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THE ART OF CASTING POLITICAL DISSENT IN LAW: THE EU’S FRAMEWORK FOR THE SCREENING OF FOREIGN DIRECT INVESTMENT

STEFFEN HINDELANG AND ANDREAS MOBERG

Abstract

This paper describes and analyses the EU Regulation establishing a framework for the screening of foreign direct investments (FDI) into the Union. The negotiations that preceded the adoption of the Regulation were characterized by greatly divergent views of Member States on the proper use of FDI screening. Under such conditions, the Regulation’s framework for administrative cooperation and information sharing was as much as the Commission could hope for. The main challenge going forward lies in balancing the policy priorities of individual Member States in determining what constitutes a threat to security and public order, with the needs of the collective, that is the EU. In that respect, the indicative criteria set out in the Regulation may initiate a drive towards a rough consensus. While any ambition to fully harmonize FDI screening has now become only a long-term goal, this paper finds that the Regulation has established a nascent EU screening mechanism, albeit a well-camouflaged one.

1. Introduction

On 11 April 2020, Regulation (EU) 2019/452 establishing a framework for the screening of foreign direct investments into the Union¹ (hereinafter referred to as the Regulation²) celebrated the first anniversary of its entry into force. The Regulation concerns the review of inward foreign, i.e. third country, direct investment (FDI) on the grounds of security and public order. Its adoption marks an important step in the establishment of foreign direct

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¹ Regulation (EU) 2019/452 establishing a framework for the screening of foreign direct investments into the Union, O.J. 2019, L 79.

² Articles without an indication of specific legislation or treaty are articles of Regulation 2019/452 ibid.
investment (“FDI”) screening as a new EU regulatory field.\(^3\) It does not require psychic abilities, but merely a look back at the history of regulatory harmonization, in sectors such as energy,\(^4\) to predict that there is more to come once the Regulation becomes fully applicable on 11 October 2020. And just to prove its ambitions, the European Commission, in a communication in response to the ongoing pandemic caused by the SARS-CoV-2 virus, explained that while, “[a]t present, the responsibility for screening FDI rests with Member States”, it is high time “[f]or those Member States that currently do not have a screening mechanism, or whose screening mechanisms do not cover all relevant transactions, to set up a full-fledged screening mechanism …”\(^5\)

The adoption of the Regulation was anything but uncontroversial. It proved very challenging to find consensus, in particular among the European Union Member States. Basically, every aspect, from whether, to how and by whom FDI screening should be carried out, was disputed. These difficulties, however, did not come as a surprise to anyone familiar with the historic development of the field.\(^6\)

The debate was held against the backdrop of a major shift in the political perception and appreciation of FDI. Traditionally, the EU has maintained one of the most liberal regimes for FDI in the world economy.\(^7\) Although global FDI has been sliding for three consecutive years, mainly due to US multinationals switching to domestic investment,\(^8\) the EU has been one of the biggest receivers of FDI, as well as the biggest FDI exporter, in the world.\(^9\)

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Thus, neither the EU nor its Member States dispute, as such, the fact that FDI, both inward and outward, is beneficial to the Union’s economy in terms of growth. Lately, however, due to significant changes in the global political and economic climate, a debate has erupted as to what extent FDI has become more of an instrument of political strategy and less of a function based on economic rationale. Jean-Claude Juncker, the former President of the Commission, formulated the EU’s position as follows: “We are not naïve free traders. We will not trade for the sake of it or compromise on our principles for a quick deal. I cannot accept that those who work hard to make ends meet suffer at the hands of those who dump, de-regulate or distort the market”. It was in this context that he placed the Regulation, presenting it as a trade defence instrument. More recently, the Commission in the abovementioned communication on SARS-CoV-2 impact on the European economy seems to have gone even further in mixing economic, security, and industrial policy considerations: “FDI screening should take into account the impact on the European Union as a whole, in particular with a view to ensuring the continued critical capacity of EU industry, going well beyond the healthcare sector. The risks to the EU’s broader strategic capacities may be exacerbated by the volatility or undervaluation of European stock markets. Strategic assets are crucial to Europe’s security, and are part of the backbone of its economy and, as a result, of its capability for a fast recovery.”


11. This quote was a recurring theme in several speeches made by the then President of the Commission, e.g. in the State of the Union Address in 2017. Here is another, longer, quote: “But let me be very clear: we are not naïve free traders. We will not trade for the sake of it or compromise on our principles for a quick deal. I cannot accept that those who work hard to make ends meet suffer at the hands of those who dump, de-regulate or distort the market. This is why we have shown our teeth by raising tariffs on cheap steel coming from China or taken a no tolerance approach on the forced transfer of technology. It is why we have modernized our trade defence instruments and have just recently agreed new rules on screening foreign investment in areas that may affect security or public order.” Keynote speech by President Juncker at the EU Industry Days 2019, Brussels 5 Feb. 2019, Speech/19/870.

12. This political perception will also be reflected in a reorganization of DG Trade, where dual use goods, export control, and FDI are handled in a new unit on “trade and security”.

13. Commission Communication cited supra note 5, p. 1. Despite this special blend of policy considerations, one could indeed start to believe that the Commission is serious in suggesting that the Member State governments may be in a better position than the market to value an undertaking and, further, that a discrepancy between a government set price and market price could justify government intervention in sectors which are nebulously labelled “strategic”.

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It is this blend of policy considerations which also reflects the arguments advanced in favour of an EU instrument specifically addressing FDI screening, i.e.:

- a lack of reciprocity: the “unfair” situation supposedly caused by the fact that major trading partners subjected EU outward FDI to screening, while FDI into the EU was not necessarily subject to a review process; 14
- security concerns: the need to screen third-country investors who target companies that operate in “politically or strategically sensitive areas” such as transport, health or energy infrastructure, high-tech, research and innovation, software and cryptography, or manufacture of dual-use products; 15
- market economy concerns: some third-country investors are State owned enterprises (SOEs), which may additionally pose security concerns; the same holds true for investors whose ultimate ownership remains unclear; 16
- the threat of rendering ineffective individual Member States’ already existing screening mechanisms: the fact that some Member States did not screen FDI is also a reason forwarded by those who did


screen since circumvention of national screening mechanisms was possible using the EU freedom of establishment, after already setting up, or taking control of, a company in another – non-screening – Member State.

As indicated earlier, these arguments (and the policy concerns they express) were not accepted by all the Member States. Quite the contrary: at the time of writing, only 14 of the 27 Member States maintain some sort of formal mechanism dedicated to screening FDI, and these vary greatly in breadth and depth. This fact already illustrates the diversity of political thinking on FDI screening. The spectrum of existing regulatory approaches in the Member States ranges from essentially no FDI ever getting restricted, and no investment ever being unwound, to far-reaching FDI screening regimes covering all sectors of the economy, allowing for conditioning, prohibiting, or unwinding FDI.

Under such conditions, the task of designing an EU regulation is no mean challenge. While the EU Treaties provide the outer limits to the spectrum of political choices available to the EU, and while they indeed include an obligation to contribute to the progressive abolition of restrictions on foreign direct investment in Articles 64(2) and 206 TFEU, in the end it will be the political priorities in the Member States, reflected in particular in the voting in the Council, but also in the European Parliament, that control any remaining ambition at the European level to harmonize FDI screening.

This paper analyses the compromise which emerged out of this complex setting of cooperation and conflict: i.e. the Regulation which, according to its title seeks to establish “a framework for the screening of foreign direct investments into the Union”. Firstly, with a view to providing the background,
this paper will briefly revisit the evolution of thinking on the regulation of FDI screening at the European level, in which the expansion of the Common Commercial Policy (CCP), in 2009, to include FDI worked as a catalyst (section 2). The Commission chose to base the Regulation on Article 207(2) TFEU, which means that screening of inward FDI was considered a part of the “framework for implementing the common commercial policy”. Secondly, the paper will critically assess this choice, analysing whether the outer limits provided for by the EU Treaties have been observed (section 3). It will then, thirdly, turn to the substance of the Regulation, clarifying and reviewing the specific compromise which ultimately emerged from the complex mix of interests, in particular among the Member States. In a nutshell, the Regulation seeks to establish “a framework for the screening by Member States of foreign direct investments into the Union on the grounds of security or public order” and to bring about a “mechanism for cooperation between Member States, and between Member States and the Commission, with regard to foreign direct investments likely to affect security or public order” (section 4 below). The paper will conclude with a reflection on what has been achieved so far, and what lies ahead for this budding field of EU policy (section 5).

2. The evolution of thinking on FDI screening

Over the past decade, the Commission, as well as many Member States, has gone through a significant change of attitude towards the idea of screening inward FDI. Bismuth puts the rhetorical question “would the Barroso Commission have reacted negatively to the 2017 Juncker Commission’s proposal establishing a framework for screening FDI into the EU on the grounds of security and public order?”, and it is not unlikely that indeed it would have.

