

# EVALUATION OF THE EU SCREENING MECHANISM AND THE QUESTION OF RECIPROCITY WITH CHINA

Matija Kontak\*

*Abstract: This paper comments on the EU's legal framework for screening foreign direct investment. This concerns the EU Regulation related to this matter. The difficulty of determining in certain cases whether a company is controlled by a foreign government is shown using the example of Huawei. The paper argues that the current screening mechanisms should be modified so that they also take into consideration reciprocity, namely whether the country of origin of foreign direct investment equally allows access to foreign direct investment from the EU. The German screening mechanism is analysed along with the most notable cases of Chinese foreign direct investment that aroused the suspicion of the German authorities. The paper highlights the discrepancy between the legal justification for blocking foreign direct investment, in particular public policy and public security reasons, with the reality in which investments are often analysed from the government standpoint of the economic or political consequences of the investment.*

*Keywords: screening mechanism, foreign direct investment, free movement of capital, EU law, China, Germany, Huawei, public policy, public security.*

## 1 Introduction

TikTok is a social platform. Users upload short video clips of up to 60 seconds in length. Machine-learning algorithms pick the most entertaining videos to serve them to a swelling number of users in the West, especially teenagers. Unlike other social platforms such as Facebook or Instagram, TikTok is Chinese. The US Committee on Foreign Investment in the United States<sup>1</sup> (CFIUS) has opened an investigation into TikTok, based on the billion-dollar acquisition of Musical.ly that the parent company of TikTok, ByteDance, made in 2017.<sup>2</sup> The concern was that vast

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\* Graduated from the Faculty of Law, University of Zagreb, in 2018. Gained an LLM in European Law (cum laude) from Radboud University, Nijmegen, the Netherlands, in 2020 (ORCID iD: 0000-0002-5859-6498). DOI: 10.3935/cyelp.17.2021.451.

<sup>1</sup> CFIUS is a committee of the United States Government that reviews foreign investment in the United States on the grounds of national security.

<sup>2</sup> An overview of the US government relation to TikTok is available from the Congressional Research Service Report R46543 <<https://crsreports.congress.gov/product/pdf/R/R46543>> accessed 27 July 2021.

amounts of user data can go back to China and finally end up in the hands of the Chinese government.

Are millions of short clips, such as those where people show off their dancing moves, a national security concern by which the rulers in Beijing could gain strategic leverage over the US? Or are the reasons for the CFI-US investigation ultimately economic? Is China able to assert any kind of control over companies such as TikTok? Cases like this sparked my interest and I was keen to explore the subject in the context of the EU.

How do EU countries restrict foreign investment? Most of the debate in the news focuses on issues of the economy, but can EU countries prohibit such investment on economic grounds? Are there any restrictions that the screening laws of EU Member States must adhere to? What is the role of public policy, public security, or related concepts? Is China taking over European champions? My main research question is how FDI screening mechanisms operate in the EU.

The screening of foreign direct investment means to assess foreign direct investment that could have a negative effect on the country receiving the investment. In particular, two of the most important justification grounds in EU law are public policy and public security. Foreign direct investment (hereinafter: also FDI) is, in European Union (hereinafter: EU) law, a form of movement of capital.<sup>3</sup> Free movement of capital is a fundamental freedom of the EU.<sup>4</sup> What is more, capital movements from third countries are also covered by the free movement of capital.<sup>5</sup> For example, FDI by a Chinese investor into Germany is a movement of capital, and if Germany wants to prevent this FDI, it must adhere to the justification grounds provided for restricting the free movement of capital. No other fundamental freedom extends to third countries. Some EU Member States have set up screening laws, which allow them to prevent FDI, mostly on the grounds of public policy or public security considerations. These screening laws are a form of restriction of movement of capital and must be justified in accordance with the requirements of EU law.

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<sup>3</sup> 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) is no longer in force, but still has indicative value in defining what is considered a capital movement, although the list there is not exhaustive. See Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* ECLI:EU:C:1995:451, para 34; Case C-181/12 *Welte* ECLI:EU:C:2013:662, para 31; Joined Cases C-282/04 and 283/04 *Commission v Netherlands* ECLI:EU:C:2006:608, para 19; Case C-222/97 *Trummer and Mayer* ECLI:EU:C:1999:143, para 21; Case C-483/99 *Commission v France* ECLI:EU:C:2002:327, para 36.

<sup>4</sup> Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326/47 (hereinafter: TFEU) Articles 63 to 66.

<sup>5</sup> Art 63(1) TFEU.

Screening laws, or screening mechanisms of Member States, are just one type of common restriction to the movement of capital. Another type is golden shares, which restrict the movement of capital by dissuading investors from investing in companies in which a Member State holds special rights which do not correspond to the State's share in the company – thus, golden shares.<sup>6</sup> A further type of restriction of capital movements that define jurisprudence on the matter of FDI is authorisation schemes, by which a Member State can withhold approval for a certain movement of capital.<sup>7</sup> These restrictions of capital movement can be justified on public policy and public security justification grounds.<sup>8</sup> In this paper, I will focus on screening mechanisms. In particular, I will assess the Regulation on the screening of FDI in the EU. Secondly, I will discuss the German screening mechanism, with particular attention given to its handling of Chinese FDI into Germany.

## 2 Structure of the paper

First, I will present an overview of the Regulation on the screening of FDI into the EU.<sup>9</sup> I will address how the system devised by the Regulation operates and the relationship with the screening mechanisms of the EU Member States. In this context, I will assess aspects of the Regulation that are particularly relevant for the subject of this paper. I will consider in detail some of the factors that may be taken into consideration in order to determine whether a foreign direct investment is likely to affect security or public order as mentioned in Article 4 of the Regulation. The factors chosen may reveal a motivation behind the Regulation to focus on the screening of investment coming from particular countries.

Finally, I will look at some aspects of the screening mechanisms that exist in Germany, the biggest EU economy and an important recipient of FDI. In a few notable cases where Germany screened an FDI, we will observe how its screening mechanism works.

We should bear in mind that screening mechanisms must be governed by law because these mechanisms not only restrict the free movement of capital but also restrict private economic relations between investors and companies who receive the investment. The perspective of

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<sup>6</sup> An example of a case concerning a 'golden share' is Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326.

<sup>7</sup> For a notable example of an authorisation scheme in the context of foreign direct investment, see Case C-483/99 *Commission v France* ECLI:EU:C:2002:327.

<sup>8</sup> Art 65(1)(b) TFEU.

<sup>9</sup> 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 L79I/1 (Regulation on the screening of FDI into the EU).

the government may differ from the perspective of the companies involved. Foreign direct investment is generally considered beneficial, and countries around the world strive to attract it. Therefore, preventing foreign direct investment must be an exception. The purpose of this paper is not to give a definitive and detailed overview of all aspects of screening mechanisms, but to provide a general overview of the Regulation on the screening of FDI into the EU with a focus on researching its most intriguing features.

### **3 The Regulation on screening FDI into the EU**

The Regulation does not give the Commission the tools to ultimately decide on incoming foreign direct investment. That right stays with the Member States. Here is the Commission's perspective on foreign direct investment into the EU:

A series of take-overs of European companies involved foreign investors with strong ties to their home governments which strategy focus on the purchase of European companies that develop technologies or maintain infrastructures that are essential to perform critical functions in society and the economy. The ultimate risk is that such investment could be detrimental to security and public order of the Union or its Member States.<sup>10</sup>

It is clear that the Regulation is aimed at 'foreign investors with strong ties to their home governments', which means China and to a lesser extent Russia and others. But, proving that a company has strong ties to a government is difficult, as we shall see in the analysis of Article 4 of the Regulation. An important fact we should keep in mind is that the most valuable and technologically advanced companies are predominantly found in the more developed Member States. Therefore, the Regulation primarily protects assets of the richer part of the EU. The less developed east and south of the EU may have a different view of investment coming from China or Russia. In the proposal for the Regulation, the Commission repeatedly stresses the importance of investment and free trade, but, ultimately, the purpose of the Regulation is to restrict investments, not to promote free trade.

Bismuth notes the change of attitude of the Commission towards the screening of foreign direct investment.<sup>11</sup> In 2006, France enacted a

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<sup>10</sup> Commission, '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' SWD(2017) 297 final, 10.

<sup>11</sup> Régis Bismuth, 'Screening the Commission's Regulation Proposal Establishing a Framework for Screening FDI into the EU' (2018) 3 *European Investment Law and Arbitration Review* 45, 46.

decree which required authorisation for foreign investment which concerns public policy, public security or national defence.<sup>12</sup> The Commission initiated infringement proceedings against France, as some provisions of that law could infringe the EU Treaty rules on the free movement of capital and the right of establishment.<sup>13</sup> The Commission has since refined its view on the benefits of foreign investment into the EU. The turning point was marked by a speech given by the then President of the Commission. Mr. Juncker stated that ‘we are not naive free traders’.<sup>14</sup>

### **3.1 Should reciprocity be considered when screening FDI?**

A regulation is a legal act of the EU which is binding in its entirety and directly applicable in all Member States.<sup>15</sup> The Regulation on the screening of FDI into the EU is based on Article 207(2) TFEU, which concerns common commercial policy.<sup>16</sup> The EU has exclusive competence in the area of common commercial policy<sup>17</sup> which concerns, *inter alia*, foreign direct investment.<sup>18</sup> The Regulation is therefore based on exclusive EU competence regarding common commercial policy, and foreign direct investment in particular.

The Regulation acknowledges the delicate issues of the division of competence between Member States and the EU. Recital 7 and Article 1(2) of the Regulation state that the Regulation does not infringe upon the sole responsibility of Member States for safeguarding their national security, as provided for in Article 4(2) TEU. The Regulation also claims to be without prejudice to the protection of essential security interests of Member States, as provided for in Article 346 TFEU.<sup>19</sup> These articles of the Treaties prevent the EU from creating a framework which would give the Commission definite veto power over matters concerning the screening of foreign direct investment into the EU. Bismuth speculates that this may yet be a foot-in-the-door policy, where the Commission’s soft cooperation mechanism would be a base to expand its authority later. The UK also thought that the Regulation creates an ‘unhelpful precedent’ in security matters.<sup>20</sup>

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<sup>12</sup> Bismuth (n 11) 46.

<sup>13</sup> Bismuth (n 11) 46.

<sup>14</sup> President Jean-Claude Juncker’s State of the Union Address 2017 <[https://ec.europa.eu/commission/presscorner/detail/en/SPEECH\\_17\\_3165](https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_17_3165)> accessed 25 July 2021.

<sup>15</sup> Art 288 TFEU.

