, where the investor's focus is mostly on 'earnings resulting from the acquisition and sales of shares and other securities without expecting to control or influence the management of the assets underlying these investments. See: OECD, *Benchmark Definition of Foreign Direct Investment* (2008), p 22-23.

[5] Finland, for example, stated that the proposal was unsuitable and that it would take years to find the right balance. It was worried that the proposal would not achieve much, while there is a chance that it will provoke a trade war with, for example, China, the US or India (Financial Times 2017). Portugal and Greece had reportedly expressed their reservations at a European Council discussion on the topic in June 2017 (Cerulus and Hanke 2017).

[6] Regulation (EU) 2019/452 establishing a framework for screening of foreign direct investments into the Union [2019] OJ L 79 I/1.

[7] Art. 17.

[8] Hindelang (2009), p 19.

This favorable view helps explaining the far-going endorsement of the free movement of capital in the EU treaties (art. 63 Treaty on the Functioning of the European Union, TFEU). The free movement of capital does not only apply between Member States. It applies between a Member State and third countries as well. This is regardless of whether the third county itself acknowledges the free movement of capital for EU Member States. This does not mean that free movement of capital cannot be restricted. Exemptions for reasons of public security and public policy apply just as to the other freedoms, as does the "overriding reasons" exemption developed in case law (for more detail, see para. 4.2). The ECJ has however consistently ruled that these exemptions have to be interpreted strictly.

The European policy attitude towards FDI is mirrored in economic reality. According to European Commission calculations, foreign investors in the EU control about 3% of EU companies and 35% of assets, and (indirectly) employ about 16 million workers in the EU.[9]

In 2017, the European Commission published a reflection paper on globalization that also touches on FDI, in which it stated:

> *"Openness to foreign investment remains a key principle for the EU and a major source of growth. However, concerns have recently been voiced about foreign investors, notably state-owned enterprises, taking over European companies with key technologies for strategic reasons. EU investors often do not enjoy the same rights to invest in the country from which the investment originates. These concerns need careful analysis and appropriate action."*[10]

The Regulation is to be seen as the EU's follow-up on the action announced in this paragraph.[11]

2.2. What Kind of Concerns are at Stake?

The Explanatory Memorandum states that the Regulation *"provides a policy response to protect legitimate interests with regard to foreign direct investments that raise concerns for security or public order of the Union or its Member States."*[12] The Explanatory Memorandum is not very specific on how these interests can be harmed by FDI. It does mention that *"recently, a series of take-overs of European companies involved foreign investors with strong ties to their home governments which strategy focus on the purchase of European companies that develop technologies or maintain infrastructures that are essential to perform critical functions in society and the*

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[9] Commission Staff Working Document on Foreign Direct Investment in the EU, SWD(2019) 108 final, p 67. Figures of 2016.

[10] European Commission, *Reflection Paper on Harnessing Globalization*, COM (2017) 240, 10 May 2017, p 15.

[11] European Commission, Explanatory memorandum to the Regulation, p 2.

[12] European Commission, Explanatory memorandum to the Regulation, p 2.

economy."[13] In the recitals of the Regulation, "disruption, failure, loss or destruction" are mentioned as specific occurrences relating to critical infrastructure and technology that may affect security and public order.[14] Below an attempt is made to illustrate how actual security and public interests may be affected by the recent take-overs that the Commission refers to.

2.2.1. Security

Security is not easily defined. Many different definitions have been proposed.[15] Collins, in a leading academic textbook on the subject, avoids giving one definition and instead sets out some key elements. Firstly, Collins points out that security presupposes a "referent object", i.e. "a thing to be secured". Collins adds that the means of achieving security depend on the nature of the referent object. Traditionally, the referent object has been the state. The way to protect it was traditionally military might. More recently, different approaches to security have evolved. According to Collins, "despite the contested nature of security … ultimately we are interested in how referent objects are threatened."[16] The focus on threats when interpreting security is consistent with the ECJ approach (see para. 4.2).

The methodology for the assessment of national security risk in the Netherlands, for example, distinguishes the following referent objects:[17]

(1) Territorial security, which can be impacted by harm of the integrity of the national territory; harm of the international position of the state.
(2) Physical security, which can be impacted by death of humans, injury, and chronical diseases.
(3) Economic security, which can be impacted by cost to and harm of the economy.
(4) Ecological security, which can be impacted by long-term harm to the environment, plant and animal life.
(5) Social and political stability, which can be impacted by disturbance of daily life, harm of the rule of law and the democratic system and social-psychological impact and social unrest.

How can these forms of security realistically be at stake because of an FDI transaction? Firstly, FDI will – depending on the size of the stake – provide a degree of control to the investing entity over the target of investment. Secondly, private companies regularly perform activities that have the potential to affect different aspects of security. Thirdly, the control resulting from an FDI transaction may be used (or not used) in a way that is detrimental to the security aspects involved.

One rather obvious way that FDI may impact security, is by the acquisition of companies that produce military goods. This can influence the military power balance between countries.

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[13] European Commission, Explanatory memorandum to the Regulation, p 10.
[14] Recital 13.
[15] For an overview, see Collins (2016), p 3.
[16] Collins (2016), p 2.
[17] Ministerie van Veiligheid en Justitie (2013), p 19. See also: Bulten et al. (2017).

More recent security discussions around FDI often focus on critical infrastructure, such as ports, roads, telecommunication networks, and energy networks. The disruption of these networks is likely to affect economic security, because of the range of activities that depend on it.

Foreign ownership could lead to disruption of such infrastructure in different ways. Examples include deliberate harmful corporate decisions, insufficient investment or neglect of maintenance by the controlling shareholder(s), as well as the use of ownership as an instrument of pressure.[18]

Aside from disruption, there can also be the risk of unwarranted access to sensitive information. Depending on the nature of the information and its use, this can affect almost every form of security mentioned above. The 2017 hacks of the Democratic Party and its possible effects on the U.S. elections are a salient example of the effect of the effect of unwarranted access to sensitive information on political and social stability. For this reason, states have an interest in avoidance of foreign control of national encryption and cyber security companies. Countries also have an interest in having some sort of assurance regarding the safety of telecommunication networks and data-storage.

2.2.2. Key Technologies and Systemic Competition

Aside from security, there is amongst EU Member States a present concern about loss of strategic technological knowledge from not only a security but also from a more economic perspective. The competitiveness of EU countries relies to a large extent on a technological edge over emerging economies. The "recent series of take-overs of European companies" that the Commission mentions in the quote above refers to a series of take-overs by – first and foremost – Chinese companies. The resistance caused by this is not only influenced by fear of loss of competitive strength, but also by the concern that China is competing in an unequal and non-reciprocal manner. It has been argued that Chinese and EU companies do not only compete directly, but that Chinese companies benefit from different forms of support and protection provided by Chinese state intervention. The Bundesverband der Deutschen Industrie, the umbrella organization of German industrial companies, has labeled this "systemic competition"[19] and the EU has called China a "systemic rival".[20]

A key to China's ambitions in this context is the program Made in China 2025. This is a plan published by the Chinese government in 2015 that aims to upgrade China's industrial base.[21] In the tradition of Chinese economic planning, the plan

