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Broadening the “Foreign (Direct) Investment” Concept: A Second Chance for an Effective FDI Screening in the EU?

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Contents

Abstract

This research presents a quest for the definition of "foreign direct investment" under the EU framework for FDI screening by the Member States, established by Regulation 2019/452 based on public policy and security. This Thesis argues that the scope of the current Regulation, excluding "indirect" FDI made by foreign investors via an EU subsidiary, coupled with the lenient, non-compulsory nature of the Regulation, undermines the effectiveness of FDI control in the EU. As a result, the screening system creates legal uncertainties for the investors.

After the confirmation that the Regulation's scope is limited to investments made directly by the foreign investor into the EU target, thereby excluding FDI made via an EU subsidiary in the *C-106/22 Xella* judgment, the discussions revealed that most Member States that have a mechanism in place, screen the latter category as well. Some of the implications include a partial halt to the cooperation mechanism under the Regulation or, paradoxically, limited recourse to provisions EU subsidiary can rely upon when challenging the restriction. AG Ćapeta warns that it could overburden the fundamental freedoms instruments, ultimately undermining the relevance of Regulation 2019/452.

Increasing security concerns and inefficiencies decrease the EU's attractiveness to inward investment. In January 2024, the Commission proposed a new regulation intended to repeal the existing Regulation 2019/452. Apart from gaining a compulsory nature, the new regulation should also cover the FDI made via an EU subsidiary. The final part of this Thesis explores the level of harmonization of the scope of FDI control in the EU and the possibility of the harmonized concept of FDI throughout the Union.

Preface

In memory of my beloved grandfather, a brilliant lawyer, a person with a phenomenal sense of humor, and an exceptional chef who has been following my journey from above since January. In his gentle wisdom, I found peace; in his unshakeable spirit, I found strength. His resilience, persistence, and wittiness inspire me every day.

Abbreviations

ACCI	Act on the Control of Certain Investments (Poland)
AG	Advocate General
CCP	Common Commercial Policy
CJEU / the Court	Court of Justice of the European Union
EU / the Union	European Union
EUR	Euro
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
ICA	The Austrian Investment Control Act
IMF	International Monetary Fund
MFC	French Monetary and Financial Code
OECD	Organization for Economic Co-operation and Development
SOE	State-owned Enterprise
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

Introduction

Defining the notion of foreign direct investment ("**FDI**") is the key to FDI assessment (screening) into the European Union (**"EU"** or **"the Union"**). This Thesis is a deep dive into the interpretation of this concept: under the free movement law, the common commercial policy ("**CCP**"), and under Member States' national laws establishing FDI screening mechanisms functioning under the framework of Regulation 2019/452.[1] The final provisions of the Thesis focus on the future of the FDI concept under the newly published Proposal for a Regulation on the screening of foreign investment in the Union (**"the Proposal**"),[2] and predictions of its interpretation by the Court of Justice of the European Union (**"CJEU"** or **"the Court"**).

Research Background

To understand the rationale behind EU FDI control, it is necessary to begin by reiterating the self-evident: FDI contributes to the economic growth of the recipient country (or area).[3] It can positively influence the recipient's economic development by raising the availability of production factors, such as capital, advanced technology, production techniques, facilities, machinery, and managerial expertise.[4] The domestic output of the host economy rises, and the efficiency of production increases, boosting the ability to penetrate international markets and subsequently increasing the tax revenue.[5] In 2021, the EU had inward FDI totaling EUR 117

[1] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, *OJ L 79I,* 21.09.2019, p. 1–14. (**"Regulation 2019/452"**).
[2] European Commission, Proposal for a Regulation of the European Parliament and of the Council on the screening of foreign investors in the Union and repealing Regulation (EU) 2019/452 of the European Parliament and the Council, COM(2024) 23 final, Brussels, 24.01.2024. (**"The Proposal"**).
[3] Empirical evidence shows that the positive impact of FDI on the economic growth of the recipient country is higher when the recipient country is developed. To benefit from FDI, the recipient country (area) must be developed enough to grasp the productivity spill-overs (see paragraph below). See: A. Dimopoulos, *The Origins, Definition, and Scope of EU Foreign Investment Law*, in A. Dimopoulos (ed.), EU Foreign Investment Law, Oxford University Press, 2011, p. 9–10; UNCTAD, *Economic Development in Africa, Rethinking the Role of Foreign Direct Investment*, Geneva, 2005, available at: https://unctad.org/system/files/official-document/gdsafrica20051_en.pdf, p. 26–36.
[4] L. Alfaro, J. Chauvin, *Foreign Direct Investment, Finance and Economic Development*, in F. L. Rivera-Batiz M. Spatareanu (eds.), Encyclopedia of International Economics and Global Trade, Volume 1: Foreign Direct Investment and the Multinational Enterprise, World Scientific Publishing, Singapore, 2020, p. 232–234; *Ibid.*, (Dimopoulos, *The Origins, Definition, and Scope of EU Foreign Investment Law*).
[5] *Ibid.*, (A. Dimopoulos, n. 3).

billion in 2021, approximately 8% of the world's total level.[6] In the EU, through productivity spill-overs, when highly skilled employees from foreign enterprises move to local companies, when local companies must innovate to compete with foreign enterprises, or when the local firms learn superior production technologies,[7] it is mainly the small and medium-sized enterprises that enjoy the fruit of FDI.[8]

The EU has had one of the most liberal FDI frameworks in the world.[9] For a long time, nobody could challenge the Union's stance; a resort to any form of protection equated to protectionism, contrary to the European economic project goal.[10] During the Barroso's Commission, following the 2004 accession of the former Eastern Bloc and post-Soviet Member States and the aftermath of the 2008 financial crisis, market integration and investment liberalization were the EU's key priorities.[11] For instance, in 2006, the Commission issued a letter of formal notice to France due to the authorization requirements on the grounds of public security in specific sectors of activities that could affect national defense. France subjected EU entities under the control of third-country investors to more stringent procedures, viewed as contrary to the free movement of capital and the right of establishment.[12] Ten years later, the Commission sent a reasoned opinion

[6] European Commission, Report from the Commission to the European Parliament and the Council, *Second Annual Report on the screening of foreign direct investments into the Union*, 01.09.2022, Brussels, SWD(2022) 219 final, COM(2022) 433 final, p. 2.
[7] H. Görg, E. Strobl, *Multinational Companies and Productivity Spillovers: A Meta-Analysis*, The Economic Journal, Vol. 111, No. 475, Oxford University Press, 2001, F723–F739, available at: https://www.jstor.org/stable/798312, p. 724.
[8] E. Rytter Sunesen, T. Jeppesen, C. Theilgaard, *The World in Europe, Global FDI Flows Towards Europe*, ESPON, Luxembourg, 2018, available at: https://copenhageneconomics.com/publication/the-world-in-europe-extra-european-fdi-towards-europe/, p. 7–9; E. Rytter Sunesen, J. Juul Henriksen, *The Economics of FDI Screening*, in J. H. J. Burgeois (ed.), EU Framework for Foreign Direct Investment Control, European Monographs, vol. 111, (2020) Kluwer Law International, p. 7–8.
[9] S. Robert, *Foreign Investment Control Procedures as a Tool for Enforcing EU Strategic Autonomy*, in C. Beaucillon, S. Poli (eds.), EU Strategic Autonomy and Technological Sovereignty, European Papers, Vol 8, 2023, No 2, p. 513–514; *Ibid.*, (Rytter Sunesen, Juul Henriksen, *The Economics of FDI Screening*), p. 10.
[10] *Ibid.*, (S. Robert, n. 9), p. 514. Member States are required to abolish restrictions to free movement of capital and restrictions to freedom of establishment under Articles 63 TFEU and 49 TFEU.
[11] M. Dušek, A. Caruana Galizia, *The forgotten economics of EU enlargement,* World Economic Forum Annual Meeting, 15–19 January 2024, Switzerland, 17.01.2024, available at: https://www.weforum.org/agenda/2024/01/the-forgotten-economics-of-eu-enlargement/, (accessed: 26.03.2024); R. Bismuth, *Reading Between the Lines of the EU Regulation Establishing a Framework for Screening FDI into the Union*, in J. H. J. Burgeois (ed.), EU Framework for Foreign Direct Investment Control, European Monographs, vol. 111, (2020) Kluwer Law International, p. 103–104. During this time, for instance, the CJEU delivered judgments favoring market integration under the four freedoms as opposed to social rights. Market integration really was the key priority. See, for example: Case C-341/05 *Laval* [2007], ECLI:EU:C:2007:809; Case C-438/05 *Viking Line* [2007], ECLI:EU:C:2007:772.
[12] European Commission, IP/06/438, *Free movement of capital: Commission scrutinises French law establishing authorisation procedure for foreign investments in certain sectors,* Press Release, Brussels, 04.04.2006, available at:

to several Member States regarding their requirements to purchase agricultural land, viewed as discouraging cross-border investment.[13]

The EU is battling to attract foreign investors in intense global competition. Low FDI inflows will harm the EU's economic growth.[14] Despite the consensus that the Union should remain open to FDI, concerns arise about foreign investors taking over EU undertakings with sensitive technologies.[15] Traditionally, the EU's foreign investors would not rock the boat too much; they originated from third countries with similar values regarding respect for democracy, human rights, and the free market economy,[16] and to this day these partners remain the dominant investors in the EU.[17] However, over the past decade, their portion decreased to the advantage of emerging partners with the frequent involvement of the State, such as China, the Gulf Cooperation countries, and Russia.[18] Ultimately, once the government of a third country has ties to the undertaking acquiring an EU company or taking up entrepreneurial activity in the EU, the motivation behind the FDI from such investors shifts from solely economic to strategic reasons.[19]

Acquisitions by foreign state-owned enterprises ("**SOEs**") in strategic areas may allow third countries to use these assets not only to the detriment of the EU's technological edge but also to put public order and security at risk. Between 2003 and 2016, the number of acquisitions by SOEs in potentially sensitive sectors in the EU ranged from five to thirty. However, there was a rapid surge of fifty transactions in 2016.[20] While Chinese takeovers of EU undertakings received

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https://ec.europa.eu/commission/presscorner/detail/en/IP_06_438, (accessed: 26.03.2024); cited in: *Ibid.*, (R. Bismuth, n. 11), p. 104.

[13] European Commission, IP/16/1827, *Financial services: Commission requests Bulgaria, Hungary, Latvia, Lithuania, and Slovakia to comply with EU rules on the acquisition of agricultural land*, Press Release, Brussels, 26.05.2016, available at: https://ec.europa.eu/commission/presscorner/detail/EN/IP_16_1827, (accessed: 26.03.2024); cited in: *Ibid.*, (R. Bismuth, n. 11), p. 104.

[14] In the 1990s, the EU was the destination for 50% of global FDI flows. This number lowered to 20% in 2014. See: *Ibid.*, (E. Rytter Sunesen, J. Juul Henriksen, n. 8), p. 8.

[15] European Commission, Reflection Paper on Harnessing Globalization, COM(2017) 240 final, Brussels, 10.05.2017, p. 15.

[16] These countries are also OECD members, such as the USA, Canada, South Korea, Japan, Singapore, Taiwan, EFTA countries.

[17] European Commission, Commission Staff Working Document, Foreign Direct Investment in the EU: Following up on the Commission Communication 'Welcoming Foreign Direct Investment while Protecting Essential Interests' *of 13 March 2019*, SWD(2019) 108 final, Brussels, 13.03.2019, p. 1, 67.

[18] *Ibid.*, (Following up on the Commission Communication 'Welcoming Foreign Direct Investment while Protecting Essential Interests', n. 17), p. 56.

[19] *Ibid.*, (Reflection Paper on Harnessing Globalization, n. 15), p. 15.

[20] *Ibid.*, (E. Rytter Sunesen, J. Juul Henriksen, n. 8), p. 12–13.

much public attention,[21] between 2003 and 2016, China only accounted for 7% of deals by SOEs in potentially sensitive sectors. Russian deals, amounted to 22%.[22]

In response to recent crises such as the global pandemic and Russia's aggression against Ukraine, coupled with a growing presence of State-funded investors that acquire EU companies in strategic sectors, governments are paying greater attention to the security implications of FDI. An increased resort to "protectionism" has become a global phenomenon. Based on the data supplied by 61 world economies to the OECD, we are witnessing "a historically unprecedented policy dynamic to manage security implications of foreign investment," with 80% of the 61 economies having some instruments in place to manage security implications of foreign investment and a share of economies that operate mechanisms.[23] Most of the EU's traditional partners have measures to screen FDI into sensitive sectors.[24] Screening mechanisms are becoming common in the investment landscape, and companies are integrating screening into their investment processes.

From 2020, Regulation 2019/452 establishes a framework for the optional screening of FDI by Member States on the grounds of security and public order. In 2017 (on the same day of releasing the proposal for this Regulation), Juncker addressed his State of the Union speech, where he emphasized that "Europe must always defend its strategic interests" and that "we are not naïve free traders."[25] The EU's attitude toward Member States subjecting FDI to some restrictions changed significantly over the past decade. Bismuth rhetorically wonders how Barrosso's Commission would react to Juncker's speech. The world evolves in myriad ways.

[21] European Commission, Joint Communication to the European Parliament and the Council: Elements for a new EU strategy on China, JOIN(2016) 30 final, Brussels, 22.6.2016, p. 4–8; L. Comerma Calatayud, *What can be learned from China's investment in Europe?*, King's College London, 26.04.2023, available at: https://www.kcl.ac.uk/what-can-be-learnt-from-chinas-investment-in-europe, (accessed: 28.03.2024); C. Bryant, *Wanhua takes full control of Borsodchem*, Financial Times, 01.02.2011, available at: https://www.ft.com/content/1aadca66-2e2e-11e0-8733-00144feabdc0, (accessed: 28.03.2024).
[22] *Ibid.*, (E. Rytter Sunesen, J. Juul Henriksen, n. 8), p. 14–15.
[23] OECD, Investment policy developments in 61 economies between 16 October 2021 and 15 March 2023, Freedom of Investment Project: Inventory of Investment Policy Developments, 2023, available at: https://www.oecd.org/daf/inv/investment-policy/Investment-policy-monitoring-April-2023.pdf, p. 7–10.
[24] For example: Canada Investment Act, some States already have a special designated body that screen foreign investment such as the United States' Committee on Foreign Investment in the United States (CFIUS), or Norway's Screening Committee (Screeningutvalget).
[25] European Commission, President Jean-Claude Juncker's State of the Union Address 2017, 13 September 2017, Brussels, transcript available at: https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_17_3165, (accessed: 13.03, 2024).

Moreover, there was a strong political will for an EU-wide instrument to screen FDI from several Member States reflecting worries about foreign investors taking over strategic Union companies.[26]

Pursuant to Regulation 2019/452, Member States may introduce or maintain the existing national mechanisms to screen inward FDI based on public order and security protection. The final wording is much milder than what one may expect after the rest of Juncker's speech, managing to keep the Regulation as an instrument for the protection of security and public order without touching upon the protection of the Union's economic interests.[27] Back in 2017, only twelve Member States had screening mechanisms in place to address possible risks of FDI to public order and security.[28] In 2022, the Commission urged Member States to implement FDI screening in their domestic systems.[29] As of February 2024, the number increased to twenty-two, leaving only five Member States without any mechanism.[30] Despite subjecting the existing national screening mechanisms to the framework created by Regulation 2019/452, these mechanisms still significantly differ in scope and process, leaving foreign investors in legal uncertainties.

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[26] Letter to DG Trade Commissioner Malmström from the German, French and Italian governments from February 2016, available at: https://www.bmwk.de/Redaktion/DE/Downloads/S-T/schreiben-de-fr-it-an-malmstroem.pdf?__blob=publicationFile&v=4, (accessed: 14.04.2024).

[27] Juncker continued in the following: "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 suggested that perhaps, Regulation 2019/452 could become an instrument of economic protection. *Ibid.*, (Jean-Claude Juncker's State of the Union Address, 13 September 2017). For protection of Union undertakings subject to State aid rules to compete in an undistorted competition in the internal market against foreign undertakings that received subsidies from third countries, there is a new legal instrument: Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market, OJ L 330, 23.12.2022, p. 1–45.

[28] Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain, and the United Kingdom. See: European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and Committee of Regions Welcoming Foreign Direct Investment While Protecting Essential Interests, COM(2017) final 494, Brussels, 13.09.2017, p. 7.

[29] European Commission, Report from the Commission to the European Parliament and the Council: Third Annual Report on the screening of foreign direct investments into the Union, COM(2023) 590 final, Brussels, 19.10.2023, p. 8.

[30] Bulgaria, Croatia, Cyprus, Greece and Ireland do not have a national FDI screening mechanism in place. See: European Commission, List of Screening Mechanisms Notified by Member States, last updated on 28.02.2024, available at: https://policy.trade.ec.europa.eu/enforcement-and-protection/investment-screening_en, (accessed: 18.03.2024).

Hindelang and Moberg describe the adoption of Regulation 2019/452 as "anything but uncontroversial," underlined by the challenge to find consensus in all aspects – whether to, how, and who should screen.[31] With the new Proposal on the way, legislators face the same dilemma. Four years later, the concern about some foreign investors, notably SOEs, taking over EU undertakings with critical technologies for strategic reasons increased.[32] Logically, Member States push for maximum freedom in determining the criteria for sensitive industries and conditions affecting national security.[33] Moreover, measuring the impact of stringent control on FDI in sensitive sectors proves extremely difficult since they constitute only a small portion of investments, and investors in sensitive industries are used to enhanced checks.[34] While remaining vigilant to the security threats posed by certain takeovers, notably by the SOEs, subjecting foreign investors to incoherent controls due to the misalignment of the fundamental concepts, such as the definition of FDI can turn to the detriment of the EU to attract the wanted foreign investors. Therefore, an effective FDI screening system is necessary to reduce the risk of foreign takeovers of companies in strategic sectors that threaten public security while not deterring all foreign investors in a system where, in some Member States, their investment constitutes FDI and in others, not. This is particularly relevant when that investment concerns several Member States' jurisdictions.