<sup>16</sup> Regulation on the screening of FDI into the EU, recital.

<sup>17</sup> Art 3(1)(e) TFEU.

<sup>18</sup> Art 207(1) TFEU

<sup>19</sup> Art 1(2); Recital 9 of the regulation on the screening of FDI into the EU.

<sup>20</sup> As quoted in Bismuth (n 11) 57.

Both Reins<sup>21</sup> and Bismuth<sup>22</sup> think that a different legal basis should have been chosen for the Regulation. Interestingly, Bismuth suggests that its legal basis should be Article 64(2) TFEU, which gives the EU the power to adopt measures on capital movements to or from third countries involving foreign direct investment.<sup>23</sup> Bismuth believes that the Regulation is a missed opportunity to address the lack of reciprocity and the subsidies that are often provided by foreign governments to their country's enterprises.<sup>24</sup> It might have been better to devise a mechanism to restrict foreign direct investors who receive financing below market rates or other subsidies. Bismuth concludes that such a comprehensive mechanism would indeed be under the EU exclusive competence of Article 207 TFEU.<sup>25</sup>

I see this as an interesting view on the screening of FDI. Indeed, if the problem is the lack of reciprocity, then this should be the criterion on which screening laws, as well as the Regulation itself, should have been based. However, this approach, which would consider reciprocity, is not without potential flaws. First, the foreign investor is not to blame for the policy of its government towards FDI, so it could be viewed as unfair to block a foreign investor in this case. Secondly, there might be an economic argument to disregard reciprocity. If we consider that FDI is beneficial, then it makes economic sense to allow FDI with minimal restrictions regardless of how other countries reciprocate – it is their loss if they restrict FDI. But political considerations might prevail.

### **3.2 The Regulation on the screening of FDI into the EU in changed circumstances**

The Regulation aims to establish two systems. First, it creates a mechanism for cooperation between Member States and the Commission.<sup>26</sup> Second, the Regulation creates certain obligations for Member States. Pursuant to Article 3(8) of the Regulation, all Member States must notify their screening mechanisms to the Commission. As of December 2019, fourteen Member States had screening mechanisms in place. By June 2021, that number had risen to eighteen.<sup>27</sup>

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<sup>21</sup> Leonie Reins, 'The European Union's Framework for FDI Screening: Towards an Ever More Growing Competence over Energy Policy?' (May 2019) 128 *Energy Policy* 668.

<sup>22</sup> Bismuth (n 11) 47.

<sup>23</sup> *ibid.*, 51.

<sup>24</sup> *ibid.*, 58.

<sup>25</sup> *ibid.*, 59.

<sup>26</sup> Regulation on the screening of FDI into the EU, Art 1(1).

<sup>27</sup> List of notified screening mechanisms available at <[https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc\\_157946.pdf](https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf)> accessed 26 July 2021.

One of the latest EU Member States to establish a screening mechanism is Slovenia in its Act Determining the Intervention Measures to Mitigate and Remedy the Consequences of the Covid-19 Epidemic<sup>28</sup> which, however, does not concern only the health sector, as the name suggests, but mandates screening on any critical infrastructure and other sectors. The Slovenian law is modelled on the EU Regulation on the screening of FDI into the EU. For example, in the first place of risk factors for assessing an FDI, Slovenian law stipulates that an examination be made on whether the foreign investor is directly or indirectly controlled by a foreign government.<sup>29</sup>

The Regulation on the screening of FDI into the EU entered into force in 2019. It has been applied from 11 October 2020.<sup>30</sup> However, the conditions regarding foreign direct investment have changed dramatically from 2019. On 25 March 2020, the Commission published the Guidance on FDI and the Coronavirus. The Commission warns of the danger that healthcare capacities might be targets of FDI.<sup>31</sup> Moreover, other companies, small or big, might be taken over by foreigners in a potential 'sell-off' caused by the crisis.<sup>32</sup>

### **3.3 The cooperation mechanism**

The purpose of the mechanism for cooperation between Member States and the Commission is to keep each other informed about investments that may threaten security or public order. The cooperation mechanism establishes rights and obligations for broadly three groups. First, the Member State in which the foreign investment is taking place. Those Member States must notify both the Commission and other Member States if they are conducting the screening of a foreign direct investment.<sup>33</sup> The notification should include information on the ownership structure of the investor, the value of the investment as well as the source of funding. Admittedly, the source of funding is often difficult to

<sup>28</sup> A convenient English translation is available from the list of notified screening mechanisms <[https://trade.ec.europa.eu/doclib/docs/2020/october/tradoc\\_158966.6.2020.pdf](https://trade.ec.europa.eu/doclib/docs/2020/october/tradoc_158966.6.2020.pdf)> accessed 26 July 2021.

<sup>29</sup> Art 72(4) of the Act Determining the Intervention Measures to Mitigate and Remedy the Consequences of the Covid-19 Epidemic' <[https://trade.ec.europa.eu/doclib/docs/2020/october/tradoc\\_158966.6.2020.pdf](https://trade.ec.europa.eu/doclib/docs/2020/october/tradoc_158966.6.2020.pdf)> accessed 26 July 2021.

<sup>30</sup> Regulation on the screening of FDI into the EU, Art 17.

<sup>31</sup> Commission, 'Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Free Screening Regulation)' 2020/C 99 I/01 (hereinafter: Commission Guidance on FDI).

<sup>32</sup> *ibid*, 1.

<sup>33</sup> Regulation on the screening of FDI into the EU, Art 6(1); Recital (23).

determine. The Regulation requires it 'on the basis of the best information available to the Member State'.<sup>34</sup>

Secondly, the Regulation gives certain rights to Member States apart from the one where the investment is happening. When a Member State considers that a foreign investment in another Member State is likely to affect its security or public order, it may provide comments to the Member State undertaking the screening, regardless of whether the foreign direct investment is subject to screening in the other Member State,<sup>35</sup> or is not subject to screening.<sup>36</sup>

Thirdly, the Commission may give its opinion on the effects of a foreign direct investment on the security or public order in more than one Member State.<sup>37</sup> The Commission is obliged to provide an opinion if at least a third of the Member States consider that a foreign direct investment is likely to affect their security or public order.<sup>38</sup> Both the Member States and the Commission must notify the Member State undertaking the screening<sup>39</sup> or the Member State where the foreign investment is planned or has been completed<sup>40</sup> of their intent to provide comments or an opinion, and this notification may include a request for additional information.<sup>41</sup> This system enables Member States 'to cooperate and assist each other where a foreign direct investment in one Member State could affect the security or public order in other Member States'.<sup>42</sup>

There are several interesting features of this cooperation mechanism. Member States can provide comments to Member States in which the investment is planned or completed. Member States where the investment is located might find these comments annoying. The comments on a matter of sovereignty might not be welcome, especially since we can presume that other Member States will comment only when they have a negative view of a foreign direct investment in another Member State. What is regarded as an important investment project for one country may in another country be viewed with hostility. Therefore, the usefulness of comments is not certain. Yet, it is understandable that the Commission sought to create a formal instrument where all the Member States can express their concerns.

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<sup>34</sup> *ibid.*, Art 9.

<sup>35</sup> *ibid.*, Art 6(2).

<sup>36</sup> *ibid.*, Art 7(1).

<sup>37</sup> *ibid.*, Art 6(3).

<sup>38</sup> *ibid.*, Art 6(3).

<sup>39</sup> *ibid.*, Art 6(6).

<sup>40</sup> *ibid.*, Art 7(6).

<sup>41</sup> *ibid.*, Art 6(6).

<sup>42</sup> *ibid.*, Recital 16.



Further, a Member State can ask other Member States to comment on the foreign direct investment happening on its territory and can also ask the Commission to give its opinion.<sup>43</sup> It is hard to envisage Member States inviting other countries to comment on a matter that falls within their sovereignty. However, the cooperation mechanism should only be used for the purpose of protecting security or public order.<sup>44</sup> These are the only grounds for objecting to the foreign direct investment. The reason therefore cannot be that a company from another Member State has lost a big investment project to a third country competitor, or other economic or political considerations. Regarding completed projects not undergoing screening, Member States can make comments and the Commission can issue an opinion up to 15 months after the completion of the foreign direct investment.<sup>45</sup>

Unlike Member States, which can comment, the Commission can issue opinions. Article 288 TFEU defines opinions as legal acts without binding force. The consequence is that opinions are not subject to legal review.<sup>46</sup> Therefore, an investor whose project may have been affected by the negative opinion of the Commission will not have the possibility of legal redress against it.<sup>47</sup> The Commission cannot block foreign direct investments.<sup>48</sup> It must rely on soft law and soft power to persuade (or pressure?) a Member State, or the foreign investor itself, to give up on the investment. Many foreign investors have an economic interest in not upsetting other Member States' governments or the Commission itself.

Finally, what are the consequences for a Member State disregarding either the comments of another Member State or the opinions of the Commission? The Regulation stipulates that both comments and opinions should be given 'due consideration'.<sup>49</sup> Therefore, the Member State should acknowledge that it has considered an opinion or a comment. If a Member State does not give due consideration, it acts contrary to the duty of sincere cooperation of Article 4(3) TFEU.<sup>50</sup> As a consequence, the Commission can start an infringement procedure. To avoid this, Member States

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<sup>43</sup> *ibid.*, Recital 16.

<sup>44</sup> *ibid.*, Recital 18.

<sup>45</sup> *ibid.*, Recital 21.

<sup>46</sup> Art 263 TFEU.

<sup>47</sup> A similar point was made by G Pandey, D Rovetta and A Smiatacz, 'How Many Barriers Should a Steeple Chase Have? Will the EU's Proposed Regulation on Screening of Foreign Direct Investments Add Yet More Delaying Barriers When Getting a Merger Deal Through the Clearance Gate, and Other Considerations' (2019) 14(2) *Global Trade and Customs Journal* 56, 58.

<sup>48</sup> Bismuth (n 11) 54.

<sup>49</sup> Regulation on the screening of FDI into the EU, Recital 17; Art 7(7).

<sup>50</sup> *ibid.*, Recital 17.

must provide an explanation as to why they did not take into account the opinion of the Commission or comments by another Member State.<sup>51</sup>

### **3.4 Projects and programmes of Union interest**

A special category in the Regulation concerns those foreign direct investments likely to affect projects or programmes of Union interest. The procedure regarding projects and programmes of the Union has a few distinctions. The opinion of the Commission is sent to the other Member States, instead of merely notifying them that an opinion was issued.<sup>52</sup> Member States must take 'utmost account' of the Commission's opinion as well as provide an explanation if they did not follow the opinion, instead of giving the opinion 'due consideration'.<sup>53</sup> Of course, the stronger wording does not make the opinion binding.

