www.czasopisma.pan.pl PAN www.journals.pan.pl

XLII POLISH YEARBOOK OF INTERNATIONAL LAW
2022
DOI 10.24425/PYIL.2023.147172
PL ISSN 0554-498X

*Dominika Pietkun**

THE EUROPEAN COMMISSION FILING GAPS IN THE FDI SCREENING REGULATION IN THE FACE OF THE WAR IN UKRAINE

Abstract: *On 19 March 2019 the European Union (EU) adopted the Regulation establishing a framework for the screening of foreign direct investments into the EU (the "Regulation"). Four years later, the geopolitical situation changed completely as a result of the Russian aggression against Ukraine. Since February 2022 the EU has successively expanded its sanctions imposed against Russia. In parallel – on 6 April 2022 – the European Commission published the Guidance to the Member States concerning foreign direct investment from Russia and Belarus in view of the military aggression against Ukraine and the restrictive measures laid down in recent Council Regulations on sanctions.*

The aim of the article is to draw attention to selected aspects of the Regulation which may be relevant in face of the threats to the European and national security and public order posed by the actions of the regimes of Russia and Belarus, following the invasion of Ukraine. In the perspective of the ongoing war in Ukraine, the issues discussed in this article may be points that are worth considering when amending the Regulation in view of the announced revision of the Regulation in Autumn 2023.

Keywords: war in Ukraine, Russia, sanctions, foreign direct investment, FDI screening, the EU FDI Screening Regulation, European Commission, public security, public order

INTRODUCTION

On 19 March 2019 the European Union (EU) adopted the Regulation 2019/452 establishing a framework for the screening of foreign direct investments into the

* Associate in the Corporate and M&A practice at CMS Cameron McKenna Nabarro Olswang Pośniak i Bejm sp.k.; participant of the Legal Doctoral Seminars at the PAS Institute of Legal Sciences; e-mail: pietkundominika@gmail.com; ORCID: 0000-0002-9843-1647.

www.czasopisma.pan.pl PAN www.journals.pan.pl

Union (the Regulation).[1] This is the first legislative act concerning this field, introduced at the European level. The EU adopted the mechanism in the face of the then ongoing geopolitical and economic changes, including in particular in response to the concerns of some Member States related to the significant increase in Chinese investments[2] and the influence of Chinese investors on the European market.

Four years later, the geopolitical situation has changed almost completely as a result of the Russian aggression against Ukraine. Above all, the war has changed the history of Ukraine and the lives of its citizens, probably forever. But it has also become one of the biggest challenges in the history of the EU, both for its citizens and politicians/lawmakers. The Russian invasion of Ukraine should be considered as an event which alters the course of history at many levels, including in a global sense. For the EU, above all the war in Ukraine poses challenges that it has never faced in its history, and the way the EU as an organisation will respond to these challenges will fundamentally change the nature and purpose of the Union. For the first time in its history, the EU faces the challenges connected with having a war just beyond its external borders. Moreover, this is a war started by a very strong actor on the global political scene – a state which not only uses natural resources and energy supplies as a weapon, but also an aggressor state which has a large numerical advantage over its opponent in terms of military resources and is, so it claims, prepared for a long war. As pointed out by de Witte, the outbreak of the war in Ukraine has, "highlighted the necessity and increased the willingness of the EU to defend its own values and interests".[3]

Faced with a threat from the East, the EU itself and its Member States have been forced to dramatically increase the attention they pay to safety and public order. Following the unprovoked military actions of Russia, assisted by the actions of the regime in Belarus, the EU and its Member States have become much more vigilant about any possible threats and dangers coming from foreign regimes.

Since February 2022, the EU has successively expanded its sanctions imposed on Russia. Initially, the first EU restrictive measures against Russia were imposed in

[1] 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 [2019] OJ L 79 I/1.

[2] *See* S. Norrevik, *MEPs are more likely to oppose close EU-Ukraine ties when they represent areas that receive high levels of Russian investment*, LSE Blog, 25 October 2021, available at: https://blogs.lse.ac.uk/europpblog/2021/10/25/meps-are-more-likely-to-oppose-close-eu-ukraine-ties-when-they-represent-areas-that-receive-high-levels-of-russian-investment/ (accessed 30 April 2023). *See also* C. Kao, *The EU's FDI Screening Proposal – Can It Really Work?*, 28(2) European Review 173 (2020).

[3] F. de Witte, *Russia's invasion of Ukraine signals new beginnings and new conflicts for the European Union*, LSE Blog, 14 March 2022, available at: https://blogs.lse.ac.uk/europpblog/2022/03/14/russias-invasion-of-ukraine-signals-new-beginnings-and-new-conflicts-for-the-european-union/ (accessed 30 April 2023).

March 2014,[4] "in response to the illegal annexation of Crimea and Sevastopol and the deliberate destabilisation of Ukraine"[5], with new sanctions added over time. From February 2022 to January 2023, the EU has imposed a total of ten additional packages.[6] In parallel, the EU expanded its sanctions imposed on Belarus, in response to "its involvement in the invasion of Ukraine, and on Iran, in relation to the use of Iranian drones in the Russian aggression against Ukraine".[7] As underlined by de Witte, "by acting decisively, the EU leaders have set a new course for the integration process".[8] The threat from third countries has clearly shown that the EU must prove both that it is a major player on the geopolitical scene, and that there is unity among the Member States. The role of the Union in the face of the war in Ukraine has revealed the premier purpose of the organization – to protect the public interest and the security of the European citizens.[9] Such a revision of the fundamental role of the EU as an organization of states facing threats from third countries as well as from external factors will certainly require profound changes, including changes of an institutional character and probably even changes in the EU Treaties.

The need for changes; the re-evaluation of the current solutions; and probably changes in the division of competences between the EU and its Member States is well illustrated by the area of foreign direct investment (FDI) screening. This is an extremely important area, because it is crucial from the perspective of the protection of security and public order, as well as sensitive in terms of its interactions and integration with third countries. The threats and dangers to the public interest related to direct investments in European companies by foreign investors cooperating with the aggressor, i.e. the Kremlin regime, may be enormous and cause both the European Commission (EC) and the Member States to show increased vigilance in the area of FDI screening.

The conflict in Ukraine has made it necessary to ask the question; Who in the EU has the competence in the protection of security and public order? As mentioned above, this is acknowledged to be a basic function of the Union, but since its inception, and thus also in the Treaties, competences in the field of security and

---

[4] *See* Ł. Gruszczyński, M. Menkes, *Legality of the EU trade sanctions imposed on the Russian Federation under WTO law*, in: W. Czapliński, S. Dębski, R. Tarnogórski, K. Wierczyńska (eds.), *The Case of Crimea's Annexation under International Law*, Wydawnictwo Scholar, Warszawa: 2017, pp. 239-242.