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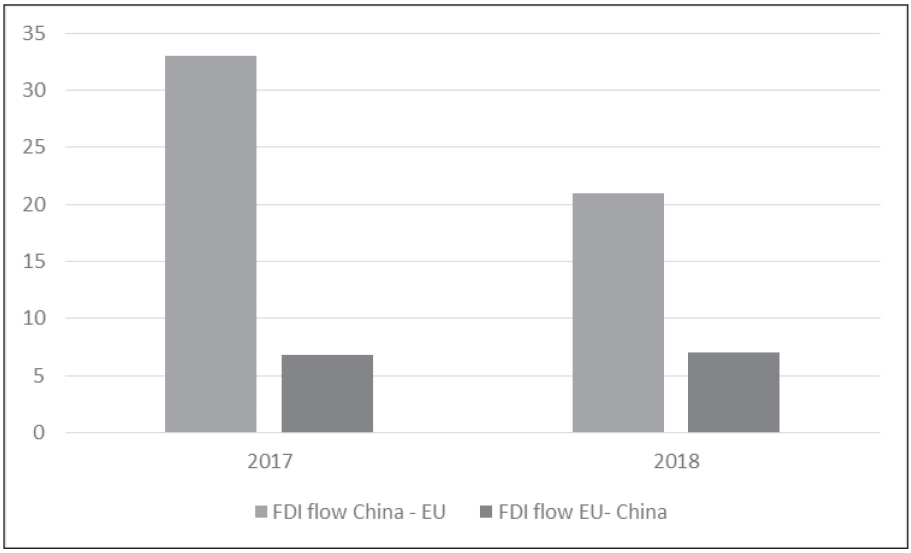
[18] An example relating to financial infrastructure is the financial messaging system Society for Worldwide Interbank Financial Telecommunication (Swift), which facilitates cross-border payments. Iranian banks have been cut-off from Swift as part of Western sanctions against that country. Hence, from the perspective of Iran, foreign ownership of Swift resulted in pressure and problems in its payment system. Recently, the U.S. Government announced that it was considering to cut off Iran from Swift again, this time with opposition from the EU. See: Financial Times (2018) "US and EU head for showdown over shutting Iran off from finance". <https://www.ft.com/content/04b831fc-5913-11e8-bdb7-f6677d2e1ce8>.

[19] Bundesverband der Deutschen Industrie (2019), p 2-4.

[20] European Commission, "EU-China – A Strategic Outlook" JOIN(2019) 5 final, p 5.

[21] European Chamber (2017), p 8.



Source: Rhodium Group 2019

Figure 1: Annual Value of bilateral EU-China FDI flows (USD bln)

specifies targets to be attained by the Chinese economy in 2025. These targets relate to market shares, level of sophistication and self-sufficiency. The European Chamber of Commerce has identified a range of policy instruments that the Chinese government uses to implement Made in China 2025. These include technology seeking investments abroad, i.e. FDI. At the same time, other policies come down to restricting foreign FDI into China:

(i) Foreign companies that want to operate in China are forced to transfer technology to Chinese companies in exchange for market access;
(ii) Government procurement restrictions apply to foreign companies;
(iii) Foreign companies have to compete with Chinese domestic companies that receive subsidies from the State, including loans on non-commercial terms and non-enforcement of environmental regulations;
(iv) Access to many sectors is restricted or impossible for foreign companies.[22]

The OECD FDI restrictiveness index ranks China amongst the most restrictive in the world. EU Member States such as France, Germany and Italy are on the other side of the distribution, below the OECD average.[23] Chinese FDI flowing into the EU is several times larger than EU FDI into China (figure 1).

[22] European Chamber of Commerce, p 16-20.
[23] Hanemann and Huotari (2018), p 12.

Regular FDI statistics suffer from several limitations that have distortionary effects. In a follow-up working document published after the Regulation, the European Commission has presented a new analysis of FDI into the EU, based on granular data, to address these limitations.[24] These figures show that investments from the area "China, Hong Kong and Macao", went from controlling 0.2 percent of the assets of all EU based companies in 2007 to 1.6 percent in 2017.[25] This should however be seen against the background of non-EU investors controlling 45% of the assets of EU listed companies and 33% of non-listed companies.[26] Chinese FDI is therefore sharply increasing but in no way dominant.

In line with Made in China 2025, many of the FDI from China into the EU is aimed at EU companies that have technological knowledge that China can use to upgrade its industry.[27] Several policy reports have recommended that EU countries correct the current imbalance in FDI regimes by introducing an FDI screening mechanism.[28]

Another concern that has not so much been articulated by the EU or Member States, but more vocally by U.S. authorities, concerns theft of intellectual property, especially through cyber enabled espionage. According to U.S. authorities, the cost of trade secret theft for the U.S. economy should be estimated between USD 180 billion and USD 540 billion annually.[29] According to one American study, 96% of a sample of cases of economic espionage were attributable to threat actors in China.[30]

3. Instruments for Protecting Public Interests Related to Undertakings

Countries have adopted different types of investment regulations to protect their national security interests in case of FDI. The UNCTAD's World Investment Report 2016[31] mentions three (groups of) strategies:

(i) Prohibiting, fully or partially, foreign investment in certain sensitive sectors. This is often the case in sectors such as defense, energy (production and

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[24] See: Commission Staff Working Document on Foreign Direct Investment in the EU, SWD(2019) 108 final, annex A.1. For instance, the Commission mentions that FDI statistics are typically based on the immediate counterparty and not the ultimate owner of the investment.

[25] Commission Staff Working Document on Foreign Direct Investment in the EU, SWD(2019) 108 final, p 13.

[26] Commission Staff Working Document on Foreign Direct Investment in the EU, SWD(2019) 108 final, p 8.

[27] Some examples of Chinese take-overs in the field of automation and digitization of industrial production in the EU in 2016 are: KraussMaffei Machine tools (Germany), Teutloff (Germany), Aritex (Spain), JOT automation (Finland), EDF EUROPE S.R.L. (Italy), Agic Capital (Italy), KuKa (Germany), Broetje Automation (Germany). See: Wübbeke et al. (2016), p 52.

[28] Wübbeke et al. (2016), p 61 and 62; Godement and Vaselier (2016), p 91.

[29] White House Office of Trade and Manufacturing Policy (2018), p 3, with further references in that document.

[30] White House Office of Trade and Manufacturing Policy (2018), p 3, with further references in that document.

[31] UNCTAD, World Investment Report (2016).

supply) and transportation (e.g. harbors and airports), and in the oil and gas industry.

(ii) Maintaining state monopolies in sensitive sectors. This happens especially in sectors that provide the population's essential basic needs, maintenance of infrastructure, railways and fixed telecom networks. Legislation could exclusively assign certain production or distribution rights to a state-owned company.

(iii) Maintaining a foreign investment screening mechanism for pre-defined sectors or across the board. We add that regulations could also specifically be tailored to individual companies.

The Regulation – and this paper – only covers the third category, screening mechanisms of a public-law[32] nature. Some countries maintain combinations of FDI screening mechanisms, e.g. a sector-specific review in the defense industry complemented by a separate cross-sectoral review mechanism for other foreign investments. A general cross-sectoral review may subject all FDI proposals to approval procedures or only FDI that meet certain thresholds. It differs between countries whether any prior notifications by investors are required, or whether the review can (also) be initiated at the discretion of national authorities.

4. European and International Legal Context of the Regulation

4.1. Hard Law and Soft Law on FDI

The Regulation should be read against the background of the existing EU and international legal framework for dealing with FDI. The European and international framework that determines states' freedom of movement to review and restrict FDI, consists of both hard law and soft law.