Projects or programmes of Union interest are defined as those which involve a substantial amount or a significant share of Union funding, or which are covered by Union law regarding critical infrastructure, critical technologies or critical inputs essential for security or public order.<sup>54</sup> Besides the abstract definition, the Regulation includes a list of those projects and programmes in the Annex. This is laudable because it provides legal certainty, precluding the Commission from using the definition of projects and programmes of Union interest too broadly. These projects and programmes concern science (eg Horizon 2020), investment in transport (Trans-European Networks for Transport), energy infrastructure (Trans-European Networks for Energy), telecommunications (Trans-European Networks for Telecommunications), and a few others. The Regulation has since been amended by a delegated act of the Commission to include further projects and programmes of Union interest.<sup>55</sup>

The Commission understandably wants a more prominent role when it comes to projects and programmes of Union (EU) interest. Both Bismuth<sup>56</sup> and Reins<sup>57</sup> note that the Commission's stance may have greater weight than a mere opinion would suggest. This is because the EU often provides the funding for infrastructure and other projects. So, we can

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<sup>51</sup> *ibid*, Recital 19.

<sup>52</sup> *ibid*, Art 8(2)(b).

<sup>53</sup> *ibid*, Art 8(2)(c); Art 7(7).

<sup>54</sup> *ibid*, Art 8(3).

<sup>55</sup> Commission Delegated Regulation (EU) 2020/1298 of 13 July 2020 amending the Annex to Regulation (EU) 2019/452 of the European Parliament and of the Council establishing a framework for the screening of foreign direct investments into the Union C/2020/4721 [2020] OJ L 304/1.

<sup>56</sup> Bismuth (n 11) 54.

<sup>57</sup> Reins (n 21) 667.

assume that Member States will be motivated not to provoke the Commission. Especially those Member States reliant on EU funding.

### **3.5 Factors to be taken into consideration**

Article 4(1) of the Regulation contains a list of factors for assessing whether a foreign direct investment is likely to affect security or public order. The word 'likely' points to the level of the burden of proof; to be more likely than not is not a high threshold to determine whether an investment affects security or public order. These factors may be considered by Member States or the Commission. The wording of the provision suggests that these factors 'may' and not 'must be' considered, and, secondly, these factors are not in any case listed exhaustively, but as 'inter alia'.<sup>58</sup>

The first category mentioned is critical infrastructure. Both physical and virtual infrastructure is included, with explicitly mentioned sectors such as energy, electoral or financial infrastructure, communications, and others.<sup>59</sup> Further listed is 'critical technology and dual use items'.<sup>60</sup> 'Dual use items' are those items, including software and technology, that can be used for both civil and military purposes.<sup>61</sup> This category mentions many of the novel technologies that induce a sense of unease because most people do not truly understand what they represent: artificial intelligence, robotics, semiconductors, cybersecurity, quantum technology, nanotechnologies, biotechnologies, etc. Surely, we do not want to sell home-grown 'quantum' technology to the Chinese instead of harnessing it for ourselves?

The next category concerns the more conventional factors of the supply of critical inputs, including energy, raw materials, and food.<sup>62</sup> Energy is a vital issue for Europe, as EU imports more than half of the energy it consumes and pays over EUR 400 billion per year for the imported energy.<sup>63</sup> About EUR 100 billion is paid for energy imports from Russia.<sup>64</sup> Another listed factor in Article 4 of the Regulation is the potential effects that the foreign direct investment has regarding access to sensitive in-

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<sup>58</sup> Regulation on the screening of FDI into the EU, Art 4.

<sup>59</sup> *ibid*, Art 4(1)(a).

<sup>60</sup> *ibid*, Art 4(1)(b).

<sup>61</sup> Council Regulation (EC) No 428/2009 of 5 May 2009 setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items [2009] OJ L134/1, Art 2(1).

<sup>62</sup> Regulation on the screening of FDI into the EU, Art 4(1)(c).

<sup>63</sup> Commission, 'Communication from The Commission to the European Parliament and the Council European Energy Security Strategy' SWD(2014) 330 final, 2.

<sup>64</sup> *ibid*.

formation. Sensitive information includes personal data as well as the 'freedom and pluralism of the media'.<sup>65</sup>

All these 'factors' represent the objects that a foreign direct investment can have. The Regulation also lists other circumstances related to the person of the foreign investor. Namely, whether the foreign investor has already been involved in activities affecting security or public order or whether there is a 'serious risk' that the foreign investor engages in illegal or criminal activities.<sup>66</sup> These seem rather straightforward. By far the most intriguing criterion states 'whether the foreign investor is directly or indirectly controlled by a foreign government'.<sup>67</sup> I consider this to be at the heart of the idea behind the Regulation (beware of China!) so I will turn to it in the following section.

#### 4 A factor to be considered: China

Is China using its tech champions to spy on the West? Does 5G equipment made by Huawei have 'back doors' which allow surveillance and control of telecommunication networks? It has just been discovered that Swiss-made encryption machines used for decades by many countries were secretly modified to allow the US and German intelligence to listen to the communications of governments such as India or Iran.<sup>68</sup> Now, Western governments worry that China might be acting in a similar manner by harnessing Huawei's equipment. China is obviously not explicitly mentioned, but the fear of China is the main reason for enacting the Regulation on the screening of FDI into the EU.<sup>69</sup>

There are plenty of examples of Chinese investments in the EU. For example, in Greece, the Chinese company COSCO invested over EUR 600 million in the biggest port in Greece in Piraeus. COSCO acquired a 35-year concession to run the container port.<sup>70</sup> The Chinese side claims that the goal is to make Piraeus the largest container port in Europe.<sup>71</sup> The President of China visited the port to affirm the investments there,

<sup>65</sup> Regulation on the screening of FDI into the EU, Art 4(1)(d) and 4(1)(e).

<sup>66</sup> *ibid*, Art 4(2)(b) and 4(2)(c).

<sup>67</sup> *ibid*, Art 4(2)(a).

<sup>68</sup> BBC, 'Swiss Machines "Used to Spy on Governments for Decades' (11 February 2020) <[www.bbc.com/news/world-europe-51467536](http://www.bbc.com/news/world-europe-51467536)> accessed 1 March 2020.

<sup>69</sup> Pandey, Rovetta, Smiatacz (n 47) 57.

<sup>70</sup> Reuters, 'China, Greece Agree to Push Ahead with COSCO's Piraeus Port Investment' (11 November 2019) <[www.reuters.com/article/us-greece-china/china-greece-agree-to-push-ahead-with-coscos-piraeus-port-investment-idUSKBN1XL1KC](http://www.reuters.com/article/us-greece-china/china-greece-agree-to-push-ahead-with-coscos-piraeus-port-investment-idUSKBN1XL1KC)> accessed 1 March 2020.

<sup>71</sup> Silvia Amaro, 'China Bought Most of Greece's Main Port and Now It Wants to Make It the Biggest in Europe' (CNBC, 15 November 2019) <[www.cnbc.com/2019/11/15/china-wants-to-turn-greece-piraeus-port-into-europe-biggest.html](http://www.cnbc.com/2019/11/15/china-wants-to-turn-greece-piraeus-port-into-europe-biggest.html)> accessed 1 March 2020.

stating that China also wants to participate in the Greek banking sector.<sup>72</sup> Further, the Chinese State Grid Corporation bought a stake in the Greek power grid operator.<sup>73</sup> Greece was ravaged by a severe economic crisis and has yet to recover. It is not surprising it welcomes investments from China.<sup>74</sup> Besides, State Grid is the world's largest electricity utility company, having both the capital and know-how to solve challenging undersea infrastructure projects connecting Greece's numerous islands.<sup>75</sup>

While the president of China might be welcomed in Greece 'bearing gifts', the EU is more suspicious. Other Member States as well as the Commission may view the Chinese expansion differently. Taking a geo-strategic view, it makes sense to invest in struggling countries which are eager for investment and where the same amount of money can have a greater impact. Also, the bigger and more developed EU countries have more products and services to potentially offer to the vast Chinese market, so are more eager for China to reciprocate in welcoming investment from the EU. It is therefore not surprising that the push for a regulation on screening foreign direct investment came from the bigger members: Germany, France and Italy, which claimed a lack of reciprocity in the treatment of investments towards foreign countries.<sup>76</sup>

The traditional main investors into the EU remain the US, Switzerland, Norway, Canada, Australia, and Japan which account for more than 80 percent of foreign owned assets.<sup>77</sup> State-owned enterprises from Norway and Switzerland have made more acquisitions in the EU than China.<sup>78</sup>

Even more importantly, foreign direct investment trends have changed in the last couple of years. Until 2016, Chinese investment into the EU had been soaring, at the same time as EU foreign investment in China had declined.<sup>79</sup> However, given the recent trends towards the

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<sup>72</sup> Reuters (n 70).

<sup>73</sup> *ibid.*

<sup>74</sup> Greece was among the countries that were against putting in place an EU screening mechanism. Bismuth (n 11) 49.

<sup>75</sup> Stelios Bouras, 'Greece Turns to China to Connect Its Far-flung Islands to the Electric Grid, Leaving Brussels in the Dark' (*Fortune*, 25 January 2020) <<https://fortune.com/2020/01/25/greece-china-power-network-ipto/>> accessed 1 March 2020.

<sup>76</sup> Bismuth (n 11) 48; Pandey, Rovetta, Smiatacz (n 47) 56.

<sup>77</sup> Commission, 'Following up on the Commission Communication "Welcoming Foreign Direct Investment while Protecting Essential Interests" of 13 September 2017' SWD(2019) 108 final, 1.

<sup>78</sup> *ibid.*, 56.

<sup>79</sup> Gisela Grieger, 'Foreign Direct Investment Screening: A Debate in Light of China-EU FDI Flows', European Parliamentary Research Service, PE 603.941 <[www.europarl.europa.eu/Reg-Data/etudes/BRIE/2017/603941/EPRS\\_BRI\(2017\)603941\\_EN.pdf](http://www.europarl.europa.eu/Reg-Data/etudes/BRIE/2017/603941/EPRS_BRI(2017)603941_EN.pdf)> accessed 1 March 2020.

tightening of investment regimes, Chinese investment into the EU has been in decline since then.<sup>80</sup> At the same time, the screening mechanisms of EU countries are being tightened (or are being established). It is a great example of the adage that law always lags behind reality. The Regulation is coming into force just as the circumstances have changed.

