THE EUROPEAN FOREIGN INVESTMENT SCREENING MECHANISM

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Free trade is central to the construction of the European market. For a very long time, this cornerstone of European commercial policy led the European Union (EU) to deal with the issue of foreign direct investment (FDI) solely in the light of the principles of the free movement of capital and freedom of establishment. The risk that some of these investments could be predatory or more generally would weaken the strategic sectors of Member States only appeared to have been seen by the States and national governments. The development of globalisation, marked politically and commercially by more competitive or aggressive relations, led the EU to completely rethink the issue (1). To maintain the attractiveness of its assets while preserving the key interests of Member States and the EU, an original mechanism was put in place by the Regulation of 13 March 2019,[5] which gave Member States considerable leeway while encouraging them to standardise their practices (2). The EU is now taking the initiative in this field, and intends to actively manage the development of national

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[5] Regulation 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJEU, 21 March 2019, L. 791/1.

mechanisms, put to the test by the health crisis and the war in Ukraine (3).

1. Origins of the European foreign direct investment screening system

The issue of foreign direct investment (FDI) is absent from the founding treaties of the EU, and for a very long time was merely treated as one method, among others, of movement of capital. And yet the priority of the institutions of what was to become the EU was precisely to give the greatest scope and the greatest strength to the principle of the free movement of capital, alongside the other fundamental economic freedoms.

Faced with direct investments throughout what came to be known as a period of happy globalisation, mainly from private companies established in countries that were traditional partners, such as Canada, the USA and Japan, the EU mainly saw the benefits of their development.

The striking attractiveness of Europe and its great openness made it the top FDI destination worldwide. According to the OECD, Europe is in fact one of the most open markets for investors.[6] For a long time this openness was mainly due to its effects on the growth of the beneficiaries, and job creation.

Member States, some of which, such as France, had a mechanism from the outset that enabled them to oppose investments liable to undermine their security, were the first to assess the risks that this openness and attractiveness involved. An increasing number of States introduced screening mechanisms which they constantly strengthened, the only point of reference and limit being the EU principles of free movement of capital and freedom of establishment.

After having shown for a long time, if not hostility, at least a certain mistrust towards this trend, the EU has in turn very recently realised the dangers that the wholesale opening up of European economies would lead to in a disrupted global context.

"Happy globalisation" has been replaced by globalisation that is more competitive than ever, in which certain States are conducting what is now referred to as a genuine trade war. Within this context, investors can be threats or predators for other States and national governments. Certain takeovers provide a prime example of how a country could lose the expertise it had acquired in strategic sectors. More generally, the idea has become accepted that States need to protect their key interests at all times, and not just in the defence and security sectors.

In connection with a series of studies on the future of Europe, a Reflection Paper on Harnessing Globalisation was published in May 2017.[7] Although it stated once again that direct investments are an essential tool for financing and technology transfer,[8] and that opening up economies enables an ever-increasing number of people to escape poverty, the document marked the end of the naivety of which some people accused Europe. For the first time it clearly emphasised the need for the EU to take steps to restore fair conditions of competition. In particular, the Commission recognised that as such it was necessary to meet the desire of Member States to protect their key technologies against potential predatory investments from non-EU States.[9]

The review that was drawn up after this announcement revealed the reasons for this change of policy. In a communication with a title which speaks for itself "*Welcoming Foreign Direct Investment while Protecting Essential Interests*",[10] the Commission stated that at the end of 2015 "*the stock of inward foreign direct investment in the EU stood at over EUR 5.7 trillion while it reached EUR 5.1 trillion in the US and EUR 1.1 trillion in China*".[11] Above all, it noted that the share of our traditional partners was decreasing, while that of emerging countries such as Brazil or China was increasing.[12] Especially, it was emphasised that public enterprises, or those simply influenced by a non-EU State, were actively attempting to take control of strategic assets or acquire influence over them.[13]

We know that Chinese companies and those whose head office is in Hong Kong receive highly flexible financing from Chinese banks and the numerous State subsidies at their disposal. Since 2010, many European ports (Piraeus,

[6] Foreign direct investment restrictions in OECD countries, OECD.

[7] Reflection Paper on Harnessing Globalisation, European Commission, 2 May 2017, https://ec.europa.eu/info/sites/default/files/reflection-paper-globalisation_fr.pdf

[8] *Ibid.*, p. 8.

[9] *Ibid.*, p. 15.

[10] 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.

[11] *Ibid.*, p. 3.

[12] *Ibid.*, p. 3.

[13] *Ibid.*, p. 5.