Back in 2010, when the Commission laid down strategic lines for its newly attributed competence in the area of FDI, investment was heralded as the new frontier for the CCP. The Commission celebrated the fact that the new
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competence in Article 207 TFEU “provides for the Union to contribute to the progressive abolition of restrictions on foreign direct investment”.25

The Commission’s strategic focus was essentially on EU outward FDI. It embarked on an ambitious negotiating agenda for free trade agreements to further liberalize FDI flows. These agreements also included chapters on the protection of FDI.26 Significant resources were invested in the negotiation of these agreements, especially since the proposed investor-State dispute settlement mechanism (ISDS) was met with heavy political and legal resistance. Only recently can the dispute be described as having been largely pacified and resolved.27

Around 2014, the Commission’s focus on outward EU FDI was becoming increasingly problematic.28 By then, as many Member States were just starting to recover from the economic crisis of 2008, Chinese FDI into the EU had been growing at a very high pace for the past few years.29 While there were definitely those who were alarmed by the obvious opportunity to “divide and conquer”30 the Member States, due to both a lack of EU policy coherence as well as the difference in need of foreign capital to kickstart suffering economies, then Trade Commissioner de Gucht opted in terms of policy

25. Commission Communication, “Towards a comprehensive European international investment policy”, COM(2010)343, at p. 2. However, not all were unreservedly open to abolishing restrictions on FDI. For example, France and Germany, at the time, already had schemes for FDI screening in place and did not think of giving them up. The Commission, however, was so determined that it even initiated infringement proceedings against France, because of a law creating an authorization procedure for foreign investments in certain sectors. “France is asked to clarify why companies established in the EU but under the control of third-country investors could be submitted to the more stringent procedure applicable to third-country companies, whereas a company legally and genuinely established in a Member State should normally be treated as a national of that Member State.” European Commission, IP/06/438, 4 April 2006. Cf. Bismuth, op. cit. supra note 23.


28. “Neither the Commission nor the Member States nor business groups seem particularly interested in addressing inbound FDI.” Meunier, op. cit. supra note 18, at 1009.

29. Cf. Bu, “The One Belt and One Road (OBOR) initiative: Reconceptualisation of State capitalism vis-à-vis remapping of global governance?” in Hindelang and Moberg (Eds.), op. cit. supra note 7.

30. Meunier, op. cit. supra note 18.
priorities for an EU-China investment agreement instead of tabling a proposal on FDI screening. The argument was essentially that the EU desperately needed the investments and that FDI screening risked getting hijacked by protectionist governments. All the while, Chinese investment in the EU soared, reaching an all-time high of 37 billion euros in 2016.

However, political tectonics were starting to move yet again. In a letter to the then Trade Commissioner Malmström, sent in February 2017, the French, German, and Italian governments jointly asked the Commission to implement FDI screening measures at the EU level. In March 2017, the European Parliament (EP) tabled a proposal for an EU act on the screening of foreign investment in strategic sectors, under the Article 225 TFEU procedure. The EP initiative gave voice to all of the concerns related to inward FDI listed in the previous section of this paper, and called for the Commission to come forward with a legislative proposal in order to remedy the problems caused by the lack of coherence and cooperation amongst the Member States.

On 10 May 2017, the Commission issued the Reflection Paper on Harnessing Globalisation which acknowledged that FDI may pose a threat to security as well as the problem of a lack of reciprocal investment conditions. The Reflection Paper was received as a small step in the right direction, but in the eyes of many, the EP for example, it was not enough. The EP once again


32. “Above all, we cannot accept – in Europe or elsewhere – that national security concerns are used as a false pretence to justify the protection of vested economic interests”, De Gucht, “EU-China investment: A partnership of equals”, speech delivered at the Bruegel Debate: China invests in Europe patterns impacts and policy issues, Brussels, 7 June 2012, Speech/12/421.


34. Letter to DG Trade Commissioner Malmström, from the French, German and Italian governments, Feb. 2017, <www.bmwi.de/Redaktion/DE/Downloads/S-T/schreiben-de-fr-it-an-malmstroem.pdf?__blob=publicationFile&v=5>. See also Warchol in Hindelang and Moberg (Eds.), op. cit. supra note 7, as well as the foreword written by Malmström in the same volume.


36. Cf. supra, section 1.

37. “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.” European Commission, “Reflection paper on harnessing globalisation”, COM(2017)240, at p. 15.
addressed the need for EU legislation in a Resolution adopted in July 2017. On 13 September 2017, the Commission President Juncker delivered the annual State of the Union address, in which, as mentioned above, he declared that “we are not naïve free traders”, and on the very same day the Commission proposed the Regulation. The Regulation was adopted on 19 March 2019, 18 months after the Commission’s proposal.

3. Investment screening and EU competences

The adoption of the Regulation was based on Article 207(2) TFEU within the Chapter on the CCP which also covers “foreign direct investment” (section 3.1. below). Article 207(2) TFEU was, however, not the only provision in the EU Treaties which could have provided a legal basis for the Regulation. Article 64(2) and (3) TFEU, in the Chapter on Capital and Payments, also contains a competence which allows the EU to adopt measures regulating the movement of capital specifically with regard to third countries, including FDI (section 3.2. below). While the CCP is an area of exclusive competence of the EU, the internal market belongs to the area of shared competence. If screening of FDI had been deemed to fall under shared competence, Member States would not need to be authorized by the Union to introduce or to maintain their individual screening mechanism until such event that the EU had decided to legislate in that field, and any such EU measure would have to be taken in conformity with the principle of subsidiarity. Moreover, different legislative procedures and voting majorities also apply in part to the respective competences. Therefore, the correct choice of the legal basis (section 3.3. below) is very relevant from a balance of powers perspective, both in the horizontal and the vertical sense.

38. “Calls on the Commission, together with the Member States, to screen third country FDI in the EU in strategic industries, infrastructure and key future technologies, or other assets that are important in the interests of security and protection of access to them, while bearing in mind that Europe depends to a large extent on FDI”, European Parliament, “Resolution on building an ambitious EU industrial strategy as a strategic priority for growth, employment and innovation in Europe”, <oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2017/2732(RSP)>.
40. Cf. Art. 3(1)(e) TFEU.
41. Cf. Art 4(2)(a) TFEU.
42. Cf. Art. 2(2) TFEU.
43. Cf. Art. 5(3) TEU.
3.1. Investment screening as part of the CCP: Is Article 207(2) TFEU a suitable legal basis for the Regulation?

The CCP provides for an exclusive competence of the EU both to adopt autonomous measures as well as to conclude international treaties with third countries (Art. 207(2) and (3) TFEU respectively).\footnote{44. Cf. Hillebrand Pohl, “The impact of investment treaty commitments on the design and operation of EU investment screening mechanisms” in Hindelang and Moberg, op. cit. supra note 7.}

In Opinion 2/15, the ECJ defined (foreign) direct investment within the CCP\footnote{45. The Court referred to its case law on free movement of capital. Cf. Case C-446/04, Test Claimants in the FII Group Litigation, EU:C:2006:774, paras. 181 and 182; Case C-326/07, Commission v. Italy, EU:C:2009:193, para 35; Case C-464/14, SECIL, EU:C:2016:896, paras. 75 and 76.} as consisting of “investments of any kind made by natural or legal persons which serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity. Acquisition of a holding in an undertaking constituted as a company limited by shares is a direct investment where the shares held by the shareholder enable him to participate effectively in the management of that company or in its control”\footnote{46. Opinion 2/15, Free Trade Agreement between the European Union and the Republic of Singapore, EU:C:2017:376, para 80 (emphasis added; in-text citations omitted).}

The definition used in the Regulation is congruent with the definition in Opinion 2/15, which in fact was handed down a mere four months before the Commission proposal. Article 2(1) of the Regulation reads: “‘foreign direct investment’ means an investment of any kind by a foreign investor \textit{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”\footnote{47. Emphasis added.}.

Furthermore, according to long-standing case law, measures taken under Article 207(2) TFEU must relate “specifically to... trade [with one or more third States] in that it is essentially intended to promote, facilitate or govern such trade and has direct and immediate effects on it”\footnote{48. Opinion 2/15, EU-Singapore, para 36.}.

The Regulation concerns the participation of third-country investors in the management or control of companies carrying out economic activities in the territory of the EU. While Article 3(1) does not generally lay down mandatory rules pertaining to any given Member State’s screening mechanism, some minimum procedural requirements for such a mechanism, stipulated in

\footnotetext{44. Cf. Hillebrand Pohl, “The impact of investment treaty commitments on the design and operation of EU investment screening mechanisms” in Hindelang and Moberg, op. cit. supra note 7.}
Article 3(2) to (6), are compulsory. This mandatory character also holds for the rules relating to the cooperation mechanism that secures the flow of information on planned or implemented third-country FDI between EU Member States and between the Member States and the Commission. It can be assumed that, in particular, the exchange of information on potentially harmful investments, but also the procedural rules, directly and immediately influence screening decisions; they thus impact FDI flows, which may seek and find alternative destinations.