The conditions for a vetting mechanism are in the first place determined by the EU's single market law. The EU Member States and the EU as a whole are also bound to international free trade agreements, such as WTO rules. Moreover, EU Member States that are bound to the First Protocol of the European Convention on Human Rights (ECHR), need to comply with its rules on protection of property (including share ownership) against government interference. Finally, there is a body of soft law in the form of guidelines developed by the Organization of Economic Co-operation and Development (OECD).[33]

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[32] See article 2(4) of the Regulation.

[33] The OECD has developed non-binding guidelines for governments that consider restrictions on FDI on national security grounds: the Guidelines for Recipient Country Investment Policies Relating to National Security (25 May 2009, <www.oecd.org>). Such restrictions should be guided by the principles of nondiscrimination, transparency of policies and predictability of outcomes, proportionality of measures and accountability of implementing authorities. These requirements are further specified in

EU law and international law thus contain different rules that give Member States the opportunity to limit FDI in order to protect public interests related to companies. These rules also serve to limit the extent to which Members States can do so. The question arises what the relation is between the Regulation and the existing legal framework. In the following, we only discuss EU law on free movement of capital, as these rules seem to provide the strictest hard law rules compared to the other ECHR[34] and WTO[35] rules. There is also potential overlap with the Merger Regulation,[36] which allows Member States to protect legitimate interests such as public security, plurality of the media and prudential rules in case of concentrations.[37] Overlapping provisions should be interpreted in a coherent manner, according to the FDI Regulation.[38] We do not further discuss this relationship with the Merger Regulation.

4.2. FDI, the free movement of capital and the freedom of establishment

Art. 63 TFEU states that all restrictions on the movement of capital between different Member States and between Member States and third countries shall be prohibited,

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an Annex. These requirements are thus quite similar to the criteria in EU law, although the guidelines are in some respects a bit more specific.

[34] According to the First Protocol of the ECHR, every natural or legal person enjoys the peaceful enjoyment of his possessions. The European Court on Human Rights (ECtHR) interprets 'possessions' autonomously and widely. Shares in limited liability companies and rights attached to these shares are considered possessions. Hence, the protection of this provision applies against infringements in the vertical relationship between the state and the investor (from a state that is bound to the Convention). A restriction of possessions by the state – in the form of deprivation or control of property – is justified when the restriction is legal, legitimate and proportional. To assess whether a restriction satisfies these criteria, the ECtHR uses three tests: the legal certainty test (legality), the public interest test (legitimacy) and the fair balance test (proportionality). These three tests are quite similar to the requirements for measures that restrict the free movement of capital (see infra, i.e. that they are non-discriminatory, suitable and proportional to meet the objective of the protection of public policy, public security of overriding requirements of the general interest). As the ECtHR grants states a wide margin of appreciation, we believe that the requirements imposed by the ECJ are felt to be stricter than or at least as strict as the requirements by the ECtHR. Moreover, the ECtHR's case law is only relevant for investors from European states that are bound to the First Protocol, whereas the free movement of capital can be invoked by investors from every foreign state.

[35] Other than the TFEU, the WTO agreement does not treat free movement of capital as an equal category next to free movement of goods and services. However, the GATS is relevant because under this agreement, provision of services through commercial presence is in scope. Commercial presence under that agreement is "any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service", see Art. XXVIII(d) of the GATS. The explanatory memorandum and consideration (35) of the Regulation mention Art. XIV(a) and Art. XIV bis of the GATS and bilateral investment treaties to which the EU or Member States are parties. Like article 65 TFEU, these provisions allow for exemptions for measures that States undertake for security reasons.

[36] Regulation No 139/2004 on the control of concentrations between undertakings [2004] OJ L 24/1.

[37] Art. 21(4).

[38] Recital 36.

unless allowed by the Treaty.[39] The Commission argues that the Regulation is consistent with article 63 TFEU and the related case law of the Court of Justice.[40] Thereby the Commission implies that the screening mechanisms under the Regulation should meet the requirements of article 63 TFEU.[41] In addition to that, it has been pointed out that FDI transactions that provide the investor with definite influence are covered exclusively by the freedom of establishment of art. 49 TFEU. Consequently, in the case of third country investors such FDI transactions would be outside of the scope of the fundamental freedoms, since the freedom of establishment does not apply in relation to third country investors.[42]

Aside from the case where a screening mechanism exclusively applies to third country investors who receive definite influence, maintaining a screening mechanism for FDI by Member States is a restriction of free movement and therefore requires justification.[43] Furthermore, it also constitutes discrimination on grounds of nationality of actors outside the EU relative to actors within the EU. If the screening mechanism also applies to FDI from other EU Member States, it also constitutes discrimination on grounds of nationality between EU actors.[44] This would not be the case if the screening mechanism also applies to nationals from the same Member State as the target of investment. However, one may wonder whether such a mechanism would still be properly called a *foreign* direct investment screening mechanism. In the following, we assume that the screening mechanism would at least distinguish between FDI from non-EU and national origin.

EU law provides a number of justifications for restrictions of free movement. Art. 65(1)(b) TFEU explicitly mentions public security and public policy. In respect of this provision, the Regulation states it is without prejudice to the right of Member States to derogate from the free movement of capital based on art. 65 TFEU.[45] The ECJ has, in addition to the explicit grounds mentioned in the TFEU, also acknowledged 'overriding requirements of the general interest' as a justification ground for

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[39] FDI transactions may also be covered by the freedom of establishment. However, this freedom does not apply to FDI from third countries, which is the subject of the Regulation.

[40] Explanatory Memorandum, p 4.

[41] See also recital 4 of the Regulation: "This Regulation is without prejudice to the right of Member States to derogate from the free movement of capital as provided for in point (b) of Art. 65(1) TFEU."

[42] Snell (2019), p 138 argues that the right of free movement of capital does not apply to screening mechanisms that only deal with situations where investors aim to exert a definite influence on the target company. According to Snell, the ECJ has ruled that such measures fall exclusively within the freedom of establishment. He refers to ECJ *Test Claimants in the FII Group Litigation v. Inland Revenue Commissioners* (C-35/11) EU:C:2012:707, para. 98. As the freedom of establishment applies only intra-EU, third country investors cannot invoke this right. However, they can invoke rights from the Regulation. This view is shared by De Kok (2019), p 3. We add that this view is supported by ECJ case law dealing with prior authorization schemes for holdings representing 20% or more of the total share capital. See: ECJ Case C-244/11 (*Commission v. Greece*), para. 25.

[43] ECJ C-54/99 (*Église de Scientology*), para. 15.

[44] See for an example where the discriminatory nature of the approval system was conceded by the Member State, ECJ C-367/98 (*Commission vs Portugal*).

[45] Recital 4.

restricting the fundamental freedoms in its case law.[46] However, it has been submitted that directly discriminatory restrictions can only be saved by reference to the express derogations in the Treaties.[47]

The ECJ has left largely open what public security and public policy mean. What kind of measures they require is, according to ECJ case law, primarily up to Member States to determine, taking into account their specific needs.[48] However, setting a first threshold, the ECJ has ruled that the grounds of public policy and public security must be interpreted strictly.[49] Additionally, the ECJ has determined that public security and public policy require a "genuine and sufficiently serious threat to a fundamental interest of society".[50] As a general rule for all restrictions on free movement, the ECJ has ruled that purely economic or administrative grounds cannot be accepted as ground to restrict free movement.[51] This applies to grounds such as the general financial interests of a member state, but also the "competitive structure of the market concerned". This refers to the aim of advancing the competiveness of national companies.[52] In recent case law, the ECJ did accept various policy aims regarding the order of the market as acceptable grounds that may be taken in to account as overriding reasons in the public interest.[53] This applied to both transparency of the market and the aim of safeguarding undistorted competition.[54]

However, the ECJ's scrutiny of restrictions of the free movement is not limited to an assessment of the grounds of the restriction. The ECJ has applied further scrutiny, primarily based on the requirement of proportionality.[55] There have been numerous examples in case law on restrictions of free movement where the proportionality requirement mentioned above was not met.

