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CELIS Briefing Note on the EU, 17 February 2022

EU merger control limits member states' FDI screening competence

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This briefing note considers the interaction between national investment screening legislation on the one hand EU law on the other. More specifically, it will focus on the possible tension with the EU Merger Regulation (EUMR) and free movement provisions in the Treaty on the Functioning of the EU (TFEU). It is good to know that the EU FDI Screening Regulation does not solve this tension.

According to Art. 21 EUMR, the Commission has the exclusive competence to exercise control over a transaction that qualifies as a "concentration with an EU dimension". In such cases, national legislation on merger control is not applicable and therefore national competition authorities are not competent to review possible competitive concerns stemming from the proposed transaction (unless the Commission refers the transaction to a member state on the basis of Art. 4(4) or 9 EUMR).

Although member states will not be competent to exercise national merger control over transactions qualifying as concentrations with an EU dimension, the question remains whether in these cases, member states are still competent to exercise other forms of control - such as under foreign direct investment (FDI) or national security screening legislation. This question becomes more pronounced with an ever-increasing number of member states adopting screening legislation, or tightening their existing legislation. According to the Commission's recently published first annual FDI report, this is the case in 16 member states. Another 8 member states are shortly expected to amend existing or adopt new legislation. In 2022 it is thus expected that at least 24 of the 27 member states will have investment screening legislation in place.

Both the EUMR and the Treaty on the Functioning of the EU (free movement of capital and freedom of establishment) limit the scope of investment screening legislation adopted by the member states. The EUMR in certain situations requires prior notification of and approval by the Commission of national screening legislation, in the absence of which that legislation cannot be applied. This tension becomes clear from the recent acquisition by AG Wiener Versicherung Gruppe of the central and east European subsidiaries of the AEGON Group. This concentration was approved by the Commission (M.10102 – VIG/AEGON CEE), but prohibited by the Hungarian competition authority on the basis of domestic FDI legislation. Not amused, the Commission started a procedure under Art. 21(4) EUMR (M.10494 – VIG/AEGON CEE). Against this backdrop, I will in this post set out the existing rules to pinpoint the procedural condition which is built into the EUMR. The current justification framework under the EUMR will also be compared with possible justifications to the impediment of the freedom of establishment or free movement of capital as FDI rules have to comply with these treaty provisions as well.

Upfront approval under the EUMR, except for recognised grounds

Art. 21(4) EUMR specifies that only

- public security,
- plurality of the media and
- prudential rules

shall be regarded as legitimate interests only on the basis of which member states will have the competence to control concentrations with an EU dimension. According to the Commission

> "*[m]easures genuinely aiming to protect one of these recognised interests and clearly in compliance with the principles of proportionality and non-discrimination, which are liable to prohibit, submit to conditions or prejudice a concentration with a Community dimension can be adopted and enter into force without prior communication to and approval by the Commission.*" (COMP/M.4685 – Enel/Acciona/Endesa; par. 23)

So the Commission adds a proportionality and non-discrimination test to the grounds mentioned in Art. 21(4) EUMR. Only when national investment screening legislation is genuinely pursuing one of the recognised grounds and when it is non-discriminatory and proportional, does it not need to be notified to the Commission. Only in such a case a national screening authority can legally exercise its competence to scrutinise a transaction that is also subject to concurrent merger control by the Commission under the EUMR.

If the reason behind a national investment screening rule is any other public interest ground then those explicitly mentioned in the EURM it must be communicated to the Commission before the adoption of the legislation. Only after securing approval does a member state become competent to adopt that legislation and subsequently to exercise control in parallel with the Commission's competence under the EUMR. The Commission is of the opinion that when member states doubt whether their envisaged investment screening legislation genuinely pursues one of the legitimate interests recognised by Art. 21(4) EUMR, they should notify it anyway on the basis of the principle of loyal/sincere cooperation (M.1616 – BSCH/Champalimaud; par. 65-67) - if not, that provision would be deprived of it *effet utile*.

EU FDI Screening Reg does not resolve this

Safeguarding national security and public order is still the competence of the member states. FDI screening legislation on the basis of those grounds is therefore also a national affair. Nevertheless, at EU-level a framework for coordination and cooperation between the member states and the Commission has been established when they exercise their competences under their co-existing national legislative instruments for screening FDI. This framework has been established by the EU FDI Screening Regulation 2019/452 (FDI Screening Reg). This regulation also acknowledges the co-existence of merger control via the EUMR and FDI screening by member states.

> "*When a foreign direct investment constitutes a concentration falling within the scope of [the EUMR], the application of this Regulation should be without prejudice to the application of Article 21(4) [EUMR]. This Regulation and Article 21(4) [EUMR] should be applied in a consistent manner. To the extent that the respective scope of application of those two regulations overlap, the grounds for screening set out in Article 1 of this Regulation and the notion of legitimate interests within the meaning of the third paragraph of Article 21(4) [EUMR] should be interpreted in a coherent manner, without prejudice to the assessment of the compatibility of the national measures aimed at protecting those interests with the general principles and other provisions of Union law*" (par. 36 of the preamble).

Art. 1 FDI Screening Reg lists *security* or *public order* as grounds for screening investments. Whereas security is recognised by both EU-law instruments, public order in the EU FDI Reg is more encompassing than plurality of the media and prudential rules recognised by the EUMR. Other public order objectives such as guaranteeing supplies of energy, food, medicine which became eminent during the COVID-19-crisis, would as such be allowed under the EU FDI Screening Reg, but not under the EUMR. Only where investment screening legislation pursuing these other public order objectives has been specifically notified to and approved by the Commission under the EUMR can it validly be applied by the notifying member states to FDI.