Moreover, according to the clear wording of Article 207(2) TFEU, the EU measure must define “the framework for implementing the common commercial policy”. This requires that the EU measure based on Article 207(2) TFEU, first, sets rules which are capable of being further developed and implemented by another EU act and, second, furthers a common EU commercial policy. A common policy may not necessarily require complete harmonization, but for it to be a common policy, there needs to be a certain measure of coordination of individual Member State actions in respect of third countries with a view to reducing contradictions and the possibility to put individual interests above the common interest.

While these rules seem to be suitable for further specification through other EU measures, some doubts have been raised whether they actually coordinate Member States’ policies. Some parts of the rules on the Member States’ screening mechanisms are not compelling, in particular concerning whether or not to introduce a screening mechanism. However, the framework – within the meaning of Article 207(2) TFEU – for which the Regulation provides, relates to the minimum procedural requirements for a
Member State’s screening mechanism (cf. Art. 3(2) to (6)) as well as the duty of mutual consideration of public order and security concerns in the screening decision exchanged within the context of the coordination mechanisms according to Article 6 et seq.  

Thus *prima facie* one could conclude that Article 207(2) TFEU is indeed a suitable legal basis.

### 3.2. Investment screening as part of the external dimension of the Internal Market – Article 64(2) and (3) TFEU

The TFEU Chapter on Capital and Payments contains a competence to adopt measures on the movement of capital specifically with regard to third countries, *inter alia*, in connection with FDI. An initial review of Article 64(2) and (3) TFEU suggests that the matters covered in the Regulation fit within the scope of this competence as well; the definition of FDI in the context of the CCP and free movement of capital, according to the ECJ, is identical.  

Article 64(2) TFEU allows the Union to remove existing obstacles to the free movement of capital between Member States and third countries. Paragraph 3 of that Article contains an authorization to “restrict or take a step backwards in the liberalization of capital movements”. While further steps towards liberalization are to be taken under the ordinary legislative procedure, steps backwards from the achieved level of liberalization are only possible using the special legislative procedure. The difference in legislative procedure, depending on whether the movement of capital is to be liberalized or restricted, illustrates the fundamental market-open orientation as regards third-country capital movements, the regulation of which is also to be carried out “endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible”.

The legislative procedure in Article 207(2) TFEU does not make such a distinction. Thus, while the *ordinary* legislative procedure applies to liberalizing measures both in the CCP (Art. 207(2) TFEU) and in the Chapter on Capital and Payments (Art. 64(2) TFEU), this “synchronization” is missing for restrictive measures under Article 64(3) TFEU. The latter prescribes a *special* legislative procedure requiring *unanimity* in the Council after consulting the European Parliament.

57. In the same direction, see de Kok, “Towards a European framework for foreign investment reviews”, 44 EL (2019), 24, 47 et seq.; very sceptical Korte, op. cit. supra note 51, 118–120.

58. Cf. supra note 45.

59. Cf. Arts. 289(1) and 294 TFEU.

60. Cf. Arts. 289(2) and 64(3) TFEU.

61. Art. 64(2) TFEU.
3.3. The relationship between Article 207(2) TFEU and Article 64(2) and (3) TFEU

Since both the CCP and the TFEU Chapter on Capital and Payments provide for an EU competence for measures in the area of foreign direct investment, the question arises as to which of the two provides the correct legal basis for autonomous Union acts. Arguments have been advanced suggesting that Article 207(2) TFEU always takes precedence over Article 64(2) and (3) TFEU. These arguments particularly relate to the phrase “without prejudice to the other Chapters of the Treaties” in Article 64(2) TFEU (section 3.3.1. below) and to the ECJ’s case law on the relationship between free movement of capital and freedom of establishment (section 3.3.2. below). However, as these arguments ultimately cannot stand up to scrutiny, the best solution seems to be to base the Regulation on a dual legal basis, i.e. Article 207(2) TFEU together with Article 64(2) TFEU (section 3.3.3. below).

3.3.1. Is Article 64(2) and (3) TFEU subordinate to Article 207(2) TFEU?

The Union’s legislative power in Article 64(2) TFEU is granted “without prejudice to the other Chapters of the Treaties”. Some authors claim that this gives the competence in Article 207(2) priority over Article 64(2) and (3) TFEU.62 However, the phrase to which these commentators refer does not indicate subordination. In fact, such an interpretation fails to recognize that the TFEU typically expresses subordination in quite a different fashion, which becomes clear if Article 64(2) and (3) TFEU is, for example, compared to Article 114(1) TFEU, which indeed stipulates a subordinate competence.63 Moreover, Article 64(2) and (3) TFEU predates the Union’s competence in the area of FDI in Article 207(2) TFEU, which was introduced in 2009 with the Treaty of Lisbon. Hence, the change in Article 207(2) TFEU, it must be assumed, was made in full awareness of the existence of Article 64(2) and (3) TFEU. As essentially no separate scope of application would remain for Article 64(2) and (3) TFEU if Article 207(2) TFEU were intended to take precedence automatically, the treaty drafters would have removed Article


64(2) and (3) TFEU from the Treaty. Apparently, they did not do so. Therefore, the “without prejudice” phrase of Article 64(2) TFEU simply indicates that the competence is competing with other competences in the EU Treaties.

3.3.2. Is the ECJ’s case law on delineation of fundamental freedoms relevant to the choice of legal basis?

Some authors suggest that priority of Article 207(2) TFEU over Article 64(2) and (3) TFEU as the appropriate legal basis for the Regulation can be deduced from the ECJ’s case law on the relationship between the free movement of capital and the freedom of establishment.64 This, somewhat surprising, argument – going against the Treaty’s clear wording – essentially claims that since the free movement of capital does not apply to Member State (sic!) legislation specifically regulating direct investment with regard to third countries, Article 64(2) and (3) TFEU cannot form the legal basis of an EU (sic!) legislative act specifically addressing direct investment with regard to third countries. However, transferring the ECJ’s case law on the delineation of freedoms to the definition of competences seems to be going a bit too far.

Free movement of capital in Article 63(1) TFEU is the only freedom whose scope of application extends, by its clear and unmistakable wording, to the third-country context. Direct investment is a subcategory of capital movement.65 As a consequence, the freedom also covers third-country direct investment, i.e. FDI. However, according to the ECJ, its applicability (also) in a third-country context is determined by the freedom’s relationship to the freedom of establishment. Although freedom of establishment is not applicable to third-country scenarios, the Court nonetheless perceives it as competing and largely prevailing. In Kronos,66 the ECJ summarized its controversial67 view on the complicated relationship between the two freedoms in a textbook-like fashion.

Essentially, the ECJ applied a three-step test. The Court held that, first, as “regards the question whether national legislation falls within the

64. Cf. Herrmann, op. cit. supra note 62, at 429, 462 et seq. (with further references).


66. Cf e.g. Case C-47/12, Kronos International Inc. v. Finanzamt Leverkusen, EU:C:2014:2200, paras. 30–43.

scope... [of free movement of capital or the freedom of establishment,...]... the purpose of the legislation concerned must be taken into consideration. National legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company’s decisions and to determine its activities falls within the scope of Article 49 TFEU on freedom of establishment. On the other hand, national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking must be examined exclusively in light of the free movement of capital”. 68

Second, if the national legislation at issue applies to such shareholdings which enable or do not enable the holder to exert a definite influence over the undertaking, it cannot be determined from the purpose of the legislation “whether it falls predominantly within the scope of Article 49 TFEU or Article 63 TFEU”. 69 In such a situation, in an intra-EU context, “account should be taken of the facts of the case in point in order to determine whether the situation to which the dispute in the main proceedings relates falls within the scope of Article 49 TFEU or of Article 63 TFEU”. 70

Lastly, in a third-country context, however, “it is sufficient to examine the purpose of national legislation in order to determine whether... [the national legislation] falls within the scope of the provisions of the FEU Treaty on the free movement of capital, as national legislation relating to... third countries is not capable of falling within the scope of Article 49 TFEU”. 71

Thus, if the purpose of national legislation is to regulate shareholdings which enable, or do not enable, the holder to exert a definite influence over the undertaking, the respective legislation is subject to Article 63(1) TFEU in a third-country context. In such a situation, it does not matter that, according to the facts of the case, “a company that is resident in a Member State and has a shareholding in a company resident in a third country giving it definite influence over the decisions of the latter company and enabling it to determine its activities may rely upon Article 63 TFEU”. 72 However, if the purpose of the national legislation is to regulate only such shareholdings which enable the holder to exert a definite influence over the undertaking, it is not covered by Article 63(1) TFEU; as a matter of fact, not by any freedom. This leads to the peculiar result that legal protection decreases when the financial commitment of the investor increases.

