THE SCREENING OF FOREIGN INVESTMENTS IN EU LAW: WHEN 'SECURITY AND PUBLIC ORDER' BECOME THE NEW BLACK IN INTERNAL MARKET LAWS AND POLICIES

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The screening of foreign investments is a hot topic within EU law and policy at this present time of poly-crisis and global geopolitical insecurity. The EU institutions are pushing very hard for adopting new legislation that will replace the Regulation 2019/452 on Foreign Direct Investment (FDI). The revised regulation, 'by stating that the principle that certain foreign investments need to undergo screening, regardless of which Member State is the location of the target', is aimed at ensuring a 'more consistent and efficient approach to risks to security and public order flowing from foreign investment into the EU'. Those four little magic words ('security and public order') have become the new black in providing a key rhetoric for ensuring the effective screening of foreign investment in the EU. Yet, 'security and public order' are complex, contextual and multidimensional concepts. As we shall see, the recent developments in EU foreign investments laws and policies confirm such an assertion. The aim of this article is to understand and clarify how the concepts of 'security and public order' operate within the screening of foreign investments and in relation to the protection of the EU internal market laws and policies.

1 INTRODUCTION

The screening of foreign investments is a hot topic within EU law and policy at this present time of poly-crisis and global geopolitical insecurity. The EU institutions are pushing very hard for adopting a new legislation that will replace the Regulation 2019/452 on Foreign Direct Investment (FDI).[1] The revised regulation, 'by stating that the principle that certain foreign investments need to undergo screening, regardless of which Member State is the location of the target', is aimed at ensuring a 'more consistent and efficient approach to risks to security and public order flowing from foreign investment into the EU'.[2] Those four little magic words ('security and public order') have become the new black in providing a key

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[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 [2019] OJ L791/1 (Regulation 2019/452 or FDI Regulation).
[2] See Hannah Ahamad Madatali with Lucia Torlai, 'Revision of the EU Foreign Direct Investment Screening Regulation' (2024) Briefing of the European Parliament, 22 July 2024, European Parliamentary Research Service (EPRS), 11 <https://www.europarl.europa.eu/RegData/etudes/BRIE/2024/762844/EPRS_BRI(2024)762844_EN.pdf> accessed 01 September 2024.

rhetoric for ensuring the effective screening of foreign investment in the EU. Yet, 'security and public order'[3] are complex, contextual and multidimensional concepts. As we shall see, the recent developments in EU foreign investments laws and policies confirm such an assertion. The aim of this article is to understand and clarify how the concepts of 'security and public order' operate within the screening of foreign investments and in relation to the protection of the EU internal market laws and policies.[4] In this article, the concepts of 'security and public order' are also used to reveal the internal and external economic threats to the integrity of the EU internal market laws and policies, as illustrated respectively by the recent case law of the Court of Justice of the European Union (CJEU, or Court) in the *Xella* judgment[5] and the proposal for a new regulation replacing Regulation 2019/452, the so-called FDI Regulation.[6]

On the one hand, in *Xella*, an EU Member State (*in casu* Hungary) relied on national '(public) security and public order' to derogate from its obligations under the Treaties to ensure the free movement of foreign investments and to protect the functioning of the internal market. On the other hand, in the new proposal replacing Regulation 2019/452, the EU legislator relied on 'the risks to security and public order' to adopt legislation preserving the internal market from foreign investments that may endanger its integrity. Article 114 TFEU – the internal market harmonization clause[7] – constitutes here the crucial additional legal basis[8] for this new EU instrument.[9] In both examples, 'security and public order' are keys to ensuring the screening of foreign investments in the EU. Enhanced by the crises such as the Covid 19 crisis and the war in Ukraine, 'security and public order' are here to stay in the laws and policies of the EU and in a world where globalization is constantly and deeply challenged at different levels. As we shall see in more details later, the concepts of 'security and public order' as used specifically in foreign investments laws and policies are akin to a sort of 'economic public order' which can be relied on by the Member States or EU institutions to protect, respectively, the national or European markets and to ensure their own 'economic security'. The concepts of 'security and public order', as derogations to the free movement of foreign investments and as justifiers of EU internal market legislation, are thus understood in this contribution as economic, contextual and multidimensional, i.e. operating at both national and EU levels and in both national and EU economic markets.

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[3] See Catherine Kessedjian, 'Public Order in European Law' (2007) 1(1) Erasmus Law Review 25; and see also Xavier Groussot and Gunnar Thor Petursson, 'Public Security and Public Order in EU Law: The Evolution of the Methodological Framework in the Laws of the Internal and Digital Markets', European Papers (forthcoming, autumn 2024).
[4] See, in general, Xavier Groussot, Marja-Liisa Öberg, and Graham Butler (eds), *The EU Law of Investment: Past, Present, Future* (Hart Publishing, Bloomsbury, forthcoming).
[5] Case C-106/22 *Xella Magyarország Építőanyagipari Kft* EU:C:2023:568.
[6] See Commission, 'Proposal of the European Parliament and of the Council on the screening of foreign investments in the Union and repealing Regulation (EU) 2019/452 of the European Parliament and of the Council' COM (2024) 23 final ('Proposal').
[7] See in general Annegret Engel, *The Choice of Legal Basis for Acts of the European Union: Competence Overlaps, Institutional Preferences and Legal Basis Litigation* (Springer 2018).
[8] This is in complement to Article 207 TFEU if compared with the FDI Regulation. See section 4 of this article for more discussion.
[9] See Proposal on the screening of foreign investments in the Union and repealing Regulation (EU) 2019/452 (n 6).

This new 'economic public order' may certainly be perceived as being at odds with the liberal values and goals[10] traditionally associated with EU internal market laws and policies and where the ideal of economic globalization is also clearly present.[11] The realization of an 'economic public order', be it national or European, implies a strong strategic dimension that may lead to the creation of barriers to trade[12] and, *in fine*, to a more protectionist Europe. These recent developments are going against the very idea of globalization. Times have clearly changed; and this new European *zeitgeist* must be thoroughly studied in the laws and policies of the EU and its Member States. This article is divided into three main parts. In doing this analysis, we will first explore the political economy, nature and limits of Regulation 2019/452, i.e. the FDI Regulation. Due to both the rapid evolutions of the geopolitical situation in the world and its own nature, the FDI Regulation has proven to be rapidly obsolete as an effective tool for protecting the European Union and ensuring an effective screening of foreign investments (Section 2). Following this analysis, we will investigate in detail the *Xella* case which illustrates the limits of the screening of foreign investments in terms of laws and policies and shows the complexity of the EU context which is profoundly marked by the backsliding of the EU rule of law and an unstoppable increase of mistrust between the EU Member States (Section 3). Finally, we will discuss the key changes brought by the proposal replacing the FDI Regulation 2019/452 by looking, in particular, at the issue of definition of foreign investments and the issue of legal competence in light of the so-called internal market clause (Article 114 TFEU) (Section 4).

