EU Regulation

FRAMEWORK FOR SCREENING FOREIGN DIRECT INVESTMENTS

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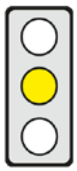
KEY ISSUES

Objective of the Regulation: The Commission wants to create an EU legal "framework" for screening foreign direct investments (FDI).

Affected parties: Foreign investors, undertakings in the EU, Member States



Pro: The Regulation provides clarity about the procedure to be used by Member States for screening FDIs.

Contra: The terms used for permitted restrictions on free movement of capital - "critical infrastructures", "critical technologies", "critical resources" and "sensitive information" - carry the risk that Member States will misuse the resulting latitude for protectionist purposes.

The important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2017) 487 of 13 September 2017 for a **Regulation** establishing a framework **for screening of foreign direct investments** into the European Union

Brief Summary

- **Context and objectives**
  - Member States may prohibit foreign direct investments or subject them to conditions. The Regulation does not however contain any requirements in this regard but instead regulates the preceding "screening" procedure.
  - By way of the Regulation, the Commission wants to create a "framework" for screening foreign direct investments (FDIs) in the EU (Art. 1).
  - Screening may be carried out (Art. 1)
    - by Member States and the Commission
    - on "grounds" of public order or security.
  - FDIs are investments of any kind (Art. 2, Nos. 1 and 2)
    - by an investor from a non-EU country ("third country")
    - to establish or maintain lasting and direct links between the investor and the undertaking,
    - to which the capital is made available in order to carry on an economic activity in a Member State.
  - This includes investments which enable effective participation in the management or control of a company carrying out an economic activity (Art. 2, No. 1)
- **Screening by the affected Member State**
  - Member States can "maintain, amend or adopt" mechanisms to screen FDIs ("screening mechanisms") on the grounds of security or public order. In so doing they must observe the requirements of the Regulation. (Art. 3 (1))
  - "Screening mechanisms" of the Member States must be transparent and not discriminate between third countries. In particular, Member States must set out (Art. 6 (1):
    - the circumstances which trigger the screening, e.g. the volume of FDIs or percentage of shares; Member States are free to determine the "circumstances";
    - the grounds for screening; the only admissible "grounds" are security and public order;
    - "detailed" procedural rules.
  - Member States must establish time-frames for issuing screening decisions in order to give other Member States and the Commission the opportunity to comment on an FDI. (Art. 6 (2)).
  - They must "protect" the "confidential" information, such as "commercially-sensitive" information provided by investors (Art. 6 (3)).
  - Foreign investors and undertakings in the EU affected by the FDI must be able to obtain judicial redress against screening decisions of the national authorities (Art. 6 (4)).

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- **Screening by the Commission**
  - For reasons of public order or security, the Commission can screen FDIs where they "are likely to affect projects or programmes of Union interest" (Art. 3 (2)).
  - This particularly includes projects and programmes which (Art. 3 (3)
    - involve a "substantial amount" or a "significant share" of EU funding or
    - are covered by Union legislation regarding "critical infrastructure, critical technologies or critical inputs". The Regulation contains a non-exhaustive list of such projects and programmes. It includes, for example, the European satellite navigation system. (Annex 1)
  - Where an FDI involves a "project or programme of Union interest" and is "likely" to affect public order or security, the Commission can issue an "opinion" to the Member State in which this investment is planned or has been completed (Art. 9 (1)). The other Member States will be informed of the Commission's opinion (Art. 9 (4)).
  - The Commission can request the Member State to provide any information about the FDI necessary for its opinion. (Art. 9 (2)).
  - The Commission must submit its opinion within a "reasonable period of time", and no later than 25 working days following receipt of the information from the affected Member State (Art. 9 (3)).
  - The affected Member State must "take utmost account" of the Commission's opinion and provide an explanation where its opinion is not followed (Art. 9 (5)).

- **Factors that may be taken into consideration in the screening**
  - When screening an FDI, Member States and the Commission may consider the potential effects on inter alia (Art. 4 sub-para. 1, Recital 12 and p. 12):
    - "critical" infrastructure, e.g. in the energy, transport, communications, data storage, space or financial sectors - such as stock exchanges or central counterparties - and "sensitive facilities",
    - "critical" technologies, including "key enabling technologies" such as artificial intelligence, robotics, semiconductors, technologies with potential dual use applications - civil and military -, cybersecurity, space or nuclear technology,
    - the security of supply of "critical inputs", which are "essential for security or the maintenance of public order",
    - access to "sensitive information" or the ability to control "sensitive information".
  - Member States and the Commission can also take into account whether the foreign investor is controlled by the government of a third country. This control may take the form of subsidies or other "significant funding" (Art. 4, sub-para. 2 in conjunction with Recital 12).