Many of these examples in case law concern (prior) authorization systems for transactions, that also cover FDI or specifically focus on FDI. The relevant case law generally concerns prior authorization systems in the form of "golden shares" – granting privileged special voting rights to public authorities – in companies that were deemed important for national security or public interests.[56] The rights attached to

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[46] ECJ C-271/09 (*Commission v. Poland*), para. 55.

[47] Barnard (2016), p 530, referring to ECJ C-302/97 (*Konle*), para. 24 and ECJ C-423/98 (*Albore*), para. 17.

[48] ECJ C-54/99 (*Église de Scientology*), para. 17.

[49] ECJ C-54/99 (*Église de Scientology*), para. 17.

[50] ECJ C-54/99 (*Église de Scientology*), para. 17.

[51] ECJ C-54/99 (*Église de Scientology*), para. 17; ECJ C-463/00 (*Commission v. Spain*), para. 35.

[52] ECJ C- 367/98 (*Commission v. Portugal*), para. 52.

[53] ECJ C-105/12 to C-107/12 (*Staat der Nederlanden v. Essent*), para. 66.

[54] ECJ C-105/12 to C-107/12 (*Staat der Nederlanden v. Essent*), para. 66.

[55] See Barnard (2016), p 541, 543-45. Barnard also mentions legal certainty as a separate criterion in case of direct discrimination. However, Barnard describes how legal certainty is also assessed by the ECJ as part of proportionality. Therefore it does not seem to make much difference if one regards legal certainty as a separate criterion or not.

[56] ECJ C-367/98 (*Commission v. Portugal*); ECJ C-483/99 (*Commission v. France*); ECJ C-463/00 (*Commission v. Spain*); joint cases ECJ C-282/04 and C-283/04 (*Commission v. the Netherlands*).

these shares often include the right to block parties from acquiring shares, thereby creating a power comparable to a screening mechanism as in the Regulation.

The assessment of proportionality of authorization systems in ECJ case law follows a pattern. The following elements have been deemed relevant by the ECJ:

- The presence of time limits for the authorization power of the state;[57]
- Clearly described powers instead of broad powers. The ECJ has consistently ruled that "wide discretionary powers" attached to systems of prior authorization, do not meet the proportionality requirement;[58]
- Ex ante versus ex post requirements of authorization. The ECJ has indicated that systems of prior authorization may be justified in cases where ex post scrutiny is inadequate;[59]
- The existence of criteria to guide the approval or non-authorization decision. The ECJ has consistently ruled that systems of authorization, which were not limited by "specific, objective conditions"[60] do not meet the proportionality requirement.[61]

In the only case where all these criteria were met, the golden shares law was deemed proportional by the ECJ.[62]

5. Discussion of Selected Elements of the Regulation

5.1. Legal Basis for the Regulation

The Commission bases the Regulation on its exclusive competence relating to FDI as part of the common trade policy (article 207(1) TFEU). FDI was included as part of the common trade policy in the Lisbon Treaty.[63] This touches upon a controversial and not yet fully clarified issue, the scope of article 207 TFEU in relation to FDI.[64] The approach followed by the Commission seems to be inspired by Opinion 2/15 of the ECJ on the Free Trade Agreement EU-Singapore.[65] In this opinion, the ECJ accepted that the Commission was allowed to use its exclusive competence of article

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[57] ECJ C-367/98 (*Commission v. Portugal*), para. 49-51; ECJ C-463/00 (*Commission v. Spain*), para. 78-80.

[58] ECJ C-483/99 (*Commission v. France*), para. 51.

[59] ECJ C-54/99 (*Église de Scientology*), para. 20; ECJ C-367/98 (*Commission v. Portugal*), para. 47. Nevertheless, a requirement of a prior declaration or notification is usually more proportionate than the requirement of authorization, although in case of a genuine and sufficiently serious threat a system of prior declaration may prove inadequate. See Barnard (2016), p 543-544, 551 with references.

[60] ECJ C-463/00 (*Commission v. Spain*), para. 80.

[61] See for a further discussion of these aspects: Barnard (2016), pp 543-545.

[62] ECJ C-503/99 (*Commission v. Belgium*).

[63] Explanatory Memorandum to the Regulation, p 8.

[64] See also Esplugues 2018.

[65] Opinion 2/15 of the Court, FTA EU-Singapore, EU:C:2017:376, para. 99-103.

207(1) TFEU to agree with Singapore on certain conditions for the use of expropriation measures with regards to foreign investments. Member States argued that this encroached upon their competence to take measures in the interest of public order and public security. The ECJ however accepted that the conditions could be agreed upon using the exclusive competence of the Commission. The ECJ pointed out that the agreed conditions "did not establish any international commitment concerning public order, public security or other public interests". The agreed conditions were limited to the requirement that a less favorable treatment of Singapore investors in this context should be "necessary" and not constitute a "disguised restriction". The ECJ considered this limitation of the discretion of Member States to be "inherent in the conduct of international trade", and therefore part of the exclusive Common Trade Policy competence of article 207(1) TFEU. Although Opinion 2/15 does not provide full clarity, it could be argued that the Regulation is consistent with this reasoning. It does not require Member States to adopt a screening mechanism. The Regulation is limited in scope to how a screening mechanism should be used if it is in place and to information and opinion sharing procedures.[66]

Since the definition of FDI is limited to investments out of third countries, the Regulation gives rise to the question whether screening mechanisms for FDI *within* the EU are allowed, and if so, under what conditions. Arguably, as the Regulation does not regulate intra-EU FDI, such screening systems are in principle allowed. The specific screening mechanisms will have to meet the requirements of the current law on the free movement of capital and the freedom of establishment (para. 4.2).

In any case, the Regulation determines the rules for screening of foreign direct investment from third countries. It is quite possible that it will require some Member States to amend their screening regulations. The requirements on information sharing and collaboration with the Commission and amongst Member States will at least require some implementation legislation.

5.2. Scope

5.2.1. What Types of Screening Mechanisms Fall within the Scope of the Regulation?

The question arises whether the Regulation applies only to screening mechanisms that only apply to FDI from third countries, or also to frameworks that cover both third country and intra-EU FDI.

The wording of the definitions of the Regulation give some space to assume that the first reading is correct. The definition of "screening mechanism" contains the element foreign direct investment. The definition of the latter term contains the element "foreign investor", which is defined as an investor from a third country.[67]

Reasoning from the principle of useful effect of the Regulation, the alternative reading seems more probable. Many screening mechanisms screen intra-EU FDI and

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[66] See, to the same effect, Common Market Law Review 2018, p 379.

[67] Art. 2 of the Regulation.

FDI from third countries. The Regulation would hardly be effective if these mechanisms would be fully out of scope.