#### 4.1 Who owns Huawei?

Regardless of the overall investment trends, there are specific current investment issues. One is the investment in 5G technology, which is the next generation of wireless data transfer. The Chinese company, Huawei, is a world leader in 5G technology. The US government has the view that Huawei Tech is the agent of a foreign power.<sup>81</sup> Others also suspect that Huawei might be the long arm of the Chinese state, a national champion which has an economic but also a hidden political agenda.<sup>82</sup> Similar accusations appeared in the Netherlands.<sup>83</sup> On the other hand, the UK government did not yield to pressure from the US and agreed to allow Huawei's involvement in rolling out the 5G network in the UK.<sup>84</sup> However, after Huawei had been put on a sanctions list by the US, the UK government once again backtracked and stated that Huawei equipment in 5G would be removed from the UK by 2027.<sup>85</sup>

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<sup>80</sup> Thilo Hanemann, Mikko Huotari, Agatha Kratz, 'Chinese FDI in Europe: 2018 Trends and Impact of New Screening Policies', Rhodium Group (RHG) and the Mercator Institute for China Studies (MERICS) <<https://merics.org/en/report/chinese-fdi-europe-2018-trends-and-impact-new-screening-policies>> accessed 26 July 2021.

<sup>81</sup> Robert Chesney, 'Is Huawei a 'Foreign Power' or an 'Agent of a Foreign Power' Under FISA? Insights From the Sanctions Case' <[www.lawfareblog.com/huawei-foreign-power-or-agent-foreign-power-under-fisa-insights-sanctions-case](http://www.lawfareblog.com/huawei-foreign-power-or-agent-foreign-power-under-fisa-insights-sanctions-case)> accessed 1 March 2020.

<sup>82</sup> Laurens Cerulus, 'EU Commissioner: "We Have to Be Worried" about Huawei' (*Politico*, 7 December 2018) <[www.politico.eu/article/ansip-we-have-to-be-worried-about-huawei/](http://www.politico.eu/article/ansip-we-have-to-be-worried-about-huawei/)> accessed 1 March 2020; Matina Stevis-Gridneff, 'Without Naming Huawei, EU Warns Against 5G Firms From "Hostile" Power' *The New York Times* (New York, 9 October 2019) <[www.nytimes.com/2019/10/09/world/europe/eu-huawei-report.html](http://www.nytimes.com/2019/10/09/world/europe/eu-huawei-report.html)> accessed 1 March 2020.

<sup>83</sup> Huib Modderkolk, 'Huawei mogelijk betrokken bij Chinese spionage in Nederland' *De Volkskrant* (Amsterdam, 16 May 2019) <[www.volkskrant.nl/nieuws-achtergrond/huawei-mogelijk-betrokken-bij-chinese-spionage-in-nederland~b4fad1c/?referer=https%3A%2F%2Fwww.forbes.com%2Fsites%2Fzakdoffman%2F2019%2F05%2F16%2Fdutch-spy-agency-investigating-huawei-back-door-and-links-to-china-espionage%2F](http://www.volkskrant.nl/nieuws-achtergrond/huawei-mogelijk-betrokken-bij-chinese-spionage-in-nederland~b4fad1c/?referer=https%3A%2F%2Fwww.forbes.com%2Fsites%2Fzakdoffman%2F2019%2F05%2F16%2Fdutch-spy-agency-investigating-huawei-back-door-and-links-to-china-espionage%2F)> accessed 1 March 2020.

<sup>84</sup> Rob Merrick, 'UK Decision to Let Huawei Build 5G Network Sparks Diplomatic Row with Australia', *The Independent* (London, 15 February 2020) <[www.independent.co.uk/news/uk/politics/uk-5g-huawei-china-australia-row-us-trump-a9337516.html](http://www.independent.co.uk/news/uk/politics/uk-5g-huawei-china-australia-row-us-trump-a9337516.html)> accessed 19 April 2020.

<sup>85</sup> UK Government, 'Huawei to Be Removed from UK 5G Networks by 2027', press release <[www.gov.uk/government/news/huawei-to-be-removed-from-uk-5g-networks-by-2027](http://www.gov.uk/government/news/huawei-to-be-removed-from-uk-5g-networks-by-2027)> accessed 27 July 2021.

The key question, then, is whether Huawei is indeed controlled by the Chinese government. Is this control direct or indirect, or is it only potential control? The EU has a unique position, as it unilaterally extends the free movement of capital to third countries. Therefore, restrictions of foreign direct investment must be carefully framed within the free movement of capital. The Regulation is an attempt by the Commission to influence how foreign direct investment into the EU is screened. Article 4(2)(a) tries to delineate threats to security or public order that come from foreign investors that are supposedly private and market oriented but are in fact controlled by a foreign state. But how can it be proven that a company is indirectly controlled by a foreign government?

The answer to the question about who owns Huawei depends partly on how we define ownership. Huawei employs almost 200,000 people, significantly more than Apple. Huawei has overtaken Apple in the number of smartphones sold,<sup>86</sup> a fact uncomfortable for many in the US. Huawei has been experiencing stellar growth. Its revenues reached USD 100 billion in 2018. In 2019, Huawei's revenues jumped further to over USD 120 billion (reaching the level of revenue of an established US tech giant - Microsoft), despite US sanctions.<sup>87</sup>

Huawei prides itself on being almost completely 'employee owned' and many have tried to decipher the true nature of that ownership.<sup>88</sup> Huawei is an umbrella term covering multiple entities.<sup>89</sup> There is Huawei Tech, the operating company, which is a single-shareholder limited liability company.<sup>90</sup> Huawei Tech is owned by Huawei Holding. Huawei Holding has two shareholders: Mr Ren Zhengfei, the founder with about one percent, while the remaining shares are held by a committee of the Huawei trade union.<sup>91</sup> Therefore, a natural person and a trade union

<sup>86</sup> Antonio Villas-Boas, 'Huawei Sold More Smartphones than Apple in 2019 Despite the Fact That Its New Phones Can't Run Google Apps — But It's Not So Surprising' (*Business Insider*, 30 January 2020) <[www.businessinsider.com/huawei-apple-smartphone-sales-google-china-earnings-apps-2020-1?r=DE&IR=T](http://www.businessinsider.com/huawei-apple-smartphone-sales-google-china-earnings-apps-2020-1?r=DE&IR=T)> accessed 1 March 2020.

<sup>87</sup> Dan Strumpf, 'Huawei's Revenue Hits Record \$122 Billion in 2019 Despite US Campaign' *The Wall Street Journal* (New York, 30 December 2019) <[www.wsj.com/articles/huaweis-revenue-hits-record-122-billion-in-2019-despite-u-s-campaign-11577754021](http://www.wsj.com/articles/huaweis-revenue-hits-record-122-billion-in-2019-despite-u-s-campaign-11577754021)> accessed 1 March 2020.

<sup>88</sup> Raymond Zhong, 'Who Owns Huawei? The Company Tried to Explain. It Got Complicated' *The New York Times* (New York, 25 April 2019) <[www.nytimes.com/2019/04/25/technology/who-owns-huawei.html](http://www.nytimes.com/2019/04/25/technology/who-owns-huawei.html)> accessed 1 March 2020; Li Tao, 'Who Controls Huawei? Chinese Telecoms Leader's Ownership Structure Explained in More Detail' *South China Morning Post* (Hong Kong 29 April 2019) <[www.scmp.com/tech/tech-leaders-and-founders/article/3007863/who-controls-huawei-chinese-telecom-leaders](http://www.scmp.com/tech/tech-leaders-and-founders/article/3007863/who-controls-huawei-chinese-telecom-leaders)> accessed 20 April 2020.

<sup>89</sup> Christopher Balding and Donald C Clarke, 'Who Owns Huawei?' (17 April 2019) 3 <<https://ssrn.com/abstract=3372669>> accessed 1 March 2020.

<sup>90</sup> *ibid.*, 3.

<sup>91</sup> *ibid.*, 3.

committee own Huawei Holding which in turn owns Huawei Tech. Not much is known about the inner workings of the trade union, not even if it is truly a union representing workers.<sup>92</sup>

Employees of Huawei do not own shares in either Huawei Tech or Huawei Holding, but instead have a contractual right to a share in the profits.<sup>93</sup> This is not a property right; it does not give the employees voting power (control), it cannot be transferred, and is cancelled with a fixed redemption fee when an employee leaves the company.<sup>94</sup> The sole copy of the contract giving the employee evidence of ownership of these 'virtual' stocks is kept by the company.<sup>95</sup> Can employees of Huawei be considered owners, if they do not have many of the rights usually attached to ownership? Huawei employees might have been true owners until company restructuring in 2001, when they exchanged their shares for 'virtual' shares in Huawei Tech.<sup>96</sup> According to the US government, Huawei had an employee award scheme, but of a different kind: it rewarded its overseas employees for engaging in industrial espionage.<sup>97</sup>

Under Chinese labour law, employees have no voice in the trade union decision-making process.<sup>98</sup> If a trade union dissolves, its assets do not go to the members of the trade union (employees) but to the higher level trade union organisation.<sup>99</sup> Crucially, trade union officers are accountable to superior trade union organisations, which are ultimately controlled by the Communist Party.<sup>100</sup> Therefore, trade unions are *de facto* government organs.<sup>101</sup> If this line of reasoning is correct, Huawei is controlled (and owned) by a body that is ultimately controlled by the state. This makes Huawei Holding state-owned, or at least state controlled.

What does this tell us in relation to Article 4(1)(a) of the Regulation, which states that a factor in determining a threat to security or public order is that the foreign investor is directly or indirectly controlled by a

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<sup>92</sup> *ibid.*, 3.

<sup>93</sup> *ibid.*, 5.

<sup>94</sup> *ibid.*, 5.

<sup>95</sup> *ibid.*, 7.

<sup>96</sup> *ibid.*, 7.

<sup>97</sup> US Government Department of Justice, 'Chinese Telecommunications Device Manufacturer and Its US Affiliate Indicted for Theft of Trade Secrets, Wire Fraud, and Obstruction of Justice: Huawei Corporate Entities Conspired to Steal Trade Secret Technology and Offered Bonus to Workers Who Stole Confidential Information from Companies Around the World' (28 January 2018) <[www.justice.gov/opa/pr/chinese-telecommunications-device-manufacturer-and-its-us-affiliate-indicted-theft-trade](http://www.justice.gov/opa/pr/chinese-telecommunications-device-manufacturer-and-its-us-affiliate-indicted-theft-trade)> accessed 27 July 2021.

<sup>98</sup> Balding and Clarke (n 89) 9.

<sup>99</sup> *ibid.*, 9.

<sup>100</sup> *ibid.*, 10.