68. Case C-47/12, Kronos, para 32 (emphasis added, in-text citations omitted).
69. Ibid., para 37.
70. Ibid., para 37.
71. Ibid., para 38.
72. Ibid., para 39.
Building on this delineation of the two aforesaid freedoms by the ECJ, some authors suggest that the EU (sic!) may not base legislative acts regulating exclusively third-country direct investment on Article 64(2) and (3) TFEU, as this situation is not covered by the TFEU Chapter on Capital and Payments and there is no competence in the TFEU Chapter on Establishment regarding the external dimension of establishment. Thus, Article 207(2) TFEU would be the only remaining legal basis.

This, however, is a bold claim. First, there is an obvious discrepancy with the wording of Article 64(2) and (3) TFEU, which expressly refers to third-country direct investment. The provision would be rendered obsolete if one were to follow the aforementioned view. Second, and even more importantly, such a view neglects the categorical difference between negative integration by fundamental freedoms and positive integration by making use of the competences in the EU Treaties. The former is addressed to the Member States, and national legislation is tested, on a selective basis, for compliance with EU law, but otherwise leaving room for political choices at the Member State level. The latter, i.e. positive integration, generally aims at setting EU-wide homogeneous standards by displacing national legislation altogether. Therefore, the ECJ case law on the delineation of the freedom of capital movement and freedom of establishment – which in itself stands on shaky legs – cannot be simply transferred to the delineation of the competences in a third-country context (which are contained alongside the freedoms in the respective TFEU chapters), since the consequences of their delineation are different. While delineating competences entails typically both horizontal as well as vertical power distribution issues, the freedoms essentially relate to the vertical distribution of power between the Union and the Member States. Furthermore, while delineating competences affects whole areas of vertical power distribution, delineating freedoms only means selective intervention. Thus, the ECJ’s case law on the delineation of freedoms is of little relevance when it comes to delineating competences.

73. Cf. Herrmann, op. cit. supra note 62, at 429, 462 et seq. (with further references); see also Günther, op. cit. supra note 51, 32–33.
74. Case C-47/12, Kronos.
75. Korte, op. cit. supra note 51, 101–102, 124; Benyon, Direct Investments, National Champions and EU Treaty Freedoms (Hart Publishing, 2010), p. 78 et seq. Furthermore, even if one assumed that Art. 64(2) and (4) TFEU do not govern situations of “establishment” and further assumed, as e.g. Herrmann does (Cf. Herrmann op. cit. supra note 62, at 429, 462 et seq. with further references), that in order for a foreign investment to qualify as a direct one, a lower threshold of control of the investment would be required than to qualify as an establishment within the meaning of the freedom of establishment, then one would still need to explain why Art. 207(2) should take precedence in cases of investments qualifying as direct investment but not reaching the threshold of control necessary to qualify as an establishment. In such a situation there would be no conflict between the freedoms.
3.3.3. **Dual legal basis?**

Hence, still being left with two legal bases which are in principle applicable for the Regulation, a choice must be made regarding which one to use. According to the ECJ’s case law, in a situation where there is no general rule granting priority to one of the two – neither an explicit one nor one to be determined by interpretation – the delimitation must be made based on the circumstances of the individual case, by means of establishing the regulatory focus according to the aim and content of the Union act.\(^{76}\) If no focus can be established in a meaningful way, a Union act is then in principle to be based on both competences.\(^{77}\)

However, “recourse to a dual legal basis is not possible where the procedures laid down for each legal basis are incompatible with each other or where the use of two legal bases is liable to undermine the rights of the Parliament”.\(^{78}\) The first scenario relates to, for example, a situation in which one of the two possible legal bases “require[s] unanimity within the Council, so that . . . additional recourse to [a legal basis could have an] . . . impact on the voting rules applicable within the Council”.\(^{79}\) The other scenario the ECJ refers to is the case in which a dual legal basis would encroach upon the Parliament’s rights in the legislative process,\(^{80}\) which means that the more democratic procedure must be chosen.\(^{81}\)

The EU – supported by some voices in legal literature – has concluded that priority must be given to Article 207(2) TFEU. The Commission proposal does not discuss whether or not Article 64(2) TFEU could serve as a legal basis. Instead, it plainly states that FDI is included in the CCP and accordingly “only the Union may legislate and adopt legally binding acts within that area”.\(^{82}\) At the same time, elsewhere in the proposal, the Commission clearly states that “foreign direct investment is a capital movement under Article 63 TFEU”\(^{83}\) which indicates that the decision need not be as straightforward as the Commission would like it to appear. Indeed, if one follows, in the present case, the view that there is no clear regulatory focus detectable, but it equally concerns the external dimension of the internal market as well as directly

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77. Ibid., para 36.
78. Ibid., para 52.
79. Ibid., para 53.
80. Ibid., para 54.
83. Ibid., at p. 4.
impacting “trade flows”, this would mean that the Regulation should be based on both competences.

This holds true at least as long as the Regulation does not restrict third-country direct investment. While the legislative procedure for liberalizing autonomous measures in the area of FDI is the same, i.e. both legal bases provide for the ordinary legislative procedure, for restrictive autonomous measures they diverge. In the case of an EU measure restricting third-country FDI we face, however, a challenge of delineating powers both at the horizontal and at the vertical level. As regards the horizontal level, in Article 207(2) TFEU the European Parliament acts as co-legislator within the ordinary legislative procedure. In contrast, Article 64(3) TFEU requires the Council only to consult the EP. As regards the vertical level, the two legal bases provide for different voting majorities in the Council: qualified majority voting when acting in accordance with Article 207(2) TFEU, unanimity when doing so on the basis of Article 64(3) TFEU. Therefore, basing an EU measure restricting third-country FDI on Article 64(2) TFEU instead of Article 207(2) TFEU would do justice to the vertical balance of powers. If members of the Council did not vote on the basis of unanimity as prescribed for in Article 64(3) TFEU, the Member States would be deprived of their “veto right”. Article 207(6) TFEU also speaks in favour of opting for Article 64(3) TFEU in case the legislative act restricts FDI. That provision requires that the exercise of the competences conferred under the CCP must not affect the delimitation of competences between the Union and the Member States; something that taking away the “veto right” would clearly do. Moreover, Article 4(2) TEU provides that the EU “shall respect [the Member States’]... essential State functions, including... maintaining law and order” – which is pertinent to the Regulation addressing an aspect of “public order and security”.

With regard to the Regulation, in the end, it might not even be necessary to make hard choices and play the vertical level of power distribution off against the horizontal one. This is because the Regulation, arguably, does not restrict direct investment from third countries. If this is true, Article 207(2) TFEU and

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84. Korte, op. cit. supra note 51, 104.
85. Although unusual, it is not unheard of that the Commission proposes legislative acts based on dual legal bases belonging to different types of competence. In Case C-370/07, Commission v. Council (CITES), EU:C:2009:590, the Commission had proposed a decision based on both exclusive and shared competence. The case was brought before the ECJ because when adopting the decision, the Council decided not to specify a legal basis, but in para 49 the ECJ indicates that such a dual legal basis would have been possible.
86. For a different view, see Korte, op. cit. supra note 51, 127, who suggests that different voting majorities in Art. 64(2) and (3) TFEU do not touch upon (vertical) competence allocation, but are only “procedural” in nature, to which Art. 207(6) TFEU does not apply.
87. Ibid., 105.
Article 64(2) TFEU together are the appropriate legal bases. According to its Article 3(1), the Regulation leaves it to the Member States to maintain or adopt a screening mechanism. Only in the case of an establishment (as opposed to mere investment), does it prescribe minimum procedural standards – largely inherent in the EU fundamental rule of law standards anyway – in Article 3(2) to (6). In light of this, the EU framework introduced by the Regulation for the screening of FDI actually does not seem to restrict access or treatment of FDI into the EU per se, since this function is voluntarily carried out by the Member States, establishing such screening mechanisms.

The Regulation’s potential effects on third-country direct investment, may on the other hand turn out to be more problematic, due to the setting up of a comprehensive FDI monitoring mechanism by the EU Member States in order to fulfil the obligations in Articles 6(1), 7(5), 8(2), 9(1) and (2), and 11 of the Regulation. This mechanism, as suggested above, may well come to impact FDI flows, particularly through reporting duties for investments enacted in Member State law. However, whether this FDI monitoring mechanism actually reaches the threshold of constituting “a step backwards in Union law as regards the liberalization of the movement of capital to or from third countries” triggering the necessity for unanimity vote in the Council, is doubtful.88

In conclusion, we submit that both Article 207(2) TFEU and Article 64(2) TFEU are suitable legal bases. The EU has not presented any convincing arguments as to why Article 207(2) was chosen as the sole legal basis for the Regulation.