Prior administrative approval hinders free movement of capital

Similar to Art. 21 EUMR, the free movement of capital guaranteed by Art. 63 TFEU also limits national FDI control. This is because FDI control constitutes a restriction to the free movement of capital. That provision applies to inward investments from third countries as well (or even freedom of establishment which only applies within the internal market). The ECJ considered prior administrative approval of investments to be a hinderance of capital movement (Case C-463/00, Commission/Spain). This infringement procedure concerning the take-over of the Spanish energy company Endesa demonstrates how investment screening legislation can be contrary to both Art. 21(4) EUMR and the free movement provisions. Next to the infringement procedure, the Commission decided that the conditions imposed upon E.ON when it wanted to purchase Endesa were contrary to Art. 21(4) EUMR. The Commission came to a similar decision the same when Enel and Acciona tried to purchase Endesa a year later; for a broader and more in-depth analysis of those cases, see the informative 2008 article of Damien Gerard, 'Protectionist threats against cross-border mergers: Unexplored avenues to strengthen the effectiveness of Article 21 ECMR' in the *Common Market Law Review*.

Grounds for the justification of restrictions to free movement

Just as art. 21(4) EUMR mentions grounds for justifying national investment screening legislation, overriding reasons in the public interest are accepted to justify limitations to the free movement of capital. There are grounds explicitly mentioned in the TFEU (treaty-justifications). Next to treaty justifications, the Court of Justice of the European Union (CJEU) has accepted additional grounds of justification in its case-law (rule-of-reason-justifications).

The treaty justifications for hindering the free movement of capital can be found in Art. 65(1) TFEU. Alongside the grounds of public policy or public security- the prevention of infringements of national legislation (especially tax law and prudential rules for supervising financial institutions) and declaration of capital movements are also listed. Most rule-of-reason-justifications are invoked by member states during infringement or preliminary procedures which concern the question of whether national law is contrary to the free movement provisions. Although in most cases the ECJ did not accept the justifications relied on by a member state, it has affirmed several grounds:

- plurality of media (C-148/91,Veronica);
- transparency of the mortgage system (C-222/97,Trummer);
- urban and country planning and tourism (C-302/97,Konle);
- the protection of small-scale agricultural holdings (C-452/01,Ospelt);
- the prevention of illegal activities, of money laundering, of trade in narcotics and of terrorism (Joined Cases C-163, 165 & 250/94,Sanz de Lera);
- safeguard energy supplies (C-174/04, Commission v. Italy); and
- justifications related to tax law of the member states (the effectiveness of fiscal supervision (Joined Cases C-155/08 and C-157/08, X and Passenheim-van Schoot), prevention of tax avoidance and the need for effective fiscal supervision (C-53/13 and C-80/13, ACO Industries Tábor), the prevention of abuse (Case C-196/04, Cadbury Schweppes), the effective collection of taxes (C-498/10, X NV), the preservation of the coherence of the tax system (Case C-204/90, Bachmann), the balanced allocation of the power to impose taxes between member states (C-446/03, Marks & Spencer) and the principle of territoriality (C-250/95, Futura Participations)).

Next to an accepted overriding reason in the public interest, the measures hindering the free movement must be proportionate.

Justification of hinderance by golden shares

Nearest in subject matter to the FDI screening legislation are probably judgments of the ECJ in the so-called golden share cases. Those concerned infringement procedures against member states which had controlling voting rights in national utility companies, without having the majority of the shares in those companies (cases C-367/98, Portugal; C-483/99, France; C-503/99, Belgium; C-463/00, Spain; C-98/01, United Kingdom; C-282 & 283/04, Netherlands). The ECJ decided that those golden shares were contrary to the free movement rules. Only in the procedure against Belgium, the ECJ accepted "*the objective of guaranteeing energy supplies in the event of a crisis*" as a rule-of-reason-justification. In the Portuguese golden shares case, the ECJ indicated that justifications of economic nature such as industrial policy arguments are not accepted as rule-of-reason-exceptions.

Conclusion

The similarity between the public interest grounds of Art. 21(4) EUMR and the justifications to free movement restrictions, is that they concern well-described grounds codified in the EUMR and the TFEU respectively. They also allow for public interest justifications which are not explicitly listed, such as security to supply essential goods and services. They differ however on a procedural level. Under the EUMR, legislation based on public interest grounds not listed in Art. 21(4) EUMR has to be notified to and approved by the Commission prior to being allowed. On the other hand, in case of grounds not listed under the TFEU, rule-of-reason-justifications can be relied upon by member states without such a notification procedure.

As for FDI screening legislation of the member states, the legislature of the concerned member state has to self-assess conformity with EU law. Especially, the additional regulatory burden for legislation pursuing other public order grounds than national security, plurality of the media and prudential rules should be taken into account. If not done properly, that FDI screening legislation itself and decisions based on that legislation (conditional approval or prohibition) might risk to be invalidated against the EUMR. That is what happened in the Endesa cases and might happen in relation to the Hungarian FDI decision in the currently pending case. As for the FDI Screening Reg: that regulation does not give member states a licence to adopt FDI screening legislation on any public interest ground; that regulation only provides for a cooperation and coordination framework.