<sup>101</sup> *ibid.*, 10.



foreign government? Not much, in my view. Despite speculation, there is no definite proof that Huawei is state-controlled or that it uses its resources to harm security or public order in the EU. However, the Regulation on the screening of FDI into the EU asks for a relatively low level of proof: it is enough for it to be merely likely that an FDI affects security or public order. The same standard of proof is applied in the German screening mechanism.<sup>102</sup> Thus, we can conclude that, indeed, according to this analysis, it is likely that Huawei is, at least indirectly, controlled by a foreign government. Member States may take opposite views on the issue whether it is 'likely' that Huawei is state controlled. Some may focus on the quality and affordability of Huawei goods and services and the economic benefits. Others, like the US, may put security concerns (and their domestic industry) first.

## **5 EU FDI screening and the screening mechanisms of Member States**

Screening mechanisms are legal provisions in the laws of the Member States which allow Member States to screen and potentially prevent unwanted incoming foreign direct investment. Here is how the Regulation defines a screening mechanism:

[A]n instrument of general application, such as a law or regulation, and accompanying administrative requirements, implementing rules or guidelines, setting out the terms, conditions and procedures to assess, investigate, authorise, condition, prohibit or unwind foreign direct investments on grounds of security or public order.<sup>103</sup>

This definition has the hard task of uniting all the different forms that screening mechanisms take in different Member States. For example, some Member States, such as the Netherlands, have a sectoral approach.<sup>104</sup> This means that screening mechanisms are differently set out for particular sectors, such as energy or telecommunications.<sup>105</sup> Other Member States may have a general screening mechanism applicable to all foreign direct investments within their borders.<sup>106</sup> However, all screening

<sup>102</sup> See 3.5 of the paper for comments on the Regulation on the screening of FDI into the EU and the standard of proof, and part 7 for the German screening mechanism standard of proof.

<sup>103</sup> Regulation on the screening of FDI into the EU, Art 2(4).

<sup>104</sup> Dutch Government <[www.government.nl/latest/news/2017/02/16/national-government-seeks-legal-conditions-for-takeovers-in-the-telecom-sector](http://www.government.nl/latest/news/2017/02/16/national-government-seeks-legal-conditions-for-takeovers-in-the-telecom-sector)> accessed 1 March 2020.

<sup>105</sup> European Parliament, International Trade (INTA) Committee COM(2017) 487, 3-4 <[www.europarl.europa.eu/RegData/etudes/BRIE/2018/614667/EPRS\\_BRI%282018%29614667\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/614667/EPRS_BRI%282018%29614667_EN.pdf)> accessed 25 July 2021.

<sup>106</sup> *ibid.*

mechanisms assess foreign direct investments on grounds of security or public order. The grounds are limited and must be in line with EU law on the free movement of capital.<sup>107</sup>

Screening mechanisms may restrict the free movement of capital, so they have to be justified on the grounds provided in Article 65(1)(b) TFEU, namely they have to be based on grounds of public policy or public security. It is peculiar that the Regulation uses the term 'security or public order' which does not perfectly match the terms 'public policy or public security' of Article 65(1)(b) TFEU. However, the Regulation mentions that it 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'.<sup>108</sup>

Member States are not obliged to have a screening mechanism.<sup>109</sup> If they do, they are obliged to notify the Commission.<sup>110</sup> In the mentioned Guidance on FDI, the Commission calls upon Member States to set up screening mechanisms if they do not have one.<sup>111</sup> This could mean that many more states will enact screening laws, making the issue of FDI screening based on public security and public policy more relevant than ever.<sup>112</sup> Whatever the case, Member States must provide an annual report,<sup>113</sup> including all the decisions on 'allowing, prohibiting or subjecting foreign direct investments to conditions' in their territory.<sup>114</sup> The Commission itself draws up an annual report on the implementation of the Regulation, which incorporates the annual reports submitted by Member States.<sup>115</sup> The report of the Commission is submitted to the European Parliament and to the Council. It should be made public.<sup>116</sup> The Commission evaluates the functioning of the Regulation at five-year intervals, with the first evaluation scheduled for October 2023.<sup>117</sup> This report should be the basis for possible amendments to the Regulation.

Screening mechanisms that do exist have to satisfy a number of basic conditions set by the Regulation. They must be transparent and

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<sup>107</sup> In particular with Arts 63 to 66 TFEU.

<sup>108</sup> Regulation on the screening of FDI into the EU, Recital (4).

<sup>109</sup> *ibid.*, Art 3(1).

<sup>110</sup> *ibid.*, Art 3(7); Recital 22.

<sup>111</sup> Commission Guidance on FDI (n 31) page 2 of Annex 2.

<sup>112</sup> In fact, four other Member States have notified the existence of their screening mechanisms in the last year.

<sup>113</sup> Regulation on the screening of FDI into the EU, Art 5(1).

<sup>114</sup> *ibid.*, Recital 22.

<sup>115</sup> *ibid.*, Art 5(3).

<sup>116</sup> *ibid.*, Recital 32.

<sup>117</sup> *ibid.*, Art 15; Recital 34.

must not discriminate between third countries.<sup>118</sup> Member States must also set timeframes for screening to allow time for comments from other Member States and for the opinion of the Commission.<sup>119</sup> It is not certain how much additional time the process of notifying, commenting and responding to comments will take. It is estimated that national screening procedures last from two to four months.<sup>120</sup> Further, foreign investors must have the right to appeal against the screening decisions of national authorities.<sup>121</sup> Finally, Member States must not allow fraudulent circumvention of their rules.<sup>122</sup>

With these conditions in mind, we can conclude that Member States are not obliged (perhaps, they are gently nudged) to have a screening mechanism, but if they have one, it must satisfy these specifications. The principles of transparency, non-discrimination and the possibility of legal review are well known in EU law. It is more difficult to make screening mechanisms safe from circumvention, as it is often hard to trace layers of ownership back to the original owner or to the grey eminence in control.

## **6 Final thoughts on the Regulation on the screening of FDI into the EU**

The Regulation on the screening of FDI into the EU does not give the Commission the right of veto regarding a foreign investment. Nevertheless, the Regulation creates extra hurdles for getting a deal done.<sup>123</sup> The vast majority of foreign direct investments, which represent no threat to security or public order, may suffer delays because of the screening. We can summarise the main features of the Regulation on the screening of FDI into the EU as follows: it does not oblige EU Member States to set up their own screening mechanisms and it does not give the Commission the right to decide whether to allow FDI in particular Member States. However, the Regulation on the screening of FDI into the EU provides certain common rules for EU screening mechanisms. The most useful aspect, in my view, is the obligation of every Member State to report their

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<sup>118</sup> *ibid.*, Art 3(2).

<sup>119</sup> *ibid.*, Art 3(3).

<sup>120</sup> Commission, 'Staff Working Document Accompanying the document 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' SWD/2017/0297 final - 2017/0224 (COD) final, 8.

<sup>121</sup> Regulation on the screening of FDI into the EU, Art 3(5).

<sup>122</sup> *ibid.*, Art 3(6).

<sup>123</sup> Pandey, Rovetta, Smiatacz (n 47) 65.

own screening mechanisms so that they are presented for all the Member States in a practical table.<sup>124</sup>

Further, the circumstances have changed. Chinese investment is not exponentially rising but is falling. The economic crisis might prompt many to wonder why we erect barriers for investment into the EU. It may happen that the Screening Regulation gets tacitly side-lined because the attitude towards (Chinese) investments may change. Or it may happen that the screening of FDI based on public policy and public security occurs even more frequently. More than thirty years ago, Donald Trump warned fellow Americans of the economic threat from Japan,<sup>125</sup> which was then on the path to overtaking the US as the world's largest economy. Most people today do not feel that Japan will dominate the world. Yet, the case for China is stronger. The Chinese population is about ten times larger than Japan's, even though China is, on a per capita basis, still poorer than the poorest EU country.<sup>126</sup>

## 7 Germany: foreign direct investment screening and notable cases

Germany is considered to have a friendly attitude towards foreign direct investment.<sup>127</sup> It has the biggest economy of the EU Member States. In line with the overall investment trends, it has amended its rules on the screening of foreign direct investment by expanding the sectors covered and lowering the thresholds of shares required to activate the screening mechanism. The purpose of this section is to comment on these changes in order to evaluate the foreign direct investment screening of the German system.

The German version is a good example of an EU Member State screening mechanism. First, the German screening mechanism is elaborate, as it distinguishes two types of screening: cross-sectoral and sector-specific (both types of screening are justified with respective EU law provisions). Second, Germany is an important recipient of FDI, including FDI from China. Finally, German screening, with its detailed provisions,

<sup>124</sup> Regulation on the screening of FDI into the EU, Art 3 (7). Table available at <[https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc\\_157946.pdf](https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf)> accessed 29 August 2021.

<sup>125</sup> Jacob M Schlesinger, 'Trump Forged His Ideas on Trade in the 1980s—and Never Deviated' *The Wall Street Journal* (New York, 15 November 2018) <<https://www.wsj.com/articles/trump-forged-his-ideas-on-trade-in-the-1980sand-never-deviated-1542304508>> accessed 1 March 2020.

<sup>126</sup> Measured by GDP per capita (constant USD 2010) from data by the World Bank <<https://data.worldbank.org/>> accessed 1 March 2020.

<sup>127</sup> Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia 2018) 422.

may serve as an inspiration for other EU Member States that want to establish or revise their screening mechanisms.

### **7.1 General overview of the German foreign direct investment screening mechanism**

Germany has amended its screening mechanism repeatedly in the last few years. A practical way to keep track of the modifications is to look at the notifications that Germany provides to the Organisation for Economic Co-operation and Development (hereinafter: OECD) that present and explain the amendments to its screening mechanism.<sup>128</sup> Germany is obliged to notify the OECD regarding modifications on the grounds of national security that it makes to its investment policy.<sup>129</sup>

The provisions regarding the screening of foreign direct investment are contained in the Foreign Trade and Payments Ordinance (in German: *Außenwirtschaftsverordnung*, hereinafter: AWV). The foreign investment screening mechanism in Germany is divided between cross-sectoral screening (contained in Sections 56 to 59 AWV) and sector-specific screening (contained in Sections 60 to 62 AWV). Cross-sectoral screening applies if the investor is not based in the EU (or in the European Free Trade Organisation). On the other hand, sector-specific screening applies to acquisitions by any person that is not a German resident.