- **"Cooperation mechanism"**
  - The screening Member State must inform the Commission and the other Member States about the screening within five working days from the start of the screening (Art. 8 (1)).
  - Where a Member State considers that an FDI, planned in another Member State, affects its security or public order, it can send "comments" to this Member State which it must also forward to the Commission in parallel (Art. 8 (2)). This also applies even where the Member State in which the FDI is planned does not maintain a "screening mechanism" (Recital 14).
  - Where the Commission considers that an FDI is likely to affect security or public order in the Member State in question, or in another Member State, it can issue an "opinion" to the Member State in which the FDI is planned or has been completed (Art. 8 (3)).
  - Where the Commission or a Member State "duly considers" that an FDI in another Member State is likely to affect the security or public order in the first Member State, they can request, from the Member State in which the FDI is planned or has been completed, any information necessary to issue the opinion or provide comments (Art. 8 (4)).
  - The opinions and comments must be issued within 25 days of receipt of the requested information (Art. 8 (5).
  - The Member State in receipt of the opinions and comments must give them "due consideration" (Art. 8 (6)).

- **Notification and annual reporting**
  - Member States must notify the Commission of their existing "screening mechanisms" within 30 days of the entry into force of this Regulation. They must report amendments or newly adopted "screening mechanisms" within 30 days of their entry into force (Art. 7 (1)).
  - Member States with "screening mechanisms" must report annually to the Commission on their application. Member States without screening mechanisms must report annually to the Commission on FDIs that took place in their territory (Art. 7 (2) and (3)).

Main Changes to the Status Quo

Until now, there have been no EU legal provisions on the screening of foreign direct investments. Some sector-specific EU legal instruments - such as on gas supply and aviation - do however contain special provisions for operators from third countries.

Policy Context

Recently, foreign direct investments in the EU from China have risen sharply. In 2016, they amounted to € 37 billion (2015: € 6 billion). In some Member States, this has given rise to concerns about the economy and about security policy. In February 2017, Economics Ministers from Germany, France and Italy submitted a joint paper on dealing with foreign direct investments. They called inter alia for reciprocal equality of investment terms, such as the abolition of the obligation existing in third countries for investors from the EU to set up joint ventures.
At the European Council Meeting of 23 June 2017, the Heads of State and Government of the EU welcomed the "Commission's initiative (...), to analyse investments from third countries in strategic sectors while fully respecting Members States' competences." The European Council indicated that it would revert to this issue at one of its future meetings.
In light of attempts by Chinese investors to take over AIXTRON SE and KUKA AG, the German Government passed an amendment to its foreign trade regulations which came into effect in July 2017. The amendment introduced the term "critical infrastructure" which has now been picked up by the EU Regulation.
At the same time as the proposal for a Regulation, the Commission also submitted a Communication on "Welcoming Foreign Direct Investment while Protecting Essential Interests" [COM(2017) 494] . Here it announced in-depth analysis of FDI-flows into the EU by the end of 2018, especially in strategic sectors and for certain assets. Since 2013, the EU and China have been negotiating a bilateral investment treaty which also aims to facilitate direct investment.

Legislative Procedure

13 September 2017	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Directorates General:	DG Trade (leading)
Committees of the European Parliament:	International Trade (leading), Rapporteur: Franck Proust (EPP-Group, France)
Federal Ministries:	Federal Ministry for Economic Affairs and Energy (leading)
Committees of the German Bundestag:	N.N.
Decision-making mode in the Council:	Qualified majority (adoption by 55% of the Member States making up 65% of the EU population)

Formalities

Legislative competence:	Art. 207 (2) TFEU (Principles of the Common Commercial Policy)
Form of legislative competence:	Exclusive competence (Art. 3 (1) TFEU)
Legislative procedure:	Art. 294 TFEU (Ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