2 THE POLITICAL ECONOMY AND NATURE OF REGULATION 2019/452

With less than forty recitals and seventeen articles, Regulation 2019/452 appears quite blank and insipid compared to other sizable technical legislations or even the new proposal for a regulation replacing the FDI Regulation.[13] Yet, an extensive policy hides behind this brief text. Regulation 2019/452 creates a common EU framework for screening FDI from third countries on security and public order grounds. Again, considering its compressed content, the Regulation pursues two rather bold aims: to establish 'a framework for the screening by Member States of FDI into the Union on the grounds of security and public order'; and to set up a 'mechanism for cooperation between Member States, and between Member States and the European Commission, with regard to FDI likely to affect "security and public order"'. Regulation 2019/452 authorizes Member States to screen FDI on grounds of security and public order. It establishes a common framework of standards and procedures

[10] See Articles 2 and 3 TEU.
[11] See in particular Article 3(5) TEU.
[12] Economic justifications are, in principle, forbidden under the CJEU case law in free movement. However, some exceptions may arguably be found within the CJEU. See Sue Arrowsmith, 'Rethinking the Approach to Economic Justifications under the EU Free Movement Rules' (2015) 68(1) Current Legal Problems 307. See e.g. Case C-7/78 *Thomson* EU:C:1978:209: invoking a justification to avoid the destruction of coin and invoking a right to mint coin. See also Case C-384/93 *Alpine Investment* EU:C:1995:126: invoking the good reputation of the financial sector.
[13] See Proposal on the screening of foreign investments in the Union and repealing Regulation (EU) 2019/452 (n 6).

that the national screening mechanisms of Member States willing to screen must comply with.

Regulation 2019/452 has thus established a framework for the optional screening of FDI by Member States on the grounds of 'security and public order' since 2020. 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'.[14] The EU's attitude towards Member States subjecting FDI to some restrictions changed drastically over the past decade. One commentator of the FDI Regulation rhetorically wonders how Barroso's Commission would have reacted to Juncker's speech.[15] Indeed, the world has evolved in myriad ways since the end of the Barroso's Commission in 2014. At the time of its adoption, there was clearly a strong political will for an EU-wide instrument to screen FDI from several 'original' and influential Member States reflecting worries about foreign investors taking over strategic Union companies.[16]

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 have expected considering 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.[17] Back in 2017, only twelve Member States had national screening mechanisms in place to address possible risks of FDI to 'security and public order'.[18] In 2022, the European Commission urged Member States to implement FDI screening mechanisms in their domestic systems.[19] As of spring 2024, the number increased to twenty-two with a new national legislation adopted in Sweden in December 2023, leaving only five Member States

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[14] Commission, 'President Jean-Claude Juncker's State of the Union Address 2017' (*European Commission*, 13 September 2017) <https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_17_3165> accessed 01 September 2024.

[15] Régis Bismuth, 'Reading Between the Lines of the EU Regulation Establishing a Framework for Screening FDI into the Union' in Jacques Bourgeois (ed), *EU Framework for Foreign Direct Investment Control* (Kluwer Law International 2020) 104.

[16] Letter to DG Trade Commissioner Malmström from the German, French and Italian governments (February 2017) <https://www.bmwk.de/Redaktion/DE/Downloads/S-T/schreiben-de-fr-it-an-malmstroem.pdf?__blob=publicationFile&v=4> accessed 01 September 2024.

[17] 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 – Jean-Claude Juncker's State of the Union Address (n 14). 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 [2022] OJ L330/1.

[18] That was the situation in 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, 7.

[19] 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, 8.

without any mechanism.[20] 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 and putting into jeopardy the cohesiveness and efficacy of the system of protection newly established.[21]

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.[22] With the new Proposal on the way, legislators face the same dilemma.[23] Four years later, the concern about some foreign investors, notably state-owned enterprises (SOEs), taking over EU undertakings with critical technologies for strategic reasons has increased.[24] Logically, Member States push for maximum freedom in determining the criteria for sensitive industries and conditions affecting national security.[25] 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.[26] 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 in attracting 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 'security and public order' 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.

The peculiar nature of Regulation 2019/452 is best described by AG Ćapeta in her opinion in *Xella* who referred to it as 'a kind of platypus, a strange creature' in comparing this Regulation to the conventional type of regulations. She noted 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 types of competencies: one exclusive, on the one hand, that excludes unilateral action by the Member States, and on

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20 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 5 August 2024) <https://policy.trade.ec.europa.eu/enforcement-and-protection/investment-screening_en> accessed 01 September 2024.

21 We find three types of Member States: Some 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. The national screening mechanisms differ from one another in the most fundamental aspect, i.e. the personal scope of FDI control.

22 See Steffen Hindelang and Andreas Moberg, 'The Art of Casting Political Dissent in Law: The EU's Framework for Screening of Foreign Direct Investment' (2020) 57(5) Common Market Law Review 1428.

23 See Section 4 of this article for development.

24 ibid. See also Commission, 'Reflection Paper on Harnessing Globalization' COM (2017) 240 final, 15.

25 See 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'. See also in relation to digitalization, Groussot and Petursson (n 3).

26 See Eva Rytter Sunesen and Jonas Juul Henriksen, 'The Economics of FDI Screening' in Jacques Bourgeois (ed), *EU Framework for Foreign Direct Investment Control, European Monographs* (Kluwer Law International 2020) 19.

another hand, a shared competence, allowing Member States to act as long as they are not preempted by measures adopted at the EU level.[27] AG Ćapeta, going further, 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. 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 empowered by the Union.[28] By authorizing the Member States to keep and continue introducing national screening mechanisms, Regulation 2019/452 must be viewed as the Union giving back the lost competence to the Member States.[29] In a similar vein, it is lucidly observed 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'.[30] Regulation 2019/452 practically authorizes Member States to take matters into their own hands, but if they do so, they must remain within the framework of EU primary law.[31] The result of this very special set-up is that different criteria apply for who the 'foreign investor' is and whether it is necessary to screen foreign investors investing to pursue an economic activity via an EU entity. Regulation 2019/452 regards the 'foreign investor' as a third-country investor who intends to make or actually makes direct investment in the EU. It permits screening of EU investors controlled directly by third-country entities.

Interestingly, the European Court of Auditors (ECA) has produced a report on the state of FDI screening in the EU in December 2023 after an audit of one year.[32] This special report considers that, although the European Commission took appropriate steps for implementing the FDI framework, three years after the regulation entered into force, significant limitations remain in effectively addressing security and public order risks. This is so particularly because some of the Member States do not boast a national FDI system. The ECA underlines that approximately 42% of FDI stocks are located in Member States without a fully applicable screening mechanism. In addition, many differences persist in the scope and coverage defining critical sectors, leading to blind spots that compromise EU-wide protection. Therefore, the ECA has proposed the European Commission to clearly define the key concepts of the FDI framework to avoid the current inefficiencies; enhance the recommendations and reporting process; improve the cooperation mechanism through

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[27] See Opinion of AG Ćapeta in Case C-106/22 *Xella Magyarország Építőanyagipari Kft* EU:C:2023:267 paras 28-32.
[28] ibid para 33. See also Article 2(1) TFEU.
[29] See Marise Cremona, 'Regulating FDI in the EU Legal Framework' in Jacques Bourgeois (ed), *EU Framework for Foreign Direct Investment Control* (Kluwer Law International 2020) 33, 35 and Opinion of AG Ćapeta in *Xella* (n 27) para 33.
[30] See Hindelang and Moberg (n 22) 1446.
[31] This is confirmed explicitely by Article 1 of the Proposal on the screening of foreign investments in the Union and repealing Regulation (EU) 2019/452 (n 6).
[32] 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 2023) 5 <https://www.eca.europa.eu/en/publications?ref=SR-2023-27> accessed 01 September 2024.

preliminary risk-assessment of notified cases and provide better justification of mitigating actions; and assess national screening mechanisms for compliance.