The screening thresholds are as low as 10 percent of voting rights regarding certain sectors, such as the sectors of critical infrastructure or defence. Furthermore, media enterprises have been added to the list of sectors where even a 10 percent voting rights shareholding can be screened.<sup>130</sup> In a further amendment in 2020, during the pandemic, the health sector was added to this list.<sup>131</sup> Can acquiring one tenth of a company's voting rights be considered a direct investment? Direct investment requires the ability to exert control over the company, otherwise

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<sup>128</sup> Organisation for Economic Co-operation and Development, DAF/INV/RD(2019), 1 <[https://one.oecd.org/document/DAF/INV/RD\(2019\)1/en/pdf](https://one.oecd.org/document/DAF/INV/RD(2019)1/en/pdf)> accessed 15 March 2020.

<sup>129</sup> OECD, 'Code of Liberalisation of Capital Movements', Art 11, available at <[www.oecd.org/daf/inv/investment-policy/OECD-Code-capital-movements-2019-EN.pdf](http://www.oecd.org/daf/inv/investment-policy/OECD-Code-capital-movements-2019-EN.pdf)> accessed 15 March 2020.

<sup>130</sup> Oliver Schröder, 'Germany' in Calvin S Goldman QC and Michael Koch (eds), *The Foreign Investment Regulation Review* (7th edn, Law Business Research 2019).

<sup>131</sup> The list of notified screening mechanisms also shows a table with recent changes and links to the amendments: <[https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc\\_157946.pdf](https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf)>; <[www.bmwi.de/Redaktion/DE/Downloads/F/fuenfzehnte-verordnung-zur-aenderung-der-aussenwirtschaftsverordnung-regierungsentwurf.pdf?\\_\\_blob=publicationFile&v=10](http://www.bmwi.de/Redaktion/DE/Downloads/F/fuenfzehnte-verordnung-zur-aenderung-der-aussenwirtschaftsverordnung-regierungsentwurf.pdf?__blob=publicationFile&v=10)> accessed 26 July 2021.

the investment can be regarded as a portfolio investment.<sup>132</sup> The OECD benchmark stipulates that 10 percent of voting rights is the minimum to exert control.<sup>133</sup> Naturally, there are many cases where 10 percent will not give an investor control, and possibly other situations where an investor with even less than 10 percent will be able to exert control. It depends, in my view, primarily on how fragmented the shareholders structure is. If there is one shareholder with 80 percent of the voting rights, then having the remaining 20 percent can hardly be considered a controlling stake. The line between portfolio and direct investment is thus undefined. The chosen value of 10 percent is surely capable of catching even those investments that do not give the foreign investor control over the company. In those cases, we can say that there is a system of screening of foreign direct and portfolio investment. Both FDI and portfolio investment are forms of capital movement, but only FDI should be the subject of the EU Screening Regulation and the German AWV.

When calculating the percentage of voting rights, the share of voting rights that a third company holds is added to the share of the voting rights of the investor if the latter also holds voting rights in the third company.<sup>134</sup> For this rule to be applied, the foreign investor needs only to hold either 10 or 25 percent of the voting rights in the third company, depending which threshold is applied for screening of the German company.<sup>135</sup> So, if a company in which a foreign investor owns 10 percent of the voting rights itself purchases a share of 5 percent of voting rights in a German media company, that transaction can be reviewed under the AWV, even though in itself it is a purchase of only 5 percent. Similarly, if a foreign investor holds, let us say, 25 percent of the voting rights in a German company, and that German company acquires a voting rights stake in another German company, that transaction may be subject to review. This is a far-reaching attribution rule, as it is possible to imagine a string of companies that only own a stake of 10 percent in each other, and if the final owner is foreign, the transaction to acquire the stake may be subject to review.

Any type of acquisition of shares can be subject to review by the authorities, regardless of whether the shares are acquired through a merger, capital increase, swap or otherwise.<sup>136</sup> Only shares carrying voting

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<sup>132</sup> Portfolio investment is also covered by the free movement of capital and can be screened but is considered to present a much lower potential threat to public policy and public security as it does not confer control over the investment to the investor. See, for example, Commission Guidance on FDI (n 31) Annex, part 3, para 3.

<sup>133</sup> OECD, *OECD Benchmark Definition of Foreign Direct Investment* (4th ed, OECD 2008).

<sup>134</sup> AWV, Section 56.

<sup>135</sup> *ibid*, 56(2).

<sup>136</sup> Schröder (n 130) 82.

rights trigger the possibility of screening, and the law does not concern the acquisition of non-voting shares or options.<sup>137</sup> The value of the acquisition is not important, but the share of the voting rights is. This opens the possibility for reviewing small, even tiny, monetary transactions.

It is possible to challenge a decision to open a review, a decision to prohibit an acquisition, or a decision to impose restrictions, pursuant to the general principles of German administrative law.<sup>138</sup> In order to enforce a prohibition, the Federal Ministry for Economic Affairs and Energy (German: *Bundesministerium für Wirtschaft und Energie*, hereinafter: BMWi) can in particular prohibit or restrict the exercise of voting rights in the acquired company or can appoint a trustee for the unwinding of the completed acquisition, at the expense of the acquirer.<sup>139</sup>

The phrase 'essential interests of security' is used in Article 346 TFEU. This Article gives Member States the right to take the measures they consider necessary for the protection of the essential interests of their security which are connected with the production of war material, or the supply of information which would endanger their essential security interests. The German screening mechanism uses both the 'essential interests of security'<sup>140</sup> in its sector-specific screening as well as the 'public order or security'<sup>141</sup> term for cross-sectoral screening. This shows how the German screening mechanism is structured in line with the EU legal framework.

## 7.2 Cross-sectoral screening

The BMWi investigates acquisitions of domestic (German) companies by non-EU residents. The scope of the cross-sectoral screening is defined as follows: first, the acquisition of a domestic (German) company must be carried out by a non-EU resident. Secondly, this acquisition must have a 'likely effect to the public order or security' of the Federal Republic of Germany.<sup>142</sup> This same standard of proof is used in the Regulation on the screening of FDI into the EU, which asks whether an FDI is 'likely to affect security or public order'.<sup>143</sup> Thirdly, the voting rights of the acquirer in the domestic company must reach a certain threshold. This threshold is 25 percent of the voting rights, except for particularly

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<sup>137</sup> *ibid.*

<sup>138</sup> *ibid.*, 89.

<sup>139</sup> AWV, Section 59(3)(2).

<sup>140</sup> *ibid.*, Section 60.

<sup>141</sup> *ibid.*, Section 55.

<sup>142</sup> *ibid.*, Section 55.

<sup>143</sup> Regulation on the screening of FDI into the EU, Recital 7; Art 1; Art 4.

listed cases, where the threshold has been lowered to 10 percent.<sup>144</sup> It is irrelevant whether the investor is a state-owned or a private investor or whether it is already operating in the EU through a branch.<sup>145</sup> The determining factor is the place of incorporation of the investor or the factual place of management.<sup>146</sup>

The AWV contains a list of activities which may be a particular threat to public order or security if companies operating in those sectors are acquired by foreigners. In those cases, the threshold for screening is reached when 10 percent of the voting rights is acquired by the foreign investor. First on this list are companies which operate critical infrastructure. The second category concerns companies that develop and modify software used for operating critical infrastructure. Sector-specific software means software for the energy, water, information and telecommunications sectors, as well as the financial, healthcare, transport and food sectors.<sup>147</sup> The following categories concern companies in the telecommunications sector as well cloud computing services, presumably because companies that operate cloud services store vast amounts of sensitive data from many other companies, public bodies and individuals. Two more categories are on the list. The first concerns companies providing telematics infrastructure (a combination of telecommunication and informatics, such as Global Positioning System services). Finally, the list includes domestic companies active in the media industry. This last category regarding media companies was added in one of the latest amendments.

Even EU residents who acquire German companies can be subjected to screening.<sup>148</sup> This is possible if there are indications that there was abuse of the rules or a circumventing transaction. An example would be if a shell EU company has been used to circumvent the rules on screening. According to the AWV, indications of abuse are when the direct acquirer does not maintain any business operations of its own other than the acquisition itself or does not have any permanent establishment of its own including offices, staff and equipment within the European Union.<sup>149</sup>

Is it permitted to restrict free movement of capital even within the EU? In principle, Article 65(1)(b) TFEU can be used to restrict free movement of capital when it concerns public policy or public security. Article

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<sup>144</sup> AWV, Section 56.

<sup>145</sup> Schröder (n 130) 81.

<sup>146</sup> *ibid.*

<sup>147</sup> AWV, Section 55(1) 1-7.

<sup>148</sup> *ibid.*, Section 55(2).

<sup>149</sup> *ibid.*, Section 55(2).



65(1)(b) does not provide justification grounds solely in relation to non-EU countries. Therefore, the answer is yes: Germany or any other EU country can restrict foreign direct investment from another EU Member State on the grounds of public security or public policy. The term 'public order or security' used in the AWV must be interpreted with regard to Article 65(1) TFEU.<sup>150</sup>

The regime of the AWV does not distinguish between state-owned and private foreign investors. In relation to cross-sector screening, it is only relevant that the investor has its place of incorporation or factual place of management outside the EU or the EFTA.<sup>151</sup> The potential acquirer has the obligation to notify the BMWi of the conclusion of a contract concerning the categories with the 10 percent threshold.<sup>152</sup> Regarding the form or content of the notification, it is only specified that it must be provided to the BMWi in writing. The notification triggers a three-month period during which the BMWi must notify the potential acquirer that it has started screening.<sup>153</sup> If the acquisition is not reviewed after that period, it is considered to be cleared. The BMWi can request additional documentation from the direct acquirer.<sup>154</sup> The BMWi then has a further four months after the receipt of the complete documentation to either prohibit the transaction or issue instructions.<sup>155</sup> If the BMWi engages in negotiations with the acquirer about the instructions, the deadline is extended for the duration of these negotiations.<sup>156</sup> Negotiations can result in a public contract which stipulates obligations for the acquirer so that the threat to public order or security is removed.

It is also possible to apply for a certificate of non-objection.<sup>157</sup> This represents clearance by the BMWi that the acquisition does not pose a threat to the public order or security of Germany. It is useful for foreign investors to apply for this certificate. Otherwise, an *ex officio* review may be initiated by the BMWi up to five years after the conclusion of the contract.<sup>158</sup> A certificate of non-objection thus provides legal certainty that the acquisition will not be questioned in the future. Therefore, three review processes are possible regarding the cross-sectoral screening: the

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<sup>150</sup> Schröder (n 130) 88.

<sup>151</sup> *ibid.*, 81.

<sup>152</sup> AWV, Section 55(4).

<sup>153</sup> *ibid.*, Section 55(3).

