AN OVERVIEW OF THE HISTORY OF FOREIGN DIRECT INVESTMENT SCREENING IN FRANCE: THE BALANCE BETWEEN FREEDOM AND STATE PROTECTIONISM

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1. The European Union (EU): the need for protection in keeping with its attractiveness.

Prior to the health crisis, the EU attracted the most foreign direct investment (FDI) in the world. At the end of 2017, assets held by non-EU investors totalled €6.295 billion. The constant increase in these investments has prompted foreign investors to take an increasingly large share in key sectors, such as oil refining, pharmaceuticals, electronics and optical products.[5] But when the Covid-19 crisis hit, FDI plummeted by 42% globally in 2020 to around $859 billion, before returning to pre-2019 levels: volume amounting to around $1,600 billion in 2021, according to a report by the United Nations Conference on Trade and Development (UNCTAD),[6] and the same UN agency established that the increase in flows into Europe in 2021 is linked to large swings in conduit economies.[7]

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[5] Commission staff working document, Following up on the Commission communication "Welcoming foreign direct investment while protecting essential interests", p. 1 and 2 https://trade.ec.europa.eu/doclib/docs/2019/march/tradoc_157724.pdf.
[6] World investment report 2022: https://unctad.org/webflyer/world-investment-report-2022
[7] UNCTAD 19/01/2022 - Global foreign direct investment rebounded strongly in 2021, but the recovery is highly uneven: https://unctad.org/news/global-foreign-direct-investment-rebounded-strongly-2021-recovery-highly-uneven

Among Member States and within the European Union (EU), FDI flows have increased but have remained at pre-pandemic levels, and are expected to take a downward trajectory due to the war in Ukraine.[8]

This attractiveness, which is key to doing well in a highly competitive global economy, can lead to hostile or simply harmful investments for national ecosystems or for the Union itself. Furthermore, after having essentially devoted itself to enshrining the principle of freedom of investment and having perhaps acted in naivety for a time, the European Union saw the need to find an internal agreement to protect the interests of Member States, while maintaining a European framework that would encourage foreign investment. To understand the dynamics at work, we need to take a look at evolution that led to the establishment of the freedom of investment principle, and then to its regulation through measures designed to defend States' economic sovereignty.

2. Origins of the European principle of freedom of investment: the development of a fully competitive common market. With the signing of the Treaty of Rome in 1957, which, along with the Atomic Energy Community, also established the European Economic Community, the Member States set out to form a large competitive common market. It is also worth noting that this goal was achieved sooner than others. Prior to 1st January, 1970, Member States had successfully imposed the free movement of goods within a customs Union protected by a common external customs tariff.

This policy has paid off, as evidenced by the considerable development of intra-Community trade, including in Business to Consumer relations. Quality and price now take precedence over the geographical origin of products, which has gradually made the European Community a homogeneous consumption zone.

It became clear very early on that we needed to take things further. To avoid distortions of competition, it was considered that other production factors should also be freed. Freedom of movement for workers, establishment, provision of services and movement of capital, however, took longer to come into effect. The movement had to be steered towards a truly integrated market, which is what the Single European Act achieved in 1986. A new Article 8 A paragraph 2 of the EEC treaty set Member States a goal to be met before 1992, namely the establishment of an internal market that it defined as "*an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties*".

It was not until the Maastricht Treaty, in 1994, that any restrictions on cross-border capital movements and payments were banned by the treaties themselves. It is worth noting, however, that from 1957 to 1992, the treaties only addressed the notion of "investment" indirectly, as one of many aspects of capital movements.

3. Enshrinement of the free movement of capital: the cornerstone of the European Single Market. The free movement of capital was a major objective, as it was seen as the cornerstone of the single market. In addition to the growth gains it was expected to induce through the optimal allocation of capital, this freedom was a prerequisite for the establishment of the Economic and Monetary Union and the Euro.

Movement in this direction initially came from secondary legislation. The 1957 treaty lifted restrictions on the movement of capital, only when necessary for the European market. From 1960 onwards, subsequent directives gradually put an end to restrictions for an increasing number of types of capital movements, until the founding directive adopted by the Council on 24 June 1988.[9]

This expressly stated that the capital movements regime was not limited to transfers of funds, but also included underlying transactions, such as direct investments. These were defined in a broad sense,[10] thereby covering equity interests in a company and placing under freedom of movement the possibility to participate effectively in the management of the company, based on the stake held. The European Court of Justice garnered support in opposition of the "golden shares"[11] that States had devised to extend the exercise of their sovereign power to within private companies.