As we shall see in Section 4, these recommendations are largely taken on board by the new proposal of the European Commission replacing the FDI regulation.[33] Our next section discusses the judgment in *Xella*, which has given rise to the problems of the limited application of Regulation 2019/452, as applying strictly to third-country investors and to third-country investors directly investing in an EU entity.[34] The outcome of *Xella* judgment has undermined the effectiveness of national screening mechanisms and revealed the weakness of the FDI Regulation in terms of competences. The *Xella* case has thus created the perfect storm highlighting the many gaps of Regulation 2019/452 and has provided the 'last argumentative straw' in demonstrating the need of reforming the Regulation. Therefore, before looking specifically at the reform of Regulation 2019/452 in Section 4, we now need to have a look in detail to the *Xella* case and to the problematic of national economic security in the EU internal market and the crucial (but quite hidden) issue of EU competences.

3 NATIONAL ECONOMIC SECURITY AND THE *XELLA* CASE

3.1 INTRODUCTION TO *XELLA*

The case of *'Xella'* is a preliminary ruling on interpretation by the CJEU under Article 267 Treaty of the Functioning of the European Union (TFEU) of Xella Magyarország Építőanyagipari Kft v Innovációs és Technológiai Miniszter (Minister) – C-106/22. The case was referred to the CJEU upon request of the Fővárosi Törvényszék (Budapest High Court, Hungary) and heard by the Second Chamber, composing of five judges. They delivered their judgment on 13 July 2023. The Opinion was delivered by AG Ćapeta on 30 March 2023. The case relates to the proposed takeover of Janes és Társa (Janes), a company incorporated under Hungarian law, and owned by PAN3, another company incorporated under Hungarian law. The party intending to takeover was Xella, also a Hungarian company. Xella's composition and ownership is complex – it is directly 100% owned by a German company. However, it is also indirectly owned by a Luxembourg company (which owns 100% of the German company). Importantly, the Luxembourg company is indirectly owned by LSF10 XL, registered in Bermuda. LSF10 XL is a subsidiary of Lone Star, the ultimate parent group, which is a US private equity firm and owned by an Irish national.

Xella concluded a sale agreement for the purpose of acquiring 100% of the shares in Janes and sent the Hungarian Minister a notification of the takeover, as required under Hungarian law – a national foreign investment screening mechanism, known as the 'Vmtv'. However, the Minister blocked the transaction on the legal basis of the Vmtv, providing two justifications for this. Firstly, under the Vmtv, a Hungarian company (and member of a group of companies established in several Member States), over which an undertaking of a third

[33] ibid. See also Ahamad Madatali with Torlai (n 2). Certainty of investors v. Security. Security is the new black. The economy of the new proposal is based on the need to avoid the circumvention of the system. Lack of harmonization – endanger. Blind spots. Nevertheless, they also highlighted several shortcomings in the current framework, including the absence of national screening mechanisms in some Member States, the lack of EU-wide harmonization, and room for improvement in EU cooperation on FDI screening – Ahamad Madatali with Torlai (n 2) 11.

[34] See *Xella* (n 5).

country has decisive influence, may be prohibited from acquiring ownership of another Hungarian company. The Minister classified Xella as a 'foreign investor' who had decisive influence from a third country undertaking, within the meaning of Hungarian law, because it is indirectly owned by a company registered in Bermuda. Secondly, Janes' main activity is the extraction of gravel, sand and clay, the supply of which the Minister argued should be secured by restricting foreign companies having ownership of these 'strategic' companies (especially following the COVID-19 pandemic), in the 'national interest' as per the Vmtv.

Xella challenged the decision before the Budapest High Court, arguing that the Minister's decision was a restriction on the free movement of capital and freedom of establishment and stated that the only reason why the acquisition was prohibited was the 'non-national' nature of its ownership structure. Xella also argued that the unclear concept of 'national interest', within the meaning of the Hungarian law, was capable of breaching the fundamental principles of the rule of law. The Budapest High Court referred the issue to the CJEU, asking in essence whether the free movement of capital provision (Article 65 TFEU) must be interpreted as precluding national law which included a foreign investment screening mechanism and provides powers to a Minister to block acquisitions.[35] A key underlying issue in the case is whether indirect foreign investments can fall within the scope of Regulation 2019/452, which regulates foreign direct investment and which also brings the competence issue to the front.

3.2 THE APPLICABLE LAW AND THE HIDDEN COMPETENCE ISSUE IN *XELLA*

The first issue addressed by the CJEU concerns the applicable law in the *Xella* case. With regards the FDI Regulation, the important point of contention is that the Vmtv (the national screening mechanism) included within its scope not only investments made 'directly' by undertakings of a third country, but also 'indirectly', by undertakings registered in Hungary or in another Member State over which an undertaking registered in a third country has 'majority control'.[36] Thus, if a third country undertaking had 'majority control' over a Hungarian or EU company, and attempted to acquire a Hungarian company, it would be subject to the Vmtv – notably by imposing a notification to the Minister, who decides whether to authorize or prohibit the acquisition (based on the Vmtv justifications).[37] 'Majority control' is defined under Section 8.2 of the Hungarian Civil Code, as 'any link by which a natural or legal person ("influential entity") holds more than 50% of the voting rights or exercises decisive influence over a legal person'.[38]

The CJEU rejected the applicability of the FDI Regulation by considering that this second criterion relating to 'majority control' did not meet the definition of foreign investment or investor enshrined in the FDI Regulation, and thus that the Vmtv cannot be considered as a valid FDI screening mechanism.[39] It also followed that Xella was not

[35] See *Xella* (n 5)paras 15-26 and Opinion of AG Ćapeta in *Xella* (n 27) paras 7-16.
[36] The Vmtv, Law No LVIII of 2020 on transitional provisions relating to the end of the state of emergency and to the pandemic crisis, 17 June 2020, para 276 (2) (a).
[37] Vmtv, Paragraphs 277 and 283.
[38] Hungarian Civil Code, Section 8.2.
[39] See *Xella* (n 5) paras 29-39.

considered to be a foreign investor for the purposes of the FDI Regulation, but rather an EU company with a 'majority control' from a third country undertaking, and therefore Xella's proposed acquisition of Janes should not be considered as 'foreign investment', as per the Regulation.[40] This was consistent with the European Commission's argument that the Vmtv and acquisition was not caught by the FDI Regulation, for precisely the reason that indirect FDI was not covered by the Regulation.[41] To summarize, in CJEU's and Commission's view, FDI Regulation was only meant to cover FDI made directly by undertakings established in third countries.