Research Purpose and Research Questions

The central aim is twofold. First, this research points to the issues in the current system of FDI screening by the Member States relating to the definition of FDI under Regulation 2019/452. Second, it explores the future wording and prediction of interpretation of the FDI concept following the adoption of the new regulation. The research questions ask:

[31] S. Hindelang, A. Moberg, *The Art of Casting Political Dissent in Law: The EU's Framework for Screening of Foreign Direct Investment*, Common Market Law Review 57(5), 2020, available at: https://kluwerlawonline.com/journalarticle/Common+Market+Law+Review/57.5/COLA2020743, p. 1428.
[32] *Ibid.*, (*Reflection Paper on Harnessing Globalization*, n. 15).
[33] Article 4(2) TEU: It is the sole responsibility of Member States to safeguard their national security; Article 346 TFEU: Member States are free to take measures they consider necessary for the protection of the essential interests of their security connected to defense and Member States are not obliged to supply information which they consider contrary to essential security interests.
[34] *Ibid.*, (E. Rytter Sunesen, J. Juul Henriksen, n. 8), p. 19.

1. **How does the current framing of Regulation 2019/452 and the "foreign direct investment" concept render FDI screening under the Regulation ineffective?**
2. **How should the new regulation define the "foreign (direct) investment" notion to increase the effectiveness of the FDI screening into the Union?**[35]

Delimitation

This Thesis is limited to mechanisms that protect the internal market based on public policy and security. Economic protection instruments are outside the scope. The research addresses only a part of the complex problem of ineffective FDI screening in the EU. Other factors contributing to the legal uncertainties, such as the misalignment in review time, lack of shared understanding of national security and public order, and alignment of the review triggering events, thresholds, and sectoral coverage, are outside the scope. International mechanisms by the WTO and OECD are also outside the scope. Outbound investment control is outside the scope. Intra-EU investments will only be discussed to the extent necessary to further the questions central to the Thesis' aim.

Methodology

The research roots in the legal hermeneutics method, stemming from the works of Gadamer, who views hermeneutics as seeking to "discover and bring into consciousness something that methodological dispute serves only to conceal and neglect",[36] focusing on the act of understanding and the circumstances allowing us to understand.[37] Hermeneutics establishes a philosophical objective of explaining relations that underlie the understanding. The relation between the text and the interpreter, past and present, present and future.[38] Legal hermeneutics is a study of the interpretation and meaning of written law.[39] Gadamer argues that: "Someone who is seeking to understand the correct meaning of law must first know the original one. Thus, he

[35] Foreign (direct) investment refers to the new wording by the Proposal that aims at defining both "direct" foreign direct investment and "indirect" foreign direct investment, referred to as "foreign investment". See: Article 2(1) of the Proposal. For discussion on the distinction see Section 2.1.4.2. and Section 2.3.
[36] H. Gadamer, *Truth and Method,* Second Edition, Continuum, New York, 2004, p. xxvi.
[37] B. Sherman, *Hermeneutics in Law*, The Modern Law Review, *51*(3), 1988, https://doi.org/10.1111/j.1468-2230.1988.tb01762.x, p. 388.
[38] O. Merezhko, Legal Hermeneutics and Methodology of Law, Evropský Politický a Právní Diskurz, 2014, available at: https://eppd13.cz/wp-content/uploads/2014/2014-1-2/03.pdf, p. 4–5.
[39] P. Goodrich, *Legal Hermeneutics*, Routledge Encyclopedia of Philosophy, Taylor & Francis, 1998, available at: https://www.rep.routledge.com/articles/thematic/legal-hermeneutics/v-1.

must think in terms of legal history… the jurist, in addition, applies what has been learned in this way to the legal present".[40] Hermeneutics, therefore, provides the scholar with a set of tools aiding them to determine the meaning of laws and norms. Rather than addressing the issue of meaning directly, hermeneutics guides how to ascertain the essence.[41]

This Thesis concerns the interpretation of FDI in the past, present, and future, using written EU primary and secondary law, case-law of the CJEU, and national laws, taking into account external factors such as the geopolitical circumstances and problems based on conflicts of interpretation – in a quest to find its essence and propose an adequate interpretation. With the great power of the CJEU as the sole interpreter of EU law comes great responsibility, as it gives meaning to terms and expressions in the often vague legal texts.[42]

The Court admits that "[Union] law uses a terminology which is peculiar to it."[43] The type of interpretation used by the Court to fill the gaps has not yet been defined.[44] For many years, academia has discussed the so-called "European legal methods", a set of methodologies applied in the sui generis EU legal order by the CJEU to interpret the norms and concepts.[45] Accordingly, this Thesis draws from the different European legal methods used by the Court when giving meaning to the concepts this research intends to elaborate on, such as "capital movement", "investment", "direct investment", or "foreign investor". Interpretations like comparison of national laws to find a common denominator,[46] teleological interpretation when the Court looks at the policy considerations behind the norm it is asked to interpret,[47] notoriously used for gap-filling, or contextual interpretation when the concept is placed within the circumstances of

[40] *Ibid.*, (H. Gadamer, n. 36), p. 322.
[41] C. Douzinas, R. Warrington, S. McVeigh, *Postmodern Jurisprudence*, Routledge, London, 1991, p. 28–31.
[42] L. Azoulai, *The Europeanisation of Legal Concepts*, in U. Neergaard, R. Nielsen (eds.), European Legal Method in a Multi-Level EU Legal Order, DJØF Publishing, Copenhagen, 2012, p. 165–166.
[43] Case 283/81 *CILFIT* [1981], ECLI:EU:C:1981:335, para. 19.
[44] X. Groussot, *Creation, Development and Impact of the General Principles of Community Law: Towards a jus commune europaenum?*, PhD Dissertation, Faculty of Law, Lund University, 2005, p. 41.
[45] U. Neergaard, R. Nielsen, *Introduction*, in U. Neergaard, R. Nielsen (eds.), European Legal Method in a Multi-Level EU Legal Order, DJØF Publishing, Copenhagen, 2012, p. 21–22.
[46] For example: Case 155/79 *AM & S Europe Limited v Commission* [1982], ECLI:EU:C:182:157, paras. 18, 27.
[47] For example: Case C-144/04 *Mangold* [2005], ECLI:EU:C:2005:709, para. 74; Case C-555/07 *Kücükdevici* [2010], ECLI:EU:C:2010:21, para. 20. Teleological interpretation plays an important role in the fundamental rights. In: J. Gerards, *Judicial Argumentation in Fundamental Rights Cases – the EU Court's Challenge*, in U. Neergaard, R. Nielsen (eds.), European Legal Method in a Multi-Level EU Legal Order, DJØF Publishing, Copenhagen, 2012, p. 34–37.

the particular legal regime[48] are thus, collectively referred to under the umbrella term of "European legal methods" and considered together in this Thesis.

Thesis Outline

After a brief introduction of Regulation 2019/452, this Thesis consists of three chapters. The first chapter provides a general overview of how investments, in general, are regulated and how the regulation has evolved. It outlines the competence problems of the EU framework for FDI control, underpinning the adoption of Regulation 2019/452 and how FDI is defined. The second chapter looks into the implementation of Regulation 2019/452. It analyzes the Court's narrow interpretation of the FDI concept under this Regulation in *Xella* judgment. Then, it takes examples from four Member States' national screening mechanisms and assesses the contrast between the Regulation as interpreted by the Court and national laws. The third chapter furthers the practical implications of *Xella* and focuses on future FDI screening into the Union. It discusses the shift in the scope of the FDI in the newly published Proposal and attempts to predict what the future interpretation will encompass. Lastly, the conclusion provides an overview of the findings.

[48] For example: *Ibid.*, (Case 283/81 *CILFIT*), para. 19; Case C-234/98 *Allen* [1999], ECLI:EU:C:1999:594, paras. 19–20; Case C-257/99 *Barkoci and Malik* [2001], ECLI:EU:C:2001:491, para. 52.; *Ibid.*, (L. Azoulai, n. 42), p. 173–174.

A Brief Introduction of Regulation 2019/452

This part aims at readers unfamiliar with the contents of Regulation 2019/452 or those who wish to refresh their memory. If You are familiar with the aim pursued and the content of Regulation 2019/452, feel free to skip this part.

With less than forty recitals and seventeen articles, Regulation 2019/452 appears blank compared to sizable technical legislations. However, an extensive policy area hides behind the brief text. Regulation 2019/452 creates a common EU framework for screening FDI from third countries on security and public order grounds. Again, considering the compressed content, the Regulation pursues two rather bold aims:

1) to establish "a framework for the screening by Member States of FDI into the Union on the grounds of security and public order"; and
2) to set up a "mechanism for cooperation between Member States, and between Member States and the Commission, with regard to FDI likely to affect security or public order".[49]

This Thesis mainly concerns the former aim, which is the scope of the FDI screening. Article 2 defines "foreign direct investment" and "foreign investor". It is important to notice early on that the purpose of the Regulation is not to introduce an EU FDI screening mechanism but to allow Member States to introduce their national legislation governing the screening of FDI.

Article 3 discusses Member States' screening mechanisms as tools to screen FDI on the grounds of security and public order, sets out minimum procedural standards, such as transparency and non-discrimination, and ensures that foreign investors can seek recourse against the screening decisions. Article 4 provides a non-exhaustive list of potential effects and factors that may be considered when determining whether the FDI will likely affect public order or security.

Article 5 establishes a yearly reporting duty of the Member States to the Commission concerning FDI activities and the operation of national screening mechanisms. Articles 6 and 7 establish the

[49] Article 1(1) of Regulation 2019/452.

cooperation mechanism concerning FDI undergoing and not undergoing screening. Member States are required to notify the Commission and other Member States of investments undergoing screening in their territory and allow the Commission and other Member States to comment. A Member State is informed that a planned investment in another Member State may affect the public order and security in its territory. Article 8 prescribes rules for cooperation in FDI that will likely affect projects or Union interest programs. Articles 9 to 14 set out rules on handling information between the Member States or the Member States and the Commission and create a base for the infrastructure of the cooperation mechanism.

In summary, Regulation 2019/452 authorizes Member States to screen FDI on public order and security grounds. It establishes a common framework of standards and procedures that the national screening mechanisms of Member States willing to screen must comply with.

1. FDI Control in the EU

This chapter provides an overview of the scope of the existing FDI control in the EU under internal market rules, CCP, explains the regulatory landscape before and after Regulation 2019/452, and defines FDI. It consists of three parts: the policy context, the definition of FDI under internal market rules and Regulation 2019/452, and the summary of the findings.

Since the Lisbon Treaty entered into force, Union law has explicitly placed FDI under the CCP, falling under the exclusive competence of the EU. Nevertheless, provisions on the free movement of capital and establishment, where the Member States and the EU share competence, remain relevant instruments for investment control. Between these competencies and policy fields lies the latest legal instrument adopted – Regulation 2019/452. It comes with non-violent yet dangerous wording, *authorizing* but *not obliging* Member States to maintain, amend, or introduce national screening mechanisms on public order and security grounds. Section 1.1. sets out the policy background and explains the rationale behind the unique, non-mandatory feature of Regulation 2019/452.

Regulation 2019/452 establishes a common framework for FDI screening in the Union for those Member States that have a screening mechanism in place. As the FDI wording prescribes and as the starting point of analysis, for a transaction to fall under the screening, it must be a "direct investment" made by a "foreign investor". Section 1.2. interprets the concept of FDI using all instruments available: free movement provisions, CCP and Regulation 2019/452, and the case law of the CJEU in these fields. It sheds light on the relationship between freedom of establishment and the free movement of capital utilized to protect (foreign) direct investments and how Regulation 2019/452 settles the overlaps.

This chapter covers an extensive area of FDI control, ranging from policy considerations, internal market freedoms, choices of the legal basis, and competence division in the constitutional structure of the EU to the definition of FDI. For clarity, Section 1.3. summarizes the findings and helps the reader navigate and understand the problems of FDI control in the EU causing the inconsistencies in the implementation of Regulation 2019/452.

1.1. Common Commercial Policy

The legislator chose Article 207(2) TFEU as the legal basis for Regulation 2019/452. While that second paragraph prescribes a legislative procedure for implementing CCP measures, the first paragraph explicitly places FDI within the ambit of the CCP.[50] The Union exercises exclusive competence over FDI.[51] The rationale behind the CCP is to ensure that the trade (and FDI) policies pursued by the Union on the EU level, to the exclusion of national regulation by the Member States, provide the dynamic evolution of the EU's commercial activities vis-a-vis third countries.[52] Until the entry into force of the Lisbon Treaty, under the provisions on the free movement of capital, the Union and the Member States shared competence in foreign (direct) investment control.[53] The Member States and the EU still share competence in intra-EU direct investment (establishment) and both non-direct foreign and intra-EU investment (movement of capital).[54] By the Lisbon Treaty, only the FDI was cut off from the rest of the capital movements falling under the internal market provisions and attached to the CCP next to international trade.

As outlined above, Regulation 2019/452 *authorizes* Member States to introduce or maintain national FDI screening mechanisms in their territories.[55] Provided that FDI, as all the other forms of investment, would still fall under the shared competence, Member States would not need such authorization unless the EU decided to legislate in this field.[56] Moreover, in such a case, the Union measure would need to conform with the principle of subsidiarity.[57] Conversely, since FDI regulation falls under the exclusive competence of the Union, authorization for existing and permission for new national FDI screening measures becomes necessary.

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[50] Article 207 TFEU.
[51] Article 3(1)(e) TFEU.
[52] Opinion of AG Wahl in *Opinion 3/15* [2016], ECLI:EU:C:2016:657, para. 43.
[53] Article 4(2)(a) TFEU; Direct investment between Member State and non-Member State can only be protected under free movement of capital, as it is the only market freedom that applies to third-country capital movements. See: European Commission, Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the Union, COM(2017) 487 final, Brussels, 03.09.2017, p. 4; "It is important to ensure that the interpretation of Article 63(1) TFEU as regards relations with [non-member] States does not enable economic operators who do not fall within the territorial scope of freedom of establishment to profit from that freedom", Case C-464/14 *SECIL* [2016], ECLI:EU:C:2016:896, para. 42.
[54] Investment movement between the Member State and third-country. See: Section 1.2.1. discussing investments and categories of investments as "capital movements". Article 4(2)(a) TFEU.
[55] Article 1(1) of Regulation 2019/452.
[56] Article 2(1) TFEU.
[57] Article 5(3) TFEU – There is no need to show that the objectives of the measure can be better achieved at Union level; *Ibid*., (S. Hindelang, A. Moberg, n. 31), p. 1435.

FDI control is subject to specific rules and procedures different from those governing other investment forms. The following subsections explore the clash of competencies, the difficulties of choice of the adequate legal basis for a legal instrument such as Regulation 2019/452, and, through the Opinion of AG Ćapeta in *Xella*, the second subsection furthers the view that the form of authorization via Regulation 2019/452 acts as the legitimization of Member States' national FDI screening mechanisms.

1.1.1. Competence under Common Commercial Policy and its Use as a Legal Basis

This subsection does not attempt to analyze whether Article 207(2) TFEU is the correct legal basis. However, it points to the context of the complex, intertwined, sometimes competing policy objectives encompassing Regulation 2019/452.

In 2010, the Commission was enthusiastic about the possible impact of the newly attributed competence in FDI. However, the recovery from the crisis rather directed the discussions towards investment liberalization.[58] Cremona notes that the CCP possesses a specific characteristic: the Treaty does not predetermine the purposes for which CCP powers may be used.[59] While Article 206 TFEU provides for an objective of international trade and FDI liberalization, other objectives should be taken into account, the uniform principles in Article 207(1) TFEU under which the CCP must be "conducted in the context of the principles and objectives of the Union's external action".[60]

The Commission did not bother explaining why Article 207(2) served as a legal basis for Regulation 2019/452. It merely stated that FDI falls within the CCP. The Regulation nevertheless

[58] The Commission applauded the new opportunity behind Article 207 TFEU, stating that it "provides for the Union to contribute to the progressive abolition of restrictions on foreign direct investment." See: European Commission, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: Towards a comprehensive European international investment policy, COM(2010) 343 final, Brussels, 07.07.2020, p. 2; *Ibid.*, (S. Hindelang, A. Moberg, n. 31), p. 1432–1433.
[59] M. Cremona, *Regulating FDI in the EU Legal Framework*, in J. H. J. Burgeois (ed.), EU Framework for Foreign Direct Investment Control, European Monographs Series Vol. 111, 2020, Wolters Kluwer, p. 33.
[60] The Court concluded that one of these principles is sustainable development, Case *Opinion 2/15* [2017], ECLI:EU:C:2017:376, para. 147.

raises questions about the boundaries between the powers of the Union and the Member States.[61] The Union has exclusive competence to direct the rules governing direct investment from third-country investors. Still, it shares the competence with Member States in rules governing direct investments from EU investors and non-direct investments from EU and non-EU investors. Now, the screening amounts to a restriction on FDI (third-country capital movement). Under Article 65 TFEU, such restrictions may be justified on the grounds of public security and public order.[62] Member States are permitted to impose a restriction only if there is a "genuine and sufficiently serious threat to a fundamental interest of the society".[63] In *Commission v Portugal*, the Court concluded 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 EU.[64] While Member States are free to impose restrictions, the EU can still establish the procedural and substantive conditions for invoking the justifications.[65]

Article 207(2) TFEU provides that the measure must define "the framework for implementing the CCP". Thus, harmonization is not implied. There only needs to be a certain level of coordination of Member States' actions concerning third countries.[66] In delineating the scope of CCP, the Court held that for the FDI measure to fall under CCP, it must have a "direct and immediate effect on trade [with third countries]".[67] Cremona concludes that the Court chose a path of "flexibility over predictability".[68] In this sense, a framework for FDI review meets the criteria for falling under CCP.