5.2.2. Types of Transactions Covered

The Regulation uses a broad concept of 'foreign direct investment'. FDI is defined as:[68]

> *"an investment of any kind by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity in a Member State, including investments which enable effective participation in the management or control of a company carrying out an economic activity"*

The definition in the Regulation is largely based on ECJ case law. In an Annex to Council Directive 88/361/EEC on liberalization of capital movements, direct investment is defined. According to ECJ case law, this source can be used to interpret the meaning of FDI in the context of capital movement. The Annex to Council Directive 88/361/EEC mentions the following cases non-exhaustively:

1. Establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings;
2. Participation in new or existing undertaking with a view to establishing or maintaining lasting economic links;
3. Long-term loans with a view to establishing or maintaining lasting economic links;
4. Reinvestment of profits with a view to maintaining lasting economic links.

FDI requires the aim to establish "lasting and direct links between the foreign investor and the entrepreneur".[69] Portfolio investments do not meet this requirement, and therefore the Regulation does not apply to them.[70] By way of positive definition, the Regulation specifies "that investments which enable effective participation in the management or control of a company carrying out an economic activity" fall within its scope. This category is most relevant for the aims of the Regulation. One may even

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[68] Art. 2(1) of the Regulation.

[69] This is consistent with the ECJ formula for direct investments. See: ECJ C-446/04 (*Test Claimants in the FII Group Litigation*), para. 181.

[70] See recital 9 of the Regulation. The ECJ has described portfolio investment as: "the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking" See: Joint cases C-282/4 and C-283/4 (*Commission v. Netherlands*), para. 19.

wonder why investments that do not provide any control are considered potentially relevant from a perspective of security or public order.

The definition in the Regulation leaves open the question when "effective participation" in the management or control is involved. ECJ case law sheds some light on this. When investments take the form of a shareholding in new or existing undertakings, "the objective of establishing or maintaining lasting economic links presupposed that the shares held by the shareholder enable him, either pursuant to the provision of the national laws or in some other way, to participate effectively in the management of that company or in its control."[71] The definition incorporates this specification relating to investment in the form of shareholding somewhat loosely. The definition applies the case law also to other forms of FDI. Reading the definition in conjunction with ECJ case law, we assume that investments in the form of shareholdings that do not result in effective participation in the management of the company or control do not qualify as FDI under the Regulation. This still leaves significant space for interpretation, e.g. regarding the percentage of shares, or the percentage of voting rights that results in effective participation or control.

This legal uncertainty is undesirable for the effectiveness of the cooperation mechanism between the Member States and the European Commission, which would be undermined by discussions whether or not investments are to be qualified as FDI. A clarification of the definition may prove to be necessary.[72] Arguably, the definition of qualifying holdings in the financial sector provides more legal certainty than the current definition of FDI. The MIFiD II Directive defines it as a direct or indirect holding which represents 10 % or more of the capital or of the voting rights, or which makes it possible to exercise a significant influence over the management of the firm in which that holding subsists.[73-74] The question also arises whether the definition of FDI is sufficient to prevent circumvention of the Regulation by (foreign) investors who are acting in concert. In EU company and financial law, the concept of acting in

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[71] ECJ C-446/04 (*Test Claimants in the FII Group Litigation*) para. 182.

[72] The European Commission may provide such a clarification, but ideally, the Regulation itself should contain a more precise definition. The Regulation's provision on evaluation, art. 15, recognizes the possible need to modify provisions in the regulation.

[73] Council Directive 2014/65/EU on markets in financial instruments [2014] OJ L 173/349, article 4(1)(31), in conjunction with Council Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market [2004] OJ L 390/38.

[74] To ensure uniform applications across countries, the Organisation for Economic Co-operation and Development (OECD), as in EU financial law, sticks to a definition that uses a presumption of effective participation in case of 10% voting power: *The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship. Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of any significant influence while on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does not allow any qualification of the 10% threshold and recommends its strict application to ensure statistical consistency across countries."*

concert is used in the Takeover Directive,[75] Transparency Directive[76] and the rules on prudential assessment of acquisitions and holdings in the financial sector.[77] If an acting in concert rule would be adopted within the context of FDI screening, it would not be possible for a number of investors who collectively – but not individually – hold a percentage that provides effective participation to escape the applicability of the Regulation. The Regulation contains an anti-circumvention rule (see par. 5.4 below), but leaves it to the Member State to develop suitable rules. However, it would seem more logical if an acting in concert or aggregation rule is part of the Regulation.

It is noteworthy that direct and lasting links in other forms than share ownership can potentially also qualify as FDI under the Regulation. This is the case for, amongst others, loans (see the Annex to Council Directive 88/361/EEC mentioned above). A great amount of transactions can potentially come under scrutiny this way. It is to be expected that many EU-domiciled undertakings that carry out activities outside the EU have credit facilities from local banks in local currency. These will generally not lead to lasting and direct links, however. In the case of large creditors, it is possible that the link may qualify.

5.2.3. Type of Assets

Another issue is the type of asset involved in screening. The definition in article 2(1) of the Regulation aims at undertakings and entrepreneurs. We take this to mean that the Regulation applies to both legal persons and natural persons. Of course such enterprises can own a wide array of assets including real estate and intellectual property. It is important to note that the Regulation does not apply to transactions directly aimed at real estate, land or intellectual property. This is in line with the normal usage of the concept of FDI. It terms of effectiveness, it should be pointed out that the Regulation does not provide full coverage for the safeguarding of the public interests that it aims to protect. Foreign investors can still get hold of critical infrastructure, critical technologies or any other asset mentioned in article 4(1), by buying it directly. This is an important limitation of the Regulation.

5.2.4. Geographical Scope

Screening mechanisms in Member States may be limited to participations in *domestically domiciled* undertakings. Considering the wide definition of FDI in the Regulation, the question arises whether screening is also allowed of (changes in) holdings

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[75] Council Directive 2004/25/EC on takeover bids OJ L 142/12, article 5(1) in conjunction with article 2(d).

[76] Council Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market OJ L 390/38, article 10.

[77] See art. 22 Council Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms [2013] OJ L 176/338); Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) [2009] OJ L 335/1); Directive 2014/65/EU [2014] OJ L 173/349. .

in *foreign domiciled* companies, when they carry on important economic activities, e.g. in a member state's critical infrastructure.[78] More clarity on this point is necessary in our opinion.

5.3. Screening Criteria

According to the Regulation, Member States may screen foreign investments on grounds of security and public order.[79] This is not new, given the existing powers of Member States under the TFEU to restrict free movement on similar grounds.[80] In addition to the broad criteria of security and public order, the Regulation provides a list of *factors* to be taken into account when making a screening decision.[81] These factors are elements that are deemed relevant for the screening decision. These do not constitute a list of detailed *criteria*. This is left to national screening legislation.

According to article 4(1), Member States and the Commission, when screening FDI, may consider the potential effects on, among other things:

"*(a) critical infrastructure, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defense, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure;*
(b) critical technologies and dual use items as defined in point 1 of Article 2 of Council Regulation (EC) No 428/2009, including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies;
(c) supply of critical inputs, including energy or raw materials, as well as food security;
(d) access to sensitive information, including personal data, or the ability to control such information; or
(e) the freedom and pluralism of the media."[82]

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[78] The OECD defines a company's place of establishment as the place of the 'center of predominant economic interest'. Changes in control relationships in a company governed by foreign (non-EU) law that has the center of gravity of its economic activities in a member state could fall within the scope of the Regulation, if the OECD approach would be followed by the ECJ in its interpretation of the Regulation.