Notably, in a more thorough analysis, AG Ćapeta took a different approach by considering that the Hungarian screening law did fall within the scope of the FDI Regulation, given the wording of Article 2(1), which 'encompasses any type of investment through which the foreign investor gains effective participation in or control over an EU undertaking'.[42] According to her, there seems no reason to exclude 'indirect' FDI from the Regulation's scope – i.e. where a third country undertaking gains control over an EU company, which then acquires another EU company.[43] There is no substantive difference between direct and indirect FDI – both involve a third country undertaking, in effect, taking over an EU company. As AG Ćapeta states, this would run counter to the intention of the Regulation. The FDI Regulation is described in her Opinion as 'bridging the gap'[44] between the shared competence of regulating FDI within the internal market[45] and the exclusive competence in common commercial policy (CCP)[46] creating a uniform screening of FDI. The Advocate General in *Xella* concluded that the FDI Regulation applied and thus authorized the Hungarian national screening mechanism. She stated that the mechanism was still subject to the Treaty rules on the fundamental economic freedoms given that FDI relates to overlapping competences, one of which is the internal market.[47] This is an important point, emphasized by some commentators, who state that this is one of the main reasons why *Xella* is significant – since the case confirms that even if a national screening measure is present (and valid according to the AG), fundamental economic freedoms remain fully applicable. Thus, these measures must still comply with the fundamental economic freedoms and be justified accordingly, which national courts can review given that the economic freedoms have direct effect.[48] Also, AG Ćapeta noted that, at the hearing of the case, there was

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[40] ibid.
[41] Opinion of AG Ćapeta in *Xella* (n 27) para 39.
[42] ibid para 42.
[43] See ibid, in particular para 43. Paragraph 43 is important in outlining her rationale, where she states that the FDI Regulation 'encapsulates all possible types of investment through which a foreign investor acquires control over an EU undertaking […] the investment process need not necessarily be conducted directly (such as where a foreign investor acquires control over an EU undertaking by directly buying its shares), but may be carried out indirectly (such as where a foreign investor acquires control over an EU undertaking by acquiring its shares through another EU undertaking). What matters is who ultimately acquires control over the EU undertaking in question'.
[44] ibid para 33.
[45] Article 3(1)(e) and Article 207 TFEU.
[46] See Article 4(2)(a) TFEU.
[47] See Opinion of AG Ćapeta in *Xella* (n 27) para 51.
[48] Alberto 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*, 26 July 2023) <https://eulawlive.com/op-ed-the-court-of-justice-draws-a-line-in-the-sand-for-foreign-investment-screening-ruling-in-xella-magyarorszag-c-106-22-by-alberto-perez/> accessed 01 September 2024.

discussion as to what makes a situation 'internal' and elements that may be taken into consideration to classify a transaction between two companies in the same Member State as a 'cross-border' transaction, given that there was a possibility of qualifying the Xella situation as 'internal'. This included discussion of the *Ullens de Schooten* case.[49] On this issue, she took the opinion that the FDI Regulation applied and thus that the CJEU had jurisdiction by providing detail on the possibility of a 'potential' cross border element. She stated that the Court has in the past gained jurisdiction based on a case having a 'potential' cross border impact, thus it is 'obvious' that this would apply in *Xella* given the German ownership of the parent company and 'potential' cross border implications of this.[50] This concept of a 'potential' cross border element relates to a line of case-law, including CJEU judgments of *Attanasio Group*,[51] *Libert and Others*;[52] and *Venturini and Others*.[53]

As already seen before, the CJEU moved instead straight to the Treaty rules on the fundamental economic freedoms and excluded indirect FDI from the scope of the Regulation 2019/452. In our view, the CJEU's decision on the FDI Regulation is a clear message to the Hungarian legislature that it has overstepped the powers granted to them in the FDI Regulation to create a national screening mechanism by including indirect FDI within their law that infringes the economic fundamental freedoms protected by EU primary law. It is interesting to note that, when Hungary passed the national FDI screening law initially, it notified the Commission in line with Article 3(7) of the Regulation, and the Commission had no issue in publishing the Hungarian law as part of the list of Member States' screening mechanisms in line with Article 3(8), as AG Ćapeta outlines in her Opinion.[54] Yet, it is difficult here to ignore the rule of law context of Hungary, given that this case is decided at the time of serious and systematic (and unfortunately still persisting) backsliding of the rule of law. The CJEU considered that whilst Janes and Xella are both Hungarian companies, Xella forms part of a group of companies established in different Member States (parent German and grandparent Luxembourg company), which qualifies as the relevant foreign element and cross-border ownership structure, to ensure that this case falls within the scope of the internal market.[55] The CJEU concluded that the FDI Regulation is not applicable (despite Xella being ultimately owned by a third country undertaking) as Xella is an EU company which is not falling within the definition of 'foreign investor'. Therefore, in deciding that Xella is not Hungarian (and thus this was not an internal situation), it viewed the ownership of Xella beyond the Hungarian company. And consequently, in deciding that Xella is an EU company (thus falling outside the FDI Regulation as a third-country undertaking), the Court is not in a position to recognize the Bermudan ownership.[56]

Xella confirms that the 'line of ownership' can be considered in determining that a case has a cross-border element and is thus not a purely internal situation. The fact that both

[49] See Case C-268/15 *Ullens de Schooten* EU:C:2016:87.
[50] Opinion of AG Ćapeta in *Xella* (n 27) para 62. AG Ćapeta, however, states that she is 'not an ardent supporter of that case-law' and this was not discussed further here.
[51] See Case C-384/08 *Attanasio Group* EU:C:2010:133 para 24.
[52] See Joined Cases C-197/11 and C-203/11 *Libert and Others* EU:C:2013:288 para 34.
[53] See Joined Cases C-159/12 to C-161/12 *Venturini and Others* EU:C:2013:791 para 25.
[54] Opinion of AG Ćapeta in *Xella* (n 27) para 40.
[55] *Xella* (n 5) paras 50-57.
[56] *Xella* (n 5) paras 55-65.

companies were Hungarian-based did not prevent both the CJEU and AG from deciding that this was not an internal situation, and this seems a sensible approach, given the complex and cross-border ownership structure of Xella. However, what if the parent company was Hungarian too? Would it be sufficient that the grandparent company was from Luxembourg, and thus an EU company? How far up the 'line of ownership' can be considered to determine that a company acquisition is cross-border and not internal? Since no answer was logically provided by the CJEU, there is thus no legal certainty on this issue.[57] But the issue of legal certainty was not the decisive factor in the eyes of the European judges. Instead, the risks to 'security and public order' on the internal market appeared to be the pivotal grounds for understanding the rationale of the Court in *Xella* in conjunction with the constitutional issue of competence. In our view, however, it is reasonable to understand the logic of the CJEU if put within the prism of EU competences and their constitutional limits – an issue which is unfortunately not discussed by the Court in *Xella* in contrast to the AG Opinion. By concluding that the FDI is not applicable, the CJEU adopted a narrow reading of the scope of application of Article 207 TFEU, which is the legal basis of Regulation 2019/429. The Court thus impliedly considered that the Regulation cannot be considered to include 'indirect' FDI. Indeed, this inclusion would necessitate a reform of the regulation and a new legal basis since the Regulation 2019/429 is directed towards Foreign Direct Investment and not indirect foreign investment. Seen in this light, it appears difficult in our view to disagree with the conclusion of the Court in *Xella*. The concept of 'indirect' FDI which is often used to expand the scope of the FDI regulation constitutes in fact an oxymoron that should not be used to extend the competence of the Union through judicial activism as argued for instance by the Advocate General. Traditionally, direct investment refers to an investment of any kind where the investor intends to control the target – pursue an economic activity.[58] Indirect investment, on the contrary, rather refers to portfolio investment – without the intention of participating in the management of the target.[59] FDI is a direct investment where the third-country foreign investor intends to control the target. However, the direct-indirect concept in the context of FDI Regulation actually refers to whether the FDI was made directly by an investor established under the laws of a third country, or indirectly, by an EU investor with a third-country control. A clear conceptual distinction should instead be established between direct foreign investment and indirect foreign investment. This distinction, as we shall see in Section 4, is adopted by the new proposal for replacing the FDI Regulation.

