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Research Report

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FDI screening regulation and the recent EU guidance:

What options do member states have?*

by

Jens Velten**

FDI screening is on the rise, and the EU has joined in. A major step was the adoption of the [FDI Screening Regulation](#) (Regulation) in March 2019.¹ Applicable as of October 11, 2020, the Regulation seeks to harmonize member states' approaches to FDI screening by providing certain substantial and procedural cornerstones for national screening mechanisms.² Its most important element is the proposal of a common screening criterion: FDI "likely to affect security or public order." However, the decision on whether to set up an FDI screening mechanism and on what grounds remains the sole responsibility of member states.

In light of the COVID-19 crisis, the EU Commission is intensifying political pressure. In its guidance on the protection of Europe's strategic assets dated March 25, 2020 ([Guidance](#)), the Commission warns member states of possible hostile takeovers of "Europe's strategic assets"—facilitated by the current economic shock, not only in health, but all sectors. The Guidance urges member states to address these risks by adopting and applying FDI screening mechanisms in accordance with the Regulation's framework.

If member states want to set up screening mechanisms, the most important question is what screening criterion to choose. The meaning of "security or public order" oscillates between two poles. One pole constitutes a narrow concept of security. It protects countries' military sectors, possibly enlarged by fundamental interests of society, such as the need for electricity, water and food supply. The other pole represents a broader, more economic notion of security, comprising industrial policy as well as geopolitical and economic considerations. Another crucial element is the degree of risk the screening mechanism requires for an investment to affect "security or public order." Is an abstract possibility of harm enough, or must an FDI project pose an immediate threat? The former would constitute a low threshold and, thus, result in a more restrictive screening mechanism.

The Regulation provides a fairly broad understanding of "security" for two reasons. First, it does not replicate the well-known ground of exception to the EU Fundamental Freedoms "public policy or public security."³ That notion would have ensured a narrow scope, since the European Court of Justice (ECJ) defines it as "a genuine and sufficiently serious threat to a fundamental interest of

society.”⁴ Instead, the Regulation seems to reference the broader exceptions of public international law.⁵ Second, the notion of “likely to affect” sets a significantly lower threshold of risk than the ECJ’s definition.

The term “strategic assets” indicates an even broader security understanding. The Regulation only lists “critical infrastructure and technologies” as potentially relevant to “security or public order.”⁶ That notion is closely related to the ECJ’s narrow understanding of “public policy or public security.” The term “strategic assets,” in contrast, also includes geopolitical and industrial policy considerations, such as building and keeping future technology capacities. This is why the EU Parliament’s proposal to add the word “strategic” to the above-mentioned list was rejected. The Regulation, thus, clearly chooses a narrower security understanding.⁷ Against that background, the Guidance’s repeated use of the term “strategic assets” and the Commission’s call on member states to use the Regulation to “prevent a sell-off of strategic EU assets” may be misleading.⁸

Member states now have the opportunity to take a stance and determine how the EU’s FDI screening landscape will look. They can decide whether to adopt FDI screening mechanisms and, if so, how far-reaching these mechanisms will be. Without prejudice to constraints deriving from pre-existing national legislation, member states have four options:

- No screening mechanism.
- Mechanisms with a narrower scope, by explicitly limiting the mechanism’s scope to the notion of “public policy or public security” and/or its narrow interpretation by the ECJ (“Fundamental Freedom Option”).
- Mechanisms with a broader scope, by implementing the Regulation’s notion of “likely to affect security or public order,” while emphasizing its limitations to “critical assets” (“EU Regulation Option”).
- Screening with an even broader scope: in addition to the EU Regulation Option, endorsing an understanding that includes “strategic assets” (“Strategic Asset Option”).

Member states may choose between these options according to their evaluation of three main interests: attracting incoming FDI, protecting certain domestic assets and participating in EU-wide harmonization. Adopting no screening mechanism promotes only the first interest and neglects the other two. The Strategic Asset Option risks deterring FDI inflows, undermines the Regulation’s focus on critical assets and disguises industrial policy as security considerations.

Consequently, member states should, depending on their individual interest constellation, opt for either the narrower Fundamental Freedom Option or the broader EU Regulation Option.

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¹ FDI Screening Regulation, (EU) 2019/452, Mar. 19, 2019, Recital (2).

² See [Carlos Esplugues, “A future European FDI screening system: solution or problem?,” *Columbia FDI Perspectives*, no. 245, Feb. 11, 2019.](#)

³ See, e.g., Treaty on the Functioning of the European Union, Art. 65(1)(b).

⁴ *Commission v Greece*, C-244/11 (Nov. 8, 2012), para. 67.

⁵ Regulation, Recitals (3) and (35).

⁶ Regulation, Art. 4(1).

⁷ See [Amendment 39 and 40 in Report A8-0198/2018 on Regulation, Art. 4\(1\).](#)

⁸ See [“Coronavirus: Commission issues guidelines to protect critical European assets and technology in current crisis,” *EU Commission press release*, Mar. 25, 2020,](#) and the title of the Guidance.

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