[79] Art. 3(1) of the Regulation.

[80] The wording used differs somewhat from Arts 2/65 TFEU that are aimed at "public security and public policy". Security seems to be broader than "public security". "Public order" seems to be more narrow than "public policy". It is not clear what's behind this difference in terminology. "Overriding requirements of the general interest" are not mentioned as a criterion. This is consistent with the point of view that overriding requirements cannot justify measures that discriminate between nationals and foreign parties, which is something that FDI screening mechanisms do. See note 41 above and para. 4.2.

[81] Art. 4 of the Regulation.

[82] Art. 4(1) of the Regulation.

These factors give a clue as to what kind of industries are in scope. The list is non-limitative.[83] From a security perspective, these factors can be seen as the "referent objects" that are to be protected against threats (see para. 2.1). This provision does not specify when a FDI transaction that involves these referent objects can be said to impact security or public order. However, the Regulation mentions further aspects of the transaction that are considered relevant in article 4(2). This is also done in a non-limitative fashion. The relevant aspects can be summarized as follows: involvement of a foreign government, previous negative experience with the foreign investor and the risk of him being involved in illegal or criminal activities. This gives some idea of the threats that are deemed relevant, but the picture is by no means complete.

It is clear that article 3 and 4 of the Regulation enable Member States to screen for a broad range of security interests. Hence, the security issues mentioned in para. 2.1 are in scope. It is not clear whether the criteria "security and public order" enable a Member State to block an FDI transaction if it concerns a critical technology that is essential for its national industrial capacity or industrial policy (para. 2.2).[84] The inclusion of critical technologies in article 4(1)(b) seems to point in this direction. Another opening for a broad interpretation is provided by article 8(1) of the Regulation that considers FDI that affects Union interests. Union interests are defined by referring to projects within the EU industrial policy. Finally, the ECJ's case law on free movement of capital shows that Member States may be able to offer justifications for a restriction on capital movements to or from non-member countries that would not be valid in an intra-EU context.[85] Thus, it may be argued that acquisition of key technologies that affect national industrial policy are also in scope.[86]

But the factors of article 4 of the Regulation can also be construed more restrictively, meaning that FDI in relation to these technologies can only be screened for security and public interests in a narrow sense.[87] This interpretation could be supported by reference to the ECJ case law that rejects restrictions of the free movement "on purely economic grounds"[88] (see para. 4.2).

The incorporation of economic criteria in the concept of security and public order can lead to protectionist tendencies and a less attractive investment climate.[89] On the other hand, it could be argued that the TFEU is a living document, which may need to be reinterpreted in the view of evolving public needs. Especially when a public

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[83] See recital 12 of the Regulation.

[84] See also Snell (2019), p 138 ('It is not clear how far the Treaty rules on free movement of capital actually allow Member States to go in this respect').

[85] *Test Claimants in the FII Group Litigation v. Inland Revenue Commissioners* (C-446/04) EU:C:2006:774 para 171.

[86] However, it could also be argued that industrial policy for the EU as a whole is of a different nature than national industry policy.

[87] This is argued by De Kok (2019).

[88] It is remarkable that this requirement is not included in the list of requirements for screening mechanisms in article 3. See also CMLR (2018).

[89] See in this sense: Lavranos (2018), p 364. See also Snell (2019), p 138 ('If a Member State takes a wide view of security … economic considerations will easily slip into the assessment.').

need is expressed in secondary legislation such as the Regulation. In the Essent case,[90] the ECJ also used secondary legislation, in this case the aims underlying the directives on the gas sector, to interpret the needs of public policy. Also, it could be argued that the ECJ case law did not consider FDI from "systemic rivals" that operate under a different legal-economic framework that entails an unlevel playing field (para. 2.2). We can imagine that the ECJ will take these factors in consideration and will apply a more liberal approach which would allow a Member State to block an FDI transaction if it concerns a critical technology that is essential for its national industrial capacity or industrial policy. In terms of Commission policy, it is conceivable that the Commission as the guardian of the Treaties, will be less pro-active in the assessment of screening of investors from third countries and more pro-active to prevent investment screening from becoming an excuse for protectionism between Members States.

Reciprocity is *not* mentioned as a relevant factor for screening. This concerns the extent to which the country of origin of the investor is itself open to FDI. The lack of reciprocity from third countries was one of the motivations for the Regulation. However, during the interinstitutional negotiations, an amendment to include reciprocity in the screening factors was rejected.[91] A possible opening to assessing reciprocity is left, because the list of screening factors in article 4 of the Regulation is non-exhaustive and Member States, in accordance with art. 4(2) TEU and this Regulation, have an independent competence to determine how national security is protected. Nevertheless, the criterion of reciprocity is hard to link with any security or public policy interest, which is a necessary condition to justify FDI screening. Reciprocity is better addressed through attempts by the EU to establish free trade agreements with countries that are not sufficiently open.[92]

5.4. Anti-circumvention Clause

Member States may take measures to identify and prevent circumvention of the screening mechanism, according to article 3(6). The Regulation mentions investments from within the EU by means of artificial arrangements that do not reflect economic reality and circumvent screening mechanisms, where the investor is ultimately owned or controlled by a natural person or an undertaking of a third country.[93]

Anti-circumvention rules are generally hard to apply, because they refer to an intention that is difficult to prove. It is unclear when a construction can be regarded as artificial and how extensively this must be substantiated by Member States. In the ECJ's case law it has been accepted that a limitation of the freedom of establishment

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[90] ECJ C-105/12 to C-107/12 (*Staat der Nederlanden v. Essent*).

[91] Committee on International Trade (INTA), Report on the Proposal, Amendment 35.

[92] Schill (2019) argues that the possibility to limit inward FDI based on the Regulation can be used by the EU as a bargaining chip in negotiations with powerful countries. Thus, the framework for screening of FDI can achieve further investment liberalization, rather than shielding the internal market from external forces.

[93] Recital 10.

(Articles 49 and 54 TFEU) is justified in cases of abuse. Member States should provide specific evidence on a case-by-case basis.[94] It is not clear how the Regulation relates to this case law.

More specifically, it is to be determined what will happen if an investor from a third country makes investments from a company domiciled in an EU county where that company is a truly active economic entity. Even though the company may conduct significant economic activity, the effect of such a transaction may still be to circumvent a screening mechanism.

As a more practical approach, Member States that have screening mechanism in place, may also want subject *intra-EU FDI* to screening, so as to be able to vet cases in which circumvention by a third country is possible but hard to prove.

5.5. Minimum Requirements for Member State Screening Mechanisms

The Regulation contains a number of safeguards for foreign investors.[95] These relate to transparency, non-discrimination, timeframes, confidentiality and the possibility to seek recourse against screening decisions.

The first requirement is that the rules and procedures related to screening mechanisms are transparent and do not discriminate between third countries. For example, Chinese investors cannot be treated differently than U.S. investors, solely on grounds of nationality. Part of the transparency requirement is that Member States make explicit under which circumstances a screening is carried out, what the grounds are for screening the investment, and how the applicable detailed procedural rules apply.

Regarding the other requirements, the Regulation stipulates that timeframes shall allow Member States to take into account comments of other Member States and the opinion of the Commission (see para. 5.6). Moreover, confidential information, including commercially-sensitive information, provided by investors to the Member State undertaking screening shall be protected. The Regulation also aims to guarantee confidentiality of the information that is transmitted (article 10, see para. 5.8 below). Finally, the Regulation refers to the processing of personal data as protected by the General Data Protection Regulation[96] and Regulation 2018/1725[97] regarding data processing by the Union institutions, bodies, offices and agencies and on the free movement of such data (article 14).