The free movement of capital constitutes a fundamental freedom of the EU (Art. 63 (1) TFEU) and also applies in favour of investors from non-EU countries which is why, on a global comparison, EU Member States rarely restrict them (OECD Foreign Direct Investment Regulatory Restrictiveness Index). **The EU should remain open to FDIs:** The EU generally profits from foreign direct investments. **FDIs promote growth and employment** in the EU and stimulate productivity and innovation in local companies thereby strengthening their link to the increasingly global value chain and increasing their competitiveness.
The Regulation creates the first standard EU procedure for screening FDIs. Whereas the USA, Japan, Canada and Australia have established such procedures, only 15 of the 28 EU Member States have them. Even though the Regulation does not oblige Member States to set up screening procedures for FDIs or regulate the specific design of the measures to be taken by Member States, it does set out the framework for FDI-screening. **The Regulation** therefore **provides clarity about the procedure to be used for screening FDIs.**
Primary EU law only permits restrictions on the free movement of capital for reasons of public order and security. Until now, this exception has been given a strict interpretation by the European Court of Justice (CJEU): According to the CJEU, public order and security "may be relied on only if there is a genuine and sufficiently

serious threat to a fundamental interest of society. Moreover, those derogations must not be misapplied so as, in fact, to serve purely economic ends." (Case C 54/99, para. 17). The Regulation extends the existing scope for discretion.

The selected terms for permitted restrictions on free movement of capital - "critical infrastructures", "critical technologies", "critical resources" and "sensitive information" - are however extremely imprecise and vague. They therefore **carry the risk that Member States will misuse the resulting latitude for protectionist purposes.** Since a substantiation of these terms by the CJEU is likely to take years, increased legal uncertainty looms. In the course of providing a definition, the CJEU should not give up its restrictive interpretation of "public order and security" as a legal condition for restricting the free movement of capital.

The discussions were triggered by increased Chinese FDIs, particularly in what were considered to be strategic sectors. Chinese FDIs in the EU remain relatively low, however: In 2016, they amounted to € 37 billion, as compared with US American direct investment of € 250 billion in 2015 - more recent figures are not available. On the one hand, there are certainly good political reasons for careful screening of Chinese FDIs. State-owned companies still play a key role in China. It cannot be ruled out that the authoritarian Chinese regime will try to advance its own political interests with the aid of these state-owned companies that have made FDIs in the EU. Since these companies are only indirectly subject to market discipline, their conduct may also be motivated by non-economic factors.

On the other hand, there is a range of economic reasons which explain the increase in Chinese FDIs. These include China's high current account surplus which results in a high amount of Chinese foreign currency reserves being invested abroad. Chinese exporters also have an incentive, in some circumstances, to build up production capacity in the EU by way of FDIs in order to avoid import duty. Over-capacities in some sectors of the Chinese economy and the increase in domestic competition also result in attempts by Chinese producers to develop new markets in the EU. At the same time, FDIs offer access to established European markets, distribution channels and technical expertise. For the avoidance of protectionist tendencies, it would be advantageous for both sides if the EU and China could agree on a bilateral investment agreement providing for the relaxation of currently very restrictive Chinese regulations on European FDIs.

Legal Assessment

Legislative Competency

The Regulation is rightly based on the EU competence to implement the common commercial policy (Art. 207 (2) TFEU) because foreign direct investments fall under common commercial policy (Art. 207 (1), sentence 1 TFEU).

Subsidiarity

The subsidiarity check does not apply because the EU has exclusive competence for the common commercial policy (Art. 5 (3) TEU in conjunction with Art. 3 (12) (e) TFEU).

Proportionality with respect to Member States

Unproblematic.

Compatibility with EU Law in other respects

The free movement of capital applies both between Member States and between Member States and third countries (Art. 63 (1) TFEU). Member States may adopt restrictive measures that are justified on the grounds of public order and security (Art. 65 (1) (b) TFEU). As an exception to the principle of the free movement of capital, this provision is interpreted very narrowly by the CJEU (Case C-54/99, para. 17)). In particular, supplying the population with certain goods in a crisis may constitute an aspect of public security (Case C-483/99 para. 47; C-503/99 para. 46)). It remains to be seen whether and to what extent the Regulation will lead to a broader interpretation by the CJEU.

Impact on German Law

The Regulation has direct application in every Member State (Art. 288 TFEU) so no national implementation act is required. For reasons of legal certainty, however, national law - the Foreign Trade Act (Außenwirtschaftsgesetz) and Foreign Trade Ordinance (Außenwirtschaftsverordnung) - will have to be adapted.

Conclusion

The EU should remain open to FDIs: FDIs promote growth and employment. The Regulation provides clarity about the procedure to be used for screening FDIs. The terms used for permitted restrictions on free movement of capital - "critical infrastructures", "critical technologies", "critical resources" and "sensitive information" - carry the risk that Member States will misuse the resulting latitude for protectionist purposes.