With the Maastricht Treaty, primary law caught up with secondary law. Article 63 of the TFEU reversed the

[8] Rebeca Grynspan, Secretary-General of UNCTAD, World investment report 2022: https://unctad.org/webflyer/world-investment-report-2022

[9] Council Directive 88/361/ EEC of 24 June 1988 for the implementation of Article 67 of the Treaty Official Journal, no. L178 of 08/07/1988.

[10] Direct investments are "*Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity*", above-cited directive, Annex I.

[11] See, in particular, ECJ 4 June 2002, Commission v. Portugal, case C-367/98; Commission v. France, case C-483/99.

original principle and now prohibits all restrictions, subjecting those in breach of the principle to the infringement procedure of Articles 258 to 260.

For companies, the liberalisation of direct investment means the possibility of investing in other European companies, becoming owners of such companies and raising funds with maximum profitability. This is the result of a European initiative beginning with the Treaty of Rome, which sought to set up integrated, open and efficient European financial markets by freeing the circulation of capital.

Any step backwards in this area now looked particularly difficult. Article 64 of the TFEU makes this possibility conditional on a unanimous decision of the Council. Moreover, while the Maastricht Treaty provided that national provisions prior to its entry into force would not be affected, the Lisbon Treaty, which came into effect on 1 December 2009, enshrined in the TFEU the principle of phasing out restrictions on FDI.[12]

Meanwhile, Member States were given limited room for manoeuvre. They maintained the ability to prevent breaches of their tax and prudential supervision laws, but could theoretically only impose reporting measures for information or statistical purposes. Finally, any restriction must be justified on the grounds of public policy or public safety.

4. The origins of the European control system: the diverging evolution of standards in certain Member States, particularly France.

In France, the first major French law that dealt with the subject was the Law of 28 December 1966,[13] adopted under the presidency of Charles de Gaulle. This law was then fully in line with European primary law resulting from the 1957 Treaty. On the one hand, it was based on the principle that "financial relations between France and foreign countries are free".[14] On the other, it authorised the government to subject capital movements to declaration or authorization in order to ensure the defence of national interests,[15] at a time in European history when primary law had not yet sought to remove national restrictions. But it reflected awareness of a risk that it was difficult to guard against effectively, without running afoul of European principles as they were later understood and reinforced. By holding its course, France has therefore gradually fallen out of step with the European trend outlined above.

The prior authorisation system revised by Decree of 29 December 1989[16] did not yet address this head-on. But Member States' assessment of the room for manoeuvre provided by grounds relating to public policy or public security was a source of tension. As such, in a decision dated 14 March 2000, the CJEU considered that the right of Member States to take "*measures which are justified on grounds of public policy or public security*" did not allow them to establish a principle of prior authorisation, without an adequate definition of the investments subject to control. The French system, although approved by the Council of State,[17] was then deemed "*contrary to the principle of legal certainty*".[18]

France was not the only Member State aware of the need to protect itself from certain investments, at the risk of appearing to hinder the opening of the European market. The number of initiatives in this regard increased to the point where, in 2017, the Commission noted[19] that almost half of the Member States had set up a control mechanism to protect their strategic companies.[20] However, it was difficult to do so without running afoul of EU principles and rules. Control procedures were often seen as barriers to the free movement of capital[21] or establishments.[22]

However, French regulations have continued to evolve. Such evolution has often taken the form of reactions to threats affecting large French companies more or less directly.

A little over ten years after the signing of the Maastricht Treaty, in response to rumours of a hostile takeover bid by PepsiCo over Danone, a 2005 decree[23] took two sets of