4. Analysis of the Regulation

The declared aim of the Regulation is twofold: first, to establish “a framework for the screening by Member States of foreign direct investments into the Union on the grounds of security or public order” (see section 4.1. below) and, second, to set up a “mechanism for cooperation between Member States, and between Member States and the Commission, with regard to foreign direct investments likely to affect security or public order” (see section 4.2. below).89 Article 2 contains the definitions essential to the Regulation, such as “foreign direct investment”, “foreign investor” and “screening mechanism”. Article 3 addresses the Member States’ screening mechanisms, i.e. instruments of general application to screen FDI on the grounds of public order and security,

88. Ibid., 125–126.
89. Cf. Art. 1(1).
setting certain procedural standards. In Article 4, the Regulation refers to a number of factors – the list is not exhaustive – which may or may not be taken into account when determining whether FDI is likely to affect “security or public order”. Article 5 establishes, inter alia, an annual reporting duty of the Member States to the Commission on activities relating to FDI in general and the operation of domestic investment screening mechanisms. Articles 6 and 7 respectively set up a cooperation mechanism “in relation to foreign direct investment undergoing screening” and FDI not undergoing screening in a Member State. Articles 9, 10, and 14 provide detailed rules on the handling of information to be shared among the Member States themselves, as well as between the Commission and the Member States. Article 8 lays down special rules for cooperation when FDI is likely to affect projects or programmes of Union interest. Projects and programmes subject to these rules are listed in the Annex to the Regulation. Articles 11, 12, and 13 relate to a “minimalist infrastructure” designated to the cooperation mechanism, including an international cooperation component.

4.1. The EU framework for the screening by Member States of foreign direct investments

4.1.1. “Light-touch” harmonization

According to its Article 1(1), the Regulation aims at establishing an EU framework for screening by the Member States of “foreign direct investment into the Union on the grounds of security or public order”. This seems somewhat counter-intuitive, since it is basically the opposite of what one may typically expect to find when a legislative act in an area of exclusive Union competence claims to establish an EU framework for screening. The Regulation turns exclusive Union competence largely upside down, by handing a large chunk of the actual powers to regulate screening of FDI back to the Member States.

What the Regulation refers to as a “framework” is essentially a “light-touch” harmonization of the Member States’ screening mechanisms, if the States choose to adopt or maintain such a mechanism. In that case, in Article 3(2) to (6), the Regulation requires a Member State:

90. “Security or public order” is the phrase chosen by the EU legislature to define the grounds which legitimate restrictive measures relating to foreign direct investment. Cf. Recital 3 of the Preamble of the Regulation and Art. 1(1). The exact relation, and potential overlap, of the term “security and public order”, in relation to e.g. “national security” in Art. 4(2) TEU and “public policy” or “public security” in Art. 65(1) TFEU will be covered in more depth infra.

91. The Annex is amendable in accordance with Arts. 8(4) and 16.

92. Cf. Art. 3(1).
to enact transparent\textsuperscript{93} rules and procedures which include relevant
timeframes, the circumstances triggering the screening, the grounds
for screening and the applicable detailed procedural rules;
to apply such rules in a non-discriminatory fashion between third
countries;
to set timeframes under their screening mechanisms in such a way as
to allow for sufficient time to take into consideration comments
provided by other Member States, and the opinions of the Com-
misson, within the context of the cooperation mechanism;
to protect confidential information, including such information that
is commercially sensitive;
to provide foreign investors and the undertakings concerned with the
possibility to seek recourse against screening decisions of the
national authorities; and
to maintain, amend or adopt measures necessary to identify and
prevent circumvention of the screening mechanisms and screening
decisions.

Essentially, the Regulation sets administrative procedural law requirements,
which are – or at least should be – a “matter of course” in a Union governed by
the rule of law.\textsuperscript{94} Nonetheless, they are binding, and their express reference
and specification may make it easier for the Commission to monitor, on a daily
basis, Member States’ domestic legislation for compliance with such basic
rule of law standards.

In addition to such procedural requirements, the Regulation also stipulates,
as discussed further in more detail below,\textsuperscript{95} a duty to provide information\textsuperscript{96}
and to take into account the view of other Member States and the Commission
on likely effects of a certain FDI on public order and security.\textsuperscript{97} Such a duty
applies irrespective of whether a Member State has a screening mechanism or
not. No duty exists to publish – not even in anonymized form – the outcome of
the screening process and the principles guiding respective decisions, which
could have provided future guidance for other market participants and
increased legal certainty in a field characterized by a significant degree of
opacity.

\textsuperscript{93} In order to further transparency, according to Art. 3(7) and (8) of the Regulation,
Member States shall notify the Commission of their existing, newly adopted, or altered
screening mechanisms, which the Commission will make publicly available.

\textsuperscript{94} Evaluating the degree to which existing Member State screening mechanisms require
adaptation is beyond the scope of this paper. Cf. on this the country reports cited supra in note 20.

\textsuperscript{95} Cf. infra section 4.2.

\textsuperscript{96} Cf. Arts. 6(1), 7(5) and 8(2).

\textsuperscript{97} Cf. Arts. 6(9), 7(7) and 8(2)(c).
4.1.2. **Will there be any impact of the Regulation on the ordre public exception in the context of fundamental freedoms?**

What is more, Article 4 constitutes a non-exhaustive list\(^98\) of factors that Member States and the Commission “may consider” in determining whether a foreign direct investment “is likely to affect security or public order”.\(^99\) An important issue in this regard is whether this enumeration increases the Member States’ leeway to interfere with third-country direct investment beyond the limits stipulated essentially by the fundamental freedoms.

In determining whether a foreign direct investment “is likely to affect security or public order” the Member States as well as the Commission may consider factors linked to the foreign investment itself (Art. 4(1)) as well as factors linked to the investor (Art. 4(2)).\(^100\) According to Article 4(1), Member States and the Commission may take into consideration, *inter alia*, an FDI’s “potential effect” on critical infrastructure and related real estate, critical technology and dual-use items, the supply of critical inputs, food security, access to and control of sensitive information, as well as on freedom and pluralism of the media. Regarding the foreign investor, the Member States and the Commission may also “take into account” control or funding by non-EU countries, previous involvement in activities affecting security and public order, as well as the serious risk of engagement in illegal or criminal activities (Art. 4(2)).

What is already clear from the language is that Article 4 does not harmonize the material scope of the Member States’ screening mechanisms. As it merely enumerates factors which may be relevant for the determination of whether or not an FDI “is likely to affect security or public order”, the Regulation leaves the decision on what the factors actually are to the Member States’ discretion. The Member States “may consider” “inter alia” the factors relating to the

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99. Although the discussion of potential future disputes under international trade law as a consequence of restrictive measures taken following decisions by screening mechanisms acting on the basis of the Regulation falls outside the main remit of this paper, it is important to emphasize that the terminology chosen (“security and public order”) is consistent with the language used in WTO/GATS. Cf. Recitals 3 and 35 of the Preamble of the Regulation as well as European Parliament Report on the 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, A8-0198/2018, p. 49. It would seem that the EU is not expecting investment screening carried out by the Member States to conflict with WTO law, since the invocation of the national security interest has been consistently accepted in dispute settlement under the WTO. A potential change may be on the horizon, in particular concerning the discussion of good faith in relation to self-judging clauses. Cf. Sanklecha, “The limitations on the invocation of self-judging clauses in the context of WTO dispute settlement”, (2019) Indian Journal of International Law (no page number).

100. See also Recital 13 of the Regulation.
particular FDI mentioned in Article 4(1), and “may also” take into consideration “in particular” the factors listed in Article 4(2) in respect of the investor.\textsuperscript{101} By suggesting a number of factors that the Member States “may consider” when determining whether or not an FDI is likely to affect security or public order, the Regulation initiates a collective process, aimed at a converging interpretation and application of those legal terms across the EU Member States: in other words a “rough consensus”. As a “harmonizing” measure, this rough consensus approach still has to prove, in practice, whether it can bring together the diverging interests and needs of the Member States when it comes to “security” and “public order”.\textsuperscript{102}

Besides informing, but without prejudicing, the Commission’s and Member States’ assessments of likely effects of a particular FDI on security and public order within the cooperation mechanism,\textsuperscript{103} the further effects of Article 4 are subject to debate. In particular, the question arises whether Article 4 increases the Member States’ leeway to interfere with third-country direct investment beyond the limits stipulated essentially by the ECJ’s strict interpretation of the ordre public exception in the third clause of Article

\textsuperscript{101} The European Parliament proposed that some of these factors should in fact be made compulsory, by switching “may” to “shall”. However this was not accepted in the final version of the Regulation. See Warchol in Hindelang and Moberg, op. cit. supra note 7; see also Neergaard in Bourgeois, op. cit. supra note 3, at p. 155.