[5] European Commission, *Sanctions adopted following Russia's military aggression against Ukraine*, available at: https://finance.ec.europa.eu/eu-and-world/sanctions-restrictive-measures/sanctions-adopted-following-russias-military-aggression-against-ukraine_en (accessed 30 April 2023).

[6] *Ibidem.*

[7] European Council and Council of the European Union, *EU sanctions against Russia explained*, available at: https://www.consilium.europa.eu/en/policies/sanctions/restrictive-measures-against-russia-over-ukraine/sanctions-against-russia-explained/ (accessed 30 April 2023).

[8] *Ibidem.*

[9] *Ibidem.*

www.czasopisma.pan.pl www.journals.pan.pl

the protection of public order have been assigned to the Member States. It is the Member States that can take measures to limit the freedoms of the internal market – within the limits of the provisions of the Treaty on the functioning of the European Union (TFEU) – on the rights of establishment and capital movements (see Arts. 52 and 65.1(b)). This allows States to implement certain measures deemed necessary on the grounds of public policy or public security.

On 6 April 2022, the European Commission (EC) published its Guidance to the Member States concerning foreign direct investment from Russia and Belarus in view of the military aggression against Ukraine and the restrictive measures laid down in recent Council Regulations on sanctions (the Guidance).[10] In its first paragraph, the EC underlined that "[t]he European Union is open to foreign investment, which is essential for our economic growth, competitiveness, employment and innovation. (...) But our openness is not unconditional, and it needs to be balanced by appropriate tools to safeguard our security and public order".[11] The EC expressed the need for greater caution and more careful analysis of the investments originating from Russia and Belarus,[12] while emphasizing that the EU vigilance should go "beyond investments by persons or entities that are subject to sanctions"[13], as threats to the security of both the EU and the Member States may be equally well posed by other entities (i.e. not covered by sanctions).

The aim of this article is to draw attention to selected aspects of the Regulation which may be relevant in face of the threats to the European and national security and public order deriving from the actions of the regimes of Russia and Belarus following the invasion of Ukraine. The article focuses on analysis of the two gaps in the Regulation: (i) gaps in definition of a foreign direct investment; and (ii) gaps in the definition of a foreign investor. These flaws in the current wording of the Regulation were selected based on the analysis of the Guidance. The conflict in Ukraine has highlighted certain gaps in the Regulation, which the EC drew attention to and in respect of which it encouraged the Member States to fill them up through national mechanisms.[14] This shows that the adoption of the Regulation has not really changed the perception of who is responsible for protecting public

[10] European Commission, *Guidance to the Member States concerning foreign direct investment from Russia and Belarus in view of the military aggression against Ukraine and the restrictive measures laid down in recent Council Regulations on sanctions*, 6 April 2022, 2022/C 151 I/01. *See also* Council Regulation (EU) 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, OJ L 229 1 (as subsequently amended) and Council Regulation (EC) 765/2006 of 18 May 2006 concerning restrictive measures concerning restrictive measures in view of the situation in Belarus, OJ L 134 1 (as subsequently amended).

[11] European Commission, *supra* note 10, p. 1.

[12] *Ibidem*.

[13] *Ibidem*.

[14] *Ibidem*, p. 2.

security and public order, i.e. that it is the sole competence of the Member States to adopt and maintain certain measures deemed necessary on grounds of public policy or public security.

This article first briefly describes the sanctions that have been imposed by the EU on Russia in connection with the war in Ukraine, with emphasis on the differences between the role of sanctions and the function of FDI regulations in the protection of public order and security. Next, it refers to the definitions of a foreign direct investment and a foreign investor in the Regulation, and then uses them to explain the two above-mentioned gaps in the Regulation. After indicating the gaps in the Regulation, the article presents proposals for potential changes that could be made at the level of the EU in order to patch these areas.

In the perspective of the ongoing war in Ukraine, the issues discussed in this article may be points that would be worth considering when amending the Regulation – particularly in view of the announced revision of the Regulation in Autumn 2023.

1. THE EU SANCTIONS IMPOSED IN RESPONSE TO RUSSIA'S INVASION OF UKRAINE

The official position of EU leaders and institutions is well captured in the following statement: "[T]he EU strongly condemns Russia's unprovoked and unjustified military aggression against Ukraine and the illegal annexation of Ukraine's Donetsk, Luhansk, Zaporizhzhia and Kherson regions. It also condemns Belarus' involvement in Russia's military aggression".[15] Since February 2022, the EU has firmly supported Ukraine, providing humanitarian, political, financial and military assistance. In addition, the EU significantly extended the scope of sanctions originally imposed on Russia following its illegal annexation of Crimea in 2014. These measures are designed to weaken Russia's economy[16] to such an extent as to make it as difficult as possible for the regime to continue the war, acquire raw materials and technology, and exchange information for the purpose of military operations. As underlined in the Guidance, "the sanctions against Russia are designed to undermine the Kremlin's ability to finance the war, impose clear economic and political costs on those in Russia's political elite responsible for the invasion, and diminish its economic base".[17]

[15] European Council and Council of the European Union, *EU response to Russia's invasion of Ukraine*, available at: https://www.consilium.europa.eu/en/policies/eu-response-ukraine-invasion/ (accessed 30 April 2023).

[16] European Council and Council of the European Union, *EU restrictive measures against Russia over Ukraine (since 2014)*, available at: https://www.consilium.europa.eu/en/policies/sanctions/restrictive-measures-against-russia-over-ukraine/ (accessed 30 April 2023).

[17] European Commission, *supra* note 10, p. 1.

www.czasopisma.pan.pl www.journals.pan.pl

On 25 February 2023, the EU adopted its tenth package of sanctions in response to Russia's invasion of Ukraine. Overall, the EU's actions against Russia include: (i) targeted restrictive measures (individual sanctions); (ii) economic sanctions; and (iii) visa measures. The economic sanctions target the financial, trade, energy, transport, technology and defence sectors.[18] The individual sanctions target those persons responsible for supporting, financing or implementing actions which undermine the territorial integrity, sovereignty and independence of Ukraine, or who benefit from these actions.[19] As of the end of January 2023, 1,386 individuals and 171 entities are subject to an asset freeze and/or a travel ban. The above numbers include some Russian controlled entities based in the illegally annexed Crimea or Sevastopol in order to avoid circumvention. With respect to visa measures, in February 2022, "the EU decided that Russian diplomats, other Russian officials and business people may no longer benefit from visa facilitation provisions, which allow privileged access to the EU".[20] Further, in September 2022 "the Council adopted a decision that fully suspend[ed] the visa facilitation agreement between the EU and Russia. Consequently, the general rules of the visa code [started to] apply to Russian citizens".[21] Furthermore, "the EU has suspended the broadcasting activities and licenses of several Kremlin-backed disinformation outlets"[22], including the Russia Today news channel, which is known all over the world. In the opinion of the EU institutions, "these outlets have been used by the Russian government as instruments to manipulate information and promote disinformation about the invasion of Ukraine, including propaganda aimed at destabilising the countries neighbouring Russia, the EU and its member states".[23]