3.3 JUSTIFICATIONS, PROPORTIONALITY AND NATIONAL SECURITY

Since the case falls within the scope of the EU law, the next issue to be discussed is to determine which is the applicable economic freedom in *Xella*. Indeed, the national court

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[57] Alexia Crivoi, 'The ECJ's Judgment in Xella – Judicial Cherry Picking?' (*CELIS Institute Blog*, 18 October 2023) <https://www.celis.institute/celis-blog/the-ecjs-judgment-in-xella-judicial-cherry-picking/> accessed 01 September 2024. Furthermore, these contradictions have been emphasized by some scholars as an example of judicial 'cherry picking'.

[58] Annex I to the Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5 (Directive 88/361); Case C-367/98 *Golden Shares I* EU:C:2002:326 para 38.

[59] Annex I to the Directive 88/361, Joined Cases C-282 and 283/04 *Commission v Netherlands* EU:C:2006:608 para 19.

referred the question to the CJEU as to whether the national FDI law (and its execution by the Hungarian Minister) constitutes a restriction on the free movement of capital enshrined in Article 63 TFEU, which states that 'all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited'.[60] The CJEU concluded that the freedom of establishment has been restricted under Article 49 TFEU.[61] There are two side questions to underline before analyzing the core issues of restriction, justification and proportionality.

Firstly, does the acquisition of Janes by Xella relate to a breach of the freedom establishment? On the surface, the acquisition of a company may be associated with the movement of capital – i.e. the use of capital by Xella to purchase shares in Janes. However, the CJEU referred to its case-law,[62] which stated that shareholdings which enable the holder to exert an influence on a company's decisions and determine its activities fall within the scope of freedom of establishment, not capital. In *Xella,* the Court stated that the acquisition of all shares in a company (and thus 'majority control') is sufficient to allow Xella to exert a definite influence on the management and control on Janes, thus falls within the scope of freedom of establishment.[63] The European Commission made this argument in the case too. AG Ćapeta tried to make a clearer distinction between these terms reiterating the existing case-law and nomenclature in Annex I of the Directive 88/361:

> shareholding in an undertaking that enables an investor to participate effectively in that undertaking's management and control, is governed by the rules on freedom of establishment. On the other hand, short-term or minority investments – that is to say, the acquisition of shares solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking in question – must be examined exclusively in the light of the free movement of capital.[64]

AG Ćapeta refers to relevant case-law, such as *FII Group Litigation* and *Baars* to emphasize this.[65] In this case, it seems fair to conclude that Xella's acquisition of Janes, given its aim of 100% ownership on a long-term basis, does indeed fit the definition of the economic freedom of establishment. The CJEU's judgment seems correct on this point.

The second question relates to the location and nature of the company, i.e. Xella. Indeed, the economic freedom of establishment is normally enjoyed by companies provided that they are formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the EU (Article 54 TFEU).[66] The CJEU stated that whilst Xella is part of a group with a parent third party undertaking, it is connected to the legal system of a Member State and thus constitutes an EU company – the nationality or origin of Xella's shareholders is thus not important here. AG Ćapeta provides a helpful summary of Articles 49 TFEU and 63 TFEU, stating that if

[60] See Article 63 TFEU.
[61] See Article 49 TFEU; *Xella* (n 5) paras 41-49.
[62] See Case C-563/17 *Associação Peço a Palavra and Others* EU:C:2019:144 para 44.
[63] See *Xella* (n 5) para 42.
[64] Opinion of AG Ćapeta in *Xella* (n 27) para 27 and footnotes 18-19.
[65] ibid.
[66] Article 54 TFEU.

investment crosses only EU internal borders, it may fall within the scope of either freedom of establishment or free movement of capital. However, if Xella is classified as a third country undertaking, it would only be able to fall within the scope of free movement of capital, as per the wording of Article 63 TFEU.[67] This relates back to the point made earlier regarding the inability to clearly trace where a 'line of ownership' should stop or where it should lie, since Xella has ownership in Hungary, Germany, Luxembourg and Bermuda. The CJEU concluded that this finding is consistent with its earlier conclusion, relating to the FDI Regulation, that Xella is solely an EU company. The CJEU outlined that the Hungarian national FDI law (Vmtv) prohibits an EU company from acquiring a shareholding (and influence on management and control) in another EU company and is thus a 'particularly serious restriction' on the economic freedom of establishment.[68] Subsequently, the CJEU considered the possible justifications and assessed whether there was an overriding reason of public interest justifying the restrictions imposed by the national measure. It appears from the facts of the case that the Minister classified Janes as a 'strategic company' by the Vmtv, since the security and foreseeability of the extraction and supply of raw materials were of strategic importance. Also, the Minister stated the COVID-19 pandemic showed that serious disruption to the functioning of global supply chains could occur in a short period of time, with negative repercussions that could harm the national economy. The Minister highlighted particularly that one of the problems affecting the construction sector in Hungary was the scarcity of sufficient quantities of building materials and the production of those raw materials for the construction sector was already dominated by foreign-owned Hungarian producers. Thus, if Janes were to be indirectly owned by a company registered in Bermuda, this would pose a longer-term risk to the security of supply of raw materials to the construction sector, particularly in the region where Janes is established, given that its market share in that region would be 20.77%. The acquisition by a foreign owner of a strategic company would reduce the proportion of domestic-owned companies, which could harm or risk harming the 'national interest' in ensuring the security of supply to the construction sector of basic raw materials such as gravel, sand and clay.[69] The CJEU stated that whilst Member States can determine the requirements of '(public) security and public order' considering national needs, those requirements must be interpreted strictly and may only be relied upon if there is a 'genuine and sufficiently serious threat to a fundamental interest of society'.[70]

Importantly, the CJEU established that the security of supply to the construction sector, specifically gravel, sand and clay, does not concern a fundamental interest of society (distinguishing from petroleum, telecommunications and energy sectors). Furthermore, the CJEU ruled that the acquisition of Janes by Xella was not a 'genuine and serious threat', given that *Xella* already purchased 90% of the production of basic raw materials from Janes prior

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[67] Opinion of AG Ćapeta in *Xella* (n 27) para 28.

[68] See *Xella* (n 5) para 59. AG Ćapeta underlines that the Minister's decision to block Xella's acquisition makes the right to invest in an EU undertaking and right to establishment impossible (Opinion of AG Ćapeta in *Xella* (n 27) para 68).

[69] See *Xella* (n 5) paras 23-24 and Opinion of AG Ćapeta in *Xella* (n 27) para 13.

