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**Research Report**

## Indirect FDI under EU FDI regulation in times of war: Is the anti-circumvention clause enough?

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Perspectives on topical foreign direct investment issues

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### **Indirect FDI under EU FDI regulation in times of war: is the anti-circumvention clause enough?**

by

Fabrizio Di Benedetto \*

On July 13, 2023, the European Court of Justice (ECJ) issued its first [Judgement](#) involving the [FDI Screening Regulation](#) (Regulation), based on Art. 207(2) of the Treaty on the Functioning of the EU ([TFEU](#)). The Regulation establishes common rules for FDI control among member states and gives the EU Commission the ability to intervene on national mechanisms; members must consider the Commission's opinions.

In short, the Hungarian government blocked, for alleged security reasons, the acquisition of a national building material company by a German controlled Hungarian enterprise—the German company was owned by a Bermudan undertaking. The applicant challenged the decision before the Budapest High Court, claiming that it represented an unjustified restriction on freedoms of movement. The national court decided to stay proceedings and asked the ECJ for a preliminary ruling.

Notwithstanding that the ultimate controlling shareholder of the purchaser was an Irish citizen, the case is interesting to understand the treatment of indirect FDI under the Regulation. Indirect FDI consists of acquisitions of, or in, EU companies carried out by third-country investors (non-EU citizens or companies not incorporated under member state laws—Art. 2, [Regulation](#)) through an EU company (an undertaking incorporated under members' laws).

The [ECJ](#) and [Advocate-General Ćapeta](#) reached opposite conclusions regarding the application of the [Regulation](#) to indirect FDI. According to the [Opinion](#) of the Advocate-General, indirect FDI falls under the scope of the Regulation. Indeed, the [Regulation](#) states that FDI is an “investment of any kind by a foreign investor aiming to establish or to maintain lasting and direct links with an EU company or entrepreneur” ([Regulation](#), Art. 2(1)). In [Ćapeta's](#) view, other interpretations would run counter the Regulation's purpose. In fact, Art. 3(6) of the

[Regulation](#) requires members to adopt measures to identify and prevent the circumvention of national mechanisms, covering investments from within the EU by means of artificial arrangements, where the investor is ultimately owned/controlled by a national or an undertaking of a third-country (rec. 10). [Čapeta](#) suggested that indirect FDI must first fall within the scope of the Regulation to determine whether it is intended to circumvent the national screening mechanisms (para. 47).

By contrast, according to the [ECJ](#), indirect FDI does not fall under the scope of the Regulation. Considering Art. 2 of the Regulation, the concept of foreign investor includes that of an undertaking constituted or otherwise organized under the laws of a third-country (para. 31). Therefore, when Articles 4(2)(a) and 9(2)(a) of the [Regulation](#) suggest to members to consider the ownership structure of a foreign investor, that shall be limited to undertakings of a third-country and it cannot be extended to investments made by EU undertakings controlled by third-country persons or companies (para. 37).

Following the [Advocate-General](#)'s reasoning, if indirect FDI is excluded from the scope of the Regulation, the anti-circumvention clause cannot be applied to indirect FDI. By contrast, the [ECJ](#) left an open door to the application of the Regulation to indirect FDI when it stated that nothing in the case suggested that the situation at stake was relevant to Art. 3(6) of the [Regulation](#) (para. 39). So, if the case concerned an attempt of circumvention, the ECJ would have applied the Regulation to the indirect FDI at stake.

Although the Advocate-General's argument remains convincing, after the ECJ decision it seems clear that indirect FDI is subject to the Regulation only in case of the risk of circumvention. Though, in times of war, security threats could also originate from genuine indirect FDI where, even without circumvention, the ultimate controlling shareholder is a company or a national of a State whose security interests diverge from those of the EU (Russia, currently). Nevertheless, the Commission is entitled to issue an opinion on indirect FDI just in case of circumvention, while genuine indirect FDI will be left to members that cannot ensure the collective security of the EU alone—for example, a project of EU interest like the [Trans-European Networks for Energy](#)<sup>1</sup>.

Thus, there is a gap in the EU's collective security protection within the Regulation. One possible way to fill it is to revise the Regulation (a [public consultation](#) has already been launched), using the notion of "group" under [EU merger control rules](#) to better define the concept of "foreign investor" under Art. 2(2) of the [Regulation](#). According to such a definition, all undertakings on which the same ultimate controlling entity can exercise a dominant influence belong to the same group. Therefore, the nationality of such a group would be that of the ultimate controlling company or national. That would allow the Commission to issue more opinions to better protect EU collective security. The use of such a group notion would also exclude FDI carried out by EU investors through a third-country company from the scope of the Regulation.

Finally, if genuine indirect FDI were not covered by the EU's common commercial policy under Art. 207(2) TFEU, an extension of the scope of the Regulation would be possible by adding to its legal basis also Art. 114 TFEU on internal market harmonization.

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<sup>1</sup> On the [importance of Commission's opinions on public security in the field of energy](#).

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