The EU has also adopted sanctions against two other countries, i.e. Belarus, in response to its involvement in the invasion of Ukraine; and Iran in relation to the use and supply of Iranian drones to the Russian army.[24]

Importantly, on 28 November 2022 the Council unanimously adopted a decision to add the violation of restrictive measures (sanctions) to the list of "EU crimes" included in the TFEU.[25] This decision was based on the fact that the Member States have different definitions of what constitutes a violation of restrictive measures

[18] European Council and Council of the European Union, *supra* note 16.
[19] European Council and Council of the European Union, *supra* note 7.
[20] European Council and Council of the European Union, *supra* note 16.
[21] *Ibidem.*
[22] *Ibidem.*
[23] *Ibidem.*
[24] *Ibidem.*
[25] European Council and Council of the European Union, *Sanctions: Council adds the violation of restrictive measures to the list of EU crimes*, available at: https://www.consilium.europa.eu/en/press/press-releases/2022/11/28/sanctions-council-adds-the-violation-of-restrictive-measures-to-the-list-of-eu-crimes/ (accessed 30 April 2023).

and what penalties should be applied in the event of violations.[26] Following this decision of the Council, on 2 December 2022 the EC presented its proposal for a directive providing for minimum rules concerning the definition of criminal offences and penalties for the violation of EU sanctions.[27] The adoption of such a directive will enable harmonized enforcement of sanctions throughout the EU and deter attempts to circumvent or violate them. The timing of the process of adoption of the directive and its subsequent transposition by the Member States remains to be discussed. Given the developments in Ukraine and the continuation of military operations by Russia, this should happen as soon as possible.

2. CONCERNS THAT SANCTIONS MAY NOT BE SUFFICIENT TO PROTECT THE EU'S AND MEMBER STATES' SECURITY AND PUBLIC ORDER

One of the areas where the EU and its Members States have expressed their concerns following the Russian invasion in Ukraine is the activity of the investors – or more generally entities originating from Russia and Belarus – on the European market, including through FDIs.

On 2 September 2022, as the EC published the Second Annual Report on the screening of foreign direct investments into the Union,[28] the Executive Vice-President and Commissioner for Trade, Valdis Dombrovskis, stated that:

> At a time of mounting security challenges, in particular Russia's unprovoked war of aggression in Ukraine, it is crucial to have our strategic trade and investment controls instruments up and running. In cooperation with our international partners, the EU deployed export controls to sanction Russia for its devastating war in Ukraine. The EU remains open to foreign investments, but this openness is not unconditional. It must be balanced. We must continue enhancing our capability to ensure this balance.[29]

Further, in the Guidance the EC stressed that "in the current circumstances, there is a heightened risk that any investment directly or indirectly related to a

[26] European Council and Council of the European Union, *supra* note 16.

[27] European Commission, *Ukraine: Commission proposes to criminalise the violation of EU sanctions*, 28 November 2022, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_7371 (accessed 30 April 2023).

[28] European Commission, *Second Annual Report on the screening of foreign direct investments into the Union*, 1 September 2022, COM (2022) 433, available at: https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2022)433&lang=en (accessed 30 April 2023).

[29] European Commission, *EU investment screening and export control rules effectively safeguard EU security*, 2 September 2022, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5286 (accessed 30 April 2023).

www.czasopisma.pan.pl www.journals.pan.pl

person or entity associated with, controlled by or subject to influence by the Russian or Belarusian government into critical assets in the EU may give reasonable grounds to conclude that the investment may pose a threat to security or public order in Member States".[30]

Consequently, although the Regulation and restrictive measures (sanctions) are separate legal instruments, adopted in different procedures and regulating different areas, what they have in common is that they both allow for the control of certain investments coming from abroad, and importantly, they have a significant impact on each other. In the Guidance, the EC pointed out that "EU sanctions apply to any person inside the territory of the Union, to any legal person, entity or body, inside or outside the territory of the Union, which is incorporated or constituted under the law of a Member State, and to any legal person, entity or body in respect of any business done in whole or in part within the Union. Therefore, EU restrictive measures can affect direct investments from Russia and Belarus in several ways".[31] For example, based on entity criteria certain restricted persons or companies on whom individual sanctions are imposed are excluded from transactions, and/or certain assets are frozen and cannot be traded.

Despite certain similarities and their mutual impact on each other, the key difference between FDI screening mechanisms and sanctions is the aim of their adoption. Both the Regulation and various national screening mechanisms adopted by the Member States were introduced as tools to safeguard the EU and/or Member States from foreign direct investments that may affect their security or public order. Although screening mechanisms may take various forms, including *ex-post* or *ex-ante* control, the preventive function of such mechanisms remains paramount in both cases. These mechanisms are primarily intended to prevent situations in which a given investment could pose a threat to public order or security. On the other hand, restrictive measures (sanctions) are generally intended to be severe measures aimed at punishing a given state or entity for its actions that pose a threat to peace or security or constitute violations of fundamental rights, including human rights. In the case of the EU sanctions imposed on Russia in relation to its military actions against Ukraine, the aim of the measures adopted at the EU level is "to impose severe consequences on Russia for its actions and to effectively thwart Russian abilities to continue the aggression".[32] Consequently, even though sanctions are also preventive measures, they differ significantly from the FDI screening mechanisms, primarily due to their targeted nature. Sanctions are always "against"; while most FDI control regulations are general in nature and should be applied "in the

[30] European Commission, *supra* note 10, p. 1.

[31] *Ibidem*, p. 2.