[12] Articles 206 and 207 of the Treaty on the Functioning of the European Union (TFEU) (version resulting from the Lisbon Treaty).
[13] Law no. 66-1008 of 28 December 1966, on foreign financial relations.
[14] Art. 1 of Law no. 66-1008 of 28 December 1966, on foreign financial relations.
[15] Art. 3, 1 of Law no. 66-1008 of 28 December 1966, on foreign financial relations.
[16] Amended by Decrees No. 90-58 of 15 January 1990 and No. 92-134 of 11 February 1992.
[17] Council of State, 15 April 1996, no.160550, Pathé France Holding case, published in the Recueil Lebon.
[18] ECJ, 14 March 2000, Association *Eglise de Scientologie de Paris* and Scientology International Reserves Trust v. Prime Minister, case C-54/99.
[19] See below, no. 12.
[20] These countries include Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain and the UK.
[21] See, in particular, ECJ, 1 June 1999, No. C-302/97, Konle v. Austria, pt 39, requiring the absence of discrimination and compliance with a principle of proportionality. CJEU, 17 July 2008, no. C-207/07, Commission v. Spain.
[22] CJEU, 8 Nov. 2012, no. C-244/11, Commission v. Greece, on the grounds that the discretion left to the national authorities was too broad.
[23] Decree no. 2005-1739 of 30 December 2005.

measures. Firstly, it strengthened anti-takeover mechanisms. Secondly, it redefined the scope of foreign investment control. For both EU and non-EU investors, acquiring a company or holding over one third of the share capital[24] was likely to trigger controls, if the transaction involved activities quite naturally considered to be sensitive. These included gambling, private security, anti-terrorism, IT, and in particular encryption, techniques for intercepting conversations and companies that possess national defence secrets.[25]

The broadening of controls to include activities that are less readily perceived as strategic began in 2014, with the "Montebourg" decree,[26] presented by its initiator as "*a choice of economic patriotism*" and a "*rearmament of public power*". The announcement of ongoing negotiations for the takeover of Alstom Energie by General Electric sent shockwaves through the government and prompted it to speed up the implementation of the decree.

Six additional sectors were added to the previous list, namely water, healthcare, energy, transport, telecommunications and sites of vital importance. Furthermore, the decree also extended the list of conditions and undertakings that the Minister of the Economy may attach to his or her authorisation by including, in particular, the transfer of a sensitive business to an entity independent of the investor (R153-9 CMF).

Implemented 10 days before the European elections, this decree was also presented as a political message. Message well received, as this extension of controls earned France a reminder from the European Commission that restrictions imposed by Member States on the free movement of capital should be strictly proportionate to the protection of national interests.[27]

This did not prevent a decree issued 29 November 2018[28] from further extending the list of sensitive activities to include a whole group of research and development activities, relating to techniques such as cybersecurity, artificial intelligence, robotics, additive manufacturing, semiconductors, data storage or dual-use goods and technologies.[29] Some questioned the legal validity of the updated mechanism. Aside from the potential infringement of the rights of associated investors, it was asked whether the regime applicable to investors from EU Member States could be so similar to that of investors from third countries without unduly restricting the principle of free movement of capital.[30]

5. Time for clarification: the European framework and the Pacte Law. Recognising the risks which, in the context of a trade war, go hand in hand with its attractiveness to investors, the EU belatedly yet substantially changed its approach. Foreign investment control suddenly became a central concern for the Union. As part of a series of studies on the future of Europe, a 2017 reflection paper was dedicated to harnessing globalisation.[31] The Commission stressed the need for the EU to take action to restore a level playing field. As such, it recognised the need to address Member States' desire to protect their key technologies from potentially predatory investment from outside the EU.[32] One result was a Commission Communication entitled "Welcoming foreign direct investment while protecting essential interests".[33] The paper further recalled the EU's open policy in this area and the importance of maintaining it, as well as the risks that come with foreign investment. Noting that, like the EU's partners, almost half of Member States already had a foreign investment control mechanism in place, it proposed a regulation for the screening of foreign direct investment in the EU.[34]

This proposal had three objectives. First, it provided that national control mechanisms should be developed to include guarantees of transparency, appeal and non-discrimination. Second, the proposal provided for a mechanism for cooperation between Member States. Finally, it aimed to provide the Commission with the means to screen investments that pose risks for European programmes or projects.[35]

[24] Art. R153-1 and R153-4 of the CMF in their version resulting from the 2005 decree.
[25] Art. R153-2 and R153-5 of the CMF in their version resulting from the 2005 decree.
[26] Decree no. 2014-479 of 14 May 2014.
[27] Letter dated 19 June 2014 from the European Commission to the French authorities.
[28] Decree No. 2018-1057 of 29 Nov. 2018.
[29] As defined in Annex I to Reg. (EC) no. 428/2009 of 5 May 2009.
[30] E. Schlumberger, *Du renforcement du contrôle des investissements étrangers*, BJS 2019, no. 2, p. 1. 31 Reflection paper on harnessing globalisation, European Commission, 2 May 2017, https://ec.europa.eu/info/sites/default/files/reflection-paper-globalisation_en.pdf
[32] *Ibid*, p. 15.
[33] Communication of 13 September 2017 from the Commission to the European Parliament, the European Council, the European Economic and Social Committee and the Committee of the Regions
https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2017:0494:FIN:FR:PDF.
[34] *Ibid,* p. 12.
[35] *Ibid,* p. 12.