Lastly, the framework created by Regulation 2019/542 can establish a structure for internal market activities, which is viewed as a competence shared between the EU and Member States.

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[61] Recital 6 of Regulation 2019/452; *Ibid.*, (Proposal for a Regulation establishing a framework for screening of foreign direct investments into the Union), p. 8.
[62] Article 65(1)(b) TFEU; *Ibid.*, (Proposal for a Regulation establishing a framework for screening of foreign direct investments into the Union), p. 4.
[63] Case C-54/99 *Eglise de Scientologie* [2000], ECLI:EU:C:2000:124, para. 14–17.
[64] *Ibid.*, (S. Hindelang, A. Moberg, n. 31), p. 1453; Case C-543/08 *Commission v Portugal* [2010], ECLI:EU:C:2010:669, paras. 84–85.
[65] *Ibid.*, (M. Cremona, n. 59), p. 35–38.
[66] *Ibid.*, (S. Hindelang, A. Moberg, n. 31), p. 1437.
[67] *Ibid.*, (*Opinion 2/15*), paras. 36, 84.
[68] *Ibid.*, (M. Cremona, n. 59), p. 40.

Article 207(6) excludes the exercise of competencies conferred by CCP to encroach upon the delimitation of competencies between the Union and the Member States. This means that it prevents the exercise of CCP competence by the EU externally from having a pre-emptive effect on shared competence within the internal market.[69] While Regulation 2019/452 may initially establish a framework for non-voluntary existing and future national mechanisms, it can also be viewed, to a certain level, harmonizing the scope and the procedures, as encroaching upon the internal market competence that is shared. This can raise eyebrows, especially given that the Commission would choose to adopt Regulation 2019/452 based on provisions on the free movement of capital,[70] then Article 64(3) TFEU "laying down procedure for harmonization of the movement of capital to or from third countries", requires a special legislative procedure.[71] A unanimous agreement would be required instead of a qualified majority vote by the Council under the ordinary legislative procedure used to adopt Regulation 2019/452 under CCP.

1.1.2. An Exotic Animal

To continue on the same note of the peculiarity of Regulation 2019/452, its nature was best described by AG Ćapeta in her opinion in *Xella Magyarország*, discussed in more detail in Section 2.1.2., who referred to it as "a kind of platypus, a strange creature" during the comparison of this Regulation to the typical type of regulations.[72] One must note that it is quite uncommon for AGs to address animals in their opinions.[73]

First, she notes that since the entry into force of the Lisbon Treaty, investments enabling effective participation of the foreign investor or control over the target are covered by two different competencies. One exclusive, excluding unilateral action by the Member States, and

[69] *Ibid.*, (M. Cremona, n. 59), p. 41; Case C-414/11 *Daiichi Sankyo* [2013], ECLI:EU:C:2013:520, para. 59.
[70] Article 64(2) TFEU applies to measures on the movement of capital to or from third countries involving direct investment; *Ibid.*, (S. Hindelang, A. Moberg, n. 31), p. 1444.
[71] Council's unanimous vote, unlike under Article 207(2) TFEU, only qualified majority vote is required.
[72] Opinion of AG Ćapeta in C-106/22 *Xella Magyarország Építőanyagipari Kft* [2023], ECLI:EU:C:2023:267, para. 32.
[73] However, there are opinions where AGs unleash their creative spirits to make the legal issue more approachable. See, for example: A Star Wars reference in the Opinion of AG Bobek in Case C-40/17 *Fashion ID GmbH & Co.KG*, [2018], ECLI:EU:C:2018:1039, para 89; or a comparison of national courts to Sisyphus from the Greek mythology in the Opinion of AG Colomer in Case C-461/03 *Gaston Schul*, [2005], ECLI:EU:C:2005:415, para. 2–5.

other shared, allowing Member States to act as long as they are not preempted by measures adopted at the EU level.[74]

She observes that under Article 288 TFEU, through regulation, the Union enacts rules binding and directly applicable in all Member States. However, Regulation 2019/452 neither imposes binding rules nor introduces a common FDI screening mechanism. It authorizes, yet does not oblige, Member States to introduce legislation governing the FDI screening. A framework for common standards that such national mechanisms must comply with is, thus, conditional upon the choice of the Member State to establish such a mechanism.[75]

She concludes that the practical outcome of the legal context behind Regulation 2019/452 is as follows: In the area of exclusive competence, Member States may act only if so empowered by the Union.[76] By the Commission authorizing the Member States to continue and introduce the national screening mechanisms, Regulation 2019/452 must be viewed as the Union giving back the lost competence to the Member States.[77] Similarly, Hingelang and Moberg, note that "the Regulation turns exclusive competence largely upside down, by handing a large chunk of the actual powers to regulate the screening of FDI back to the Member States."[78]

1.2. The Scope

This Section provides a step-by-step analysis of the scope of Regulation 2019/452. For clarity, investors must foresee whether their investments in the EU will undergo screening in the relevant Member State. Therefore, the scope is the most crucial point of every legislative analysis of FDI. By defining FDI, this Section sets out to *what* and to *whom* the screening applies.

The definition of FDI is reached in an analysis that narrows down from the broadest "investments" to a category of "direct investments". The definition of direct investments focuses on showing what distinguishes them from all investments. By adding the "foreign" element, we reach the full definition of FDI. Lastly, this Section explains the exception allowing for the

[74] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 29.
[75] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 32.
[76] Article 2(1) TFEU.
[77] *Ibid.*, (M. Cremona, n. 59), p. 35 and *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 33.
[78] *Ibid.*, (S. Hindelang, A. Moberg, n. 31), p. 1446.

screening of EU investors and analyzes how Regulation 2019/452 overlaps freedom of establishment and free movement of capital.

1.2.1. Investment as "Capital Movement"

Generally, investment is best characterized as a capital commitment with the expectation of profit and risk assumption.[79] The investor moves the capital to the target with the expectation of return. Union law refers to investment as a "capital movement" protected under the free movement of capital.[80]

Article 63(1) TFEU prohibits restrictions on all capital movements between Member States and between Member States and third countries. It is evident from this provision that the Union protects capital that crosses the border either from another Member State or a third country. Article 65(1)(b) provides an exception to this restriction prohibition. Member States may restrict investment from investors established in another Member State or third country if justified by public policy and security grounds.[81] On the same grounds as under free movement rules, Regulation 2019/452 allows Member States to subject direct investment from third-country to the screening requirement.[82]

While Article 63(1) TFEU protects cross-border capital movements, the Treaty does not define what should be understood under the "capital movement".[83] Dimpoulous explains that even under international law, "investment" as such lacks a precise definition. The reason behind the legislator's intent not to define investment is to allow a dynamic interpretation. Therefore, most international investment agreements would list an exhaustive or non-exhaustive list based on the

[79] See, for example: Article 15 of the US-Singapore FTA, which provides that in order for a transaction to constitute investment, it must meet the above-mentioned basic characteristics of investment.
[80] *Ibid.*, (Proposal for a Regulation establishing a framework for screening of foreign direct investments into the European Union), p. 4.
[81] Actual prohibition of free movement is not required. The CJEU held that even a measure that is likely to deter investors amounts to a restriction. See: Case C-112/05 *Commission v Germany* [2007], ECLI:EU:C:2007:623, para. 19.
[82] Article 3(1) of Regulation 2019/452.
[83] The literature provides that openly phrased wording was the result of the deliberate aim of the drafters who wished for a timeless provision that could accommodate future developments of the capital markets and economic reality. S. Hindelang, *Foreign Direct Investment and the Material Scope of Application of Article 56(1) EC*, in S. Hindelang (ed.), Free Movement of Capital and Foreign Direct Investment, 2009, Oxford University Press, p. 43–44.

needs of the parties to protect particular investment types.[84] He adds that in the Union's case, inward investment from third countries, mainly linked with instruments of protection, traditionally fell under the competence of the Member States. Intra-EU investments were protected under different terminology, as protection of establishment further discussed in Section 1.2.2., influencing the language used in the investment control.[85] Despite the Treaty's silence on the definition of capital movement, to this day, the annexed non-exhaustive list to Directive 88/361[86] provides the most detailed definition. Hence, the Court notoriously relied on this secondary law instrument as guidance in determining what constitutes capital.[87]

Utilizing the nomenclature in Directive 88/361, the Court concluded that a movement of capital must be "concerned with the investment of the funds in question".[88] Thus, the essence of the capital movement is its purpose of "financial investment"[89] or pursuit of an "economic activity".[90] A similar conclusion is reached by Dimopulous, who notes that such characterization led to the Court's indirect acknowledgment that as in most international instruments, profit expectation and risk assumption are the basic characteristics of capital movements linked to investments.[91] The following subsection discusses "economic activity," pursuit as a distinguishing factor between direct investment and investments in general.

1.2.2. Direct Investment

Direct investment is a category of capital movements. Not all investments (capital movements) constitute "direct investment". Direct investment is a category of capital movement. While capital movements cover a broader range of operations, such as portfolio investment (acquisition

[84] He uses explanation by Delaume, one of the main negotiators of the ISCID Convention as and example, and adds that the drafters explained that the limited definition would have arbitrarily limited the scope, making it impossible for the parties to refer the dispute to the Centre disputes which would be considered as a genuine dispute by both parties. See: *Ibid.*, (A. Dimopoulos, n. 3), p. 22–23.
[85] *Ibid.*, (A. Dimopoulos, n. 3), p. 36.
[86] Annex I of the Council Directive 88/361/EEC of 24 June 1988 on the implementation of Article 67 of the Treaty [1988], OJ L 178/5.
[87] C. Barnard, *Free Movement of Capital*, in C. Barnard (ed.), The Substantive Law of the EU: The Four Freedoms, 6th edition, 2019, Oxford University Press, p. 523–524; Case C-222/97 *Trummer and Mayer* [1999], ECLI:EU:C:1999:143, paras. 21–24.
[88] Joined Cases 286/82 and 26/83 *Luisi and Carbone* [1984], ECLI:EU:C:1984:35, para. 21; Case 203/80 *Casati* [1981], ECLI:EU:C:1981:261, paras. 11–12; Joined Cases C-163, 165 and 250/94 *Sanz de Lera* [1995], ECLI:EU:C:1995:451, para. 33; *Ibid.*, (C. Barnard, n. 87), p. 524.
[89] *Ibid.*, (S. Hindelang, n. 83), p. 47.
[90] Case C-367/98 *Golden Shares I* [2002], ECLI:EU:C:2002:326, para. 38.
[91] *Ibid.*, (A. Dimopoulos, n. 3), p. 39.

of shares without the intention of participating in the management of the undertaking),[92] inheritance,[93] or physical currency,[94] direct investment presupposes the pursuit of *economic activity*.[95]

The nomenclature in Directive 88/361 associates direct investment with the establishment and extension of lasting direct links between the person providing the capital and the target to which the capital is made available to carry on an economic activity.[96] Hindelang explains the direct link as when the investor is put into a position to pursue entrepreneurial aims.[97]

The nomenclature in Directive 88/361 lists four examples of direct investment:

1) The investor owns all shares in the existing undertaking or a newly extended branch;
2) The investor participates in new or existing undertakings with a view of establishing or maintaining lasting economic links;
3) The investor provides a long-term loan to the target with a view to establish or maintain lasting economic links;
4) The investor reinvests the profits to maintain lasting economic links.[98]

The first situation is the most straightforward. By all shares belonging solely to the investor, they exercise the control.[99] The remaining situations are more problematic. The Court is unclear as to what *lasting economic links* are supposed to mean. It consistently holds that lasting economic links enable the investor to *effectively participate in the management and control* of that target.[100]

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[92] Joined Cases C-282 and 283/04 *Commission v Netherlands* [2006], ECLI:EU:C:2006:608, para. 19.
[93] Case C-513/03 *Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst* [2006], ECLI:EU:C:2006:131, para. 41.
[94] Joined Cases C-358 and 416/93 *Bordessa* [1995], ECLI:EU:C:1995:54, para. 13.
[95] *Ibid.*, (C-367/98 *Golden Shares I*), para. 38.
[96] *Ibid.*, (Annex I of the Directive 88/361); Ibid, (C-112/05 *Commission v Germany*), para. 18.
[97] *Ibid.*, (S. Hindelang, n. 83), p. 70.
[98] *Ibid.*, (Explanatory Notes of the Annex I of Directive 88/361).
[99] *Ibid.*, (A. Dimopoulos, n. 3), p. 39; Opinion of AG Alber in Case C-251/98 *C Baars* [1999], ECLI:EU:C:1999:502, para 34.
[100] *Ibid.*, (C-367/98 *Golden Shares I*), para. 38; Case C-174/04 *Commission v Italy* [2005], ECLI:EU:C:2005:350, para. 28; Case C-446/04 *Test Claimants in the FII Group Litigation* [2006], ECLI:EU:C:2006:774, paras. 179–181; *Ibid.*, (C-112/05 *Commission v Germany*), para. 18.

In summary, unlike all investments, such as portfolio investments, direct investment requires that the investor intends to establish or maintain long-term economic links with the target. In the clearest cases, the investor owns all shares of the target. The Court finds a lasting economic link when the investor can effectively participate in managing and controlling the target company. The following subsections clarify what is meant by effective participation in the management and control and then add the foreign element to the direct investment, distinguishing the direct investment from FDI.

1.2.2.1. Effective Participation in the Management and Control

The Court intentionally omits further guidance on what effective participation in the management and control of the target company means. Understandably, the Court avoids the limitation of factors not to narrow down the scope of direct investment. Instead, the application is left to the national courts that need to assess the facts on objective criteria and a case-by-case basis.[101] Therefore, effective management participation and control in this subsection are discussed using academic articles and international instruments.

Some international instruments, such as the OECD Benchmark Definition of Foreign Direct Investment, prescribe a holding of a minimum of 10 percent of the ordinary shares or voting power to exercise control over the target company.[102] Secondary Union law instruments on financial regulation, such as the Directive on the common system of taxation for parent companies and subsidiaries and the Directive on the annual financial statements of certain types of undertakings, establish control at a minimum holding of 10% and 20%, respectively.[103] The CJEU also excludes the possibility of effective control in holdings below 10%.[104] Qualifying holding in financial instruments closely relates to direct investment, with the difference that it does not require further assessments once thresholds are set and it provides more legal certainty.

[101] *Ibid.*, (C-446/04 *Test Claimants in the FII Group Litigation*), paras. 181–182.
[102] OECD Benchmark Definition of Foreign Direct Investment (4th ed. 2008), available at: https://www.oecd.org/investment/fdibenchmarkdefinition.htm, p. 17, 49.
[103] Article 3(1) of the Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345, 29.12.2011, p. 8–16; Article 2(2) of the Directive 2013/34/EU of the European Parliament and the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182, 29.06.2013, p. 19–76. See: *Ibid*., (Hindelang, *Foreign Direct Investment and the Material Scope of Application of Article 56(1) EC*), p. 71.
[104] Joined Cases C-436/08 and C-437/08 *Haribo* [2011] ECLI:EU:C:2011:61, para. 137.

In other words, a holding of 10% automatically qualifies, and further assessment is needed only if the holding is below 10%.[105] Hindelang calls such thresholds "magical numbers" and sees their necessity only for establishing criteria and for statistical purposes, requiring clear-cut and revisable criteria. He argues that magical numbers do not reflect reality since they cannot adequately provide answers to whether an investor is actually in a position to exercise control over their investments.[106]

In Hindelang's view, the investor exercises control when major or important entrepreneurial decisions cannot be reached without their consent. This can only be determined on an individual basis. His reasoning finds support in *Baars*, where the Court examined the Dutch company law to determine whether the investor can exercise his or her influence.[107] Hindelang proposes that looking into the national company law of the investment target could be one of the aspects courts should take into account when determining whether the investor exercises control over major or important entrepreneurial decisions. He also repeats that majority holding is not implied, minority stakes coupled with veto rights are also capable of allowing the investor to exercise control over major entrepreneurial decisions.[108]

In other words, in not-so-straightforward cases, a distinction of direct investment is left to an individual assessment. This evaluation should take into account the company law of the target and other relevant factors to determine whether the ownership or management structure actually allows the investor to exercise control over major business decisions of that target company.

1.2.2.2. The "Foreign" Delineation and "Foreign Investor"

The previous subsection more-or-less settled the definition of direct investment. One element still needs to be added to reach the full definition of FDI. Again, not all direct investments constitute FDI, but all FDI belongs to the category of direct investment. Based on the definition of "foreign" and "direct investment", Hindelang drafts a simplified general definition of FDI as

[105] B. J. de Jong, *The EU Foreign Direct Investment Screening Regulation: in Search of a Clear Concept of FDI*, Radboud Economic Law Conference Book: The Rise of Public Security Interests in Corporate Mergers and Acquisitions, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3981571, p. 3–4.
[106] *Ibid.*, (S. Hindelang, n. 83), p. 71.
[107] Case C-251/98 *Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem* [2000], ECLI:EU:C:2000:205, para 20.
[108] *Ibid.*, (Hindelang, n. 83), p. 71.

when investors from one State establish or maintain direct economic links with the undertaking in another State, thereby pursuing economic activities in another State.[109]

Regulation 2019/452 defines FDI as:

"an investment of any kind by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry out 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."[110]

In effect, the definition of FDI in Regulation 2019/452 constitutes a definition of direct investment with the difference that it is made by a "foreign investor", corresponding to Hindelang's definition and the CJEU's case law defining control in direct investments. To have a full understanding of what constitutes the FDI for the purpose of this Regulation, it is necessary to look into the definition of a foreign investor.