\textsuperscript{102} The empowerment of the EU Member States by the EU in the area of the CCP can also be found – taking various forms and different scopes – in other regulatory areas. Cf. e.g. Art. 10 of Regulation (EU) 2015/479 of the European Parliament and of the Council on common rules for exports, O.J. 2015, L 83/34 (“Without prejudice to other Union provisions, this Regulation shall not preclude the adoption or application by a Member State of quantitative restrictions on exports on grounds of ... public policy or public security ...” (emphasis added)); similar also in Art. 24(2)(a) of Regulation (EU) 2015/478 of the European Parliament and of the Council on common rules for imports (codification), O.J. 2015, L 83/16; Art. 8(1) of Council Regulation (EC) 428/2009 setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items (Recast), O.J. 2009, L 134/1, (“A Member State may prohibit or impose an authorisation requirement on the export of dual-use items not listed in Annex 1 for reasons of public security or human rights considerations.” (emphasis added).

\textsuperscript{103} Cf. e.g. Art. 6(1): “The notification may include a list of Member States whose security or public order is deemed likely to be affected.”; Art. 6(2): “Where a Member State considers that a foreign direct investment undergoing screening in another Member State is likely to affect its security or public order ...”; Art. 6(3): “Where the Commission considers that a foreign direct investment undergoing screening is likely to affect security or public order in more than one Member State ...”; Art. 7(1): “Where a Member State considers that a foreign direct investment planned or completed in another Member State which is not undergoing screening in that Member State is likely to affect its security or public order ...”; Art. 7(2): “Where the Commission considers that a foreign direct investment ... is likely to affect security or public order in more than one Member State ...”; Art. 8(1): “Where the Commission considers that a foreign direct investment is likely to affect projects or programmes of Union interest on grounds of security or public order ...” (emphasis added).
65(1)(b) TFEU. 104 In the absence of EU harmonization, the regulation of third-country investment by a Member State is in principle controlled by that freedom and its narrow exceptions.

As explained above,105 however, the scope of application of Article 63(1) TFEU (also) in the third-country context is significantly determined by the relationship between the freedom of capital movements and the freedom of establishment, which the ECJ perceives as competing and largely prevailing.106 Consequently, even before the question arises of whether Article 4 factors have any harmonizing or concretizing effect with regard to the _ordre public_ exception in the context of free movement of capital and, consequently, may broaden the Member States’ leeway, that freedom must be applicable to the situation.

In a nutshell, following the ECJ’s view on the relationship between Articles 63(1) and 49 TFEU,107 if the Member State’s investment screening legislation in a third-country context applies only to investments which enable the investor to exert a definite influence over the investment, i.e. qualifying as FDI,108 the freedom of capital movement is not applicable. In fact, the national screening legislation would be outside the scope of any fundamental freedom if the legislation only applies to third-country scenarios. If the national legislation also covers investment which does not enable the investor to exert a definite influence over the investment, i.e. applying to portfolio and direct investment, Article 63(1) TFEU is applicable to the legislation (irrespective of the facts of the individual investment case). The question of whether the Article 4 factors have any harmonizing or concretizing effect with regard to the _ordre public_ exception in Article 65(1)(b), 3rd clause, TFEU is thus only relevant with regard to the second scenario, allowing the Member States more leeway with regard to restricting FDI.109

104. There are certain exceptional cases where the rules relating to the freedom of establishment may be applicable. Cf. infra.
105. Supra section 3.3.2.
106. Cf., _inter alia_, Case C-47/12, _Kronos_, paras. 30–43.
107. Supra section 3.3.2.
108. We assume that the notion of “(foreign) direct investment” within the context of free movement of capital is by and large identical to that of “establishment” within the freedom of establishment; cf. Hindelang, op. cit. _supra_ note 63, at 85 et seq. For a different view see Herrmann, op. cit. _supra_ note 62, at 464, who suggests that a certain investment could qualify as (foreign) direct investment within the meaning of free movement of capital without reaching the threshold of qualifying, at the same time, as an establishment.
109. Since the Regulation is only applicable to FDI, the question of a broader leeway for the Member States only arises with regard to direct investment. For portfolio investments, the ECJ’s strict standard for restricting their free flow on the basis of the first clause of Art. 65(1)(b) TFEU would apply anyway.
Moreover, in some cases, EU resident investors will also be subjected to a Member State’s investment screening mechanisms. This is the case, for example, when an EU-based undertaking is used by third-country nationals as a vehicle to circumvent investment screening. The Regulation in Article 3(6) explicitly tasks the “Member States which have a screening mechanism in place [to] . . . maintain, amend or adopt measures necessary to identify and prevent circumvention of the screening mechanisms and screening decisions”. Some Member States’ legislation actually already provides for anti-circumvention, such as the respective German legislation in Section 55(2) of the Außenwirtschaftsverordnung – AWV (Foreign Trade and Payments Ordinance).110 In such a situation, Union citizens and legal persons resident in an EU Member State can, in principle,111 rely on both the freedom of establishment and the free movement of capital112 and, thus, the question of whether the Article 4 factors have any harmonizing or concretizing effect with regard to the ordre public exception becomes relevant here as well.

All in all, there seem to be constellations in which someone affected by Member State investment screening legislation may in principle rely on fundamental freedoms. For example, a third-country investor making an FDI into the EU is protected by Article 63(1) TFEU if the screening legislation of the Member State in question applies to both portfolio and direct investment. In an intra-EU context, the freedom of establishment may be applicable. This, in turn, would mean that the EU Member States may not restrict (foreign) direct investment with reference to security and public order enshrined in

110. Available at <www.gesetze-im-internet.de/englisch_awv/englisch_awv.html#p05
10>.

111. While the ECJ has recognized in principle that economic activities can be excluded from benefiting from the protection of the fundamental freedoms if they constitute an abusive or fraudulent exploitation of the fundamental freedoms (Cf. Case C-196/04, Cadbury Schweppes, EU:C:2006:544, para 34 et seq.), the Court seems to assign the problem of the abusive exploitation of the fundamental freedoms predominantly to the level of justification. In the area of the free movement of capital there is an explicit provision in Art. 65(1)(b), 1st clause, TFEU; in the areas of the other fundamental freedoms, the ECJ falls back on unwritten grounds of justification. Cf. Hindelang, op. cit. supra note 63, “Artikel 65”, para 14 et seq., 19. Addressing cases of abuse at the level of justification is also the more convincing solution overall. It enables the State measure to be examined on the basis of the principle of proportionality to determine whether it merely accompanies a protectionist Member State regulation or whether it follows legitimate interests. Finally, it should be remembered that it is precisely the full exercise of fundamental freedoms by those entitled to them that Union law wishes to see. Hindelang and Hagemeyer, “Enemy at the Gates? Die aktuellen Änderungen der Investitionsprüfverordnung in der Außenwirtschaftsverordnung im Lichte des Unionsrechts”, (2017) EuZW, 882–89, 886; see also Ress and Ukrow in Grabitz, Hilf and Nettesheim, op. cit. supra note 63, “Art. 65 AEUV” para 45 with further references.

112. In an intra-EU scenario, the above-mentioned problem of delineation of fundamental freedoms is only of secondary importance.
Articles 65(1)(b), 3rd clause, or 52(2) TFEU unless they are addressing “a genuine and sufficiently serious threat to a fundamental interest of society”.\footnote{113}

Some authors point to the fact that EU secondary law can have a concretizing effect on primary law, which can diminish the protective scope of the fundamental freedoms and broaden Member State leeway to interfere with FDI. In enacting such secondary law, the EU institutions may also deviate from the requirements set by case law, for example relating to the protective scope of fundamental freedoms. The harmonization competences of the EU also regularly allow the EU to enact secondary law restricting the fundamental freedoms to a degree which the Member States could not justify by reference to the exceptions to the fundamental freedoms if they sought to enact restrictive legislation themselves.\footnote{114} However, while the description of the possibility of concretizing effects of EU secondary law on EU primary law as such is correct, the Regulation does not have such effects. By its clear and unmistakable wording, Article 4, with its illustrative, non-exhaustive list of factors potentially affecting security and public order, simply does not harmonize.