[32] European Council and Council of the European Union, *supra* note 7.

case of". With respect to the Regulation, the EC explicitly underlined that "[n]o specific third country is "targeted". Concerns relating to security and public order can potentially arise from anywhere. Nondiscrimination among foreign (non-EU) investors is a key principle of the Regulation and the sole grounds for screening a foreign investment are the risks – assessed on a case-by-case basis – to security and public order, regardless of the foreign investor's origin".[33]

Considering the role that the FDI screening mechanisms are playing in the protection of public security, the EC called upon the Member States "to urgently set up comprehensive investment screening mechanisms, if they have not done so already. They are also called upon to enforce anti-money laundering rules in order to prevent the misuse of the EU financial system by investors from Russia and Belarus".[34] Furthermore, in the Guidance the EC underlined that:

> In the current circumstances, there is a significantly heightened risk that FDI by Russian and Belarusian investors may pose a threat to security and public order. Therefore, within applicable rules, such FDI should be systematically checked and scrutinized very closely. These risks may be exacerbated by the amount of Russian investments in the EU and the intensity of prior business relations between EU and Russian companies. Moreover, particular attention must be given to the threats posed by investments by persons or entities associated with, controlled by or subject to influence by the two governments because these governments have a strong incentive to interfere with critical activities in the EU and to use their ability to control or direct Russian and Belarusian investors in the EU for that purpose.[35]

3. THE FRAMEWORK INTRODUCED BY THE REGULATION

The Regulation does not impose any obligation on Member States to adopt national screening mechanisms but leaves them the freedom to adopt or maintain such mechanisms in their national legal systems. The Regulation only requires that national FDI control mechanisms are transparent and do not discriminate between different third countries (Art. 3.2 of the Regulation). The above results from the well-established position of the Court of Justice of the European Union (CJEU) regarding permissible restrictions on the freedoms of the internal market, including the free

[33] European Commission, *Frequently asked questions on Regulation (EU) 2019/452 establishing a framework for the screening of foreign direct investments into the Union*, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1867 (accessed 30 April 2023).

[34] European Commission, *Investment screening*, available at: https://policy.trade.ec.europa.eu/enforcement-and-protection/investment-screening_en (accessed 30 April 2023).

[35] European Commission, *supra* note 10, p. 2.

www.czasopisma.pan.pl www.journals.pan.pl

movement of capital.[36] If a given entity from a third country considers a national FDI screening regulation to be a discriminatory measure, it may file a complaint and the CJEU will assess whether such national regulation complies with the EU law. As emphasized by the EC, at the stage of the legislative process the Regulation does not determine the compliance of national monitoring mechanisms with the EU law.[37]

However, the Regulation imposes certain information obligations on the Member States regarding the adoption of a new monitoring mechanism or any changes to the national investment control system (Art. 3.7). This information is provided to the EC, which maintains a list of monitoring mechanisms used by the Member States (Art. 3.8). Moreover, pursuant to Art. 5 of the Regulation, the Member States are required to submit annual reports to the EC on foreign direct investments that were carried out on their territory.

The Regulation also provides for the creation of a cooperation mechanism, under which the Member States and the EC should exchange information and voice concerns related to specific investments, in particular those investments which have a European impact. Importantly, the cooperation mechanism set out in Arts. 6 and 7 of the Regulation applies to the screening of: (i) the investments subject to a screening procedure in a given Member State; and/or (ii) the cases where a Member State or the EC considers that a FDI planned or implemented in another Member State, which is not monitored in that Member State, may affect its own security or public order, or where it has information relevant to that FDI. Additionally, the EC has acquired new powers, i.e. to issue an opinion on a given FDI (in cases of both investments undergoing a screening procedure in a Member State, and investments not undergoing screening). Such an opinion is non-binding, but the Member State where a given investment would take place should give "due consideration" to the views expressed by the EC. If such opinion concerns an investment involving funding from an EU programme, then its views must be given "utmost regard" by the recipient Member State. In each case however, a Member State will have to explain if it does not follow the opinion of the EC.

4. THE DEFINITION OF A FOREIGN DIRECT INVESTMENT AND A FOREIGN INVESTOR IN THE REGULATION

The Regulation "establishes a framework for the screening by Member States of foreign direct investments in the Union on the grounds of security or public order,

[36] *See e.g.* Case C-120/78 *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein* [1979] ECLI:EU:C:1979:42; Case C55/94 *Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECLI:EU:C:1995:411; and Case C-367/98 *Commission v. Portugal* [2002] ECLI:EU:C:2002:326.

[37] 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, COM/2017/0487 final – 2017/0224 (COD), p. 2.

and for a mechanism for cooperation between Member States, and between Member States and the Commission, with regard to foreign direct investments likely to affect security or public order. It includes the possibility for the Commission to issue opinions on such investments" (Art. 1).

The Regulation defines FDI as an investment made "by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity in a Member State, including investments which enable effective participation in the management or control of a company carrying out an economic activity" (Art. 2.1). As emphasized by the EC, the definition of an FDI contained in the Regulation covers any kind of such investments.[38] The above definition comes directly from the judgment of the CJEU of 12 December 2006,[39] where the Court underlined that although a foreign direct investment is a concept not defined in the Treaties,[40] it was able to develop a single definition (subsequently copied to the Regulation) based on how the FDI concept was understood in EU law and previous case law.[41] In the same judgment, the CJEU pointed out that an investment consisting in the acquisition of shares in a given company that has not been subscribed for the purpose of establishing or maintaining permanent and direct links between the shareholder and the company and enabling him to actively participate in the management of that company or in exercising control over it cannot be considered as a direct investment[42]. In further judgments the CJEU differentiated a "direct investment" which covers "investments in the form of participation in an undertaking through the holding of shares which confers the possibility of effectively participating in its management and control", from a "portfolio investment" involving an "investment in the form of acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking".[43]

The definition of a foreign direct investment developed by the CJEU and copied to the Regulation mirrors the widely-accepted and used definitions proposed by

[38] European Commission, *supra* note 33.

[39] Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, para. 181.

[40] *Ibidem*, para. 177.

[41] *Ibidem*, paras. 178-180.

[42] *Ibidem*, para. 196.

[43] *See e.g.* Case C-171/08 *Commission v. Portugal* [2010] ECR I-06817, para. 49; Joined Cases C282/04 and C-283/04 *European Commission v. Netherlands* [2006] ECR I-09141, para. 19; Case C-367/98 *Commission v. Portugal* [2002] ECLI:EU:C:2002:326; and Case C-741/19 *Republic of Moldova v. Komstroy LLC* [2021] ECLI:EU:C:2021:655.

www.czasopisma.pan.pl www.journals.pan.pl

both the OECD[44] and the International Monetary Fund (IMF).[45] Furthermore, the above definition of a foreign direct investment developed by the CJEU is in line with the economics and investment regimes.[46] However, the concept of investment is vastly complex and "typically consists of several interrelated economic activities", and in legal terms the approaches towards defining the term "investment" are the subject of debate, both in the context of EU law, investment law treaties (including bilateral investment treaties (BITs)), as well as in economic discourse.[47] Bearing in mind the above, it should be emphasized that there is no single universal definition of the term "investment", and the definition adopted in the Regulation is also to some extent a compromise, which may turn out to be imperfect.

Further, the Regulation defines foreign investor as "a natural person of a third country or an undertaking of a third country, intending to make or having made a foreign direct investment" (Art. 2.2), adding that an undertaking of a third country "means an undertaking constituted or otherwise organised under the laws of a third country" (Art. 2.7). This means that the definition of a foreign investor under the Regulation covers both natural persons and legal entities originating from third countries. In addition, the preamble to the Regulation underscores that "[i]t should be possible for Member States to assess risks to security or public order arising from significant changes to the ownership structure or key characteristics of a foreign investor" (Recital 11).