[70] *Xella* (n 5) paras 64-66. AG Ćapeta in her Opinion in *Xella* (n 27) para 74 helpfully emphasized that this is a two-part test – 'a Member State is required to explain, first, why the interest causing the restriction at issue is perceived as fundamental in its society; and, second, why the restricted activity represents a genuine and sufficiently serious threat to that fundamental interest'.

to the takeover. Also, these raw materials were unlikely to be exported out of Hungary anyway, given the transportation cost.[71] It is worth noting that AG Ćapeta takes here a slightly different approach in arguing that the security of supply of sand, gravel and clay may be viewed as a fundamental interest in society given that their supply may be scarce, particularly at times of crisis. However, on the second part of the test, she concluded that given Janes accounts for just 0.52% of Hungarian national production of sand, gravel and clay, Xella's takeover is not a genuine and sufficiently serious threat. She therefore rejected the Minister's argument that any foreign ownership of such a company represents a threat to the security of supply justifying the restriction on FDI.[72]

What can we learn from the *Xella* judgment regarding justifications based on '(public) security and public order' used to derogate from an EU economic freedom? The CJEU considered that sand, gravel and clay do not have the same status as petroleum, telecommunications and energy sectors, in that they are not capable of forming a 'fundamental interest in society'. The methodological approach adopted by the CJEU to assess the 'fundamental interest in society' is here not surprising and follows its longstanding jurisprudence on '(public) security and public order'.[73] In fact, the CJEU following a constant jurisprudence controls the existence and scope of the 'fundamental interest in society' invoked by a Member State as a justification since this issue cannot be unilaterally defined by a Member State.[74] In addition, the CJEU ignored the relevance of the COVID-19 pandemic crisis as a reason to justify an obstacle to the freedoms for '(public) security and public order'. Whilst it has been analyzed whether the Minister's rationale for prohibiting Xella's takeover could be justified, it is important to distinguish between the Hungarian national FDI law (Vmtv) and the Minister's decision blocking Xella's takeover – i.e. what was the cause of the Minister's incorrect decision?

The referred question from the Budapest High Court asked whether the Hungarian national FDI law (Vmtv) is permitted by EU law.[75] Crucially, the CJEU and AG came to two different conclusions on this specific question, despite their general agreement that the Minister's decision to block Xella's takeover of Janes constitutes a restriction to a fundamental economic freedom. In addressing this question, AG Ćapeta discussed the proportionality of the national legislation at length. For the Advocate General, the Vmtv should provide for the requirement that each Minister decision is 'appropriate and necessary' for the protection of a genuine and serious threat to a fundamental interest of society of a Member State.[76] Thus, she stated that the Vmtv should include an additional provision obligating the Minister to explain why an FDI represents a genuine and serious threat to the fundamental interest (and security of supply of Hungary), and why it is appropriate and necessary (proportionate). In these facts, AG Ćapeta suggested that the Minister should address whether blocking Xella's acquisition of Janes was proportionate, 'observing' that it

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[71] See *Xella* (n 5) paras 68-73.

[72] Opinion of AG Ćapeta in *Xella* (n 27) paras 76-89. AG Ćapeta addresses also another point, which the CJEU does not confront – that Hungary seek to prevent speculative acquisitions in sectors deemed strategic to the Hungarian economy, given the COVID-19 pandemic. The AG rejects that this could be considered as a public policy exception, as such investments are part of economics, which cannot be a valid justification.

[73] See e.g. Case C-54/94 *Église de scientologie* EU:C:2000:124.

[74] See *Xella* (n 5) para 66.

[75] Opinion of AG Ćapeta in *Xella* (n 27) para 27.

[76] Opinion of AG Ćapeta in *Xella* (n 27) para 90-94.

is unclear how the prohibition of indirect foreign ownership of Janes secures the supply of sand, gravel and clay, and questioning why a less restrictive measure, such as a local distribution quota at market, could not have been used instead.[77] However, importantly, in answering the referred question, the Advocate General concluded that the Vmtv does not contravene EU law (and thus the Hungarian national FDI screening law is not precluded by EU law). The proportionality of the national measure was here carefully analyzed, and the AG considered that it is for the national court to decide the outcome of the case and whether specifically the national measure was appropriate and necessary.[78]

By contrast, the CJEU took no such cautious approach to defer to the national court. Instead, the CJEU provided a clear indication on the outcome of the case and underlined the disproportionality of the Ministry decision (thus going beyond the text of the referred question from the Hungarian court which only focused on the Vmtv). The CJEU ruled that the interpretation of the Hungarian national screening law on foreign direct investment, as applied in this case, is incompatible with EU law, specifically the freedom of establishment. As put by the CJEU,

> the provisions of the TFEU on freedom of establishment must be interpreted as precluding a foreign investment filtering mechanism provided for by the legislation of a Member State by means of which a resident company which is a member of a group of companies established in several Member States, over which an undertaking from 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 harms or risks harming the national interest in ensuring the security of supply to the construction sector, in particular at the local level, with respect to basic raw materials such as gravel, sand and clay.[79]

It should be underlined that this conclusion made by the CJEU needs obviously to be considered in the context of the political climate in Hungary and its known failure to comply with EU requirements more broadly. It is also worth noting that *Xella* is the second significant Hungarian case whereby the EU has censored a decision on FDI by the Hungarian authorities based on the Vmtv. The first case concerned the acquisition of AEGON Group's Hungarian subsidiary by Vienna Insurance Group and the EU Commission's finding that Hungary's veto over this acquisition breached Article 21 of the Merger Regulation.[80] *Xella* is another opportunity for the CJEU to highlight the Hungarian State's inability to adhere to EU law. From a general perspective, Hungary's numerous breaches of the rule of law in the free movement context[81] are also difficult to separate from the *Xella* case; and this particularly in a litigation that concern the use of '(public) security and public order' by Hungary to justify a restriction on the freedom of establishment. The backsliding context has probably played

[77] ibid.
[78] ibid para 95.
[79] See *Xella* (n 5) para 74.
[80] See Commission Press Release, 'Mergers: Commission finds that Hungary's veto over the acquisition of AEGON's Hungarian subsidiaries by VIG breached Article 21 of the EU Merger Regulation' (21 February 2022) <https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1258> accessed 01 October 2024.
[81] See Xavier Groussot, Niels Kirst, and Patrick Leisure, '*Segro* and Its Aftermath: Between Economic Freedoms, Property Rights and the "Essence of the Rule of Law"' (2019) 2(2) Nordic Journal of European Law 69.

a significant role in the judges' psyche when deciding upon this case which deals in essence with the national economic security of a rogue Member State. In this sense, *Xella* exemplifies a clash between the national economic security of a Member State and the economic integrity and security of the EU internal market, which constitutes a sort of European economic public order. The next section of this article looks particularly at the anatomy of this European economic public order and how it is used to reform the laws and policies of the EU in the field of screening of foreign investment.