Most of these rules are can already be considered part of the current law on free movement (para. 4.2). Nevertheless, the rules may be difficult to implement or have their drawbacks.

Firstly, it is difficult to specify in a detailed way the grounds for screening and the circumstances that will be taken into account. This is especially the case in across-

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[94] See for example ECJ *Centros* [1999] ECLI:EU:C:1999:126, para. 24-25; ECJ *Inspire Art* [2003] ECLI:EU:C:2003:512, para. 105.

[95] Art. 3 of the Regulation.

[96] Regulation 2016/679, OJ L 119/1.

[97] OJ L 295/39.

the-board screening mechanisms compared to screening mechanisms for pre-defined sectors or company specific screening. However, we do not see that the Regulation can easily solve this problem. Requiring transparency is a good thing for the investment climate, but a strict interpretation of the requirement by the Commission or the ECJ would put Member States in a difficult position.

Secondly, if screening decisions are subject to court review, the proceedings may take years. This could kill the momentum for a takeover.[98] Additionally, it is questionable whether investors will be interested to pursue their investment, if the state is opposed to it. In practice, many investors withdraw if a state signals its opposition. On the other hand, judicial procedures may also put the Member State in a difficult position. Often, the opposition to an investment will be based on information or expectations that will be hard to substantiate in court. A Member State may have to rely on information from intelligence services for instance, that it may have to keep secret or at least protect the source of. The Regulation does seem to provide a possibility for Member States not to give an investor access to a national court, as article 3(5) only grants a minimum right to seek "*recourse"* against screening decisions. In the original proposal, the term "judicial redress" was used. This seems to open the possibility of recourse by administrative, rather than judicial appeal.[99]

5.6. The Cooperation Mechanism Between Member States and the Commission

The Regulation establishes a 'cooperation mechanism' that should facilitate cooperation between Member States when dealing with FDI. Specifically, the Regulation introduces an obligation for Member States to communicate the actual screening of foreign investments to the other Member States and to the European Commission.[100] The purpose of this notification obligation is primarily to enable other Member States and the Commission to comment on the intended or completed foreign investment.[101] In order to comment or take a position, Member States and the European Commission may request the necessary information from the Member State on whose territory the foreign investment is made.

With regard to the relevant timeframes, the Regulation introduces a somewhat complicated regime. Other Member States and the European Commission must be provided with the relevant information[102] by the screening Member State as soon as possible. Subsequently, these Member other States and the Commission must within 15 calendar days after receipt of the relevant information notify the Member State

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[98] To mention one aspect, investing undertakings may struggle to keep funding available for the duration of the proceedings.

[99] However, Snell (2019), p 138 argues that denial of judicial appeal may conflict with art. 47 of the EU Charter of Fundamental Rights. This article provides a right of access to courts for anyone whose rights guaranteed by EU law are violated.

[100] Art. 6 of the Regulation.

[101] The screening Member State should also indicate whether the FDI is likely to fall within the scope of the Merger Regulation (EC) No 139/2004, see article 6(1) Regulation.

[102] The information referred to in article 9(2) of the Regulation, see para. 5.8 *infra*.

undertaking screening their intention to provide comments, or request additional information. Comments from other Member States and the position of the European Commission should be communicated to the screening Member State within a reasonable time, and in any case no later than 35 calendar days following receipt of the notification.

Further delays nevertheless seem possible, if Member States and the Commission request *additional* information (within 15 calendar days after receipt of the first patch of information). The Regulation allows them to provide their comments or opinion within 20 days after the *receipt* of the additional information. Hence, the request for additional information will temporarily stop the clock, until the moment the screening Member State provides the additional information. Moreover, the Commission is given the right to issue an opinion following comments from other Member States, where possible within the relevant deadlines, and in any case no later than 5 calendar days after those deadlines have expired.

As this procedural framework can be time consuming, the Regulation rightly authorizes immediate action by the screening Member State in exceptional circumstances. Specifically, where the Member State considers that its security or public order requires immediate action, it shall notify other Member States and the Commission of its intention to issue a screening decision *before* the timeframes mentioned above, and duly justify the need for immediate action. The other Member States and the Commission shall endeavor to provide comments or to issue an opinion expeditiously.

The cooperation mechanism described above is not limited to cases in which an FDI is actually screened. In cases the FDI is *not* undergoing screening (article 7), a Member State may comment if a planned or completed FDI in the territory of another Member State is likely to affect its security or public order or if it has relevant information in relation to that FDI. The European Commission is empowered to take a position if the FDI is likely to have an impact on security or public order in more than one Member State, or has relevant information in relation to that FDI. Member States and the Commission may request relevant information from the Member State where the FDI is planned or has been completed. Comments by other Member States or an opinion by the Commission must be sent to the relevant Member State within a reasonable period of time.[103] Member State comments and the Commission opinion may not be provided later than 15 months after the FDI has been completed. This regime does not apply to FDI completed before 10 April 2019.

The Member State where the FDI is planned or has been completed shall give "due consideration" to the comments or Commission opinion. This means that it should take, where appropriate, measures available under its national law, or in its broader policy-making.[104] Although a certain pressure can be exerted on the Member State, it remains legally competent to take its own decision. Nevertheless, it is conceivable that ex post scrutiny of completed transactions raises concerns about legal certainty

[103] See article 7(6) for the relevant deadlines.
[104] Recital 17.

among investors. The evaluation of the Regulation will have to show to what extent the investment climate is affected by this possibility.

Arguably, there is a clear logic to the cooperation mechanism, given that a FDI may touch the interest of several Member States at the same time. However, in practice the cooperation mechanism may turn out to be cumbersome. Information will have to be shared with 28 countries and the European Commission.

Thus, screening decisions can take up more time, which in itself is not conducive to the investment climate. To address this concern, the Regulation does impose relatively strict timelines and allows immediate action in exceptional cases. Thus, it tries to find the right balance between additional scrutiny and an attractive investment climate. Cooperation between Member States could also be difficult, as sensitive issues are concerned and the interests of Member States do not always run parallel.[105] Finally, it is yet unclear whether foreign investors and undertakings will have access to comments and opinions communicated to the screening Member State.

There is undoubtedly potential benefit from cooperation. Member States are generally political allies and have a shared interest in not having their vital interests compromised by third countries. An example of successful international cooperation was the intended take-over of the German company Aixtron, active in the semiconductor industry, by the Chinese company Fuijan in 2016, about which the U.S. authorities alerted the German authorities after the latter at first had no objections. Also for smaller Member States with less intelligence capacity, there is a clear benefit in receiving security insights from larger Members States.[106] Apart from the willingness to share, having the right information available will prove a challenge for all Member States and the Commission. Identifying critical interests within all industries is a daunting task, especially when it comes to critical technologies, which is a complex and ever changing subject. Even the U.S. does not have an overview of the critical technologies it wants to protect, according to a government report.[107] And the U.S. have been more active on FDI screening than the EU countries.