At this point, it should be emphasized that neither the term "foreign direct investment" nor "foreign investor" are defined in any other acts of EU law. However, as noted above these concepts are defined and interpreted in the jurisprudence of the CJEU, and in investment law as broadly understood (including investment law treaties, in particular BITs, international customary law, unilateral statements, or the case law analysed by the tribunals adjudicating investment disputes). But – primarily due to the multitude of definitions of both foreign direct investment and

[44] According to the OECD: "Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy. Ownership of 10 percent or more of the voting power in an enterprise in one economy by an investor in another economy is evidence of such a relationship" (*see* OECD, *Foreign Direct Investment (FDI)*, available at: https://doi.org/10.1787/9a523b18-en, accessed 30 April 2023).

[45] According to the IMF: "Foreign direct investment (FDI) is an investment in which the objective of a resident in one economy is to obtain a lasting interest in an enterprise in another economy". (*see e.g.* IMF, *Foreign Direct Investment Trends and Statistics: A Summary*, 28 October 2003, available at: https://www.imf.org/external/np/sta/fdi/eng/2003/102803s1.pdf (accessed 30 April 2023).

[46] *See* R. Dolzer, Ch. Schreuer, *Principles of International Investment Law* (3rd ed.), Oxford University Press, Oxford: 2022, p. 60; R. Dolzer, *The notion of investment in recent practice*, in: S. Charnovitz, D.P. Steger, P. van den Bosche (eds.), *Law in the Service of Human Dignity: Essays in Honour of Florentino Feliciano*, Cambridge University Press, Cambridge: 2005, pp. 261, 263; N. Rubins, *The Notion of "Investment"*, in: N. Horn (ed.), *Arbitrating Foreign Investment Disputes*, Kluwer Law International, The Hague: 2004, p. 283.

[47] Dolzer, Schreuer, *supra* note 46, p. 61.

foreign investor in various sources of international law, as well as in the positions of researchers and economists, and also due to the ongoing debate and search for the best possible definitions for the needs of modern trade – it would be difficult to present in this article all possible solutions and references to the existing definitions of both analysed terms.[48] Furthermore, in relation to EU law the situation became even more complex following the judgment of the CJEU in the *Achmea* case[49] related to intra-EU BITs, and the more recent judgment in *Komstroy* case related to the Energy Charter Treaty and its interpretation. Clearly, all these developments, both in jurisprudence and in investment law as broadly interpreted, cannot be ignored. However, taking into account that sometimes different definitions are adopted even for the purposes of one category of investment treaties (e.g. BITs), for the purposes of this article the author has chosen to limit the analysis only to the discussion of definitions from the EU law, specifically from the Regulation.

5. AREAS OUTSIDE THE SCOPE OF, AND GAPS IN THE REGULATION

The above-described two definitions – of a foreign direct investment and a foreign investor – determine the scope of the Regulation. It is crucial to identify the areas that fall outside the scope of the Regulation, and further to analyse what are the existing gaps. With respect to the latter, the following two aspects will be discussed below: (i) gaps in the definition of a foreign direct investment; and (ii) gaps in definition of a foreign investor. In this context, I present selected flaws in the current wording of the Regulation, together with proposed amendments to the Regulation deemed necessary for a better and more efficient protection of the EU and the Member States against threats related to hostile transactions made by entities from outside the EU, including those controlled or dependent on third countries' governments and state institutions.

5.1. Gaps in the definition of a foreign direct investment

The first issue boils down to the interpretation and scope of the word "control", which appears in the definition of a foreign direct investment in the Regulation. As discussed above, the definition of FDI formulated in the Regulation covers any investment by a foreign investor "aiming to establish or to maintain lasting and direct links between the foreign investor" and the target, "including investments which enable effective participation in the management or *control* of a company carrying out an economic activity" (Art. 2.1, emphasis added). But the Regulation lacks a

[48] See the positions indicated in note 46.

[49] *See* Case C-284/16, *Slowakische Republik v Achmea BV* [2018] ECLI:EU:C:2018:158.

www.czasopisma.pan.pl PAN www.journals.pan.pl

definition of "control", which consequently causes difficulties in interpreting the whole definition of an FDI. Of course, the fact that a given legal act does not contain a particular definition or a reference to a definition of a given concept in another legal act is not in and of itself a defect. However, considering the area regulated by the Regulation and the definitions of an FDI and a foreign investor, it is crucial to precisely determine the scope and limitations of the definition of "control" for the purposes of the screening of FDI flows in the EU.

One can try to derive a definition of "control" – and thus the scope of application of the Regulation – by starting from a determination of which transactions fall outside the scope of the Regulation. The first such area encompasses portfolio investments. The Regulation explicitly states that it does not apply to portfolio investments (Recital 9), which as a rule do not result in granting an investor full management control rights over a given company. As concluded by Dolzer, the following elements allow us to assess that we are dealing with a direct investment as such type of an investment "involves (a) the transfer of the funds, (b) a longer term project, (c) the purpose of regular income, (d) the participation of the person transferring the funds, at least to some extent, in the management of the project, and (e) a business risk".[50] Therefore, a portfolio investment may not be classified as a direct investment as it lacks "the element of personal management".[51] Furthermore, as established in the CJEU's jurisprudence, portfolio investments are defined as "the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking".[52] However, as underlined by the EC, "while portfolio investments are not part of the scope of the Regulation, the Regulation does not establish quantitative criteria for the delimitation of portfolio investments and FDI".[53] The above sentence actually addresses the key problem discussed in this article, i.e. the lack of a definition of 'control'. Indeed, the Regulation does not introduce quantitative criteria, such as percentage thresholds for the number of shares held by an investor in a given company; but more importantly the Regulation does not allow to clearly determine whether a given investment is still a portfolio investment or should already be considered a transaction covered by the scope of the Regulation and, consequently, the screening procedure.

Another area not covered by the Regulation concerns internal restructurings, as such transactions do not result in a change of control over a given company. As explained by the EC, "investments where the foreign investor and the EU target

[50] Dolzer, Schreuer, *supra* note 46, p. 60.
[51] *Ibidem*.
[52] *See* Joined Cases C-282/04 and C-283/04 *European Commission v. Netherlands*, para. 19.
[53] European Commission, *supra* note 34.

are owned or controlled by the same foreign company may, in principle, not be considered as falling under the scope of the Regulation and should not be notified under the cooperation mechanism".[54] This means that all corporate processes such as mergers, divisions, or transformations remain outside the scope of the Regulation, unless they lead to a change of control over a given company. This case is less controversial than, for example, the portfolio investment discussed above, mainly due to the fact that such internal restructuring processes usually do not involve a third party. But this again does not mean that the lack of a precise definition of control does not cause complications. There may be complex internal restructurings where, for example, management receives more powers and gains some degree of control over the company beyond the scope of standard management control. Of course, in such a case we would be dealing with natural persons, but it is conceivable that indirectly someone else would gain control or at least the possibility of exerting decisive influence over the entity in question. In this case we would most likely be dealing with an attempt to circumvent the law, and such cases are discussed below, but it should be pointed out here that a clear and precise definition of control would make it easier to distinguish whether a given transaction, or even a restructuring process, falls within the scope of the Regulation or not.