Since the Regulation does not harmonize and does not further define the level of protection of security and public order, the Member States are “still, in principle, free to determine the requirements of public order and public security in the light of their national needs”.\footnote{115} They must, therefore, justify any restriction of the fundamental freedoms with reference to the order public clause, i.e. first and foremost Article 65(1)(b), 3rd clause, TFEU.\footnote{116} A (permissible) restriction requires “a genuine and sufficiently serious threat to a fundamental interest of society”.\footnote{117}

Even if the ECJ were to seek inspiration in Article 4 in the context of assessing a Member State’s restrictions on FDI in light of Articles 65(1)(b), 3rd clause, or 52(2) TFEU with a view to identifying and specifying legitimate public interests capable of justifying a restriction on free movement of capital or the freedom of establishment, this does not mean that the Member States have received a carte blanche in Article 4.\footnote{118} Rather, the ECJ in Commission v. Portugal made it clear that, absent harmonization and despite the

\begin{itemize}
\item \footnote{113}{Case C-54/99, Scientologie, EU:C:2000:124, para 17; cf. also Hindelang, op. cit. supra note 65, at 226.}
\item \footnote{114}{Herrmann, op. cit. supra note 62, at 429, 465.}
\item \footnote{115}{Case C-54/99, Scientologie, para 17.}
\item \footnote{116}{In this way one must understand Recital 4 of the Regulation which reads “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 Article 65(1) TFEU”.}
\item \footnote{117}{Case C-54/99, Scientologie, para 17; Hindelang op. cit. supra note 65, at 226.}
\item \footnote{118}{Possibly of a different view is Herrmann, op. cit. supra note 62, at 465–466, which seems, however, not to find strong support in the judgment cited in support of his opinion.}
\end{itemize}
“importance attached by...the European Union to the protection of a secure energy supply [reflected in some EU secondary legislation,]...it is undisputed that requirements of public security must, in particular as a derogation from the fundamental principle of the free movement of capital, be interpreted strictly, so that their scope cannot be determined unilaterally by each Member State without any control by the institutions of the European Union. Thus, public security may be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society”.119 Thus, Article 4 does not seem to broaden Member States’ powers to interfere with FDI. This, however, does not rule out that the ECJ may further develop its case law on the notion of “genuine and sufficiently serious threat to a fundamental interest of society” in light of technological advancement and changing political landscapes.

Furthermore, and needless to say, a Member State measure restricting FDI must be proportionate. Thus, when a Member State finds, inspired by or even exclusively using the factors mentioned in Article 4, that “a foreign direct investment is likely to affect security or public order”, this does not automatically mean that the said Member State may restrict fundamental freedoms by “conditioning, prohibiting, or unwinding foreign direct investment”, as Article 4 does not set the threshold (or “risk level”) for permissible government intervention of such severity. Rather, and at most, in the event of a “likely effect” on security and public order, the Member State may have recourse to the Regulation’s coordination mechanism. More severe interferences with an FDI, therefore, (still) require a more specific and more concrete risk to security and public order.

By way of example, the recent bill amending the German Foreign Trade and Payments Act (AWG)120 seeks to reduce the said threshold. Section 5(2) of the AWG will be changed as follows:

“Restrictions or obligations to act pursuant to Section 4 subsection 1 no. 4 can particularly be imposed with reference to the acquisition of domestic companies or shares in such companies by non-EU residents if the acquisition [endangers] [is likely to affect] the public order or security of the Federal Republic of Germany [another Member State of the European Union, or relating to projects or programmes of Union interest]”

119. Case C-543/08, Commission v. Portugal, EU:C:2010:669, paras. 84–85 (emphasis added). In para 89, the ECJ also stated that “[e]ven were it accepted that, pursuant to provisions of European Union secondary legislation, a Member State has an obligation to guarantee the supply of energy within its territory, as is claimed by the Portuguese Republic, compliance with such an obligation cannot be relied on to justify any measure which is contrary in principle to a fundamental freedom”.

pursuant to Section 4 subsection 1 no. 4. [For this to be the case, there must be an actual and sufficiently serious danger affecting a fundamental interest of society.] …”

In light of the above, one may wonder whether the proposed legislative changes are not overshooting the mark.

Moreover, while Article 4 may be read as also relating to the empowerment of the Member States to act within an area of exclusive EU competence according to Article 2(1) TFEU in connection with Article 3(1) of the Regulation, at the same time it does not in any way further specify (or restrict) such empowerment beyond the point that screening must be “on the grounds of security or public order”. The Member States may also refer to any other possible factor not listed, as long as it relates to the screening of FDI on the grounds of security or public order. Article 4, therefore, serves as a source of inspiration only. At any rate, when exercising such empowerment, the Member States are not exempted from observing other EU law, especially fundamental rights, such as the rights to property or to conduct a business, and fundamental freedoms.

4.2. The cooperation mechanism

An essential part of the Regulation is the establishment of a cooperation mechanism among the Member States and between the Commission and the Member States. In that regard, the Regulation contains rules affecting all

121. Proposed legislative additions in italics, deletions in strikethrough text. Translation by the authors. The original reads as follows: “Beschränkungen oder Handlungspflichten nach § 4 Absatz 1 Nummer 4 können insbesondere angeordnet werden in Bezug auf den Erwerb inländischer Unternehmen oder von Anteilen an solchen Unternehmen durch unionsfremde Erwerber, wenn infolge des Erwerbs die öffentliche Ordnung oder Sicherheit der Bundesrepublik Deutschland [...], eines anderen Mitgliedstaates der Europäischen Union oder in Bezug auf Projekte oder Programme von Unionsinteresse gemäß § 4 Absatz 1 Nummer 4 [ge-fährdet ist][voraussichtlich beeinträchtigt wird]. [Dies setzt voraus, dass eine tatsächliche und hinrei-chend schwere Gefährdung vorliegt, die ein Grundinteresse der Gesellschaft berührt.] …”. Cf. Deutscher Bundestag, Entwurf eines Ersten Gesetzes zur Änderung des Außenwirtschaftsgesetzes und anderer Gesetze, 21 April 2020, Drucksache 19/18700.

122. Since the EU based the Regulation on its exclusive competence under Art. 207(2) TFEU, it is only consistent that it empowers (cf. Art. 2(1) TFEU) the Member States in Art. 3(1) of the Regulation to “maintain, amend or adopt mechanisms to screen foreign direct investments in their territory on the grounds of security or public order”. At the same time, this also means that the Member States may not screen FDI for any grounds other than security and public order.

Member States, irrespective of whether they do or do not currently maintain a screening mechanism.\footnote{124} The Regulation distinguishes in Articles 6 and 7 between FDI “undergoing screening” (4.2.1. below) and FDI “not undergoing screening” (4.2.2. below). Thus, whenever a Member State screens FDI, i.e. subjects it to “a procedure allowing to assess, investigate, authorize, condition, prohibit or unwind foreign direct investments”,\footnote{125} the Member State must automatically notify the Commission and the other Member States according to Article 6(1) and provide the information referred to in Article 9(2).

4.2.1. \textit{FDI “undergoing screening”}

Notably, the Regulation ties the duty to notify and provide information to FDI undergoing screening. It does, however, not relate to FDI subject to a “screening mechanism”. While the Regulation’s definition of “screening” covers any procedure “allowing to assess, investigate, authorize, condition, prohibit or unwind foreign direct investments”, a “‘screening mechanism’ means an instrument of general application . . . setting out the terms, conditions and procedures to assess, investigate, authorize, condition, prohibit or unwind foreign direct investments on grounds of security or public order”.\footnote{126} The Member State must therefore actively provide information for any kind of procedure reviewing FDI. However, this duty is limited by the Member States’ empowerment in Article 3(1) to screen only on the grounds of security or public order. Nevertheless, linking the duty to “screening” instead of a “screening mechanism” obliges the Member States to report FDI screening also outside a formal “instrument of general application” which specifically sets out the terms for screening FDI. A reporting duty therefore includes any kind of ad hoc screening on a legal basis not specifically tailored towards FDI screening.

Once the information provided by a Member State has been received, other Member States and the Commission may provide a comment or opinion respectively if they consider an investment “likely to affect” their respective security or public order, the factors in Article 4 serving as a source of inspiration. A Member State screening a certain FDI may also request comments and/or an opinion respectively from other Member States and the Commission according to Article 6(4).

Following the receipt of such comments or opinions through contact points to be established in each Member State,\footnote{127} the screening Member State “shall

\footnotesize{\begin{itemize}
\item \footnote{124} Cf. Arts. 6 and 7.
\item \footnote{125} Cf. Art. 2(3).
\item \footnote{126} Emphasis added. Cf. Art. 2(4).
\item \footnote{127} Cf. Arts. 6(10) and 11.
\end{itemize}}
give due consideration” to them, although the final decision remains with the screening Member State.\footnote{128} It seems that the screening Member State is under no obligation to provide reasons if it does not follow the comments or opinions.\footnote{129} However, giving “due consideration” amounts to a duty of care, as an expression of the general principle of sincere cooperation according to Article 4(3) TEU,\footnote{130} which goes beyond the mere acknowledgement of the existence of the interests formulated in the comments and opinions. The other Member States’ or the Union’s interests\footnote{131} are thus capable of influencing the screening Member State’s decision,\footnote{132} in which process – due to a lack of a common understanding of public order and security – considerable deference can be exercised. That said, the Regulation does not provide for a duty to inform the other Member States of the final decision taken with regard to the FDI being screened. This may render it somewhat challenging to observe whether “due consideration” was actually given to the comments. The same holds true for the opinion rendered by the Commission within the context of Article 7. Only when it comes to FDI likely to affect projects or programmes of Union interest under Article 8, is the Member State required to “provide an explanation to the Commission if its opinion is not followed”.\footnote{133} 

4.2.2. FDI not “undergoing screening”

As mentioned above, the cooperation mechanism also covers FDI not undergoing screening. In accordance with Article 7(1) and (2), other Member States and the Commission may provide comments, or in the case of the Commission, an opinion, on FDI likely to affect their security and public order to a Member State in which the FDI is planned or completed, but not screened.