4 THE REFORM OF REGULATION 2019/452 AND EUROPEAN ECONOMIC SECURITY

4.1 FROM THE EXCLUSION OF INTRA-EU INVESTMENT FROM THE SCOPE OF REGULATION 2019/452 TO ITS INCLUSION IN THE NEW PROPOSAL

Safeguarding national security is a sensitive matter, and the screening of FDI is, to a considerable extent, a highly political and discretionary decision.[82] Regulation 2019/452 does not harmonize the protection level of 'security and public order' at EU level, meaning that the Member States are, in principle, free to determine the requirements of '(public) security and public order' considering their national needs and then justify the restriction to the economic fundamental freedoms with reference to their own national 'security and public order' standards.[83] Even though Regulation 2019/452 puts FDI screening under the Common Commercial Policy (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.[84] 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 direct investments.[85] While third-country (foreign) investors can only rely on free movement of capital in relation to their direct investments in an EU target,[86] EU-based investors

[82] Aldo Sandulli, 'The *Xella* Case: Screening FDI is a matter of proportionality' (*EU Law Live*, 20 November 2023) <https://eulawlive.com/op-ed-the-xella-case-screening-fdis-is-a-matter-of-proportionality-by-aldo-sandulli/> accessed 01 September 2024.
[83] ibid, see also Hindelang and Moberg (n 22) 1452; 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'.
[84] See Recital 4 of Regulation 2019/452.
[85] Trajan Shipley, 'Where Investment Screening and the Internal Market Meet – *Xella Magyarorszag* (C-106/22)' (*EU Law Live*, 22 September 2023) <https://eulawlive.com/op-ed-where-investment-screening-and-the-internal-market-meet-xella-magyarorszag-c-106-22-trajan-shipley/> accessed 01 September 2024.
[86] Commentators are still not aligned on whether free movement of capital should apply in relation to FDI, or whether 'direct investments' are exclusively covered by freedom of establishment, thus excluding the coverage of FDI by any of the internal market freedoms. See: Steffen Hindelang, 'The Influence of Competing Freedoms on the Scope of Application – Direct Investment between Free Movement of Capital and the Free Movement of Establishment' in Steffen Hindelang (ed), *Free Movement of Capital and Foreign Direct Investment* (Oxford University Press 2009) 90; Case C-35/98 *Verkooijen* EU:C:2000:294. For opposing view, see: Jukka Snell, 'EU Foreign Direct Investment Screening: Europe qui protège?' (2019) 44(2) European Law Review 137, 138; Case C-446/04 *Test Claimants in the FII Group Litigation* EU:C:2006:774 para. 98. In the Explanatory Memorandum of the Regulation 2019/452 the Commission simply stated that the instrument is consistent with Article 63 TFEU and disregarded the application Article 49 TFEU, providing that it does not apply to third country nationals in the EU.

traditionally relied on freedom of establishment in relation to investments that enabled them to control the target.[87]

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 EU freedom of establishment, given that Xella is an EU company.[88] 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.[89] Peréz summarizes that the Court drew 'a line in the sand for [FDI]'. Indirect FDI falls exclusively under the freedom of establishment. In contrast, direct FDI falls under the scope of Regulation 2019/452.[90] 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.[91] 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.[92] After all, FDI Regulation established certain procedural safeguards for foreign investors to rely upon, EU investors are now left only to rely on the freedom of establishment.

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 foreign investment to the extent that the restrictions comply with the Treaty rules on fundamental freedoms.[93] The Regulation establishes specific standards that protect investors against abuse of screening by Member States by imposing procedural rules on the national authorities. The Regulation excludes indirect foreign investment, so the procedural safeguards do not apply to EU investors with foreign control.[94] 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.[95] Interpreting the scope of Regulation 2019/452 to cover indirect foreign investment could have struck a balance between the rights of the EU investor and Member States' need to screen FDI.[96] 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

[87] See Case C-196/04 *Cadbury Schweppes* EU:C:2006:544 para 33; Case C-524/04 *Test Claimants in the Thin Cap Litigation* EU:C:2007:161 para 34.
[88] ibid. See *Xella* (n 5) paras 31, 41–44.
[89] ibid. See *Xella* (n 5) paras 59 and 69.
[90] See Perez (n 48).
[91] ibid; Shipley (n 85).
[92] See Nicolò 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*, 25 July 2023) <https://eulawlive.com/op-ed-screening-of-foreign-direct-investment-within-the-union-protection-of-essential-interests-or-abuse-of-rights-c-106-22-xella-magyarorszag-by-nicolo-andreotti/> accessed 01 September 2024.
[93] ibid; see also Perez (n 48).
[94] See Andreotti (n 92).
[95] ibid. See Opinion of AG Ćapeta in *Xella* (n 27) para 53.
[96] Andreotti (n 92); see also Perez (n 48).

that does not screen FDI.[97] However, Member States screening FDI are likely to screen EU investors. Negating the application of Regulation 2019/452 to the indirect foreign investment arguably 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.[98] The new proposal extending the scope of the FDI Regulation is not only based on this economic rationale but also clearly takes into consideration the risks to 'security and public order' that the EU is facing in having a system of screening that resembles a Swiss cheese, i.e. a screening system that is full of holes/gaps since it only focuses on FDI and allows some Member States to keep their national system of screening through a minimum level of harmonization.

According to the new proposal of a Regulation replacing Regulation 2019/452, there is a need to include both direct and indirect foreign investments, and thus to extend the scope of the cooperation mechanism, in order to ensure that any investment creating a lasting link between the foreign investor and the Union target, whether it is carried out directly by a foreign investor or through an entity established in the Union and controlled by a foreign investor, is consistently captured and assessed.[99] Accordingly,

> This should foster the consistency and predictability of screening rules across Member States, which in turn will reduce compliance costs for foreign investors and limit incentives to target an investment in Member States where such transactions are out of scope.[100]

The key rationale for extending the scope of the FDI Regulation is based on the need to develop the legal certainty of screening rules based not only on the necessity to reduce the cost for foreign investors but also, more importantly it is argued, to reduce the 'risks to security and public order' in the EU.

4.2 THE SCOPE OF THE NEW PROPOSAL

On the 24th of January 2024, the European Commission published a Proposal for a new screening regulation that is supposed to 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.[101] The European Commission notes that currently there is only little framing as to its scope.[102] Similarly, the European Court of Auditors warned that there are 'significant divergences across the screening mechanisms of Member States',

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[97] See Recital 10 of Regulation 2019/452; and Sophie Meunier, 'Divide and conquer? China and the cacophony of foreign investment rules in the EU' (2014) 21(7) Journal of European Public Policy 996, 1010-1011.
[98] See Andreotti (n 92).
[99] See Recital 10 of the Proposal (n 6).
[100] ibid.
[101] 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, 37–38 ('Evaluation of Regulation (EU) 2019/452').
[102] Evaluation of Regulation (EU) 2019/452 (n 101).

causing legal uncertainty.[103] It remains unclear who should undergo screening and what needs to be screened but also what constitutes 'security' or 'essential security interests' concepts, for instance. Problems arise in cases where the foreign investment concerns several Member States' jurisdictions, causing regulatory nightmares to investors who must navigate in which Member States they must undergo screening in relation to their investment, ultimately decreasing EU's effectiveness to attract the wanted investment. With the European Commission's duty to evaluate the functioning and effectiveness of the Regulation no later than three years after its implementation,[104] the European Commission underlined that 'the chain is only as strong as its weakest link'[105] and found that a new legislative instrument is necessary to address the critical shortcomings in the effectiveness of FDI screening into the Union.[106]

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.[107] Screening will remain in the realm of Member States, which will be obliged to screen.[108] The shift to a compulsory nature intends to close the compliance gap in the remaining five Member States, which do not have any mechanism in place.[109] In need to address the shortcomings of the regime under Regulation 2019/452, the European Commission proposes extending the scope of the new regulation to cover indirect FDI, defined as 'foreign investment'.[110] This 'foreign investment' is made by an EU investor, ultimately controlled[111] by a foreign investor, and is intended to establish or maintain direct and lasting links between the foreign investor and the Union target.[112] 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.