Considering the above, it can be assumed that the scope of the Regulation covers all cases of change of control. This is why the cases where the ownership or control over a given company is transferred from one foreign investor to another fall under the scope of the Regulation.[55] The EC underlines that cases of indirect change of control are covered by the Regulation as well. It seems that 'indirect change of control' refers to cases where control over a given company changes because of a change of control or change in ownership in the parent entity. This is quite surprising, as the EC extends the application of the Regulation to a higher level, i.e. to cases of an indirect change of control, while in the Regulation itself it is not clear how to interpret the meaning of "control" (not to mention the distinction between direct or indirect).

In response to the question about an indirect change of control, the EC explains that "the transaction falls under the scope of the cooperation mechanism if the foreign investor has the power to participate effectively in the management or control of the target undertaking even if the foreign investor (i.e. ultimate controlling entity) does not intend to exercise such power".[56] Despite the fact that the above sentence is clear enough, in my opinion its wording is too vague to treat it as a definition of control and to enable a precise determination of the scope of application of the Regulation.

[54] *Ibidem.*
[55] European Commission, *supra* note 34.
[56] *Ibidem.*

www.czasopisma.pan.pl www.journals.pan.pl

Furthermore, considering the above-mentioned cases – which are indications of both exemplary areas that are *outside the scope of*, and exemplary transactions that *are covered by* the Regulation – they do not allow to clearly state what it means to exercise control over a company. However, a clearer answer to this question can be found in two other sources, i.e. in (i) national screening mechanisms and/or (ii) in other acts of EU law.

In order to present how the concept of control can be defined in more detail, the relevant provisions of the Polish Investment Control Act[57] (a national screening mechanism notified by Poland under Art. 3.7 of the Regulation) are briefly discussed below. The Act distinguishes four general types of acquisition of control, i.e.: (i) acquisition of the domination,[58] (ii) acquisition or gaining of significant participation,[59] (iii) indirect acquisition,[60] and (iv) consequential acquisition.[61] Each of these types of transactions is precisely defined. Discussing all the above-mentioned definitions would be of little use for the purpose of this article, but in my opinion it is worth briefly analysing the last one, i.e. consequential acquisition, due to the fact that it is the least acute at first glance. The purpose of introducing the concept of consequential acquisition, as in the case of indirect acquisition, was to specify the scope of the Polish Investment Control Act.[62] The cases covered by the concept of consequential acquisition are related in particular to the situation when the share capital of a company is decreased (e.g. by redemption of the shares of one shareholder), which at the same time results in an increase in the capital share of another shareholder, who is the addressee of the provisions of the Polish Investment Control Act.[63] In other words, this concept covers situations when, even without

[57] Ustawa z dnia 24 lipca 2015 r. o kontroli niektórych inwestycji [Act on control of certain investments], Journal of Laws 2015, no. 1272 as amended.

[58] *See ibidem*, Art. 3.3.

[59] *See ibidem*, Arts. 3.4 and 3.1(4).

[60] *See ibidem*, Arts. 3.5 and Art. 3.6.

[61] *See* Art. 3.7 of the Polish Investment Control Act which defines the "consequential acquisition" as cases when "an entity holds stocks or shares, or rights arising from stocks or shares of a company being an entity subject to protection, including also in cases defined in paragraph 5 [*i.e. indirect acquisition*], in the number providing for reaching or exceeding, respectively, 20%, 25%, 33%, 50% of the total number of votes in the general meeting or meetings of shareholders, or interest in the share capital, or being a parent undertaking towards a company being an entity subject to protection, or acquires significant participation, in the case of:

1) the redemption of shares or stocks of a company being an entity subject to protection, or the acquisition of treasury shares or stocks of such a company,

2) the division of a company being an entity subject to protection, or its merger with other company,

3) the amendments to the company deed or articles of association of a company being an entity subject to protection, in the scope of privileged shares or stocks, establishing or abolishing of entitlements allocated to individual partners or shareholders of such a company,

4) the cancellation of stocks or documents of stocks of a company being an entity subject to protection".

[62] M. Saczywko, *Article 3*, in: M. Mataczyński (ed.), *Ustawa o kontroli niektórych inwestycji. Komentarz* [Investment Control Act. Commentary], Wolters Kluwer, Warszawa: 2016.

[63] *Ibidem*.

active action on the part of an investor, the investor's share may reach or exceed the thresholds provided for in the Polish Investment Control Act, and therefore be subject to the screening procedure. The above example is intended to illustrate the degree of detail by which an act can provide for situations to which the screening procedure will apply. It is worth noting the advantages of such a solution, starting with the certainty of trading from the perspective of a foreign investor, and ending with the clarity of regulations regarding the protection of public safety and order, while not opting for a casuistic approach to creating law.

The above example of Poland is only illustrative, because the definitions of control over and/or further significant participation in a given company are to some extent similar in other national control mechanisms, but they are not identical. The postulate resulting from this part of the article is that it would be more effective to rely on one common EU-wide definition of control for the purposes of the screening of FDI flows in the EU. In particular, such is the case in: (i) in face of changes and increased threats, including from Russia or Belarus; (ii) as well as considering the deepening processes of globalization and integration (which is manifested, for example, in the increase in multi-national investments or the share of global concerns in the European market); and (iii) also taking into account the fact that the cooperation mechanism has been introduced by the Regulation.

At this point, it is worth recalling another national screening mechanism, i.e. the Austrian Investment Control Act.[64] The solution adopted in this Act shows that there is no need to reinvent the wheel and develop a definition from scratch. The act defines "acquisition of a controlling interest" as "the possibility of exercising a decisive influence on the activity of the target undertaking, either individually or jointly, through rights, contracts or other means, taking into account all circumstances".[65] Further, it indicates that

> a contolling interest may be exercised in particular by a) ownership or right of use of all or substantially all of the tangible or intangible assets of a target undertaking or b) rights or contracts which confer a decisive influence within the meaning of *Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (EC Federal Law Gazette I – Issued on 24 July 2020 – No. 87 3 of 1 Merger Regulation), OJ No L 24 from 29 January 2004, p. 1, on the composition, deliberations or decisions of the organs of that undertaking*.[66] (emphasis added)

[64] 87th Federal Act enacting an Investment Control Act and amending the Foreign Trade Act 2011 (Bundesgesetz über die Kontrolle von ausländischen Direktinvestitionen (Investitionskontrollgesetz – InvKG) StF: BGBl. I Nr. 87/2020 (NR: GP XXVII RV 240 AB 276 S. 45. BR: AB 10376 S. 910.)