Together with a Commission working document including a precise overview of FDI in the EU,[36] European regulation of 19 March 2019,[37] applicable since 11 October 2020,[38] responded point by point to the proposal. The scheme, which only covers investments from non-EU countries, therefore leaves investments within the EU to national mechanisms, which must simply be compatible with the fundamental principles governing the common market. The regulation is innovative in that it does not impose a uniform regime. Rather like a directive, it offers Member States a non-exhaustive list of sensitive sectors and factors to which legislators can refer.[39] More conventionally, it establishes a single mechanism for cooperation between Member States and the Commission[40] and sets up a separate screening mechanism at Commission level in cases where investments affect the interests of the Union itself.[41]

It is in this thoroughly updated context that the Pacte Law,[42] followed by the Decree of 31 December 2019,[43] came into effect to both clarify and further strengthen the French system.

In addition to clarification, the scope of control has also been broadened. As a result of the redefinition of what constitutes an investor, an investment and a target's business, more transactions fall within the scope of potential control.[44] Firstly, because the essential distinction between European and non-European investors disappears. Secondly, because the notion of foreign investor encompasses any "entity" controlled by a foreign individual or legal entity and, for a non-EU investor, exceeding the 25% ownership threshold may be enough to constitute control.[45] Finally, because the decree continues to extend the list of sensitive activities by integrating a new "critical technologies"[46] category. In order to facilitate understanding of the French system and therefore the investor's pathway, the decree also established the possibility of making a prior request to examine an activity[47] and specified the information to be provided.

The Pacte Law also strengthened the coercive powers of the Minister of the Economy and Finance. They can now issue protective measures that affect the rights attached to the securities held by the investor. Voting rights, the right to receive dividends or the freedom to dispose of the underlying assets may be challenged.[48] In general, penalties have been increased,[49] and will differ depending on whether the investment was made without authorisation or without complying with applicable conditions. Conditional authorisation,[50] the criteria for which are set out in Article R. 153-9 of the French Monetary and Financial Code (CMF) to give investors greater visibility, must comply with a proportionality principle,[51] and the conditions may change at the request of the investor or Minister.[52]

The importance of commitments made by the investor and monitoring by the State are illustrated perfectly by a recent case. Volkswagen had bought German group Man Energy Solutions in 2011, whose French subsidiary happened to be the manufacturer of diesel engines that power French nuclear submarines. As part of an overall restructuring plan, Volkswagen had announced a streamlining of its sites, which would lead to a halt in the production of spare engines used by French submarines. The State therefore had to remind Volkswagen of the commitments made upon the change of control and, thanks to the foreign investment mechanism, was able to obtain a guarantee for the delivery of this sensitive equipment until 2030.

6. A system put to the test by the health crisis. It very quickly became apparent that the global health crisis was going to worsen for purely cyclical reasons, with a large

[36] Commission staff working document, Following up on the Commission communication "Welcoming foreign direct investment while protecting essential interests", https://trade.ec.europa.eu/doclib/docs/2019/march/tradoc_157724.pdf
[37] Regulation (EU) No. 2019/452, 19 March 2019.
[38] Art. 17, Regulation (EU) No 2019/452, 19 March 2019.
[39] Art. 4.1 and 4.2, Regulation (EU) No 2019/452, 19 March 2019.
[40] Arts. 6 and 7, Regulation (EU) No 2019/452, 19 March 2019.
[41] Art. 8, Regulation (EU) No 2019/452, 19 March 2019.
[42] Law No. 2019-486 of 22 May 2019 on the growth and transformation of companies.
[43] Decree 2019-1590 of 31 December 2019 on foreign investment in France.
[44] Art. R151-1 of the CMF as amended by decree of 31 December 2019.
[45] Art. R151-2 of the CMF as amended by decree of 31 December 2019.
[46] Art. R151-3, III, 1 CMF.
[47] Art. R151-4 CMF.
[48] Art. L. 151-3-1 of the CMF.
[49] Art. L. 151-3-2 of the CMF.
[50] Art. L.151-3, II of the CMF.
[51] Art. L. 151-8 of the CMF.
[52] Art. L. 151-9 of the CMF.

number of companies likely to appear as opportunities for potentially predatory investors.