<sup>154</sup> *ibid.*, Section 57.

<sup>155</sup> *ibid.*, Section 59(1).

<sup>156</sup> *ibid.*

<sup>157</sup> *ibid.*, Section 58.

<sup>158</sup> Schröder (n 130) 85.

first is initiated by notification, the second by the BMWi *ex officio*, and the third is the review for obtaining the certificate of non-objection.<sup>159</sup>

Even if the German screening system efficiently reviews all the transactions in a timely manner, all the time limits mentioned nevertheless prolong the transaction, making it less certain and more expensive. On top of this, the Regulation on the screening of FDI into the EU adds another period by which other Member States and the Commission are able to assess the transaction in Germany as well.<sup>160</sup> Even if the system is running smoothly, this adds up to a considerable amount of time. Foreign investors may refrain from investing in Germany because of these factors. Due to this uncertainty, sellers and buyers often agree on a sale of shares conditionally upon approval from the German government. In this way, they mitigate the risk of having to unwind a transaction prohibited by the BMWi.<sup>161</sup>

### 7.3 Sector-specific screening

Unlike cross-sectional screening, sector-specific screening of foreign direct investment can be applied only to certain sectors. The BMWi can examine whether 'essential security interests' of Germany are endangered if foreigners acquire a domestic company.<sup>162</sup> This concerns German companies that produce goods listed as weapons of war (including missiles, guns, combat aircraft, etc), specially constructed engines or gears for tanks or military tracked armoured vehicles, products with IT security functions which process classified information, or certain military goods listed for export. If the company that is the target of acquisition is involved in the production of these goods, a non-German acquirer must notify the BMWi.<sup>163</sup> The notification must provide rudimentary information: the acquisition, the acquirer, the domestic company to be acquired, and an outline of the fields of business where the parties operate.<sup>164</sup>

Acquisitions even by German residents may be subjected to investigations if there are indications of abuse or circumvention of the law.<sup>165</sup> This makes it possible to screen transactions of German residents and shows that sector-specific screening involves even more delicate issues

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<sup>159</sup> *ibid.*, 86.

<sup>160</sup> See 3.7 of this paper on the timeframes of the Regulation on the screening of FDI into the EU.

<sup>161</sup> Schröder (n 130) 85.

<sup>162</sup> AWV, Section 60(1).

<sup>163</sup> *ibid.*, Section 60(3).

<sup>164</sup> *ibid.*

<sup>165</sup> *ibid.*, Section 60(5).

of security, phrased as ‘essential security interests’ instead of simply ‘public order or security’.<sup>166</sup> The connection to security in the sense of external security (connected to issues of war) is clear when it comes to specific-sector screening in Germany. The concept of essential security interests corresponds closely to the formulation used in Article 346 TFEU. It is primarily a war-related, or to phrase it differently, a defence-related justification ground. While the cross-sectoral screening relies on concepts developed within EU fundamental freedoms, particularly free movement of capital, the sector-specific screening resembles the formulation used in Article 346 TFEU.<sup>167</sup>

The threshold of voting rights which triggers the duty to notify is 10 percent.<sup>168</sup> As in the case of cross-sectoral screening, there are also rules on the attribution of voting rights of third parties to the acquirer.<sup>169</sup> If there are no objections, the BMWi must issue a clearance in writing to the person who provided the notification within three months.<sup>170</sup> In the event of further investigation or the requirement for additional documents, rules for cross-sectoral screening are applied.<sup>171</sup> Likewise, the BMWi can prohibit the acquisition or can issue instructions to ensure the essential security interests of Germany.<sup>172</sup> The deadline for a decision is three months after the reception of the complete documentation,<sup>173</sup> but this can be extended for the duration of the negotiations between the BMWi and the parties involved in the acquisition.<sup>174</sup> The AWV was amended again in 2020 as well as in 2021. Further sectors of industry where FDI is subject to screening were added.

After this critical overview of the German legislation on the screening of foreign direct investment, I will now discuss some notable cases which show the interplay of law and politics.

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<sup>166</sup> *ibid.*, Section 60(1); Section 55(1).

<sup>167</sup> Steffen Hindelang ‘Enemy at the Gates? Recent Changes in the German Rules on Investment Screening in the Light of EU Law’ (2017) 28(22) *Europäische Zeitschrift für Wirtschaftsrecht* 882.

<sup>168</sup> AWV, Subdivision 2.

<sup>169</sup> *ibid.*, Section 60a.

<sup>170</sup> *ibid.*, Section 61.

<sup>171</sup> *ibid.*

<sup>172</sup> *ibid.*, Section 62(1).

<sup>173</sup> *ibid.*

<sup>174</sup> *ibid.*, Section 62(2).

## 7.4 Germany: notable cases regarding screening of foreign direct investment

### 7.4.1 KUKA

KUKA is a German company which manufactures industrial robots and other solutions for factory automation. It was founded in 1898 and during its history it has been involved in developing a diverse range of products, starting with acetylene gas for street lighting, garbage trucks in the 1920s, to knitting machines after the Second World War.<sup>175</sup> In 1972, KUKA developed the world's first industrial robot, the FAMULUS.<sup>176</sup> KUKA robots operate in bakeries, car factories, the European aerospace industry, solar panel production as well as in the production of house appliances and baby strollers.

In August 2015, the Chinese household appliance maker Midea acquired 5.4 percent of KUKA shares and then raised its stake to 10.2 percent in 2016.<sup>177</sup> Soon after, Midea made an offer of EUR 115 per share for the outstanding shares, which caused Kuka's market value to reach EUR 4.5 billion.<sup>178</sup> A prominent German politician, Markus Ferber, stated that they should try to keep KUKA in European hands.<sup>179</sup> Unfortunately for those like Mr Ferber, there were no European hands willing to match the offer of Midea. The reason was that Midea's offer of EUR 115 was 60 percent higher than the share price of KUKA a few months before the offer. KUKA was not worth that amount of money to European businesses.<sup>180</sup> The KUKA takeover rattled German politics and an opinion formed that it was necessary to change the screening rules so that takeovers such as that of KUKA by Midea could be scrutinised by the German government.<sup>181</sup> However, both the managing and supervisory board of KUKA recommended that shareholders accept Midea's offer. Soon after, Midea announced that it held 94.55 percent of KUKA. The German ministry stated that it could not launch a formal inquiry under the existing rules.<sup>182</sup> At the moment of writing, the share price of KUKA is under EUR 60.<sup>183</sup> Those who sold to Midea seem to have made the

<sup>175</sup> KUKA website <[www.kuka.com/en-de/about-kuka/history](http://www.kuka.com/en-de/about-kuka/history)> accessed 17 March 2020.

<sup>176</sup> *ibid.*

<sup>177</sup> Bas Hooijmaaijers 'Blackening Skies for Chinese Investment in the EU?' (2019) 24 *Journal of Chinese Political Science/Association of Chinese Political Studies* 451.

<sup>178</sup> Hooijmaaijers (n 177) 8.

<sup>179</sup> *ibid.*

<sup>180</sup> *ibid.*

<sup>181</sup> *ibid.*

<sup>182</sup> *ibid.*, 9.

<sup>183</sup> KUKA website <[www.kuka.com/en-de/investor-relations/shares/share-price-and-chart](http://www.kuka.com/en-de/investor-relations/shares/share-price-and-chart)> accessed 25 July 2021.

right decision: the current value of the company is still much lower than what Midea paid in 2016.

For Hooijmaaijers, the ‘most fundamental’ question in the KUKA case is why would a household appliance manufacturer acquire a high-tech robotics firm?<sup>184</sup> For me, the question is why should we examine the reasoning of business decisions made by private parties? Should Midea have the proper motivation, the appropriate background, as seen by commentators and politicians, to do business? It is the very essence of an ‘open market economy, with free competition’<sup>185</sup> to let individuals make decisions as they see fit. Even if Chinese leadership approaches the economy with a top-down view, it does not mean that this is the right approach or that the EU should counter it by doing the same. There is no convincing proof that Midea is controlled by the Chinese state. Besides, KUKA has also changed its line of business throughout its history, at one point producing household appliances as well.

#### 7.4.2 Aixtron

Aixtron is a German company involved in the chain of production of semiconductors. It suffered losses for years and then had a big order cancelled in 2015, which caused a crisis.<sup>186</sup> A Chinese company named Fujian Grand Chip Investment FUND LP (hereinafter: Fujian) offered EUR 676 million for Aixtron,<sup>187</sup> which Aixtron’s executive and supervisory boards welcomed.<sup>188</sup> Germany at first approved the sale, but then reversed it by citing that new and previously unknown evidence had emerged.<sup>189</sup> Supposedly, American intelligence services nudged Berlin towards changing its stance because the US was concerned that China might use the products of Aixtron in its nuclear programme.<sup>190</sup> This shows the uncertainty that foreign investors may face even in a stable investment regime such as that of Germany.

Aixtron technology has military applications and is used by a major US defence contractor.<sup>191</sup> The German Minister of the Economy, Sigmar

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<sup>184</sup> Hooijmaaijers (n 177) 10.

<sup>185</sup> Art 119 TFEU.

<sup>186</sup> Hooijmaaijers (n 177) 11.

<sup>187</sup> *ibid.*

<sup>188</sup> *ibid.*

<sup>189</sup> Maria Sheahan, Caroline Copley, ‘Germany Stalls Chinese Takeover of Aixtron, Citing Security Worries’ (*Reuters*, 24 October 2016) <[www.reuters.com/article/us-aixtron-m-a-fujian-germany/germany-stalls-chinese-takeover-of-aixtron-citing-security-worries-idUSKC-N12O13G](http://www.reuters.com/article/us-aixtron-m-a-fujian-germany/germany-stalls-chinese-takeover-of-aixtron-citing-security-worries-idUSKC-N12O13G)> accessed 27 July 2021.

<sup>190</sup> Hooijmaaijers (n 177) 11.