[65] *See* Chapter 1 Sec. 1 point 7 of the Austrian Investment Control Act.

[66] *Ibidem.*

www.czasopisma.pan.pl PAN www.journals.pan.pl

Here the key is the highlighted part of the provision of the Austrian Investment Control Act, as it is a direct reference to an act of EU law (i.e. to the EU Merger Regulation).[67] This is important because recently (especially after the entry into force of the Regulation), in a given transaction the requirement to report transactions under FDI screening mechanisms has become a requirement treated similarly to the requirement to report merger filings (for example, an FDI notification is often, similarly to a merger filing, treated as a condition precedent to the closing of a transaction). Although the relationship between the Regulation under discussion and merger rules is complex,[68] it is worth noting that the EU Merger Regulation contains a definition of control, which could be used in the Regulation or could constitute a basis for developing such a definition; or the Regulation could simply refer to the definition of control from the EU Merger Regulation. The Merger Regulation defines control as rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by: (a) ownership or the right to use all or part of the assets of an undertaking; (b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking" (Art. 3.2). Furthermore, the Merger Regulation provides that "control is acquired by persons or undertakings which: (a) are holders of the rights or entitled to rights under the contracts concerned; or (b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the rights deriving therefrom". (Art. 3.3).

Indeed, this is not the only act of EU law on the basis of which a definition of control could be introduced into the Regulation. It seems to be at least as good an idea to base the definition of control for the purposes of FDI screening on the definition of the "beneficial owner" from the Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (AML Directive).[69] A reference to the concept of "beneficial owner" would enable verification of the entity at the end of the structure, i.e. the entity that controls the foreign investor involved in a given transaction subject to the screening procedure. Certainly, analysing who is the ultimate beneficial owner in some cases would be complicated and time consuming, but it should be emphasized that, firstly, if a given

[67] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the Merger Regulation), OJ L 24.

[68] *See* OECD, *The Relationship Between FDI Screening and Merger Control Reviews*, OECD Competition Policy Roundtable Background Note, 2022, available at: www.oecd.org/daf/competition/the-relationship-betweenfdi-screening-and-merger-control-reviews-2022.pdf (accessed 30 April 2023).

[69] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC [2015] L 141/73 (AML Directive).

foreign investor successfully completes the transaction, it will still have to report the persons who are the ultimate beneficial owners of the company over which it acquires control; and above all, the referral to the concept of ultimate beneficial owner ensures protection primarily in such sensitive cases as where the investor is ultimately owned or controlled by a third country's authorities or government.

At this point it should be noted that the definition of "beneficial owner" introduced in the AML Directive refers only to a natural person (or persons) who ultimately owns or controls a given entity and/or the natural person(s) on whose behalf a transaction was conducted.[70] Therefore, in the context of the issue under discussion such a definition could not be fully reflected in the definition for the purposes of FDI screening, but in terms of understanding and interpretation of the concept of control it seems to be fairly adequate.

The introduction of one coherent definition of control in the Regulation would have a great advantage, primarily in the case of multi-national transactions, where national screening mechanisms may differ, and the cooperation mechanism should not be limited to the exchange of information and opinions but should ensure consistency in the interpretation of the regulations. While neither the definition from the Merger Regulation nor from the AML Directive is perfect, nonetheless each of them is much simpler than, for example, the concepts defined in the Polish Investment Control Act. In any case, apart from the degree of complexity of the definition of "control", most importantly the introduction to the Regulation of either a definition of control, or a reference to such a definition from another act of the EU law, would make it possible to eliminate, or at least reduce, the number of situations in which there would be an issue with deciding whether a given transaction falls within the scope of the Regulation or not.

5.2. Gaps in the definition of a foreign investor

As explained above, the first issue could be reduced to the word. "control". Similarly, the second aspect, discussed below, can be described by just one word. Here the key word would be the adjective "foreign", and juxtaposing it with the term "domestic", which for the purposes of these considerations should not mean so much national as European. We are dealing here with two opposing concepts – a foreign investor which may potentially pose a threat to security and public order, and a "domestic" target (implicitly an "EU company"), i.e. an object of concern, but above all an object of protection introduced by the Regulation. As concluded by Dolzer and Schreuer, "the decisive criterion for the foreignness of an investment is the nationality of the investor".[71]

[70] *See ibidem*, Art. 3.6.

[71] Dolzer, Schreuer, *supra* note 46, p. 78.

www.czasopisma.pan.pl PAN www.journals.pan.pl

In the context of this analysis of the definition of a "foreign investor", one should start by emphasizing the fact that the Regulation defines the concept of "undertaking of a third country" as "an undertaking constituted or otherwise organized under the laws of a third country" (Art. 2.7). This means that any entity (either a natural or legal person) constituted or otherwise organized under the laws of a state other than the EU Member State is considered as a foreign investor.

As underscored by the EC, "cases where the acquisition of an EU target involves direct investment by one or more entities established outside the Union fall within the scope of the Regulation. Conversely, cases only involving investments by one or more entities established in the Union do not fall within the scope of the Regulation".[72] The last sentence relates to, *inter alia*, the socalled intraEU FDIs. Transactions described as intra-EU FDIs cover cases where a foreign investor uses its existing EU subsidiaries to effect a given transaction.[73] In such situations, a foreign investor is considered as a domestic entity (i.e. an EU company), and therefore such transactions do not fall within the scope of the Regulation. The fact that there are such cases is, on the one hand, a defect in the definition of a foreign investor, but above all the problem arises from the above-discussed lack of definition of 'control' in the Regulation and of a verification procedure about who ultimately exercises control over a given company, and who plays the role of a buyer /investor in a given transaction. It should be noted that in 2021, 8% of the investments (greenfield investments and equities) were originated by EU subsidiaries of ultimate Russian global owners.[74] At the same time, as presented in by the EC, Russia exerts influence or control in over 30,000 companies in the EU (0.12% of all EU companies). It controls about 17,000 EU companies, has potentially controlling stakes in another 7,000 companies, and minority stakes in 4,000 thousand companies. We can also observe an additional 2,000 companies with a reported non-controlling Russian shareholder, for which the amount of the stake is not known.[75]

As underscored by the EC, "there is one exception to this rule. Investments by EU entities may nevertheless come within the scope of the Regulation when they fall under the anti-circumvention clause".[76] The Regulation does not define or give examples of circumvention of FDI screening mechanisms, but one of the most com-

[72] European Commission, *supra* note 34.

