Against the backdrop of Sino-US trade frictions and the European Union's systematic reassessment and adjustment of its China policy, the US, the EU as well as core EU members such as Germany, France, Italy and the United Kingdom have all adjusted their legal frameworks concerning foreign investment security review (FISR) and tightened the supervision on foreign investments in order to cover national security risks they may bring into the country or the region, which either explicitly or implicitly targets China. Chinese investment to the US and the EU has plummeted under this circumstance. An in-depth analysis of the content and motivations of the new FISR regime in the US and the EU will not only map out the newly emerging legal risks facing Chinese enterprises when they invest abroad, but will also pilot Chinese enterprises to take preemptive measures and prepare the Chinese authorities to update its own FISR system.

Measures to Tighten FISR

On August 13, 2018, US President Donald Trump signed the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), which was

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the first major overhaul of the FISR system in nearly a decade. On February 14, 2019, the European Parliament also voted on a regulation establishing a framework for the screening of foreign direct investments into the EU, building a dual-track review framework with EU member states taking major responsibility for FISR and the EU commission conducting subsidiary review. The regulation took effect on April 10, 2019, and will be implemented on October 11, 2020. Various EU member states have also adjusted their existing FISR mechanisms. For example, France issued an executive order in 2018 to expand the scope of examinations by the Ministry for the Economy and Finance on foreign mergers and acquisitions in sensitive industries. In 2017 and 2018, Germany twice revised the FISR rules in the Foreign Trade and Payments Ordinance (AWV). In 2017, Italy issued an executive order to tighten foreign investment disclosure and strengthen the government’s veto power over high-tech mergers and acquisitions. In 2018, the UK revised the merger control mechanism in the Enterprise Act (EA 2002) and later issued a white paper on foreign investment and national security, aiming to establish an American-style independent FISR system. At the same time, other EU members like Hungary have also introduced new FISR systems. Whatever form it may take, be it to tighten the existing FISR system or to set up a new review mechanism, the US and the EU have major commonalities in both the content and the procedure of their review mechanisms.

Expanding the scope of FISR: rebalancing openness with security

The applicable scope of FISR determines the breadth of state intervention into investment activities, and it is an important legal tool to

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balance economic openness and national security. In response to possible security threats posed by foreign investment, the US and the EU have expanded the scope of FISR to varying degrees.

The scope of FISR in the US has expanded significantly beyond the “acquisition of control (AoC)”. Since President Gerald Ford established the Committee on Foreign Investment in the United States (CFIUS) by executive order in 1975, the United States has passed the Exon-Florio Amendment (1988), the Byrd Amendment (1993) and the Foreign Investment and National Security Act (FINSA, 2007) in response to national security concerns triggered by Japanese, French and Middle Eastern investors’ mergers and acquisitions in the US.\(^6\) The CFIUS has thereby established and strengthened its reviewing authority. FINSA once limited the CFIUS’s authority to so-called “covered transactions,” that is, “any transaction by or with any foreign person, which could result in control of a US business by a foreign person.”\(^7\) Under such a regime, transactions in which foreign investors acquire 10% or less of voting rights and transactions for the purpose of “passive investment”\(^8\) are not, in principle, covered by the CFIUS.

In 2018, the US significantly expanded the categories and range of “covered transactions,” only leaving out the so-called “passive investment.”\(^9\) To be more specific, the FISR regime now covers all transactions that may enable a foreign investor to gain control of a US business, including mergers, acquisitions and deals made through securities markets. Such a regime

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\(^7\) “Transaction” here covers the acquisition of an ownership interest in an entity, the acquisition or conversion of convertible voting instruments of an entity, the acquisition of proxies from holders of a voting interest in an entity, a merger or consolidation, the formation of a joint venture, and a long-term lease under which a lessee makes substantially all business decisions concerning the operation of a leased entity. See Jingli Jiang and Gen Li, “CFIUS: For National Security Investigation or for Political Scrutiny,” Texas Journal of Oil, Gas and Energy Law, Vol.9, 2013, pp.67-100.