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[103] 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*, 24 October 2023), 5 <https://www.eca.europa.eu/en/publications?ref=SR-2023-27> accessed 01 September 2024 ('European Court of Auditors, Special Report').

[104] Article 15(1) of Regulation 2019/452.

[105] ibid; Evaluation of Regulation (EU) 2019/452 (n 101) 2.

[106] Commission, 'Explanatory Memorandum to the Proposal' COM (2024) 23 final, 2 ('Explanatory Memorandum').

[107] Articles1(1) and 1(2) of the Proposal (n 6).

[108] Article 1(1) and 3(1) of the Proposal (n 6).

[109] Recital 7 of the Proposal (n 6). See Explanatory Memorandum (n 101) 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 103) 27.

[110] However, see Article 2 of the Proposal (n 6). The definitions of FDI and 'foreign investor' 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.

[111] In addition to the direct control, where the foreign investor exercises control over the EU subsidiary, the Proposal also includes indirect control. The national 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 new approach broadens the scope of screening mechanisms and provides national authorities with a greater understanding of the ownership structure of the foreign investor. 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. 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.

[112] See Article 2(3) of the Proposal (n 6).

In reaction to increased security concerns over the past four years and the demand of the Member States that already screen indirect foreign investment, e.g. Austria, the European Commission proposes that the new regulation shall also cover indirect foreign investment.[113] 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 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. Article 2 of the Proposal, in addition to the FDI, defines 'foreign investment' in Article 2(1) as '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'.[114] Thus, an EU investor as in the *Xella* case with foreign control intending to exercise influence over the Union target would be caught by the new legislation. In screening indirect FDI, the European Commission opts for an approach incorporating the control over an EU investor into the definition of the foreign investor. The proposal proposes differentiating between direct FDI and investment within the Union with foreign control (IUFC). Article 2(3) of the Proposal defines IUFC as:

> 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.

An intra-EU investment, according to the Proposal, means an investment of any kind via the foreign investor's subsidiary in the Union.[115]

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, if they comply with the justifications under the derogations from the free movement Treaty provisions. 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

[113] Explanatory Memorandum (n 106) 3; see also recitals 8–10 of the Proposal (n 6).
[114] See Article 2(1) of the Proposal (n 6).
[115] See Article 2(7) of the Proposal (n 6).

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 'security and public order'.

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 by listing the activities in which targets are active.[116] 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.[117] The screening of foreign investments not covered by the proposed regulation shall nevertheless comply with the requirements of the regulation.[118] In addition to Article 207 TFEU, the new regulation is also supposed to be based on Article 114 TFEU. The European 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 economic fundamental freedoms, they affect the functioning of the internal market. Moreover, Article 114 TFEU allows the inclusion of investments made via Union subsidiaries with foreign control in the scope of the new regulation.[119] This extends the coverage of Regulation 2019/452 solely based on Article 207(2) TFEU, as it only captured direct FDI falling within the ambit of CCP.[120] The non-exhaustive list of areas where the Union target is active[121] and factors to take into account when determining whether the foreign investment has an impact on security[122] and public order confirm that the new regulation is supposed to encapsulate the justifications for the fundamental freedoms derogations, similarly to the point made by AG Ćapeta in *Xella* in respect to Regulation 2019/452.[123] In this sense, Article 14(1) of the Proposal, 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) of the Proposal, 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

[116] See Recital 6 of the Proposal (n 6).
[117] See Article 1(3) of the Proposal (n 6).
[118] See Recital 11 of the Proposal (n 6).
[119] ibid. See also Explanatory Memorandum (n 106) 10: 'This constitutes an additional step by comparison with the concept of circumvention in the current Regulation, which only applies when the transaction is carried out within the EU by means of artificial arrangements that do not reflect economic reality. This extension requires the use of Article 114 TFEU as a legal basis to reflect the fact that investments within the EU would be covered by the proposed regulation'.
[120] Explanatory Memorandum (n 106) 11.
[121] See Annex I and Annex II of the Proposal (n 6).
[122] See Article 13 of the Proposal (n 6).
[123] ibid. See Opinion of AG Ćapeta in *Xella* (n 27) paras 50–51.

movement of capital and establishment.[124] In conclusion, the new regulation will correct the outcome of *Xella* by striking a balance between the economic and procedural rights of the foreign investor as well as EU investor with a foreign control and the Member States' need to screen FDI directly under the regulation. This will prevent the disproportionate burden on the economic freedom of establishment as the only available recourse for EU investors with foreign control.

5 CONCLUSION

With the new proposal, the legislator reflected on the inadequacy of the current regime and the need for a stricter and more coherent system of control of foreign investments 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 foreign investment, or a list of industries and activities considered sensitive. The final wording of the regulation will obviously depend on the outcome of the negotiations between the institutions in a legislative procedure.[125] The broad definition of foreign investments (including both FDI and IUFC) 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 foreign investment, the CJEU will endorse an assessment on a case-by-case basis, requiring the national court to consider the factual circumstances to establish whether the foreign parent exercises the control over the EU subsidiary and to what extent the foreign investor will then exercise control over the Union target. One of the major novelties with the new proposed regulation is the inclusion, as a legal basis, of Article 114 TFEU as a complement to Article 207 TFEU. This new legal basis will probably be challenged before the CJEU. However, considering the 'security and public order' rationale of this novel secondary legislation replacing the FDI Regulation, it will be very difficult to make the CJEU annul this legislation on the ground of the use of the wrong legal basis. This is also so since the CJEU is always very cautious in annulling EU legislation by granting a broad margin of discretion to the EU legislature in making EU regulations. Such

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[124] Proposal (n 6). See also Explanatory Memorandum (n 106) 4; Recital 9 of the Proposal (n 6).

[125] See Ahamad Madatali with Torlai (n 2). This briefing discusses the implementation of the current FDI Screening Regulation in EU Member States based on the Commission evaluation findings, other institutional reports, and expert analysis. See Conclusion at page 11: 'The January 2024 legislative proposal to update the EU FDI Screening Regulation aims at modernising and strengthening the existing legal framework. It addresses the differences between Member States' screening mechanisms that could hamper the smooth functioning of the internal market for investment, creating a level playing field among Member States. Moreover, it seeks to enhance the efficiency of the cooperation mechanism by extending the scope to incoming FDIs made by EU subsidiaries but ultimately controlled by third-country investors. Overall, by stating the principle that certain foreign investments need to undergo screening, regardless of which Member State is the location of the target, the revised regulation's stated aim is to ensure a more consistent and efficient approach to risks to security and public order flowing from foreign investment into the EU'.

a margin of discretion in our specific case is also certainly increased by the explicit 'security and public order' rationales of the new regulation. 'Security and public order' are clearly making their way in the harmonization of the internal market and the constitutional development of a new European economic public order, for better and for worse.

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