[73] European Commission, *Commission Staff Working Document Screening of FDI into the Union and its Member States Accompanying the document Report from the Commission to the European Parliament and the Council Second Annual Report on the screening of foreign direct investments into the Union*, 1 September 2022, COM (2022) 433, available at: https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2022)433&lang=en (accessed 30 April 2023), p. 3.

[74] European Commission, *supra* note 29, p. 3.

[75] *Ibidem*.

[76] European Commission, *supra* note 34.

mon situations which allows to illustrate the meaning of 'circumvention' in the sense of the preamble to the Regulation is the case where a foreign investor incorporates or acquires a "shell company" (also referred to as a "letterbox company" or a "Special Purpose Vehicle" (SPV)) for the sole purpose of finalising a transaction. Such a company is indeed an EU company, but it does not have economic substance,[77] i.e. it does not conduct business activity. The absence of genuine economic activity should be assessed, considering for example the following factors: whether a company employs or engages any employees; whether it has any clients and issues invoices; whether it has a physical office (as opposed to a only a registered office existing on paper), etc. The sole purpose behind the creation of such a company is to serve as a legal vehicle for the investment. However, it should be underlined that the mere use of such a vehicle to carry out a transaction does not constitute a violation or circumvention of the law. However, Recital 10 to the Regulation provides that:

> Member States that have a screening mechanism in place should provide for the necessary measures, in compliance with Union law, to prevent circumvention of their screening mechanisms and screening decisions. This should cover investments from within the Union by means of artificial arrangements that do not reflect economic reality and circumvent the screening mechanisms and screening decisions, where the investor is ultimately owned or controlled by a natural person or an undertaking of a third country. This is without prejudice to the freedom of establishment and the free movement of capital enshrined in the TFEU.

As emphasized by the EC, the allegation of an attempt to circumvent the rules laid down in screening mechanisms should be assessed "on a case-by-case-basis, having regard to the specific circumstances of each case and on the basis of relevant evidence".[78]

Importantly, the above-quoted Recital 10 refers to the Member States that "have a screening mechanism in place" and to the prevention of "circumvention of their screening mechanisms and screening decisions". Under the current wording of the Regulation, the question of circumvention prevention has been left to the Member States. Similarly, in case of the abovementioned intra-EU FDIs, the EC has emphasised that the fact that transactions involving only EU entities are not covered by the scope of Regulation, "does not mean that such transactions could not fall under the scope of the national screening laws of the Member States".[79]

[77] OECD, *Resumption of application of substantial activities for no or nominal tax jurisdictions – BEPS Action 5,* Paris: 2018.

[78] European Commission, *supra* note 34.

[79] *Ibidem.*

www.czasopisma.pan.pl PAN www.journals.pan.pl

This means that it is the responsibility of the respective Member States to assess and enforce compliance with their national FDI screening legislation.

Consequently, there remain questions about Member States that do not have national FDI screening mechanisms, and about the EU projects for which the EC's assessment is crucial. In the Guidance, the EC called on the Member States that (i) do not have a screening mechanism in force in their national legal framework, or (ii) have a national screening procedure but such national provisions do not cover all relevant transactions or do not allow *ex ante* screening, to "urgently set up a comprehensive FDI screening mechanism and in the meantime to use other suitable legal instruments to address cases where the acquisition or control of a particular business, infrastructure or technology would create a risk to security or public order in the EU".[80] However, there still remains the question whether – in the context of potential increasing threats from the East and deepening globalization processes – it would not be more efficient and more consistent to clarify the Regulation and perhaps extend its scope to the circumvention procedure, and to apply the rules laid down by the Regulation to intra-EU FDIs, instead of leaving those areas within the competences of the Member States which have their own national screening mechanisms.

CONCLUSIONS

The war in Ukraine has highlighted certain gaps in the Regulation, which the EC drew attention to in the Guidance. In particular, in this author's opinion two issues in terms of the scope of application of the Regulation are crucial in the current geopolitical situation, i.e.: (i) gaps in the definition of a foreign direct investment as the Regulation lacks a definition of "control"; and (ii) weaknesses in the definition of a foreign investor as the Regulation does not provide for any anti-circumvention procedure. The analysis of the above-mentioned issues leads to the conclusion that there is a clear need for a reevaluation of the approach to the screening of EU FDI flows. In terms of the definition of a foreign direct investment, it is worth considering the addition of a definition of "control" and/or a definition of "ultimate beneficial owner" to the Regulation. Such definitions could be taken from other EU legal acts, such as the Merger Control Regulation or the AML Directive, which have been functioning in the EU legal system for some time. This would greatly facilitate the analysis of whether and when a given transaction falls within the scope of the Regulation, both for the EC and the Member States, as well as for investors from third countries themselves. In addition, taking into account the constantly

[80] European Commission, *supra* note 11, p. 3.

increasing processes of globalization and economic integration, the above change would be extremely useful in the context of multi-national transactions. The Regulation would thus introduce a uniform definition of control, which would avoid discrepancies among the various jurisdictions. Moreover, such a clarification of the regulatory procedures introduced in the Regulation would greatly simplify the process of analysing whether, for example, a given portfolio investment should be covered by the scope of control as it may pose a threat to public security and/or could be used as a possible way of circumvention of the rules laid by the Regulation. Due to the fact that there are many possible ways to circumvent the provisions of the Regulation, it is worth considering whether – apart from adding a definition of "control" and analysing who is actually "the ultimate beneficial owner" of a given entity acting as an investor in a FDI – there should also be added an anticircumvention clause, which would allow for more efficient detection of attempts to circumvent FDI restrictions.

Moreover, the conclusions with respect to the sphere of FDI screening should be viewed in the perspective of the announced changes which will take place in Autumn 2023 in the framework introduced by the Regulation. Furthermore, it should be emphasised that the outbreak of the war in Ukraine is likely to accelerate the growth of FDI controls in the EU, as both the EC and the Member States are increasingly concerned about any possible activity by unfriendly third countries, especially Russia, on the European market.

To conclude, in this author's opinion the Russian military aggression and the outbreak of the war in Ukraine should be considered as a turning point in the history of not only Ukraine, but also the EU. A shift in the role of the EU on the global political scene, as well as deepening integration and increasing the competences of the EU's institutions and its leaders, should be expected. It is the EU institutions which – in the face of war and a sharp increase in threats – must strive to take over leadership in the protection of public order and the security of Europeans, as well as the security of the European economy. In the area of FDI monitoring, it can be expected that changes in the Regulation will go towards the establishment of a single mechanism which will be commonly applied in all Member States, and not only guidelines and frameworks – even if such changes will require changes in the Treaties.