It was therefore only natural for France to ramp up its controls. The State's increased vigilance resulted in 275 operations in 2020 and 328 operations in 2021 being examined under foreign investment regulations, without resulting in an increase in the number of refusals. It is also perfectly understandable that France should also opt to strengthen an already revised normative framework in 2019.

The effects of this were twofold. Firstly, control has become more sensitive, as the threshold that triggers it has been provisionally[53] yet significantly lowered[54] when the investor is a non-EU member, nor a member of a State that is a signatory to the European Economic Area Agreement. It is now enough to hold 10% of the voting rights of a strategic French company, the shares of which are admitted to trading on a regulated market. Secondly, as of April 2020, the list of strategic activities has been extended to include research and development activities in the biotechnology sectors, in order to protect companies that produce vaccines.[55]

However, the health crisis led to more than the constant strengthening of the French system and an increase in controls. It also drew public attention to an issue no longer seen as purely technical, and which can rightly be referred to as economic patriotism. Public awareness of a transaction can be amplified due to the target company's profile, which can make it a genuine symbol.

As such, no one was particularly surprised that the strict conditions set by the French government for the takeover of Photonis by US-based Teledyne saw the deal fall through at the end of 2020. The business sector was clearly defence-related. On the other hand, the Minister of the Economy's refusal of Canadian company Couche-Tard's acquisition of Carrefour at the beginning of 2021, even before an authorisation application had been submitted, may have seemed less rational. The issue of food security and protection of agricultural sectors failed to convince observers as easily. However, there is one notable fact that couldn't be ignored. Despite the broadening and intensification of foreign investment controls, refusals are only very rarely reported in the press, suggesting that the balance sought between attractiveness and security, while fragile, is not impossible.

7. Transparency and predictability of foreign investment control in France.

Until September 2022, the foreign direct investment screening regime in France was strengthened and stabilised around defensive and offensive tools at the disposal of the Minister of the Economy and a streamlined team, the "Multicom 4" office of the French Treasury, tasked with assessing authorisation requests and managing relations with interministerial authorities and the European Commission.[56]

However, while recognised by both French and foreign stakeholders as clear, this system is not without its critics. It has been noted that the system would benefit from being more predictable, thereby offering French companies and foreign investors the legal certainty they occasionally lack. It has also been proposed that guidelines, general principles, best practices and a practical guide for foreign investors be drawn up. The lack of transparency has also been raised, in particular due to the use of concepts that are not clearly defined. It is worth noting that the examination period for a foreign investment authorisation application may not exceed 30 working days once completeness has been notified. However, in some cases, the public authorities delay such notification and therefore the examination of the application by asking questions over an extended period of time.

The publication of guidelines on foreign direct investment screening in France[57] on 9 September 2022, drawn up by the French Treasury, is an effective response to this lack of predictability and clarity.

The 49-page guideline, which is the result of public consultation carried out throughout 2022, provide stakeholders with a practical and instructive overview of the scope of application of rules relating to control, the implementation of the control procedure and the monitoring of authorisations issued by the Minister of the Economy.

May these guidelines serve as a useful tool to assist companies, advisors and other stakeholders in the implementation of foreign investment control regulations in France!

[53] Lowering of the threshold applicable until 31 December 2021, Decree No. 2020-1729 of 28 Dec. 2020, Art. 1 was extended by decree until 31 December 2022, Decree No. 2021-1758 of 22 December 2021.
[54] Decree no. 2020-892 of 22 July 2020, art. 1.
[55] French Official Journal (JORF) no. 0105 of 30 April 2020.
[56] See Part 2 of this text, which covers the current foreign investment control system in France with the Head of foreign investment control in France at the Treasury.
[57] French Treasury, Foreign investment control in France: publication of guidelines 9 September 2022: https://www.tresor.economie.gouv.fr/Articles/314615b9-70b9-417f-bb94-5dd1437e7418/files/a81a841b-dc55-4685-af34-213bb0bd88cc