Regulation 2019/452 defines the foreign investor as:

"a natural person of a third country or an undertaking of a third country, intending to make or having made a foreign direct investment."[111]

In the words of AG Geelhoed: "Any State that is not a Member State of the EU is a third country".[112] A foreign investor is therefore a natural or legal person of the non-EU country or established under the laws of a non-EU country. An investor established under the laws of the Member State, an EU investor, is not a foreign investor under Regulation 2019/452. The Regulation therefore does not apply to investments made by investors established under the laws of the Member States. In *Opinion 2/15*, the Court interpreted the FDI under Article 207(1) TFEU

[109] *Ibid.*, (S. Hindelang, n. 83), p. 65.
[110] Article 2(1) of Regulation 2019/452.
[111] Article 2(2) of Regulation 2019/452.
[112] Opinion of AG Geelhoed in Case C-452/01 *Ospelt* [2003], ECLI:EU:C:2003:232, para. 51.

in a similar manner as "direct investment" is defined under free movement rules. The Court held that the concept must be understood as encompassing:

"investments made by natural or legal persons of third State in the European Union and vice versa which enable effective participation in the management or control of a company carrying out an economic activity."[113]

The Court excludes minority or short-term investment from the domain enshrined under Article 207(1) TFEU by emphasizing that only investment leading to control or effective participation in the target covers economic activities which (in the circumstances of the EU-Singapore Free Trade Agreement) have an immediate effect on trade between the State and the EU.[114]

1.2.2.3. Anti-circumvention Mechanism

Regulation 2019/452 nevertheless applies to certain investments made by EU investors in cases of *wholly artificial arrangements that do not reflect economic reality*, where the investor is ultimately owned or controlled by a third-country undertaking or natural person.[115] Member States with screening mechanisms in place must maintain measures necessary to identify and prevent circumvention of the screening mechanisms and screening decisions.[116] These are cases where the investor deliberately exploits the more favorable regime of one Member State to circumvent the obligations of another Member State.

In wholly artificial arrangements, the CJEU accepts abuse as a justification for the limitation of free movement. The abuse is determined on a case-by-case factual basis.[117] The issue of wholly artificial arrangements, or abuse of rights to circumvent regulatory obligations is not new in the context of Treaty freedoms, as it concerns the residence of the company. In *Cadbury Schweppes*, the Court laid down the criteria for what constitutes a wholly artificial arrangement. It held that in addition to the intention, objective circumstances must also show that despite the formal observance of the conditions laid down by Union law, the objective pursued by the freedom of

[113] *Ibid.*, (*Opinion 2/15*), para. 82.
[114] *Ibid.*, (*Opinion 2/15*), para. 84.
[115] Recital 10 of Regulation 2019/452.
[116] Article 3(6) of Regulation 2019/452.
[117] Case C-212/97 *Centros* [1999] ECLI:EU:C:1999:126, para. 24-25; Case C-167/01 *Inspire Art* [2003] ECLI:EU:C:2003:512, para. 105; Case C-33/74 *Van Binsbergen* [1974] ECLI:EU:C:1974:131, para. 27.

establishment, that is the pursuit of genuine economic activity, has not been achieved.[118] In that case, a letterbox company, for example, would be regarded as a wholly artificial arrangement, since the company does not pursue a genuine economic activity in a Member State of the letterbox.

Zwartkruis and de Jong warn that from the practical perspective, foreign investors can still make investments via economically active EU entities with the same effect of circumventing the mechanism. Such cases, and even cases where the EU entity is not economically active, refer to the investor's intention, which is difficult to prove.[119]

In summary, while Regulation 2019/452 applies to direct investments made by a third-country investor to a target in the EU, it also applies to direct investments made by a third-country investor via an EU entity that appears to be an arrangement made to circumvent the screening mechanism. The conditions for abuse are established on a case-by-case basis.

1.2.3. Free Movement of Capital or Freedom of Establishment?

Direct investment is a category of "capital movement" within the meaning of Article 63(1) TFEU and, at the same time, in intra-EU investment cases, it equally constitutes establishment under Article 49 TFEU.[120] These two freedoms are the hardest to separate,[121] presenting opposite views on freedom should apply to direct investments. Some commentators suggest that direct investment overlaps both freedoms, and others exclude the application of the free movement of capital to direct investment, suggesting that only freedom of establishment applies. If we took the latter approach, third-country origin inherent to FDI would exclude the freedom of establishment from application to direct investments made by foreign investors. In short, no free movement

[118] Case C-196/04 *Cadbury Schweppes* [2006], ECLI:EU:C:2006:544, para. 64; K. Lenaerts, *The Concept of 'Abuse of Law' in the Case Law of the European Court of Justice on Direct Taxation*, Maastricht Journal of European and Comparative Law, Vol. 22, No. 3, 2015, https://doi.org/10.1177/1023263X1502200302, p. 336–340.
[119] W. Zwartkruis and B. de Jong, *The EU Regulation on Screening of Foreign Direct Investment: A Game Changer?*, European Business Law Review Vol. 31, No. 3, 2020, Kluwer Law International BV, p. 466.
[120] S. Hindelang, *The Influence of Competing Freedoms on the Scope of Application – Direct Investment between Free Movement of Capital and the Freedom of Establishment*, in S. Hindelang (ed.) The Free Movement of Capital and Foreign Direct Investment, 2009, Oxford University Press, p. 81; See: Article 65(2) TFEU and the second sentence of Article 49 TFEU.
[121] L. Flynn, *Free Movement of Capital*, in C. Barnard and S. Peers (eds.) European Union Law, 3rd. ed., 2020, Oxford University Press, p. 486.

provision would protect FDI,[122] leaving foreign investors without the possibility to challenge restrictions as contrary to the free movement of capital.

Traditionally, intra-EU direct investment evolved under the freedom of establishment.[123] In the overlapping cases, involving investments that allow investors to exercise a decisive influence, the Court examined national restrictions under freedom of establishment, concluding that there is no need to examine the rules in light of the free movement of capital.[124] This explains the use of case law concerning freedom of establishment to define control in Section 1.2.2.1.[125] The Court, therefore, delineated the freedom of establishment as protecting entrepreneurial investments and free movement of capital as protecting portfolio investments.[126] Concerning FDI, Snell and de Kok reject the application of a free movement of capital. They view that all direct investments fall exclusively within the ambit of the freedom of establishment. They find support in the judgment in *Test Claimants in the FII Group Litigation*, where the Court concluded that freedom of establishment only applies intra-Union, and therefore, third-country investors cannot invoke this right.[127] Such reading supports the claim that third-country investors cannot rely on any Treaty provisions with respect to restrictions on their FDI transactions in the EU.[128]

On the other hand, the Court's "ignorance" to answer whether the national restriction is contrary to the free movement of capital, after holding it contrary to freedom of establishment, can also be read as the Court not viewing the two freedoms as competing. Hindelang points to the judgment in *Verkooijen*. After the Court assessed the restrictions under the free movement of capital, assessment under the freedom of establishment was regarded as merely unnecessary.[129] Therefore, whether the application of one freedom excludes the application of another has not

[122] *Ibid.*, (S. Hindelang, n. 120), p. 81–82.
[123] Case C-221/89 *Factortame* [1991], ECLI:EU:C:1991:320, para. 20: The Court defined establishment as "the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period".
[124] *Ibid.*, (C-196/04 *Cadbury Schweppes*), para. 33; Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007], ECLI:EU:C:2007:161, para. 34.
[125] For instance, CJEU judgment and Opinion of AG in C-251/98 *Baars*.
[126] See: *Ibid.*, (C-251/98 *Baars*), para. 20; Case C-208/00 *Überseering* [2001], ECLI:EU:C:2001:655, para. 77; *Ibid.*, (C-221/89 *Factortame*), para. 20.
[127] J. Snell, *EU foreign direct investment screening: Europe qui protégé?*, European Law Review vol. 44, 2019, p. 138; *Ibid.*, (C-446/04 *Test Claimants in the FII Group Litigation*), para. 98; J. de Kok, *Towards a European framework for foreign investment reviews*, European Law Review vol. 44, 2019, p. 27.
[128] *Ibid.*, (W. Zwartkruis and B. de Jong, n. 119), p. 456.
[129] *Ibid.*, (S. Hindelang, n. 120), p. 90; Case C-35/98 *Verkooijen* [2000], ECLI:EU:C:2000:294.

fully been addressed. In turn, in *Commission v Italy*, the CJEU held that national measure precluding public undertakings from other Member States from effective participation in the management and control of Italian targets is contrary to the free movement of capital.[130]

In the Explanatory Memorandum accompanying the Proposal for Regulation 2019/452, the Commission lists the instrument as consistent with Article 63 TFEU, free movement of capital.[131] The Commission disregards the application of Article 49 TFEU, freedom of establishment, providing a simple explanation:

"Whereas Article 63 TFEU also applies to capital movements from third countries, Article 49 TFEU does not apply to the establishment of third country nationals in the EU. Thus the proposed Regulation does not affect the Treaty provisions on freedom of establishment."[132]

Depending on the view of whether or not FDI is excluded from the free movement of capital, one can either view Regulation 2019/452 as:

1) giving third-country investors rights to challenge the screening procedures and decisions in cases that would otherwise fall under freedom of establishment;[133] or
2) confirming that FDI also used to under Article 63 TFEU.

As a final point of the discussion, the application of screening mechanisms to intra-EU investments controlled by third-country investors, suspicious of evading the screening, suggests that Regulation 2019/452 touches upon the freedom of establishment more than admitted by the Commission in the original Proposal. When challenging a restriction imposed by the screening Member State, case law shows that it is more logical for an EU entity to rely on freedom of

[130] *Ibid.*, (Case C-174/04 *Commission v Italian Republic*), paras. 26–33; The Court reached contrary finding to AG Kokott, who concluded that restriction should be assessed under freedom of establishment. Opinion of AG Kokott in Case C-174/04 *Commission v Italian Republic* [2005], ECLI:EU:C:2005:138, para 22.
[131] *Ibid.*, (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), p. 4; See also: Recital 4 of Regulation 2019/452: "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.
[132] *Ibid.*, (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), p. 4.
[133] *Ibid.*, (J. de Kok, n. 127), p. 3.

establishment.[134] In other words, screening under Regulation 2019/452 is also capable of restricting the freedom of establishment in the case of abuse. Why do we use two internal market freedoms to address investments? Which freedom is the appropriate one for what situation?

The answer to these questions requires a study in itself. However, it is apparent from the wording of Regulation 2019/452 and above assessment of the EU's scope for FDI control that investments in general fall under the scope of free movement of capital. Intra-EU direct investments, where an EU investor seeks to pursue business activity in another Member State, are protected under the freedom of establishment.[135] This Treaty provision, however, does not apply to third-country investors. On the other hand, free movement of capital does. Therefore, since direct investment belongs to a category of investments, foreign investors should be able to rely on this provision under the free movement of capital, or on Regulation 2019/452 when faced with a restriction in one of the Member States.

1.2.4. Summary of Chapter I

This chapter introduced the broader scheme for EU FDI control and placed Regulation 2019/452 into the context of the free movement provisions and CCP. It interpreted the scope of FDI control under Regulation 2019/452 using internal market rules, CCP provisions, and CJEU case law. It aimed to answer the following questions: What is FDI, and who is the "foreign investor" under Regulation 2019/452? What makes this Regulation unique?

What is FDI?

First, investments (capital movements) were defined under the free movement of capital. Article 63(1) TFEU protects the act of making cross-border investments under the wording of "capital movements". The "capital movement", let alone "capital" or "investment" itself lacks a precise definition. In general terms, the act of investment entails the investor making a capital commitment with the expectation of return and risk assumption. To define what constitutes "capital movement" to this day, the Court utilizes the non-exhaustive list of examples in Annex I

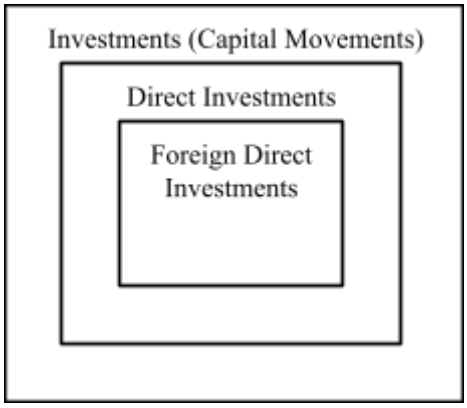
[134] W. van Zon, *The Application of Regulation 452/2019 in Response to Chinese Foreign Direct Investment*, Legal Issues of Economic Integration 50, no. 2, 2023, Kluwer Law International, p. 140.
[135] Article 49 TFEU.

of Directive 88/361. “Direct investment” constitutes a special category of investments, where the investor intends to establish or extend direct economic links with the target company. Under direct economic links, the Court views situations when the direct investment enables the investor to effectively participate in the management and control of the target undertaking. Whether or not the investor can effectively participate in the management or control of the target undertaking is left to a case-by-case assessment based on objective criteria. Examples of control would involve ownership of the majority of shares, or cases where the investor has minority stakes coupled with veto rights.

FDI, the investment type analyzed by this Thesis, constitutes a particular “direct investment” category. The distinguishing factor is the “foreign” element, in particular, that direct investment is made by a “foreign investor”. Regulation 2019/452 understands the foreign investor as a natural or legal person of a third country.

Direct investments by an EU entity traditionally evolved under the freedom of establishment. However, third-country nationals cannot rely on this freedom when challenging restrictions on FDI. The free movement of capital still includes a category of FDI. Regulation 2019/452 can be understood as confirming that foreign investors can rely on the free movement of capital when faced with restriction on FDI by a Member State or as giving rights to foreign investors to challenge the screening procedure or decision.

The figure below visualizes the FDI category within the capital movements structure.



The specialty of Regulation 2019/452

An FDI screening mechanism constitutes a prohibited restriction to the free movement of capital. Under free movement law, if justified based on the need to protect public order and security, Member States are allowed to restrict free movement. The specialty of Regulation 2019/452 lies in its wording as it allows but does not oblige Member States to maintain or establish a national screening mechanism to screen FDI.

Until the entry into force of the Lisbon Treaty, Member States did not require any authorization for national measures governing direct investment from third-country investors. However, the Lisbon Treaty placed FDI under CCP, falling under the exclusive competence of the Union, meaning that Member States were no longer able to act in this policy area without authorization. For this reason, the existence of Regulation 2019/452 can be understood as acting as a "catalyst" for the competence struggle and response to the increased demand of Member States screening foreign investment to protect their national security interests. If Regulation 2019/452 would have been an amicable divorce settlement, it would not have looked differently. The Union hands back a chunk of the lost competence to the Member States, leaving the discretion to introduce or maintain screening mechanisms with each Member State. At the same time, placing obligations on Member States having mechanisms to act within the common framework.

It is evident that Regulation 2019/452 does not fully harmonize national FDI screening mechanisms and came as a response to the changing global landscape and growing demand from the Member States to regulate inward investment from third countries. The Regulation also does not establish the FDI screening mechanisms on behalf of Member States, it only creates a common framework for the new or existing national mechanisms. This means that some Member States had control in place before its adoption, regulated under free movement rules. The following Chapter looks at how the Member States screen FDI in practice.

2. Foreign (Direct) Investment Under Regulation 2019/452 and in Practice

The first chapter provided that the screening is viewed as the Union giving back the lost competence, including much flexibility, to the Member States. When the legal instrument, as unconventionally worded as Regulation 2019/452, offers too much room to maneuver, its practical implementation is best described using a parallel to the Biblical myth of building the Tower of Babel.

FDI practically authorizes Member States to take matters into their own hands, but if they do so, they must remain in the minimally harmonized framework.[136] Approximately four thousand years later we managed to solve the language misalignment. This time, it is the system malfunction. The EU system of FDI screening is held on twenty-seven towers. Different criteria for FDI screening apply in each of these towers. Some towers look polished, some still have scaffolding on with workers applying the coating, and some do not exist at all. Now, imagine the definition of FDI as the foundation to build a tower. The first chapter established that FDI is a type of direct investment made by a foreign investor. However, under the twenty-seven towers, different criteria apply for who the "foreign investor" is and whether or not to screen foreign investors investing to pursue an economic activity via an EU entity. As a result, the Brussels headquarters tower, covering the EU's imaginary system of FDI screening towers currently looks like a straw house. The investor, in turn, has a hard time figuring out twenty-seven different rules, especially in complex cases where the intended investment concerns several jurisdictions.

Regulation 2019/452 regards the "foreign investor" as a third-country investor who intends to make or makes direct investment in the EU. In suspicion of abuse of the mechanism, it permits screening of EU investors controlled by third-country entities. Before the entry into force of Regulation 2019/452 twelve Member States already had existing mechanisms in place.[137] Some

[136] "Soft" harmonization through implied obligations arising out of cooperation mechanism: See: N. Tepeš, *Foreign Direct Investment in the EU – Future Perspectives and Implied Obligations*, Zbornik radova Pravnog fakulteta u Splitu, god. 60, 1/2023, p. 25.

[137] *Ibid.*, (Welcoming Foreign Direct Investment While Protecting Essential Interests, COM(2017) final 494, Brussels, 13.09.2017), p. 7.

Member States adopt stricter criteria and screen EU investors controlled by third-country nationals. Other Member States do not regard nationals of certain third countries as "foreign investors". There are also Member States which do not screen investors at all. This chapter shows how the national screening mechanisms differ from one another in the most fundamental aspect, the personal scope of FDI control.

Section 2.1. discusses the judgment in *Xella* that gives rise to the problems of the limited application of Regulation 2019/452, as applying strictly to third-country investors, not third-country investors investing in an EU entity. Section 2.2. puts forth data on national FDI screening mechanisms of five Member States and how they define "foreign investor". Section 2.3. analyzes the data collected and how the outcome of *Xella* judgment undermines the effectiveness of national screening mechanisms.