<sup>191</sup> *ibid.*

Gabriel, had a rather vivid view of the problem concerning the lack or reciprocity with China: 'Germany sacrifices its companies on the altar of free markets, while at the same time our own companies have huge problems investing in China'.<sup>192</sup> There was another good reason to be sceptical of Fujian's offer for Aixtron. The firm that cancelled the important order for Aixtron was connected to Fujian.<sup>193</sup> It seemed that there was a sinister plot to make the situation difficult for Aixtron and then buy it while it was in distress. The complex situation was resolved by the Americans. President Obama issued a (rare) ban of the sale of Aixtron Inc,<sup>194</sup> which is the American subsidiary of Aixtron. The American screening mechanism resulted in a decision which held that there was credible evidence that the sale of Aixtron Inc to the Chinese investor would impair the 'national security' of the United States.<sup>195</sup> The Chinese investor decided to abandon the whole acquisition, which made it unnecessary for the BMWi to make a final decision.<sup>196</sup> Aixtron, free of Chinese control, seems to have recovered. Its current share price is about 50 percent higher than that valued by the 2016 offer by Fujian.<sup>197</sup>

The most interesting aspect of the Aixtron case is that such a small company has implications for the essential security interests of Germany. Aixtron was in a unique position, as a private company struggling to survive, and yet vital for Germany's essential security interests. If it is true that Aixtron had relevance for essential security interests, how was it that it was struggling to find orders? What if the company did not survive the crisis? Also, why is it safe for such an essential company to be freely traded on the market, and to be owned by numerous private individuals, provided they were not Chinese? To truly assess whether a company is that important for public order or essential for national security, we would need to have a much deeper understanding of what it actually does, besides having something to do with robots or microchips.

<sup>192</sup> Janosch Delcker, 'Sigmar Gabriel's Mission to Halt China's Investment Spree' (*POLITICO*, 11 January 2016) <[www.politico.eu/article/sigmar-gabriels-mission-to-halt-chinas-investment-spre/](http://www.politico.eu/article/sigmar-gabriels-mission-to-halt-chinas-investment-spre/)> accessed 27 July 2021.

<sup>193</sup> Paul Mazur, Jack Ewing, 'Rush of Chinese Investment in Europe's High-Tech Firms Is Raising Eyebrows' *The New York Times* (New York, 16 September 2016) <[www.nytimes.com/2016/09/17/business/dealbook/china-germany-takeover-merger-technology.html](http://www.nytimes.com/2016/09/17/business/dealbook/china-germany-takeover-merger-technology.html)> accessed 27 July 2021.

<sup>194</sup> The White House, 'Presidential Order Regarding the Proposed Acquisition of a Controlling Interest in Aixtron SE by Grand Chip Investment GMBH', 2 December 2016 <<https://obamawhitehouse.archives.gov/the-press-office/2016/12/02/presidential-order-regarding-proposed-acquisition-controlling-interest>> accessed 27 July 2021.

<sup>195</sup> *ibid.*

<sup>196</sup> Hooijmaaijers (n 177) 12.

<sup>197</sup> Share Prices from Yahoo Finance <<https://finance.yahoo.com/quote/AIXA.DE?p=AIXA.DE&.tsrc=fin-srch>> accessed 10 March 2020.

And that deeper understanding is usually impossible to attain, because exactly how a company contributes to national security is a matter of secrecy, also protected by Article 346 TFEU. Whatever the truth, the importance of Aixtron can be brought into question for two reasons. First, such an important company for Germany would probably not be so dependent on a single (Chinese!) customer. Secondly, if its technology was 'cutting edge',<sup>198</sup> why was no one else (preferably a European body) interested in acquiring Aixtron?

#### 7.4.3 The cases of 50Hertz and Leifeld

China's State Grid Corp made an offer to buy a stake in the German electricity transmission system operator 50Hertz. Twenty percent of the shares of 50Hertz were put on sale by an Australian investment fund.<sup>199</sup> However, Germany arranged for its state-owned bank KfW to buy the stake instead.<sup>200</sup> This was done by an interesting manoeuvre: a Belgian company, Elia, used its pre-emptive right to buy the block of shares and then immediately resold it to KfW.<sup>201</sup> Later in the year, Germany made amendments to its screening legislation so that the threshold for screening was lowered to 10 percent of the voting rights for companies in particular sectors, including critical infrastructure.

Does State Grid Corp pose a threat to public order or security? Germany thinks so, while the Greek government welcomes the investment by State Grid Corp in its electricity transmission system, as we have seen.<sup>202</sup> This shows that two EU Member States can have opposite views regarding the same investor investing in the same sector.

On 1 August 2018, the government of Germany authorised the BMWi to prohibit the acquisition of the German company Leifeld Metal Spinning AG (hereinafter: Leifeld) by Yantai Taihai Corp, a Chinese company.<sup>203</sup> Leifeld is a German Mittelstand (medium-sized) specialised

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<sup>198</sup> Hooijmaaijers (n 177) 11.

<sup>199</sup> Arno Schuetze, Gernot Heller 'Germany Nears Investment in 50Hertz to Fend Off China's State Grid' (*Reuters* 19 July 2018) <[www.reuters.com/article/us-50hertz-m-a-china/germany-nears-investment-in-50hertz-to-fend-off-chinas-state-grid-sources-idUSKBN1K91V6](http://www.reuters.com/article/us-50hertz-m-a-china/germany-nears-investment-in-50hertz-to-fend-off-chinas-state-grid-sources-idUSKBN1K91V6)> accessed 17 March 2020.

<sup>200</sup> Schröder (n 130) 78-79.

<sup>201</sup> 50Hertz website <[www.50hertz.com/en/News/FullarticleNewsof50Hertz/id/5815/closing-kfw-replaces-ifm-as-share-holder-in-50hertz-holding-company](http://www.50hertz.com/en/News/FullarticleNewsof50Hertz/id/5815/closing-kfw-replaces-ifm-as-share-holder-in-50hertz-holding-company)> accessed 17 March 2020.

<sup>202</sup> 'China, Greece Agree to Push Ahead with COSCO's Piraeus Port Investment' (*Reuters*, 11 November 2019) <[www.reuters.com/article/us-greece-china/china-greece-agree-to-push-ahead-with-coscos-piraeus-portinvestment-idUSKBN1XL1KC](http://www.reuters.com/article/us-greece-china/china-greece-agree-to-push-ahead-with-coscos-piraeus-portinvestment-idUSKBN1XL1KC)> accessed 1 March 2020.

<sup>203</sup> Arne Delfs 'Germany Toughens Stance and Blocks China Deal' (*Bloomberg*, 1 August 2018) <[www.bloomberg.com/news/articles/2018-08-01/germany-said-to-block-company-purchase-by-chinese-for-first-time](http://www.bloomberg.com/news/articles/2018-08-01/germany-said-to-block-company-purchase-by-chinese-for-first-time)> accessed 27 July 2021.

manufacturing company. Even for a Mittelstand company, it is rather small, with fewer than 120 employees and under EUR 50 million revenue per year.<sup>204</sup> Leifeld produces machine tools for various industries, including energy and aerospace.<sup>205</sup> The Chinese company Yantai Taihai Corp operates in the Chinese civil nuclear power market and is owned by Chinese billionaire Wang Xuexin.<sup>206</sup> The German decision to block the acquisition of Leifeld was monumental. It was the first time that the German authorities made a formal decision prohibiting a foreign direct investment.<sup>207</sup>

## 8 Conclusion

The Regulation on the screening of FDI into the EU expresses the view of the EU on how the screening should work. The Regulation does not give the Commission the right to decide whether a particular FDI should be restricted. That right stays with the Member States. The crisis caused by the Coronavirus seems to have made Member States and the Commission more careful about foreign investment, especially regarding what are perceived as sensitive sectors. Among the factors that may be taken into consideration by the Member States or the Commission when considering an FDI, the most revealing might be the question about whether the foreign investor is directly or indirectly controlled by a foreign government. I examined this factor in the case of Huawei, which might be owned or controlled by the Chinese government.

It is difficult to predict the effect (or the duration) of the current pandemic on international trade and foreign direct investment. My hopeful expectation that a global crisis might actually make countries more willing to cooperate seems wholly misplaced at the moment. It is important to note that the restrictions on FDI had been increasing for some years before the pandemic. However, law lags behind reality so it is possible that restrictions on FDI will ease as it becomes clear that there is actually less and less cross-border investment, especially from China.

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<sup>204</sup> As can be established by publicly available data from <[www.wer-zu-wem.de/firma/leifeld.html](http://www.wer-zu-wem.de/firma/leifeld.html)> accessed 14 March 2020.

<sup>205</sup> Leifeld <<https://leifeldms.com/en/home/>> accessed 14 March 2020.

<sup>206</sup> Kenji Kawase, 'German Deal Veto Sets Back Quiet Rise of China's Yantai Taihai' (*Nikkei Asian Review*, 2 August 2018) <<https://asia.nikkei.com/Business/German-deal-veto-sets-back-quiet-rise-of-China-s-Yantai-Taihai>> accessed 20 April 2020; Forbes <[www.forbes.com/profile/zhang-xuexin/?list=china-billionaires#52df9421488f](http://www.forbes.com/profile/zhang-xuexin/?list=china-billionaires#52df9421488f)> accessed 17 March 2020.

<sup>207</sup> Deutsche Welle 'Chinese Takeover of Leifeld Collapses Ahead of Expected German Veto' (1 August 2018) <[www.dw.com/en/chinese-takeover-of-leifeld-collapses-ahead-of-expected-german-veto/a-44906055](http://www.dw.com/en/chinese-takeover-of-leifeld-collapses-ahead-of-expected-german-veto/a-44906055)> accessed 19 April 2020.



Finally, I looked at how Germany operates its screening mechanism. The analysis of notable cases shows that the biggest concern in Germany is that Chinese companies may acquire innovative German ones. We have observed the procedure of screening foreign direct investment in Germany: the thresholds, the time limits, the specific sectors. However, it is hard to discern specific details of how the German government evaluates a potential threat. When it comes to deciding on a particular investment, the authorities have wide discretion. The primary reason is the breadth of the definition of what a threat to public order or security is or of what the essential security interests of Germany are. The German screening mechanism is elaborate. It covers both cross-sectoral and sector-specific screening, and it has detailed provisions to avoid fraudulent behaviour or abuse. Thus, it could be used as a blueprint for setting up screening mechanisms in Member States that currently do not screen FDI.

We have seen that Member States, including Germany, mention a lack of reciprocity and unfair subsidies as the problem with potential investments from China.<sup>208</sup> But neither the German nor the EU screening mechanism considers reciprocity. It is my view that reforming screening mechanisms with regard to unfair subsidies or lack of reciprocity would make them more enduring and meaningful. To address the lack of reciprocity, it would be necessary either to change Article 63 TFEU so that it requires reciprocity for extending the free movement of capital to third countries, or to apply possible restrictions towards third countries as is allowed by Articles 64 and 65 TFEU. Article 64(2) TFEU envisages that the European Parliament and the Council may adopt measures concerning direct investment between Member States and third countries, while Article 64(3) TFEU allows the Council to enact measures which would constitute a 'step backwards' regarding liberalisation of movement of capital to or from third countries.



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<sup>208</sup> See Section 3 and Section 7.4.2.