Antwerp, Rotterdam etc.) have been taken over by entities linked to China, with the takeover partly financed by the Chinese policy to develop trade routes launched in 2013 by President Xi Jinping.[14] Similarly, the takeover of the German robotics giant Kuka in 2016 by the Chinese group Midea made a big impression.[15]

Screening was therefore essential, and moreover it was noted at the time that it was used by Europe's main partners, such as the United States.[16] Finally, the Communication noted that half of the Member States had introduced control mechanisms, and that their markets were not all equally open, which compelled the EU to support this trend in order to favour the compatibility of the national mechanisms with European principles. As a result, the European Commission stated that the freedom given to States to limit the free movement of capital could only be exercised for overriding reasons in the general interest and in a way that does not cause any discrimination and respects the principles of proportionality and legal certainty.[17] Finally, the document presented what the action of the EU in this field should be in the future, and proposed in particular the introduction of a European regulation to control the screening of foreign direct investment in the EU.[18]

Beyond compliance with the stated basic principles, the proposal recommended firstly the development of co-operation between Member States and with the Commission, and secondly the possibility for the Commission to screen investments involving risks for European programmes or projects.[19]

2. The European framework for the screening of foreign direct investments

The European Regulation of 19 March 2019[20] provided a very accurate response to the Commission's invitation, and was accompanied by a Commission working document[21] which provided a review of FDI, extending that of its previous Communication.

From then on it allowed, and even encouraged, what it had previously opposed. Article 3.1 of the Regulation states that "*Member States may maintain, amend or adopt mechanisms to screen foreign direct investments in their territory on the grounds of security or public order*".[22]

The scope of the European mechanism is clearly limited to investments made by investors who are natural or legal persons, from a non-EU State, to the exclusion of intra-Community investments. This priority does not mean that intra-Community investments are not subject to any rules, or that Member States are entirely free to impose the rules they want. Any restrictions on the free movement of capital must comply with the basic principles of the common market and cannot be arbitrary. Consequently, they must at least be proportionate and allow for the possibility of a judicial/legal remedy.[23]

Within this context, the notion of investment is interpreted in the broad sense. It means investments "*of any kind 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*".[24]

The European mechanism, applicable since 11 October 2020[25] appears highly original on more than one account. Firstly, the Regulation completes the principles of European primary legislation and the case law that interprets them, which alone could not control the phenomenon.

[14] Keith Johnson, Pourquoi la Chine achète-t-elle compulsivement les ports d'Europe, Slate, 8 February 2018, http://www.slate.fr/story/157396/chine-ports-europe.

[15] Pauline Houédé, La Chine décapite la direction du géant allemand Kuka, 27 November 2018, Les Echos, https://www.lesechos.fr/industrie-services/automobile/la-chine-decapite-la-direction-du-geant-allemand-kuka-150573.

[16] *Ibid*., p. 6.

[17] *Ibid*., p. 8.

[18] *Ibid*., p. 12.

[19] *Ibid*., p. 12.

[20] 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.

[21] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.

[22] Article 3.1, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*

[23] B. Lecourt, Contrôle des investissements étrangers opérés par des personnes extérieures à l'Union européenne: l'Europe établit un cadre, Revue des sociétés 2019, p. 364.

[24] Article 2.1, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*

[25] Article 17, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*

Nevertheless, it does not impose the standardisation usually linked to that type of regulation.

It does not in itself oblige Member States to introduce a control mechanism. And those that intend to do so do not have to follow the same regime. Similarly of a directive, it provides a framework within which Member States are called upon to act.

Consequently, the Regulation proposes a non-exhaustive list of sensitive sectors and factors that national legislators can use.[26] To assess the risk that security or public order is likely to be affected by a foreign direct investment, they can therefore take into account the "potential effects" on infrastructure in fields that are very clearly linked with the security of States or their sovereignty. It therefore mentions energy, water, health, communications, aerospace, defence, critical technologies, dual use items, artificial intelligence and biotechnologies etc.[27] Some fields, such as electoral or financial infrastructure and real estate crucial for the use of such infrastructure, and personal data, are more original.

Regardless of the sector concerned, and thereby responding directly to the findings in the previous documents, the Regulation states that national legislators can also take into account the fact that the investor is controlled by the government of a third country or draw conclusions from the fact that in the past an investor has already been involved in activities affecting security or public order or is suspected of engaging in criminal activities.[28]

In addition, States are free to put in place a general or sector-specific mechanism, or introduce prior or on the contrary ex post checking. They simply have to respect a few basic principles. The national mechanism must offer a minimum level of transparency, in the sense that it must allow investors to know the procedure applicable, and in particular the time limits, as well as the trigger criteria and grounds for control. The rules must also give investors the possibility to seek recourse, and not prove to be discriminatory.[29]

The originality of the Regulation is shown by the fact that the unitary scheme that it introduces only concerns the required cooperation between Member States and in their relations with the European Commission.[30]