2.1. Case Study: C-106/22 Xella

Briefness seems to be a common denominator in the EU's FDI legal instruments and case law. However, the importance cannot be underestimated. Against the policy background set out in the previous Chapter and the Introduction, the shift in the EU's trade policy objectives from open market policies to concerns about national security lies in their translation into law. In *Xella*, the Court was essentially called to determine how much discretion Member States enjoy under the contemporary framework to screen FDI and possibly block the acquisitions by foreign investors on public order and security grounds. The issues raised in the *Xella*, therefore, have a constitutional dimension: from the competence question over FDI after its inclusion to the Lisbon Treaty under CCP, to the assessment of the concept of FDI under Regulation 2019/452 in comparison to the free movement of capital definition.

2.1.1. Case Facts

Xella Magyarország is a Hungarian company that manufactures concrete products. It has a vertical corporate structure: It is 100% owned by a German company, which is 100% owned by a Luxembourg company. The latter company is indirectly owned by the Lone Star group,

registered in Bermuda. This Bermudan company is a subsidiary of Lone Star Funds X, a U.S. private equity firm, the owner and founder of which is a natural person of Irish nationality.[138]

In October 2020, the Hungarian subsidiary of Xella concluded a sale agreement to acquire 100% of the shares in Janes és Társa, a company incorporated under Hungarian law that extracts gravel, sand, and clay. Under the Hungarian Law NO LVIII of 2020 on transitional provisions relating to the end of the state of emergency and the pandemic crisis ("**the Vmtv**")[139], Janes és Társa is a "strategic company". The Vmtv defines "foreign investor" as a natural or legal person from a third country,[140] but at the same time, it can also be a company registered in Hungary or another Member State where a third-country national exercises "majority control".[141] Therefore, pursuant to the Vmtv, Xella sent the Minister for Innovation a notification, requesting it to note the transaction concerned.[142] By the decision, the Minister prohibited the execution of the notified transaction on the grounds of "national interest".[143]

The Minister classified Xella's Hungarian subsidiary as a foreign investor within the meaning of the Vmtv because it is indirectly owned by a company registered in Bermuda.[144] Additionally, the Minister maintained that the security and foreseeability of the extraction and supply of raw materials were strategically essential and that disruption to the functioning of the global supply chains could harm the national economy. The Minister took the view that indirect ownership of Janes és Társa by a company registered in Bermuda would pose a long-term risk to the security of the supply of raw materials in the construction sector.[145]

Xella Magyarország challenged the decision before the Budapest High Court, arguing that the Minister's decision constituted arbitrary discrimination or a disguised restriction on the free movement of capital protected under Article 63 TFEU, and also of Articles 54 and 55 TFEU

[138] Case C-106/22 *Xella Magyarország Építőanyagipari Kft*, [2023], ECLI:EU:C:2023:568, para. 15.
[139] Article 276(3) of Law NO LVIII of 2020 on transitional provisions relating to the end of the state of emergency and to the pandemic crisis of 17 June 2020, Magyar Közlöny 2020/144, ('Vmtv').
[140] Article 276(2)(a) of the Vmtv.
[141] For "majority control", the Vmtv refers to a Civil Code that regards holding over 50% as majority control.
[142] Article 283(2)(b) of the Vmtv, having regard to Articles 276(1) and (2), Article 277(2)(a)(aa) and Article 283(1)(b) thereof.
[143] *Ibid.*, (Case C-106/22 *Xella*), paras. 19–22.
[144] Article 276(2) of the Vmtv.
[145] *Ibid.*, (Case C-106/22 *Xella*), paras. 23–24.

which afford, in parallel, the benefit of freedom of establishment to companies formed under the laws of a Member State.[146]

The referring court asked the CJEU whether Article 65(1)(b) TFEU, derogations from the free movement of capital, read in conjunction with Recitals 4 and 6 of Regulation 2019/452, preclude foreign investment filtering mechanism provided for by the legislation of a Member State, through which a resident company that is a member of a group of companies in the several Member States, over which an undertaking of a third country has decisive influence, may be prohibited from acquiring ownership of another resident company regarded as "strategic", on the ground that the acquisition could harm the national interest in ensuring the security of supply.[147]

In short, even though the issue at the main dispute concerned whether or not to uphold the contested decision, the referring court was also concerned whether the provisions of Vmtv conform with EU law and whether national FDI screening mechanisms can cover direct investments made by foreign investors through EU entities, the so-called "indirect" FDI.

2.1.2. Opinion of Advocate General Ćapeta

For the first part of AG's Opinion explaining the nature of Regulation 2019/452, please refer to Section 1.1.2. This analysis discusses parts of the opinion related to the scope of Regulation 2019/452, starting from Point 3. AG Ćapeta advised the Court to rule that Regulation 2019/452 allows for FDI screening of third-country origin, even if implemented via an EU company.

The AG first reiterated that the Court gave the same meaning to the FDI under Article 207(1) TFEU as under the internal market concept of "direct investment" concerning the intention of the investor to establish or maintain direct and lasting links with the target to which the capital is made available to carry out an economic activity.[148] The Commission submitted that EU undertakings cannot be subject to the FDI screening under Regulation 2019/452 because Article

[146] *Ibid.*, (Case C-106/22 *Xella*), para. 25.
[147] *Ibid.*, (Case C-106/22 *Xella*), paras. 26–27.
[148] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 23: with a reference to *Ibid.*, (*Opinion 2/15*), para. 82 and *Ibid.*, (C-446/04 *Test Claimants in the FII Group Litigation*), para. 181–182; *Ibid.*, (C-464/14 *SECIL*), para. 75–76; or Case C-326/07 *Commission v Italy* [2009], ECLI:EU:C:2009:193, para. 35 regarding lesser types of shareholding but nevertheless effective participation in the target.

2(2) defines the "foreign investor" as a person of a third country and under Article 54 TFEU the nationality of the company depends on the corporate seat, not the shareholding.[149] AG Ćapeta counter-argued that the concept of FDI under Article 2(1), in turn, encompasses *any type* of investment through which the foreign investor gains effective participation in or control over an EU undertaking:

"an investment of *any kind* by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry out 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."[150]

She added that based on this wording, the FDI concept must encompass *any type* of investment through which the foreign investor gains effective control over an EU undertaking and that consequently, Regulation 2019/452 applied to Xella Magyarország ratione personae.[151] In her view, there is no limitation on the structure of the investment process, meaning that both investments directly from a foreign investor and indirectly from a foreign investor via an EU entity fall within the scope of Regulation 2019/452. AG Ćapeta concluded that the essential element is *who ultimately gains control over the concerned EU undertaking*.[152]

She argued that interpreting the scope of Regulation 2019/452 and the definition of foreign investment strictly would counter its purpose. She added:

"Using the formal criterion of the company's seat, without considering who will acquire the ultimate control of an investment target would be to ignore both the reality of doing business as well as the purpose of the screening for FDI."[153]

[149] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 39–40.
[150] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 41.
[151] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), paras. 41–42.
[152] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), paras. 42–43.
[153] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 45.

Logically, in the case of acquiring 100% of the holding in Janes és Társa via Xella's EU entities and Xella Magyarország, or by Lone Star group, it is the Lone Star group established in Bermuda, which acquires the decisive control over the undertaking in question.

The Commission only admitted that an "indirect" FDI could fall within the scope of Regulation 2019/452 only in exceptional circumstances referred to in Recital 10 and Article 3(6), which require Member States that have screening mechanisms in place to adopt measures necessary to identify and prevent circumvention of the screening by investments made from within the Union. The AG pointed to the paradox that unless a Member State makes up a different instrument for that purpose, the act of establishing a circumvention of a screening mechanism requires the screening of a particular transaction. She concluded that to determine whether the arrangement via the EU entity constitutes an artificial arrangement, the transaction must, first of all, fall within the scope of Regulation 2019/452.[154]

In Ćapeta's opinion, Regulation 2019/452 precisely aims to prevent the potential third-country control where the investment could threaten security. She asked a rhetorical question about the difference between the foreign investor acquiring control over a strategic EU undertaking directly versus acquiring control over such an undertaking via an EU entity. In both cases, the foreign investor decides about the target's future. The essence remains: the foreign investor exercises control over the target. Consequently, she advised the Court to include investments made via EU-based entities to fall within the scope of Regulation 2019/452.[155]

She also reminded that screening does not automatically imply blocking without considering possible mitigating factors and remedies. On the other hand, subjecting the acquisition of an EU company by foreign investors to screening in itself constitutes a restriction to free movement.[156] Lastly, she noted that in an area where two competencies overlap, the legislature must pay attention to concerns arising in both areas. Therefore, the instrument must consider free movement rights despite legislation based on Article 207(1) TFEU. Despite allowing Member

[154] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), paras. 46–48.
[155] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), paras. 48–49.
[156] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 50 with a reference to case-law on free movement of capital: *Ibid.*, (Joined Cases 286/82 and 26/83 *Luisi and Carbone*), para. 34; *Ibid.*, (Joined Cases C-358/93 and *Bordessa*), paras. 24–26; *Ibid.*, (Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*), para. 24.

States to screen FDI on public policy and security grounds, the Regulation cannot evade the requirements of Article 65(1) TFEU.[157] Regulation 2019/452 reflects the justifications under Article 65(1) TFEU and in the same manner, proportionality criteria apply to restrictions under the Regulation.[158] With that said, she called for the proportionality assessment of the decision under Article 65(1) TFEU.[159]

2.1.3. The Judgment

Contrary to the AG's teleological interpretation, the Court held that the acquisition falls outside the scope of Regulation 2019/452. The Court narrowly interpreted the scope of the Regulation by limiting "foreign investor" and "undertaking of a third country" to investments into the Union only made by investors constituted or otherwise organized under the laws of a third country.[160]

The Court looked at the definition of FDI deriving from Article 2 of Regulation 2019/452. It noted that for an investment to constitute FDI, it must have a lasting and direct holding by a "foreign investor". As per the definition of "foreign investor", Regulation 2019/452 defines them as a natural person or an undertaking of a third country, which the Court interpreted as referring to "an undertaking constituted or otherwise organized under laws of a third country."[161] Therefore, it held that Regulation 2019/452 is limited to investments made by undertakings constituted or otherwise organized under the laws of a third country.[162]

The Court noted that the national screening mechanism at issue in the main proceedings also applied when investments were made by undertakings incorporated under Hungarian law or under laws of other Member States, over which an undertaking registered in a third country exercised majority control. The Court explained that the situation where a foreign investor acquires control over the EU target via an EU undertaking was not covered by Article 1 of Regulation 2019/452 and, consequently, fell outside its scope.[163]

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[157] Recital 4 of Regulation 2019/452.
[158] Article 4 of Regulation 2019/452 laying down a non-exhaustive list of factors Member States can take into consideration when determining whether the transaction likely affects public policy or security.
[159] *Ibid.*, (Case C-106/22 *Xella*), paras. 51–54.
[160] *Ibid.*, (Case C-106/22 *Xella*), paras. 29–32.
[161] *Ibid.*, (Case C-106/22 *Xella*), para. 31.
[162] *Ibid.*, (Case C-106/22 *Xella*), para. 32.
[163] *Ibid.*, (Case C-106/22 *Xella*), paras. 33–34.

Even though Article 4(2)(a) and Article 9(2)(a) of Regulation 2019/452 prescribe that the ownership structure of the foreign investor may be taken into account as a factor of risk, the Court concluded that they cannot be taken into account because they apply expressly to the ownership structure of the foreign investor. This concept is limited to undertakings of a third country. Again, the Court emphasized that the scope of the FDI Regulation cannot be extended to include investments made by undertakings organized under the laws of a Member State over which an undertaking of a third country has majority control.[164]

Moreover, the Court held that the decision at issue was not taken to counter an attempt to circumvent the screening mechanism within the meaning of Article 3(6) of Regulation 2019/452, nor there is anything to suggest that the transaction and corporate structure of Xella would not reflect economic reality or be executed employing artificial arrangements.[165]

Finally, since the contested decision related to the acquisition by a foreign investor through an EU entity of a shareholding in another EU company that enables the holder to exercise a definite influence over the target's decision, the Court concluded that it was not Article 63 TFEU but Article 54 TFEU that applied.[166] The Court reiterated that companies formed in accordance with the law of a Member State enjoy the freedom of establishment because it is the location of the registered office or central place of administration or principal place of business that serves as the connecting factor to the legal system of the Member State, not the origin and the nationality of the shareholders.[167] Therefore, Xella had the right to rely on the freedom of establishment despite the third-country nationality of the ultimate parent company. The Court then conducted a proportionality assessment.[168]

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[164] *Ibid.*, (Case C-106/22 *Xella*), paras. 35–37.
[165] *Ibid.*, (Case C-106/22 *Xella*), paras. 38–39 with regard to Recital 10 of Regulation 2019/452.
[166] With regard to CJEU judgment in Case C-563/17 *Associao Peco* [2019], ECLI:EU:C:2019:144, paras. 43–44.
[167] *Ibid.*, (Case C-106/22 *Xella*), paras. 41–4: Citing *Ibid.*, (C-167/01 *Inspire Art*), para. 97 as the company registered office and seat as the connecting factor to the legal system of the Member State and Case C-80/12 *Felixstowe Dock and Railway Company and Others* [2014], ECLI:EU:C:2014:200, para. 40 as the origin of the shareholders having no impact on whether or not the EU entity has the right to rely on freedom of establishment.
[168] *Ibid.*, (Case C-106/22 *Xella*), paras. 60–73.

2.1.4. Preliminary Observations

The judgment is divided into two parts. The first deals with the choice of the EU legislation applicable to the situation and the second establishes which internal market freedom applies to the case and whether the decision amounts to an unjustified restriction of that freedom. The outcome of the first part depended on the definition of FDI. Therefore, the AG's opinion and judgment provided a crucial dive into the notion of FDI under Regulation 2019/452.

2.1.4.1. Non-application of Regulation 2019/452

The Court interpreted the scope of Regulation 2019/452 as limited to direct investments in the EU target by undertakings constituted or otherwise organized under the laws of a third country. The CJEU's literal interpretation departed from the opinion of AG Ćapeta who, using the purpose of the Regulation to allow Member States to screen investments of third-country origin on the grounds of public policy and security, concluded that the conclusive factor in determining whether Regulation 2019/452 applies lies on the ultimate person acquiring control over the EU target.

2.1.4.2. Foreign Direct Investment

In this part, it is necessary to settle the "direct investment" under the internal market rules and Regulation 2019/452. Again, Regulation 2019/452 defines FDI as:

"an investment of any kind by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity in a Member State, including investments which enable effective participation in the management or control of a company carrying out an economic activity".[169]

Regulation 2019/452 incorporates the "direct investment" in the nomenclature under Directive 88/361 and the CJEU case law in the free movement definition, using the investor's intent as "aiming to establish or maintain lasting and direct links."

[169] Article 2(1) of Regulation 2019/452.

Concerning FDI under Regulation 2019/452, both the AG and the Court discuss the "direct" as whether made directly by an investor of a third country, or indirectly via an EU undertaking. This can be confusing, since under the free movement rules, the direct and indirect dichotomy is used to differentiate between investments where the investor pursues an economic activity or portfolio investments where the investor does not intend to control the target.

In summary, "foreign investment" in FDI would constitute a direct type of investment according to the internal market rules, with the difference that a foreign investor makes it. The differentiation between "direct" and "indirect" in FDI control distinguishes whether the foreign investor invests directly or via an EU entity. A "foreign investment" would be an indirect FDI in this case.

Another interesting point raised by the AG is the "investment of any kind" in the definition of FDI under Regulation 2019/452. She used it to interpret the Regulation as covering forms of indirect foreign investment. However, it could as well have been a legacy from the nomenclature in Directive 88/361, where the explanatory notes enumerate four examples of investment instruments through which investor can gain control over the target, such as acquisition of shares, long-term loans, reinvestment of profit or other participation in the new or existing undertaking. By narrowly interpreting the scope of Regulation 2019/452, the Court indirectly leaned towards the latter interpretation, i.e., that "any kind" refers to the instrument, not execution style.

2.1.4.3. Foreign Investor

To reach the definition of "foreign (direct) investment", the definition of "foreign investor" is vital. Undoubtedly, the foreign investor was a natural or legal person in a third country.

The disputed part of this notion was whether to strictly limit the definition to the company's seat or regard EU undertaking controlled by the third country entity as foreign. Following the strict interpretation of foreign investor as an undertaking "organized under the laws of a third country" (or a physical national of a third country), the Court held that the latter is not covered by the scope defined in Article 1 of the Regulation and drew the line that Regulation 2019/452 cannot

be extended to include investments made by undertakings organized under the laws of a Member State over which an undertaking of a third country has majority control.

2.2. Twenty-Seven "Foreign (Direct) Investment" Screening Mechanisms: Twenty-Seven Definitions of "Foreign Investor" and "Foreign (Direct) Investment"

It may come as a surprise, but this time, Hungary is not the EU's only problem. This Section analyzes how Member States define "foreign investor" and what foreign investments they screen. Member States are not bound by the definitions of "foreign investor" and FDI under Regulation 2019/452. As this Section shows, they have developed their legal tests and, in certain cases, have extended the FDI screening process even to investors of EU origin.

This Section assesses the data in a comparative analysis. Since the purpose of the analysis is to identify the scope of national FDI screening mechanisms, the Member States five Member States were chosen from Member States that have such a mechanism in place. The particular Member States were deliberately chosen after preliminary research to ensure a diversity of approaches. In other words, the author intends to present five examples of approaches. Hence, a thorough analysis of the national laws of all Member States with screening mechanisms is not considered necessary. Due to the language barrier, the collected data from national laws directly translated using the available online tools are coupled with data provided by national legal practitioners of each Member State collected by the *International Comparative Legal Guides* published by the Global Legal Group,[170] websites of international organizations monitoring FDI regimes, and law firms, to ensure correct and contextual interpretation of the definitions.