\footnote{128} Cf. Art. 6(9).
\footnote{129} Different though with regard to FDI likely to affect projects or programmes of Union interest, where the Member State “shall . . . provide an explanation to the Commission if its opinion is not followed”. Cf. Art. 8(2)(c).
\footnote{130} Cf. Ohler, “§ 9 Horizontaler Verwaltungsverbund zwischen den Mitgliedstaaten” in Terhechte, op. cit. supra note 4, at margin no. 36.
\footnote{131} An example may be found in the 2020 COVID19 public health crisis. Supply commitments for critical health infrastructure and critical inputs may extend beyond the individual Member State. Cf. Commission Communication cited supra note 5, Annex, at 2.
\footnote{133} Art. 8(2)(c). Considering the breadth and reach of the Union’s projects and programmes mentioned in the Annex to the Regulation, the Commission potentially gained a quite far-reaching voice in FDI screening. If an undertaking accepts funding out of the Union’s projects and programmes, this essentially opens up the possibility for the Commission to render an opinion according to Art. 8.
The latter Member State is under a duty “to give due consideration” to comments and opinions of the other Member States and the Commission respectively. The question arises what this duty entails with regard to a Member State not maintaining a screening mechanism or, while maintaining such a mechanism, having explicitly excluded a certain FDI (that other Member States or the Commission perceive as a threat to security or public order) from such screening. On the one hand, each Member State is free to decide whether or not to screen a particular foreign direct investment. On the other hand, not having a residual legal instrument in place allowing for consideration of whether to interfere with the contentious FDI in that Member State where it takes or took place, would to a large degree render the obligation to give due consideration to the security and public order concerns of other Member States and the Commission meaningless. The same, by the way, holds true for opinions of the Commission on a likely effect on projects or programmes of Union interest, where a Member State, in which the contentious FDI takes place, “shall [even] take utmost account of the Commission’s opinion and provide an explanation to the Commission if its opinion is not followed”. Furthermore, although a Member State is not obliged, in principle, to establish an FDI screening mechanism, according to Articles 7(5) and 9(1) and (2), it must have in place a comprehensive FDI monitoring mechanism. Upon request, Member States are under the duty to provide other Member States and the Commission with information on the ownership structure of the foreign investor and of the undertaking in which the FDI is placed. This includes information on the ultimate investor and participation in the capital, the approximate value of the FDI, the products, services and business operations of the foreign investor and of the undertaking in which the FDI is made, the Member States in which the foreign investor and the undertaking in which the FDI is made conduct relevant business operations, the funding of the investment and its source, on the basis of the best information available to the Member State, as well as the date when the FDI is planned to be completed or has been completed. By virtue of Articles 7(5) and 9(1) and (2), FDI screening as a regulatory field joins the ranks of institutionalized information.

134. Art. 7(7).
136. Cf. Commission Communication cited supra note 5, which encourages all Member States to adopt screening mechanisms.
138. Cf. Bismuth, op. cit. supra note 23, at 108, where he speaks about an “implied obligation for Member States to establish FDI screening mechanisms”.

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exchange already found in many other fields in the context of European administrative cooperation.\footnote{139. On institutionalized information exchange in general cf. Nowak, “§ 34 Europäisches Kooperationsverwaltungsrecht” in Leible and Terhechte (Eds.), Europäisches Rechtsschutz- und Verfahrensrecht, EnzEuR vol. 3 (Nomos, 2014), at margin nos. 26–27.}

It is this comprehensive information obligation in combination with the duty to “give due consideration” to comments of other Member States and the Commission’s opinion, according to Article 7(7), as well as to “take utmost account” of opinions of the Commission according to Article 8(2)(c), which gives the Regulation – while containing no formal obligation – a certain pull, in the long term, towards the introduction of at least a nascent screening mechanism in those Member States so far not having one. The intertwining of different administrations, both at Member State level as well as between the EU and the Member States, also triggers complicated questions of accountability and clarity concerning the responsibility (also for damages suffered) and of sufficient guarantees of procedural rights and other fundamental rights. While these problems are well known in the context of European administrative cooperation,\footnote{140. Ibid., at margin Nos. 50–55 with further references.} they arise here again against the backdrop of a regulatory area that is, in terms of the rule of law, particularly challenged due to a high degree of opacity, non-transparent decision making, and secrecy interests.

### 5. Concluding remarks

“In the last few years, non-EU investors have taken over more and more European companies with key technological competences for strategic reasons. At the same time, European investors do not enjoy the same rights in the respective countries of origin as these non-EU investors in the investment-friendly European Union. As a consequence, we are worried about the lack of reciprocity and about a possible sell-out of European expertise, which we are currently unable to combat with effective instruments.”\footnote{141. Letter to DG Trade Commissioner cited supra note 34.}

The governments in Paris, Berlin, and Rome reached out to the Commission in February 2017, asking for EU measures to ease their concerns. The Commission’s answer was to propose the Regulation, which was adopted after the first reading, as an instrument of the EU’s CCP. But will the Regulation be enough to ease the worried minds of the letter writers? And will...
the Regulation be too much to stomach for governments in certain other Member States?

The key to success lies in striking the right balance between ensuring “Union-wide coordination and cooperation on the screening of foreign direct investments likely to affect security and public order”\(^\text{142}\) and allowing for the diverging interests of the Member States when it comes to safeguarding security and public order. Opinions on where this balance lies are as far apart as the European capitals, which is why the Regulation limits itself to an extremely loose framework – granted that one actually wants to call it a framework at all, considering the largely voluntary nature of the provisions – for the screening by the Member States of foreign direct investments into the Union.

In this paper, we have shown that the choice of legal basis runs the risk of challenging the principle of conferral, as it could potentially violate the Council’s, and ultimately the Member States’, right to veto any proposed restrictions on the free movement of capital. This conclusion follows from the fact that actions taken under the CCP must not affect the division of powers between the Member States and the EU institutions.\(^\text{143}\) Read in combination with the unanimity requirement laid down in Article 64(3) TFEU, for adoption of “measures which constitute a step backwards in Union law as regards the liberalization of the movement of capital to or from third countries”, the choice of legal basis may indeed require a change in voting procedure should further measures be proposed, in case they are considered to constitute a step backwards in the light of Article 64 TFEU.\(^\text{144}\)

Furthermore, the analysis of the EU “framework” for Member State screening mechanisms and the respective factors that may be taken into consideration when assessing an FDI’s likely effect on public order and security (the “Article 4 factors”) revealed that the factors do not constitute a harmonization measure as such. However, it remains to be seen to what extent, if any, the “Article 4 factors” will initiate a collective process aiming at a converging interpretation and application of public order and security across the EU Member States; in other words, a “rough consensus” and/or to inspire the ECJ in future considerations on the scope of the derogations to the fundamental freedoms.

Last, but not least, our analysis of the Regulation led us to conclude that the EU legislature has indeed enacted a nascent EU investment screening

\(^{142}\) Recital 7 of the Preamble to the Regulation.

\(^{143}\) Art. 207(6) TFEU.

\(^{144}\) We would not go so far as to say that adopting the Regulation required unanimity in the Council, but, as discussed above, we see very little evidence suggesting that the Regulation is a clear step in a more liberal direction.
mechanism, albeit somewhat camouflaged, through the comprehensive cooperation mechanism established in order to secure an adequate exchange of information on FDI screening among the Member States and between the Member States and the Commission. The introduction of an administrative cooperation structure, resting on the obligation to provide information through contact points, and the duty to give due consideration to comments from other Member States and opinions of the Commission may well turn out to be a “non-harmonizing measure” having significant “harmonizing effects”.

Reflecting on how quickly the Commission went from Trade Commissioner de Gucht’s view that a “European security screening of new investments is neither desirable nor feasible” in 2012, to President Juncker’s State of the Union address in 2017, where he declared that “we are not naïve free traders”, that “Europe must always defend its strategic interests” and that “[t]his is why today we are proposing a new EU framework for investment screening”, it would be prudent to say that we are only seeing the very first baby steps of the new EU FDI policy. Based on the analysis conducted in this paper, the overall impression is that we should prepare for more coordination at the supranational level, both in terms of administrative cooperation in the actual screening decisions, and in the normative development of the valid grounds for restricting inward investments.

145. Cf. Art. 9 for the type of information to be provided.
146. Cf. Art. 11.
147. Cf. Arts. 6(9) and 7(7). When it comes to Union projects and programmes, Member States must “take utmost account” of opinions of the Commission according to Art. 8(2)(c).
148. De Gucht op. cit. supra note 32.