In addition to the cooperation mechanism, the Regulation refers to the formation of a group of experts (article 12). This expert group meets regularly to discuss issues relating to FDI, and could serve as a forum for the exchange of best practices, lessons learned, views on trends and issues of common concern. The Commission shall also consider seeking advice of the group on systemic issues relation to the implementation of the Regulation. We expect this expert group will be beneficial for the effectiveness of the Regulation. It can serve as a more informal forum which can improve

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[105] For example, certain eastern EU Member States seem more open to Chinese investments than others. China has established the 16+1 format, in which 11 eastern EU Member States and 5 Balkan countries participate. Moreover, Italy is the first G7 nation that has signed a memorandum of understanding with China, officially welcoming China's Belt and Road Initiative.

[106] See also Snell (2019), p 138.

[107] See: Defense Innovation Unit Experimental (2018), p 4: "The U.S. government does not have a holistic view of how fast this technology transfer is occurring, the level of Chinese investment in U.S. technology, or what technologies we should be protecting."

the ability and willingness of Member States to cooperate regarding the screening of FDI.

Nevertheless the success of the cooperation provisions is far from guaranteed, as its practical effectiveness will require a willingness amongst Member States to cooperate in a sensitive area. It touches national security, a competence that has been jealously guarded by Member States.

5.7. Autonomous Commission Screening

The Regulation introduces an autonomous power for the European Commission to issue an opinion to a Member State in which a FDI is planned or completed, in the event that the investment is likely to affect projects or programs of Union interest on grounds of security or public order.[108] This includes, in particular, projects and programs that are substantially funded by the EU or that fall under Union law in relation to critical infrastructure, critical technologies or critical raw materials and are essential for security or public order. An indicative list annexed to the Regulation should provide legal certainty for Member States and investors. It includes the Horizon 2020 programme[109] dealing with artificial intelligence, robotics, semiconductors and cybersecurity. We expect that the number of companies in which such a Union interest is involved will be sizeable (thousands). This means that the Commission's authority may have a significant impact on screening practices in the Member States.

The procedures as discussed in the cooperation mechanism (par. 5.6) apply mutatis mutandis, subject to three modifications.[110] The first is that Member States may indicate under the cooperation mechanism discussed above whether it considers that an FDI is likely to affect projects and programmes of Union interest. Secondly, the Commission's opinion shall be communicated to the other Member States. Thirdly, the Member State within which the FDI is planned or completed 'shall take utmost account' of the Commission's opinion and provide and explanation in case its opinion is not followed. This therefore amounts to a 'comply or explain' rule. The Regulation uses stronger wording here than for the cooperation mechanism discussed above. This does not alter the fact that the Commission's opinion is non-binding.

5.8. Information Requirements and Confidentiality

Some information obligations are imposed on Member States in the Regulation. To facilitate the cooperation mechanism and the screening authority of the European Commission, Member States should provide information on foreign acquisitions and investments (Article 9). It does not matter whether a Member State has set up a screening mechanism itself. The information that has to be collected is based on the following elements:

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[108] Art. 8.

[109] Regulation (EU) No 1291/2013 establishing Horizon 2020.

[110] Art. 8(2) of the Regulation.

(a) The ownership structure of the foreign investor and of the undertaking in which the foreign direct investment is planned or has been completed, including information on the ultimate investor and participation in the capital;
(b) The approximate value of the foreign direct investment;
(c) The products, services and business operations of the foreign investor and of the undertaking in which the foreign direct investment is planned or has been completed;
(d) The Member States in which the foreign investor and the undertaking in which the foreign direct investment is planned or has been completed conduct relevant business operations;
(e) The funding of the investment and its source, on the basis of information available to the Member State.
(f) The date when the foreign direct investment is planned to be completed or has been completed.

As far as the first point of the ownership structure is concerned, it is justified that the Regulation requires the ultimate investor to be identified. This relates to the concept of the ultimate beneficial owner (UBO), which is defined in the fourth anti-money laundering directive.[111] The UBO is a natural person who ultimately owns or controls the corporate entity through direct or indirect ownership of a sufficient percentage of the shares or voting rights or ownership interest.[112] A UBO can be hidden behind a chain of companies and other legal entities. Our expectation in practice is that opaque shareholder structures will by no means always be exposed. National screening regulations could proscribe that lack of transparency with regard to the UBO may be a factor to be considered in the screening decision.

How will Member States acquire the relevant information? This questions arises in particular where they have not set up a legal screening mechanism with information obligations. The Regulation imposes on Member States an obligation to monitor foreign acquisitions and investments on their territory. Article 9(4) of the Regulation states that the foreign investor or the undertaking concerned shall provide the requested information without undue delay. Nevertheless, the Regulation recognizes that it will not always be possible to acquire the required information. In this case, a Member State shall notify the Commission and the other Member States without delay, justify the reasons for not providing such information and explain the best efforts it has undertaken.[113]

In addition to the cooperation mechanism, Member States must inform the European Commission of their screening mechanisms, as well as changes and newly introduced mechanisms.[114] Member States shall also provide by 31 March of each

[111] Council Directive 2015/849/EU, [2015] OJ L 141/73.
[112] Art. 3(6) of the Directive. A shareholding or ownership interest of more than 25% is used as an indication of the relevant influence.
[113] Art. 9(5) of the Regulation.
[114] Art. 3(7) of the Regulation.

year an annual report to the European Commission covering the preceding calendar year.[115]

For the effectiveness of the cooperation mechanism, it is essential that the information which is transmitted between Member States can be kept confidential. Otherwise, Members States may not be willing to provide the requested information. Therefore, the Regulation requires that information is only used for the purpose for which it was requested.[116] In addition, Member States and the Commission shall ensure the protection of confidential information, including commercially-sensitive information, in accordance with Union law and their national law.[117] Moreover, classified information is not downgraded or declassified without the prior written consent of the originator.[118] Finally, the Commission shall provide a secure and encrypted system to support direct cooperation and exchange of information between the (contact points of) Member States.[119]

Despite these measures, it remains to be seen to what extent Member States will be willing to exchange confidential and classified information, especially when this could provide an indication of the confidential source or the way in which the information was gathered. Foreign investors may also worry about the confidentiality of the information and data they share with the Member State in which they plan an FDI, now that this information can potentially be much more widely distributed.

6. Conclusion

The Regulation marks a new attitude of the EU towards FDI and restrictions of this type of transaction. The most notable ambitions are 1) to facilitate screening of FDI transactions that relate to strategic key technologies; 2) to coordinate FDI screening amongst Member States and the European Commission.

These ambitions are faced by legal and practical challenges. From a legal perspective, protection of critical technologies seems to require an extensive interpretation of the grounds for restriction of the free movement as developed by the ECJ and codified in the Regulation. The practical meaning of the Regulation is that it signals a policy shift of the European Commission. One may reasonably expect that the Commission will be less pro-active in challenging Member State restrictions of FDI for security and public order, especially when it concerns FDI from third countries.

From a practical perspective, making coordination work will be challenging. The Commission will be dependent on the ability and willingness of Member States to share sensitive information on FDI. This requires goodwill from Member States that is not guaranteed by the Regulation itself. At the same time, Member States do have

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[115] Art. 5 of the Regulation.
[116] Art. 3(4) and 10(1) of the Regulation.
[117] Art. 10(2) of the Regulation.
[118] Art. 10(3) of the Regulation.
[119] Art. 11 of the Regulation.

an incentive to cooperate, as they can benefit from mutual assistance in the complex task of FDI screening.

It is likely that the screening of FDI and the division of roles between Member States and the European Commission will remain a source of controversy for years to come, given the challenges mentioned above. The work on establishing an effective coordination of FDI screening in the EU is not be finished with the adoption of this Regulation. It has only just begun.

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