2.2.1. Austria

The Austrian Investment Control Act (**"ICA"**)[171] expands the review of foreign investment in comparison to the regime under the previous Foreign Trade Act and implements Regulation

[170] ICLG.com, Foreign Direct Investment Regimes 2024, B. Adkins, S. Beighton (eds.), 16.11.2023, available online: https://iclg.com/practice-areas/foreign-direct-investment-regimes-laws-and-regulations#countrychapters, (accessed: 21.04.2024).
[171] Investitionskontrollgesetz 2020 (InvKG), BGBl. I Nr. 87/2020 v. 24.7.2020 ("**ICA**").

2019/452.[172] Under the ICA, the relevant authority[173] screens both direct and indirect investments made by foreign investors into Austrian undertakings active in one of the security-relevant sectors defined in the Annex of the ICA.[174]

A "foreign person" for the purpose of ICA is a natural person without EU citizenship or citizenship of an EEA State or Switzerland, or a legal person with its registered office or headquarters outside the EU, the EEA, and Switzerland.[175]

An "FDI" for the purpose of ICA is the "direct" or "indirect" acquisition of an Austrian company active in a sensitive area or other area where there may be a threat to public security and/or public order, or of voting rights of such a company, or controlling influence over such a company, or significant assets of such a company.[176] Since ICA screens indirect acquisitions, domestic transactions can be caught provided that the domestic investor has a foreign owner.

Lastly, ICA defines "exercise of controlling influence" over the target as a possibility of the investor having a decisive influence on the activities of the target through rights, contracts, or other means, individually or collectively, taking into account all the circumstances, even when minimum shares of voting rights have not been reached. This allows the national authority to screen particular cases where the thresholds triggering control are not met but the investor nevertheless exercises influence over the target.

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[172] UNCTAD, Investment Policy Monitor, *Austria – New Investment Control Act Widens the Scope of FDI Screening*, 25.07.2020, available at: https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3556/new-investment-control-act-widens-the-scope-of-fdi-screening, (accessed: 18.04.2024).

[173] The Federal Ministry for Labor and Economy.

[174] Part I of the Annex enumerates particularly sensitive areas in an exhaustive list, where lower thresholds triggering review apply (10%). Part II of the Annex lists a non-exhaustive list of areas critical for public order and security, where higher thresholds apply (25%).

[175] Article 1(2) of the ICA.

[176] Article 1(3) of the ICA and Article 1(6) of the ICA; V. Weiss, S. Schultz, *Foreign Direct Investment Regimes Austria*, ICLG – Foreign Direct Investment Regimes, 16.11.2023, available online: https://iclg.com/practice-areas/foreign-direct-investment-regimes-laws-and-regulations/austria, (accessed: 23.04.2024).

In summary, an investment to acquire control over the Austrian target made by non-EU, non-EEA, or non-Swiss ultimate beneficial ownership constitutes "foreign (direct) investment" under ICA.

2.2.2. Czech Republic

The Foreign Investments Screening Act enables the national authority[177] to assess whether the FDI might harm public order and security. It is also implements Regulation 2019/452.[178]

The Foreign Investments Screening Act defines "foreign investor" as anyone who has made or intends to make a foreign investment in the Czech Republic and is not a national of the Czech Republic or another Member State and does not have a registered office in the Czech Republic or another Member State or is directly or indirectly controlled by a non-national or undertaking not registered in the Czech Republic or another Member State.[179] A foreign investor is also a trustee of a trust fund if a founder, or the trustee of the trust fund in whose interest the trust is established, or another person able to control those persons, fulfills the above conditions.[180]

"Foreign investment" for the Foreign Investments Screening Act refers to assets in any form, which the foreign investor provided or shall provide to conduct economic activity in the Czech Republic and that enables that investor to effectively control that economic activity.[181]

The thresholds and definitions for "effective control over an economic activity" are provided in Article 5 of the Foreign Investment Screening Act. Similarly as in Austria, even if the thresholds of voting rights are not met, other factors may be taken into account to determine the control.

[177] Ministry of Industry and Trade of the Czech Republic.
[178] Article 1 of the Act no. 34/2021 Coll. on the screening of foreign investments and amendments of related laws ("**Foreign Investments Screening Act**") of 19.01.2021; J. Logesova, R. Pelikan, T. Naucova, T. Mrazkova, *Foreign Direct Investment Regimes Czech Republic*, ICLG – Foreign Direct Investment Regimes, 16.11.2023, available at: https://iclg.com/practice-areas/foreign-direct-investment-regimes-laws-and-regulations/czech-republic (accessed: 23.04.2024).
[179] Article 2(1) of the Foreign Investments Screning Act.
[180] Article 2(2) of the Foreign Investments Screening Act.
[181] Article 3 of the Foreign Investments Screening Act.

Interestingly, a situation where a change in the person of a foreign investor after the investment is made qualifies as a new transaction.[182]

In other words, in the Czech Republic, an investment to acquire control over a Czech target made by non-EU ultimate beneficial ownership constitutes a "foreign (direct) investment" under the Foreign Investments Screening Act.

2.2.3. France

France does not have a separate act for the FDI screening mechanism. However, the authority[183] requires prior authorization in certain foreign investments in strategic sectors under the French Monetary and Financial Code ("**MFC**").[184]

The relevant provisions of the MFC do not apply only to domestic transactions. A "foreign investor" is therefore an individual of foreign nationality, an individual of French nationality who is not a tax resident in France, a foreign legal entity, or a French legal entity controlled by one or more individuals or legal entities referred to above.[185] This means that not only, similarly to the Czech Republic, France takes into account the foreign control over the domestic entity, but France also regards any non-French investor as foreign.

MFC catches investments acquiring control of a French target, part of a branch of activity of such entity, crossing, directly or indirectly, alone or in concert with the threshold of 25% or 10% of ownership of the voting rights of such entity, whereas the lower threshold applies if the target is active in a regulated market. Higher thresholds apply to natural persons and undertakings of Member States and EEA States.[186] Article R 151-3 then enumerates what activities and industries constitute those of sensitive nature.

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[182] When the foreign investor gains another level of control enabling them to access the information and technologies important for the protection of the public order or security. See: Article 4 of the Foreign Investments Screening Act.
[183] French Ministry of the Economy.
[184] Article R. 151-3 of the French Monetary and Financial Code (the "**MFC**"); S. Walters, V. Netter, *Foreign Direct Investment Regimes France*, ICLG – Foreign Direct Investment Regimes, 16.11.2023, available at: https://iclg.com/practice-areas/foreign-direct-investment-regimes-laws-and-regulations/france, (accessed: 23.04.2024).
[185] Article R 151-1 of the MFC.
[186] Article R 151-2 of the MFC.

In summary, the French regime catches non-French investors; however, lower shareholding thresholds apply to non-EU/non-EEA entities.

2.2.4. Italy

Under Decree No. 21 of 15 March 2012 ("**Golden Power Law**"),[187] the government has special powers to approve or veto FDI to Italian targets carrying out strategic activities or holding assets with strategic relevance in Italy's critical sectors.[188] In March 2022 the Government enacted Law-Decree No. 21/2022 ("**Decree No. 21**")[189] introduced several amendments to the FDI screening regime,[190] among others, a pre-notification procedure that allows companies to do a self-assessment on the applicability of the Golden Power Law to their acquisitions, as prior, the Government enjoyed a significant discretion.[191] Neither the Golden Power Law nor Decree No. 21 defines "FDI" or "foreign investor".

The Decree No. 21 specifies conditions for notification for each of the listed sectors. For energy, telecommunication, and transport, in investments higher than EUR 1 million, a non-EU investor acquiring over 10% of the target must be notified. However, all investments affecting ownership, control, and availability of strategic assets and the creation of securities over assets in the field of

[187] Decree-Law 15 March 2012, n. 21 Rules regarding special powers on corporate structures in the defense and national security sectors, as well as for activities of strategic importance in the energy, transport and communication sectors ("**Golden Power Law**"), GU n.63 of 15-03-2012.
[188] L. Graffi, S. Scapin, *Foreign direct investment reviews 2023: Italy*, White & Case, 23.03.2023, available at: https://www.whitecase.com/insight-our-thinking/foreign-direct-investment-reviews-2023-italy, (accessed: 24.04.2024).
[189] Decree-Law 21 March 2022, n. 21 Urgent measures to counter the economic and humanitarian effects of the Ukrainian crisis ("**Decree No. 21**"), GU n.67 of 21-03-2022.
[190] UNCTAD, *Italy – Expands the scope and application of the FDI screening regime*, 22.03.2022, available at: https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3835/italy-expands-the-scope-and-application-of-the-fdi-screening-regime, (accessed: 24.04.2024).
[191] L. di Via, *Recent amendments to the Italian Golden Power Regime*: the pre-notification procedure, Clifford Chance, 23.09.2022, available at: https://www.cliffordchance.com/insights/resources/blogs/antitrust-fdi-insights/2022/09/recent-amendments-to-the-italian-golden-power-regime-the-pre-notification-procedure.html, (accessed: 24.04.2024).

defense are subject to notification. This extends to Italian and EU investors as well.[192] Decree No. 21 does not define considerations of the ownership structure of the Italian or EU investor.

In summary, depending on the sector type and transaction, even EU and Italian entities can be subject to relevant approval requirements.

2.2.5. Poland

In Poland, the Act on the Control of Certain Investments ("**ACCI**") covers the review of FDI, amended in July 2020 that substantially extended the list of sectors regarded as strategic[193] requiring approval from the authority.[194]

An Implementing Regulation of 16 December 2022 ("**Regulation**") provides a list of strategic companies requiring prior authorization, and the ACCI was amended to include a list of sectors of strategic companies subject to prior authorization.[195]

For companies listed in the Regulation, any transaction falls under the screening procedure. No foreign or domestic investor concept exists.[196] For Polish targets active in sectors listed in the ACCI Amendment, a "foreign investor" is a natural person without EU, EEA, or OECD citizenship and a legal entity that has not had a registered seat within the EU, EEA, or OECD country at least two years before the filing. EU, EEA, and OECD entities controlled by non-EU, non-EEA, and non-OECD entities qualify as foreign investors as well.[197]

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[192] L. Amicarelli, *Foreign direct investments in Italy: the revised golden power regime*, Allen & Overy, 25.03.2022, available at: https://www.jdsupra.com/legalnews/foreign-direct-investments-in-italy-the-6073239/?origin=CEG&utm_source=CEG&utm_medium=email&utm_campaign=CustomEmailDigest&utm_term=jds-article&utm_content=article-link, (accessed: 24.04.2024).

[193] J. Pietrasik, J. Michalski, *Foreign Direct Investment Regimes Poland*, ICLG – Foreign Direct Investment Regimes, 16.11.2023, available at: https://iclg.com/practice-areas/foreign-direct-investment-regimes-laws-and-regulations/poland, (accessed: 23.04.2024).

[194] Relevant Minister specified for each protected company under the Act; *Ibid.*, (J. Pietrasik, J. Michalski, *Foreign Direct Investment Regimes Poland*), Section 4.1.

[195] *Ibid.*, (J. Pietrasik, J. Michalski, n. 193).

[196] *Ibid.*, (J. Pietrasik, J. Michalski, n. 193).

[197] P. Mruk-Zawirski, *Act on the Control of Certain Investments – information on recent changes*, 06.07.2020, Allen & Overy, available at: https://www.allenovery.com/en-gb/global/news-and-insights/publications/act-on-the-control-of-certain-investments-information-on-recent-changes, (accessed: 24.04.2024).

ACCI does not have a definition of "foreign investment".[198] The Regulation lists thresholds for what is considered as the acquisition of control by either exceeding 50% of the total number of votes in the target's shareholder meeting or the target's share capital and acquisition of significant participation, i.e. acquisition of shares or rights exceeding 20%, 25% or 30% of the total number of votes.[199] The Amendment to ACCI does not list specific thresholds, for acquiring a participation in the target. It lists a threshold of at least 20% of the target's capital shares, or exceeding 20% and 40% of the total number of votes at the shareholder's meeting for establishing control over the target.[200]

In conclusion, the Polish regime covers domestic acquisitions of control of the target companies listed in the Regulation and acquisitions of control by non-EU, non-EEA, non-OECD entities or natural persons of companies active in the sectors listed in the Amendment of the ACCI. Acquisitions where the "foreign investor" controls EU, EEA, or OECD entities are covered as well.

2.2.6. Analysis of the National FDI Screening Regimes

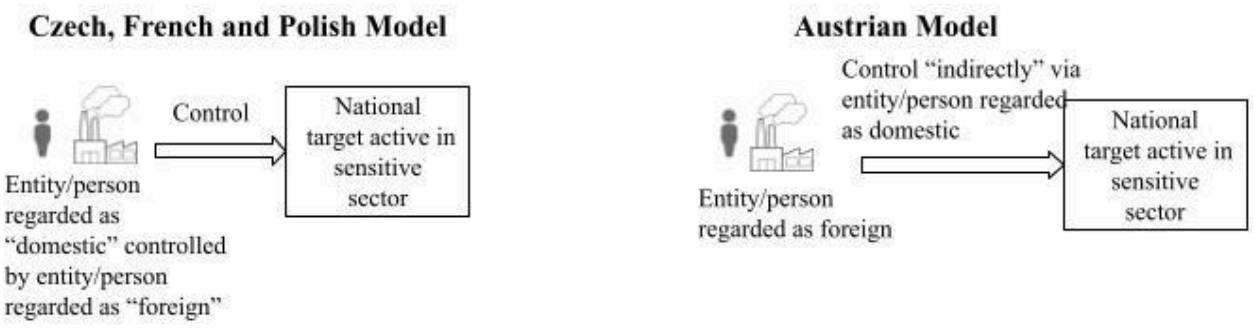
The data extracted from the national laws show three findings worth paying a closer look into:

1) Four out of five analyzed Member States screen "indirect" FDI;
2) Analyzed Member States have different criteria as to whom they regard as "foreign investor";
3) In four out of five analyzed Member States, screening is triggered in a cross-border situation.

[198] *Ibid.*, (J. Pietrasik, J. Michalski, n. 193).
[199] *Ibid.*
[200] A. Stefanowicz-Beranska, *New foreign investments control regime in Poland as of July 2024, 2020*, 27.07.2020, Dentons, available at: https://www.dentons.com/en/insights/alerts/2020/july/27/new-foreign-investments-control-regime-enters-into-force, (accessed: 24.04.2024); *Ibid.*, (P. Mruk-Zawirski, n. 197).

First, there are two ways to word "indirect" FDI in national laws: either through the definition of foreign investor or by including "indirect" acquisition of shares or control in the target via an undertaking that would be regarded as domestic.

The following figure illustrates the two ways in which "indirect" FDI is caught.



Regarding the second finding, some Member States extend the domestic investor status not only to persons and entities from other Member States but also to EEA, Swiss, or OECD nationals. The International In-house Competition Lawyer's Association warns, that different criteria for "foreign investor" are prone to trigger arbitrary outcomes as to what regulator should be notified about the upcoming investment. Imagine a situation where a Swiss investor invests in an undertaking active in several Member States with a seat in Austria, where all parts of the business in a strategic area reside. All ancillary business activities take place in other Member States. While such investment would not be notifiable in Austria, it may trigger filing in the Czech Republic, even though only ancillary business activities take place there.[201]

Lastly, except for Italy where in some situations even Italian investors are screened, the investment must occur in a cross-border situation, or have a cross-border element. As the judgment in Xella showed, the Court is generous in affording it.

[201] ICLA, *Screening of foreign direct investments (FDI) – evaluation and possible revision of the current EU framework: Consultation response from the In-House Competition Lawyers' Association*, Brussels, 14.07.2023, available at: http://competitionlawyer.co.uk/ICLA/Documents.html, (accessed: 24.04.2024).

2.3. Summary of Chapter II

If Member States screen FDI, Regulation 2019/452 sets the minimum standard. Member States, however, apply stricter standards and extend their screening mechanisms to "indirect" FDI. In *Xella*, the Court interpreted Article 2(1) of Regulation 2019/452 as limited only to investments made by investors organized under the laws of a third country, thereby excluding investments made by third-country investors via the EU entity. The CJEU ruled that the freedom of establishment covers the latter type of investments, whereas only investments made directly by a third-country investor are covered by Regulation 2019/452. As with any internal market freedom, the restriction, in the *Xella* case prohibition of acquisition, must be justified and proportionate.

Even though Article 2(2) of Regulation 2019/452 stipulates that a "foreign investor" is a national or undertaking of a third country, Member States, not bound by this definition, developed their own stricter criteria. As a result, EEA, Swiss, or OECD investors may not need to be screened in some Member States. It becomes problematic in cases where the EU target is active in several Member States, some of which may require screening. In the *Xella* judgment, the Court adopted a strict interpretation of the third-country undertaking as "undertaking constituted or otherwise organized under the law of a third country". Under Regulation 2019/452, Swiss, OECD, and EEA investors are considered foreign.

The vast majority of Member States analyzed, including Hungary, in the Xella case, screen "indirect" FDI in some form. Either through including a "foreign investment" into the definition, considering when the foreign investor invests via an entity deemed as domestic, or more frequently, including considerations of exercising control over the domestic entity in the definition of "foreign investor". The Court excluded that control and shareholding over the EU investor would have any bearing in determining whether that investor can be deemed foreign. Therefore, the scope of Regulation 2019/452 is limited only to FDI made directly by third-country nationals or undertakings constituted or otherwise organized under the law of a third country.

3. The Faith of the EU's FDI Control

The previous chapter started with a parallel to the Tower of Babel. It focused on showing the shaky foundations of the Brussels headquarters due to each of the twenty-seven national FDI screening towers applying different criteria for qualifying the "foreign investor", leading to a different interpretation of FDI. While the previous chapter highlighted the foundation cracks and holes in the Brussels straw house, the beginning of this chapter first pokes a few more holes in the leaking roof. However, it ends on a more positive note, focusing on how to consolidate the foundation and patch the holes while taking into consideration some of the engineering risks that legislators need to think of on the way toward an FDI screening system that is adequate and efficient.