This cooperation must be understood in two complementary ways. Firstly, a genuine alert mechanism is thereby put in place. Each Member State is obliged to notify the Commission and the other Member States of any FDI subject to control in its territory, where appropriate accompanied by a list of the Member States likely to be affected.[31] This makes it possible to reveal transactions that do not only have a national dimension. Furthermore, in this case the other Member States concerned can send comments to the Member State that undertook the screening and simultaneously to the Commission.[32] The Commission can also issue a purely advisory opinion addressed to the Member State undertaking the screening when it considers that an FDI undergoing screening is likely to affect security or public order in more than one Member State, or has relevant information in relation to that FDI. It must issue an opinion whenever one third of Member States consider that an FDI represents a risk for their security or public order. Above all, this enables the Commission to respond to any investment that may affect projects or programmes of the same nature as those listed in the Annex to the Regulation, that are of the European Union's interest.[33] These investments can then be examined in greater detail, after which the Commission can issue an opinion addressed to the Member State in which the FDI is planned or has been completed. In this case, if the Member State receiving the investment does not follow that opinion it must provide an explanation to the Commission. This applies the principle of "comply or explain" that exists in the field of corporate governance.

In any case, it is striking that the decision remains ultimately the responsibility of each Member State. The Member States have sovereign power to decide how to protect their interests.

The second aim of the European mechanism for cooperation is to favour standardisation of the control mechanisms already adopted by Member States. All those that have introduced a control mechanism must notify the Commission of it, and any amendments to it.[34] Because it

[26] Article 4.1 and 4.2, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*
[27] Article 4, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*
[28] Article 4, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*
[29] Article 3.2, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*
[30] Articles 6 and 7, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*
[31] Article 6, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*
[32] Articles 6 and 7, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*
[33] Article 8, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*
[34] Article 3.7 *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019.*

publishes a list of these mechanisms, the Commission encourages comparison, which may lead to the mechanisms being brought into line with the best ones. The comparison envisaged can be easily clarified by the annual report that Member States must also submit regarding the investments made in their territory, and the requests for information received from other Member States.[35] In general, by favouring cooperation and communication between Member States and enabling them to share their experience, the Regulation asks them to consider the problem as collective and European and therefore to standardise their mechanisms.[36]

3. The European mechanism and policy put to the test by the health crisis and the war in Ukraine

One of the most visible consequences of the health crisis and the economic crisis caused by Covid-19 is that it weakened a large number of companies for purely financial reasons. In this context it is quite legitimate to fear that this will favour a windfall effect, i.e. the takeover of a large number of assets at very low, undervalued prices. Moreover, it may also suggest that we cannot be so selective with regard to potential investors while there is a substantial need for financing.

The European Commission was aware of the risks to the strategic assets of its Member States, in particular in the health sector, and reacted quickly by endeavouring to coordinate a comprehensive response to preserve companies' resilience. Less than a week after the Communication regarding the relaxing of State aid measures,[37] the Commission therefore published another Communication on 26 March 2020[38] in which it proposed a series of guidelines for Member States concerning the control of foreign direct investments, and in particular the protection of Europe's strategic assets, ahead of the application of the Regulation of 19 March 2019.

In this Communication, the Commission no longer confined itself to allowing Member States to introduce a control mechanism, or even to asking them to do so, it literally "urges" vigilance, including for SMEs and simple startups. The strategic nature of a company cannot depend on its value or its level of maturity.

Similarly, in response to the war in Ukraine on 5 April 2022, the Commission published guidelines for EU Member States on assessing and preventing the threats that Russian and Belarusian investments pose for the Union's security and public order. More precisely, it emphasised the increased risk linked to investments subject to the influence of the Russian or Belarusian government in the context of the armed conflict. These guidelines call for increased cooperation between the authorities involved in screening investments and those responsible for applying sanctions. Finally, Member States are asked to ensure the strength of their anti-money laundering rules to prevent any improper use of the Union's financial system by Russian or Belarusian investors.

These two major developments showed the resilience of the European screening mechanism for foreign investments. Above all, the Commission showed exceptional agility by giving Member States the tools (guidelines) to make it easier for the Union to adapt to an ever changing environment, as soon as circumstances made this necessary.

In general, the publication of an annual report, the first of which was adopted on 23 November 2021, sanctions the whole of this control mechanism. The report emphasises in particular the fact that the Commission examined 265 operations. As 80% of them did not require extensive analysis, the operations selected were assessed by the Commission in only 15 days. The second annual report will cover 2021.

The Commission's priority, after barely two years of experience, is still the effective implementation of the screening mechanism, in constant and close collaboration with the Member States.

[35] Article 5.1 and 5.2, *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019. In addition, the Commission submits a report to the European Parliament on the application of the Regulation, Article 5.3.*
[36] B. Lecourt, aforementioned article.
[37] Communication 2020/C 91 I/01, OJEU 20 March 2020.
[38] Communication 2020/C 99 I/01, OJEU 26 March 2020.