The previous chapter concluded that, essentially, the ruling of the CJEU in *Xella* adopts the strict interpretation of Regulation 2019/452 and that intra-EU investments with third-country ultimate controller are outside the scope of Regulation 2019/452. It also found that not only Hungary but several other Member States screen intra-EU investments with third-country ultimate controller and that the "foreign investor" criteria also differ, resulting in some third-country investors being regarded as domestic. Section 3.1. provides deeper insights into the practical implications of the Xella judgment on the national FDI screening mechanisms.

As mentioned in the Introduction, on January 24th, 2024, the Commission released the Proposal for a new regulation, revising the FDI screening framework under Regulation 2019/452 and repealing this existing Regulation.[202] Section 3.2. analyzes the changes introduced by the Proposal to the definition of "foreign investor" and "FDI" concepts and addresses the improvements and risks of the envisaged changes. Section 3.3. draws from the CJEU's EU law concept case law and explores the possibility of FDI becoming a common EU law concept. A short chapter summary follows.

[202] European Commission, *Investment Screening*, [website], available at: https://policy.trade.ec.europa.eu/enforcement-and-protection/investment-screening_en#:~:text=The%20objective%20of%20the%20EU's,world's%20most%20open%20investment%20areas, (accessed: 28.04.2024); European Commission, Factsheet Economic Security – proposal for a new regulation on the screening of foreign investments, 24.01.2024, Brussels, available at: https://ec.europa.eu/commission/presscorner/detail/en/FS_24_367, (accessed: 28.04.2024).

3.1. Practical Implications of Xella Judgment for Member States' Existing Screening Mechanisms

What are some practical implications of the *Xella* judgment on the faith of national screening mechanisms? Has the Court ruled that Member States can only screen FDI made directly by third-country investors, or can the Member States unilaterally continue with screening indirect FDI?

The first subsection examines the practical implications of the judgment on the faith of the national mechanisms screening indirect FDI. The second subsection analyzes the practical procedural issues related to the cooperation mechanism under Regulation 2019/452.

3.1.1. One Clear Line Between Regulation 2019/452 and Freedom of Establishment and One Missed Opportunity

Safeguarding national security is a sensitive matter, and screening of FDI is, to a considerable extent, a highly political and discretionary decision.[203] Regulation 2019/452 does not harmonize the protection level of public order and security,[204] meaning that the Member States are, in principle, free to determine the requirements of public order and security in light of their national needs and then justify the restriction of the fundamental freedoms with reference to public order and security. Even though Regulation 2019/452 puts FDI screening under the CCP, in practice, internal market rules have consequences for investors. The Regulation itself acknowledges that it is without prejudice to the Member States' right to derogate from the free movement of capital under Article 65(1)(b) TFEU.[205] Depending on their place of business, the EU or foreign investors rely on either freedom of establishment or the free movement of capital as the standard of protection of their investments.[206]

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[203] A. Sandulli, *The Xella Case: Screening FDI is a matter of proportionality*, EU Law Live Symposium FDI Screening and the Fundamental Freedoms – Xella Judgment, (2023), p. 20.
[204] *Ibid.*, (S. Hindelang, A. Moberg, n. 31), p. 1452; Recital 4 of Regulation 2019/452: "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.
[205] Recital 4 of Regulation 2019/452.
[206] T. Shipley, *Where Investment Screening and the Internal Market Meet – Xella Magyarorszag (C-106/22)*, EU Law Live Symposium FDI Screening and the Fundamental Freedoms – Xella Judgment, (2023), p. 13.

Once the Court excluded the application of Regulation 2019/452 to the *Xella* case, it concluded that the case falls within the ambit of free movement rules and shall be settled under the freedom of establishment, given that Xella is an EU company.[207] On the merits, the Court found the national measure as constituting a restriction on the freedom of establishment, and in an extensive proportionality assessment, it concluded that security of supply in the construction sector justification does not constitute a public interest that could justify the restriction.[208] Peréz summarizes that the Court drew "a line in the sand for [FDI]".[209] Indirect FDI falls exclusively under the freedom of establishment. In contrast, direct FDI falls under the scope of Regulation 2019/452.

Let us think of what-if situation. What if the Court had followed the AG's opinion? What are the consequences of not following the AG's opinion? AG argued that the Regulation incorporates the justifications for the internal market freedom restrictions and, thereby, the general criteria for assessing the proportionality of the fundamental freedom restriction.[210] Shipley argues that by bringing intra-EU investments exclusively into the internal market framework, the Court excluded the legitimacy of national FDI screening regimes for EU investors.[211] Andreotti warns that excluding the application of Regulation 2019/452 to indirect FDI can lead to a paradoxical effect, where national authorities can abuse their screening activities concerning EU investors because of their foreign shareholding.[212]

The exclusion of intra-EU investment from the scope of Regulation 2019/452 does not preclude Member States from implementing such additional screening measures on indirect FDI to the extent that the restrictions comply with the Treaty rules on fundamental freedoms.[213] The Regulation establishes specific standards that protect investors against abuse of screening by

[207] *Ibid.*, (Case C-106/22 *Xella*), paras. 31, 41–44.
[208] *Ibid.*, (Case C-106/22 *Xella*), paras. 59, 69.
[209] A. Perez, *The Court of Justice draws a line in the sand for foreign investment screening: ruling in Xella Magyarország C-106/22*, EU Law Live Symposium FDI Screening and the Fundamental Freedoms – Xella Judgment, (2023), p. 7.
[210] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 53; N. Andreotti, *Screening of foreign direct investment within the Union: protection of essential interests or abuse of rights? (C-106/22 Xella Magyarország)*, EU Law Live Symposium FDI Screening and the Fundamental Freedoms – Xella Judgment, (2023), p. 6; See: Articles 3 and 4 of Regulation 2019/452.
[211] *Ibid.*, (T. Shipley, n. 206), p. 14.
[212] *Ibid.*, (N. Andreotti, n. 210), p. 6.
[213] *Ibid.*, (A. Perez, n. 209), p. 8.

Member States by imposing procedural rules on the national authorities. The Regulation excludes indirect FDI, so the procedural safeguards do not apply to EU investors with foreign control.[214] Therefore, as reasoned by AG Ćapeta, the market freedoms available to all EU entities could be disproportionately burdened simply because of foreign shareholding in those entities.[215] Interpreting the scope of Regulation 2019/452 to cover indirect FDI could have struck a balance between the rights of the EU investor and Member States' need to screen FDI.[216]

There is no doubt that circumvention of national screening mechanisms is possible using EU freedom of establishment after setting up or taking control of a company in another Member state that does not screen FDI.[217] However, as shown in Section 2.2.6., Member States screening FDI are likely to screen EU investors. Negating the application of Regulation 2019/452 to the indirect FDI leads to the opposite of what the legislator intended. This gives the possibility for national authorities to abuse the screening activities, leading to an increase in legal uncertainties for investors.[218]

3.1.2. Partial Pause to the Cooperation Mechanism

One could think that the Brussels headquarters tower serves as a formality since each Member State's tower does the actual work of FDI screening. The EU tower, however, fulfills a particularly important task in facilitating the exchange of information between the (now) twenty-two towers and the headquarters under the cooperation mechanism prescribed for in Articles 6 and 7 of Regulation 2019/452, fulfilling the second objective of the Regulation.[219]

In the place of exchange of information, Member States submit cases that they would screen under the national laws, including those by Union entities with a third country provenance, which the Court excluded from the scope of Regulation 2019/452. Can these cases be forwarded under the cooperation mechanism under Regulation 2019/452 after the *Xella* judgment?

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[214] *Ibid.*, (N. Andreotti, n. 210), p. 6.
[215] *Ibid.*, (N. Andreotti, n. 210), p. 6 ; *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), para. 53.
[216] *Ibid.*, (A. Perez, n. 209), p. 6.
[217] Recital 10 of Regulation 2019/452; S. Meunier, *Divide and conquer? China and the cacophony of foreign investment rules in the EU*, Journal of European Public Policy, 2014, Vol. 21, No. 7, Taylor & Francis, p. 1010–1011.
[218] *Ibid.*, (N. Andreotti, n. 210), p. 6.
[219] Article 1(1) of Regulation 2019/452.

Member States screen indirect FDI. In Austria specifically, the national FDI proceedings start after the EU cooperation mechanism has concluded.[220] This means that the authority conducts formal checks on whether the investor submitted all documentation, then forwards the information to the Commission and other Member States under the cooperation mechanism[221] that lasts 35 calendar days unless the authority enquires further information.[222] Only after that, the Austrian authorities open Phase 1 of the proceedings, which lasts approximately one month, and rarely, Phase 2 may last up to two additional months until the investment is authorized, conditionally authorized, or prohibited.[223]

Feldner and Frommelt propose that the ruling in *Xella* has implications for Austrian (and other) national screening mechanisms(s), where Member States screen indirect FDI concerning the cooperation mechanism. National mechanisms analyzed in the second Chapter screen indirect FDI and submit the information to the Commission and other Member States under the cooperation mechanism, prolonging the duration of the screening process. Intra-EU investments, however, fall outside of the scope of Regulation 2019/452.[224]

Under the principle of primacy, directly applicable Union law measures "render automatically inapplicable any conflicting provision of current national law."[225] Therefore, national authorities cannot forward indirect FDI falling under national laws but outside of the scope of Regulation 2019/452 to the cooperation mechanism. As a result, national authorities only forward direct FDI to the cooperation mechanism, and indirect FDI triggers the review at the national level only.[226]

3.2. The New Proposal: A Light at the End of the Tunnel

Finally, by looking into the future of FDI, this Thesis gains a positive angle. On January 24th, 2024, the Commission published a Proposal for a new screening regulation that is supposed to

[220] Article 15(5) of the ICA.
[221] J. Feldner, F. Frommelt, *'Time out' for EU cooperation mechanism in Austria due to Xella (C-106/22)*, EU Law Live Symposium FDI Screening and the Fundamental Freedoms – Xella Judgment, (2023), p. 17.
[222] Article 6(1) and Article 7(2) of Regulation 2019/452.
[223] *Ibid.*, (J. Feldner, F. Frommelt, n. 221), p. 17.
[224] *Ibid.*
[225] Case 106/77 *Simmenthal* [1978], ECLI:EU:C:1978:49, para. 17.
[226] *Ibid.*, (J. Feldner, F. Frommelt, n. 221), p. 17–18.

repeal Regulation 2019/452. The accompanying documents of the Proposal admit that the institutions are aware of the need to address the shortcomings of Regulation 2019/452. The Commission notes that currently, there is only little framing as to its scope.[227] Similarly, the European Court of Auditors warned that there are "significant divergences across the screening mechanisms of Member States," causing legal uncertainty.[228]

With the Commission's duty to evaluate the functioning and effectiveness of the Regulation no later than three years after its implementation,[229] the Commission poetically summarized that "the chain is only as strong as its weakest link", [230] and found that a new legislative instrument is necessary to address the critical shortcomings in the effectiveness of FDI screening into the Union. This Section evaluates the changes introduced by the Proposal.[231]

3.2.1. An Overview of the Proposal

As Regulation 2019/452, the planned regulation pursues a double objective of establishing a Union framework for the screening by Member States of FDI in their territory on the public policy and security grounds and establishing a cooperation mechanism.[232] Screening will remain in the realm of Member States, which will be obliged to screen.[233] The shift to a compulsory nature intends to close the compliance gap in the remaining four Member States, which do not have any mechanism in place.[234] The Proposal expands the scope of Regulation 2019/452 by including indirect FDI. The following subsection discusses the proposed definitions in detail.

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[227] European Commission, Commission Staff Working Document, Evaluation of Regulation (EU) 2019/452 of the European Parliament and the Council of 19 March establishing a framework for the screening of foreign direct investments into the Union, SWD(2024) 23 final, Brussels, 24.01.2024, p. 37–38.
[228] European Court of Auditors, Special Report, Screening foreign direct investments in the EU – First steps taken, but significant limitations remain in addressing security and public-order risks effectively, Publications Office of the European Union, Luxembourg, 24.10.2023, available at: https://www.eca.europa.eu/en/publications?ref=SR-2023-27, p. 5.
[229] Article 15(1) of Regulation 2019/452.
[230] *Ibid.*, (Evaluation of Regulation (EU) 2019/452, n. 227), p. 2.
[231] European Commission, Explanatory Memorandum to the Proposal, COM(2024) 23 final, 24.01.2024, Brussels, p. 2. (**"Explanatory Memorandum"**).
[232] Articles 1(1) and 1(2) of the Proposal.
[233] Articles 1(1) and 3(1) of the Proposal.
[234] Recital 7 of the Proposal; *Ibid.*, (Explanatory Memorandum), p. 1; Nearly 42% of FDI stocks are located in the Member States that do not screen. Almost 23% of FDI was in Member States that do not have a fully applicable FDI screening; *Ibid.*, (European Court of Auditors, Special Report, n. 228), p. 27.

Articles 3 and 4 set out minimum requirements for screening mechanisms. Annex I lists projects, and Annex II lists activities of particular importance for the security and public order of the Union. Member States will have to subject investments to targets active in one of the activities listed in Annex I and Annex II in their territory to prior authorization. Article 4 outlines procedural safeguards and minimum standards for national authorities and investors.

Articles 5 to 12 establish rules for the cooperation mechanism, such as conditions for investment that must be notified, information that Member States must supply, procedures regarding comments from other Member States and opinion of the Commission, channels for information exchange, confidentiality safeguards, time limitations, and a possibility for Member State to open own initiative procedure concerning unnotified foreign investment in another Member State likely to affect the security and public order.

Article 13 considers factors when determining whether foreign investment will likely negatively impact security and public order. Article 14 allows the national authorities to either authorize foreign investment likely to affect public order or security subject to mitigating measures or prohibit it. The decision must be proportionate and consider all circumstances of the investment. National authorities may authorize foreign investment without conditions if they consider that other measures under EU or national law appropriately address its effect on public order and security.

In summary, the Proposal is more concrete than Regulation 2019/452. It obliges the remaining Member States to establish screening mechanisms and imposes a higher degree of harmonization[235] by listing the activities in which targets are active. Subsequently, it imposes screening and notification requirements for the cooperation mechanisms on the Member States regarding foreign investment in those targets. At the same time, the Proposal indicates that the regulation is supposed to serve as a minimum harmonization tool, allowing Member States to adopt or maintain national provisions in fields not covered by the envisaged regulation.[236] The

[235] Recital 6 of the Proposal.
[236] Article 1(3) of the Proposal.

screening of foreign investments not covered by the proposed regulation shall nevertheless comply with the requirements of the regulation.[237]

3.2.2. Extended Scope

Regulation 2019/452 only covers direct FDI.[238] In reaction to increased security concerns over the past four years and the demand of the Member States that already screen indirect FDI, the Commission proposes that the new regulation shall also cover indirect FDI.[239] Recital 8 of the Proposal explicitly reflects the uneven playing field for investors in a system that varies in scope, deterring investors due to higher compliance costs and unpredictability, negatively affecting the internal market.

The definitions of FDI[240] and "foreign investor"[241] remain unchanged. The Proposal explicitly excludes investments through which the foreign investor does not intend to create or maintain lasting and direct economic links with the Union target, purely financial investments.[242] Article 2 of the Proposal, in addition to the FDI, defines "foreign investment". Article 2(1) of the Proposal defines "foreign investment" as:

"means a foreign direct investment or an investment within the Union with foreign control, which enables effective participation in the management or control of a Union target".[243]

Thus, EU investor with foreign control intending to exercise influence over the Union target will be caught. In screening indirect FDI, the Commission opts for a similar approach to that of Austria. Thus, rather than incorporating the control over an EU investor into the definition of the foreign investor, it proposes differentiating between direct FDI and indirect FDI as "FDI" and "foreign investment". To avoid confusion between internal market investment – direct investment, the Commission explicitly lists that "foreign investment" for the regulation is a form of FDI.

[237] Recital 11 of the Proposal.
[238] Recital 10 of the Proposal.
[239] Explanatory Memorandum, p. 3; Recitals 8–10.
[240] Article 2(2) of the Proposal.
[241] Article 2(6) of the Proposal.
[242] Recital 16 of the Proposal.
[243] Article 2(1) of the Proposal.

Two questions arise: How do we define foreign control over the EU investor? When does the foreign investor effectively participate in the target? The following two subsections will address these questions.

3.2.2.1. The Foreign Control over the EU Investor

Article 2(3) of the Proposal defines "investment within the Union with foreign control" as:

"means an investment of any kind carried out by a foreign investor through the foreign investor's subsidiary in the Union, that aims to establish or to maintain lasting and direct links between the foreign investor and a Union target that exists or is to be established, and to which target the foreign investor makes capital available in order to carry out an economic activity in a Member State."[244]

An intra-EU investment, according to the Proposal, means an investment of any kind via the foreign investor's subsidiary in the Union. Article 2(7) then deliberates that "foreign investor's subsidiary in the Union" constitutes:

"an economically active undertaking established under the laws of a Member State meeting the conditions set out in Article 22(1) of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013, and directly or indirectly controlled by a foreign investor".[245]

The first condition is that the investment must be made via an economically active EU undertaking. Nevertheless, the Proposal covers the anti-circumvention mechanism in Article 4(2)(b), ensuring that Member States have mechanisms to prevent abuse via artificial arrangements, such as economically inactive mailbox companies.

Article 22(1) of Directive 2013/34 lists four types of control by the parent over the subsidiary:

1) Having the majority of the shareholders' (or members') voting rights in the subsidiary;

[244] Article 2(3) of the Proposal.
[245] Article 2(7) of the Proposal.

2) Possessing a right to appoint or remove a majority of the administrative, management, or supervisory body members of the subsidiary while being a shareholder (or member) of that subsidiary;
3) Having a right to exercise a dominant influence over the subsidiary over which it is a shareholder (or member);
4) Exercising sole control, pursuant to an agreement with other shareholders (or members) in that subsidiary, a majority of shareholders' (or members') voting rights in that subsidiary.

In addition to the direct control, where the foreign investor exercises control over the EU subsidiary, the Proposal also includes indirect control. Thus, the authorities examine the ultimate controller. In the case of *Xella*, it would be the Lone Star Group, not the German or Luxembourg entity. On the one hand, this approach broadens the scope of screening mechanisms and provides national authorities with a greater understanding of the ownership structure of the foreign investor.[246] On the other hand, it expands foreign investor's right to rely on the new regulation and market freedoms, in cases like *Xella*, by broadening the cross-border element necessary to invoke them.[247] At the same time, the regulator will need to exercise a degree of caution not to subject FDI with only a remote link to the foreign investor to undergo screening procedures, as this could harm the functioning of the internal market and overly burden the EU investor.[248]

3.2.2.2. Establishing or Maintaining Lasting and Direct Link Between the Foreign Investor and the Union Target

The wording of "establishing or maintaining lasting and direct links with the target"[249] is identical to that of FDI under the secondary legislation in the free movement of capital and CJEU's case law. The Court only elaborates that direct and lasting economic links in the target enable the investor to "effectively participate in the management and control" of that target,[250] transcribed in the Proposal.[251]

[246] Recital 10 of the Proposal.
[247] *Ibid.,* (C-80/12 *Felixstowe Dock and Railway Company*), para. 24.
[248] *Ibid.*, (S. Hindelang, n. 83), p. 76.
[249] Article 2(3) of the Proposal.
[250] *Ibid.*, (C-367/98 *Golden Shares I*), para. 38; *Ibid.*, (C-174/04 *Commission v Italy*), para. 28; *Ibid.*, (C-446/04 *Test Claimants in the FII Group Litigation*), paras. 179–181; *Ibid.*, (C-112/05 *Commission v Germany*), para. 18.
[251] Article 2(1) of the Proposal.

The Proposal avoids setting thresholds for the percentage of share ownership, or Hindelang's "magical numbers".[252] This allows for flexible interpretation similar to internal market case law, where the Court leaves the assessment of the degree of control and participation in the management based on the facts on a case-by-case basis.[253]

Some Member States, in contrast, place thresholds in their national laws.[254] It remains to be seen what is the future of the thresholds under national screening mechanisms. The broader concept of effective participation and control in the new regulation than in Member States' national laws will likely serve the purpose of the cooperation mechanism. For example, it can allow other Member States to start their initiative procedure when investment falls outside of the threshold in another Member State, yet would de facto enable the investor to control or participate in managing the Union target. To ensure legal certainty for investors, it would not come as a surprise if the final wording of the new regulation included a particular shareholding threshold or excluded thresholds below 10%, which is unlikely to enable the foreign investor to control the target in the recital.

3.2.3. The Proposal vs Internal Market

In addition to Article 207 TFEU, the new regulation is also supposed to be based on Article 114 TFEU. The Commission justifies the additional legal basis by the need to approximate the laws of the Member States, which establish the internal market as their object, and the necessity to address the differences between the national screening mechanisms. Since the screening mechanisms restrict fundamental freedoms, they affect the functioning of the internal market.[255] Moreover, Article 114 TFEU allows the inclusion of investments made via Union subsidiaries with foreign control in the scope of the new regulation. This extends the coverage of Regulation 2019/452 solely based on Article 207(2), as it only captured direct FDI falling within the ambit of CCP.[256]

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[252] *Ibid.*, (S. Hindelang, n. 83), p. 71.
[253] *Ibid.*, (C-446/04 *Test Claimants in the FII Group Litigation*), paras. 181–182.
[254] For example, in Austria, in particularly sensitive areas lower thresholds triggering review apply (10%) and in areas critical for public order and security, where higher thresholds apply (25%).
[255] *Ibid.*, (Explanatory Memorandum), p. 10.
[256] *Ibid.*, (Explanatory Memorandum), p. 11.

The non-exhaustive list of areas where the Union target is active[257] and factors to take into account when determining whether the foreign investment has an impact on security[258] and public order confirm that the new regulation is supposed to encapsulate the justifications for the fundamental freedoms derogations, similarly as proposed by AG Ćapeta in *Xella* already in respect to Regulation 2019/452.[259] In this sense, Article 14(1), together with Recital 12, also reflect that Member States, even though empowered to subject FDI to limitations under CCP, the regulation must not evade the requirements under fundamental freedoms.

Moreover, Article 1(5), together with the Recital 11, permit Member States to impose additional limitations beyond the criteria of the proposed regulation, provided they are consistent with the permitted justifications under derogations from the free movement of capital and establishment.[260] In conclusion, the new regulation will correct the outcome of *Xella* by striking a balance between the rights of the EU investor and the Member States' need to screen FDI directly under the regulation. This will prevent the disproportionate burden on the freedom of establishment as the only available recourse for EU investors with foreign control.

3.3. A Chance for an EU Law Concept of FDI?

Similarly, as in *Xella* and *Opinion 2/15*, the Court is expected to play a role in interpreting the concept of FDI in the future under the new regulation. The Court has to interpret the provisions of EU law in preliminary rulings.[261] Where the legislation falls vague, there is an opportunity for the CJEU to develop the definitions and concepts in its case law. This Section provides a short commentary exploring the possibility of an EU law concept of FDI.

Under the principle of uniform interpretation of Union law, when provisions of EU law make no express reference to the laws of the Member States to determine their meaning and scope, the Court adopts an independent interpretation that should be uniform throughout the Union.[262] The

[257] Annex I and Annex II of the Proposal.
[258] Article 13 of the Proposal.
[259] *Ibid.*, (Opinion of AG Ćapeta in C-106/22 *Xella*), paras. 50–51.
[260] *Ibid.*, (Explanatory Memorandum), p. 4, Recital 9 of the Proposal.
[261] Article 267 TFEU.
[262] Case 327/82 *Ekro* [1984], ECLI:EU:C:1984:11, para. 11.

Court introduced the doctrine of autonomous interpretation in *Unger*.[263] The interpretation must take into account the purpose of the legislation in question and the context of that provision.[264] For instance, the Court defined the EU autonomous (or independent) concept of "fair compensation" within the copyright,[265] or "embryo" and "use for industrial or commercial purposes" within the legal protection of biological inventions.[266] For the Court to develop an EU concept, the provision of EU law cannot refer to the laws of the Member States. Therefore, once the Court develops an autonomous EU law concept, the possibility for Member States to reach their definition is denied.[267]

By the new regulation, the legislator intends to ensure a higher degree of harmonization across the EU.[268] The Commission notes that considering the level of integration of the internal market, especially in transactions of Union targets active in several Member States, there is a need to achieve greater consistency and predictability through drawing criteria and elements to be used for the screening via an EU action.[269] While Article 1(3) allows Member States to maintain in force national provisions in fields not covered by the proposed regulation, this instead appears to grant Member States flexibility in determining the sensitive sectors and factors to take into account when determining the effect on the public policy and security. Moreover, under Recital 9, the legislator aims to achieve the most consistent approach across the Union as the scope of investments to be screened. It is also important to note that the maximum harmonization of the scope within the minimum harmonization of FDI screening procedures is intended to standardize the requirements for the foreign investments that the Member States must submit to the cooperation mechanism.[270]

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[263] Case 75/63 *Unger* [1964], ECLI:EU:C:1964:19.
[264] Case C-287/98 *Linster* [2000], ECLI:EU:C:2000:468, para. 43.
[265] Case C-467/08 *Padawan* [2010], ECLI:EU:C:2010:620, para. 37.
[266] Case C-34/10 *Brüstle* [2011], ECLI:EU:C:2011:669, paras. 25, 31.
[267] Opinion of AG Cruz Villalón in Case C-364/13 *International Stem Cell v Comptroller General of Patents* [2014], ECLI:EU:C:2014:2104, para. 45; Case C-245/00 *SENA v NOS* [2003], ECLI:EU:C:2003:68, paras. 23–24. For example, in *Infopaq*, *Premier League* or *Painer*, the Member States could not contend that it was for them to define their own concepts to afford higher level of national protection to copyright outside of the concepts in question. See: Case C-5/08 *Infopaq v Danske Dagblades Forening* [2009], ECLI:EU:C:2009:465, para. 29; Joined Cases C-403/08 and C-429/08 *Premier League* [2011], ECLI:EU:C:2011:631, paras. 97, 154–157; Case C-145/10 *Painer v Standard Verglas GmbH* [2011], ECLI:EU:C:2011:798, paras. 87–93.
[268] Recital 6 of the Proposal.
[269] Rectial 8 of the Proposal.
[270] Recitals 9–10 of the Proposal.

Thus, the new regulation could be viewed as intending to fully harmonize the definitions of "FDI" and "foreign investment" for the purpose of the cooperation mechanism, giving the Court legitimacy to develop an autonomous EU law concept. Depending on the final wording of the new regulation, the Court will likely endorse the criteria for determining control by the parent over the subsidiary and foreign investor over the target from the available secondary legislation and case law in the field of fundamental freedoms.

3.5. Summary of Chapter III

This chapter first illuminated the practical implications of the *Xella* judgment, which excludes indirect FDI from the scope of Regulation 2019/452. It then analyzed the future of FDI regulation in the Union envisaged by the Proposal and attempted to predict how the CJEU will interpret the scope of the new regulation.

Implications of the Xella Judgment

Regulation 2019/452 is without prejudice to the right of the Member States to take measures justified on the grounds of public policy and security.[271] The free movement of capital and establishment protects FDI. When subjecting FDI to screening, Member States are bound by the proportionality of the measure, that there must be a genuine threat to society's interests and cannot constitute arbitrary discrimination. The *Xella* judgment is nothing new under the Sun regarding internal market law.

What came as a surprise was that the Court did not endorse indirect FDI falling under the scope of Regulation 2019/452. National authority can still require EU investors with foreign control to undergo screening or prohibit the planned acquisition on public order and security grounds. Such measure will then be subject to the Treaty rules on freedom of establishment and outside of instruments developed under Regulation 2019/452.[272] Would the Court have adopted the reasoning of AG Ćapeta and interpreted Regulation 2019/452 covering indirect FDI, it could have struck a balance between the investors' rights and Member States' FDI screening

[271] Article 207(6) TFEU; Recital 4 of Regulation 2019/452.
[272] *Ibid.*, (A. Perez, n. 209), p. 8; *Ibid.*, (T. Shipley, n. 210), p. 15.

mechanisms. Instead, there is a risk of EU investors overburdening the fundamental freedoms available to them simply because of foreign shareholding in those entities in the case of abuse of screening mechanism by the authorities.

The New Proposal

In need to address the shortcomings of the regime under Regulation 2019/452, the Commission proposes extending the scope of the new regulation to cover indirect FDI, defined as "foreign investment". This "foreign investment" is made by an EU investor, ultimately controlled by a foreign investor, and is intended to establish or maintain direct and lasting links between the foreign investor and the Union target. The proposal does not define any thresholds. Therefore, the degree of control by the foreign investor over the EU subsidiary and the foreign investor and Union target will be assessed on a case-by-case basis.

Other significant changes brought by the proposal include the compulsory nature of the planned regulation and a list of activities of particular importance and factors likely to affect public order and security. The proposed regulation is supposed to serve as a minimum harmonization tool, permitting Member States to screen direct and indirect FDI in activities not listed, provided that they comply with the justifications under the derogations from the free movement Treaty provisions.

The Future of F(D)I as an EU Concept

Provided that the EU law provision does not refer to the national law, the Court may adopt an independent interpretation of "FDI" and "foreign investment" for the purpose of cooperation mechanism under the new regulation. The FDI concept in itself is isolated from the likelihood of the FDI threatening public order and security or a list of sensitive industries, areas where Member States are supposed to be allowed to maintain a higher degree of discretion. In harmonizing the scope, or definition of direct and indirect FDI, for the purpose of the cooperation mechanism, the Proposal is clear about the intention of a maximum harmonization. The wording of the proposed definitions is broad, allowing the screening mechanisms to catch a

variety of control structures by the foreign parent over the EU subsidiary in the case of indirect FDI. The wording in both definitions of direct and indirect FDI concerning the degree of control to be acquired by the foreign investor over the EU target remains unchanged from the existing Regulation and free movement law. It is unlikely that the Court or the upcoming regulation's final text would set a particular threshold not to limit the application of the new regulation. The CJEU is, therefore, expected to reiterate the case law on freedom of establishment, resulting in a case-by-case assessment to establish whether the foreign investor exercises control over the EU entity or the EU target. National courts will be expected to examine the national laws, articles of association, shareholding structures, and other factual circumstances.

In summary, while it would, in principle, be legitimate for the Court to adopt a definite EU law concept of "FDI" or "foreign investment", it will likely never define the "control" of the foreign parent over the EU subsidiary and foreign investor over the EU target.

Conclusion

This Thesis looked into how the EU defines and should define FDI to ensure the effectiveness of national FDI screening mechanisms functioning under the framework created by Regulation 2019/452 and the new Proposal.

First, it set out the problems of regulating FDI in the EU. Traditionally, investments, as capital movements, were regulated under the free movement law. The Lisbon Treaty, however, included FDI under the CCP. This changed the nature of regulating FDI from shared competence between the EU and Member States under the free movement to the EU's exclusive competence in CCP. Against this background lies Regulation 2019/452, which authorizes Member States to screen inward FDI in their territories. Scholars view the authorization as the Union giving back the lost competence to the Member States and either legitimizing the existing FDI screening mechanisms or permitting their creation. It also establishes a common framework for the national screening mechanisms, establishing minimum procedural standards and cooperation mechanism. However, given the Regulation's voluntary nature, Member States were neither bound to establish the screening mechanisms nor by the definitions under the Regulation. This led to Member States widening the scope of the FDI screening process in their territories.

After establishing the constitutional background, the Thesis answered the research questions.

How does the current framing of Regulation 2019/452 and the concept of "foreign direct investment" render FDI screening and the Regulation ineffective?

FDI is a direct investment made by a foreign investor. Under free movement of capital, direct investment is where the investor intends to pursue an economic activity, thereby establishing and extending lasting direct links between the investor providing the capital and the target to which the capital is made available to carry on an economic activity. The Court developed that lasting direct links enable the investor to effectively participate in the management and control of the target, established on a case-by-case basis, taking into account the relevant circumstances.

Concerning intra-EU investments, direct investments traditionally evolved around the free movement of establishment due to their pursuit of economic activity nature.

According to Regulation 2019/452, a foreign investor is a natural or legal person of a third country. In *Opinion 2/15*, the Court confirmed that the concept of FDI encompasses investments made by third-country nationals in the EU that enable effective participation in managing or controlling a company's economic activity. The definition of FDI in Regulation 2019/452 is consistent with the interpretation of direct investment under free movement law and the Court's interpretation of FDI under the CCP.

Member States, not bound by Regulation 2019/452, employ different definitions of foreign investor. Two issues were identified:

1) Member States exclude certain third-country investors from the foreign investor criteria, e.g., Swiss investor, EEA investor, or OECD investor;
2) Member States consider the investor's control and shareholding structure in determining whether the investor is domestic or foreign.

Member States screen FDI made "indirectly" via an EU entity. This was the central issue in the *Xella* case, where the Court strictly interpreted the scope of Regulation 2019/452. The Regulation, therefore, does not cover investments made by an EU investor ultimately controlled by a third-country entity. In such cases, when challenging the restriction posed by the screening procedure or screening decision, EU investor can only rely on freedom of establishment. In both cases, the justification based on public policy or security will be assessed following fundamental freedoms. However, EU investors with foreign control are only left to rely on freedom of establishment, as their investments fall outside the scope of Regulation 2019/452. This paradoxically disfavors the foreign-controlled EU investors. Procedural safeguards guaranteed directly by the Regulation to foreign investors do not apply to EU investors. Other procedural issues arise in the cooperation mechanism established by the Regulation, where Member States screening indirect FDI cannot submit such cases to the cooperation mechanism.

How should the "foreign (direct) investment" notion be defined to increase the effectiveness of the FDI screening into the Union?

The final part of the Thesis discussed a Proposal for a new regulation that is supposed to repeal the current Regulation 2019/452. It found that the legislator reflected on the inadequacy of the current regime and the need for a stricter and more coherent system of FDI control in the EU to both fill the security threats caused by the possibility of circumvention of the screening mechanisms and the substantial gaps between the national laws causing unpredictability for the investors. Some of the major changes include the compulsory nature of the new regulation, extended scope by including indirect FDI, or a list of industries and activities considered sensitive. As a preliminary remark, the final wording of the regulation will depend on the outcome of the negotiations between the institutions in a legislative procedure. It will likely differ from the Proposal.

The new definition of indirect FDI shows that the new regulation will require national authorities to determine who ultimately acquires control over the Union target. The definition sets out examples of criteria for the foreign parent's control over the EU subsidiary through which they intend to invest in the Union undertaking active in a sensitive sector. Subsequently, the wording of the degree of control by the foreign investor over the EU target remains unchanged in comparison with Regulation 2019/452 and case law in the field of freedom of establishment. It is therefore expected that when called to interpret the concept of FDI, the Court will endorse an assessment on a case-by-case basis, requiring the national court to take into account the factual circumstances to establish whether the foreign parent exercises the control over the EU subsidiary and to what extent will the foreign investor then exercise the control over the Union target.

The final subsection of the third Chapter analyzed the possibility of an autonomous EU law concept of FDI. With the intention to harmonize the scope of the new regulation fully, there is a possibility that the Court could have the legitimacy to develop an independent concept. However, in order not to limit the application of the new regulation, unless required by the negotiated

wording of the final text of the regulation, the Court will likely refrain from setting a particular threshold on the degree of control.

To answer the research question, it is logically in the interest of investors and legal certainty to have a harmonized and as precisely as possible defined EU concept of FDI. While the original aim was to devise the best possible harmonized definition of FDI, throughout the research, I discovered that due to the circumstantial nature of "control," it is impossible to provide a normative conclusion on a fully harmonized concept of FDI.

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