\(^8\) “Passive investment” refers to investment in which the investor does not intend to intervene or control plans or decision-making of the target entity.

concerns cases like 1) mergers and acquisitions through joint ventures; 2) purchase, lease and acquisition of use rights by foreign investors in US airports, seaports and immovable property adjacent to sensitive military or government assets; 3) foreign investment in US “critical infrastructure,” “critical technologies” and other scenarios including: investments leading to foreign investors gaining access to non-public information of critical technology owned by US companies, investments enabling investors to obtain the status of members (or observers) of or the right to appoint members (or observers) of the board of directors (or equivalent leading bodies) of a US company, investments bringing foreign investors’ rights, other than voting, to participate in the decision-making process of a US company (involving critical infrastructure, critical technologies, and sensitive personal information of US citizens).

According to the new EU framework, the scope of FISR is limited to “foreign direct investment”, i.e. “an investment of any kind 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.” Here, “foreign investor” refers to “a natural person of a third country or an undertaking of a third country, intending to make or having made a foreign direct investment.” According to this legislative definition, the EU regime in principle excludes portfolio investments - investments with voting rights of up to 10% - from the security review.

The new EU regime has created a double-track system which separates the fundamental regulatory power of member states from the auxiliary regulatory power of the European Commission in terms of the scope of scrutiny. Take Germany as an example for the fundamental regulatory power of EU member states: the Federal Ministry for Economic Affairs

10 Art. 2 Regulation (EU) 2019/452.
and Energy (BMWi) leads the security review, including “cross-industry security review” and “special industry security review” for any non-EU entity acquiring German enterprises.11 Concerning the cross-industry security review process, after the 2017 and 2018 amendments, the German Foreign Trade and Payments Ordinance authorized the BMWi to review acquisitions that may transfer 10% or more of voting rights in certain industries (i.e. key infrastructure operators, software developers for key infrastructure industries, enterprises producing statutory telecommunications surveillance equipment and mastering relevant technological know-how, cloud computing services providers, and mass media enterprises), or 25% or more in other enterprises. Regarding the special industry security review process, the BMWi is authorized to review any acquisitions by foreign entities (including other EU member states) that may transfer more than 10% of voting rights in German military equipment and IT security equipment producers. In contrast, the auxiliary regulatory power of the EU Commission is now merely limited to foreign investments that are “likely to affect projects or programs of Union interest,”12 which involve eight projects or programs including the European Global Navigation Satellites System (GNSS) programs (Galileo & EGNOS).13

Generally speaking, the FISR in Europe and the US covers basic transaction forms such as equity acquisition, asset acquisition, formation of joint ventures, as well as foreign investments involving critical infrastructure, critical technologies and sensitive information of citizens. Specifically, the FIRRMA in the US has gone beyond the limit of “acquisition of control” and exempted only “passive investment” to rebalance economic openness and national security, as a measure to deal with so-called “unprecedented” security threats. The new EU FISR regime applies only to “foreign direct investment,” excluding foreign investment concerning less than 10% of voting rights. EU member states such as Germany have even set looser

12 Art. 8(3) Regulation (EU) 2019/452.
FISR standards for entities not involving critical infrastructure, critical technologies or media diversification in its cross-industry security reviews.

**Anti-circumvention measures: unveiling the legal framework of M&A transactions**

In principle, the FISR in the US and the EU focuses on mergers and acquisitions of domestic enterprises or assets by “foreign persons.” In comparison with traditional industrial enterprises, entities like state-owned enterprises, offshore companies, investment funds and special purpose vehicles (SPVs) are becoming increasingly active in cross-border M&A transactions. In order to prevent foreign investors from maneuvering around the security review mechanism through an SPV or other M&A operations, the US and the EU have introduced or strengthened anti-circumvention measures to ensure the effectiveness of their FISR mechanisms.

For investments made via SPVs, the CFIUS includes the SPVs’ direct or indirect parent companies into the security review. Meanwhile, the CFIUS also requires disclosure of all shareholders owning more than 5% shares of the SPVs’ parent companies. In cases involving foreign state-owned enterprises, the CFIUS also requires disclosure of the type and nature of the rights that foreign governments own over the enterprises in question. In the case of *Ralls Corp. v. Committee on Foreign Investment in the United States*, despite the fact that Ralls Corporation is a US company, its subsidiary status to a Chinese corporation, Sany Group, rendered the CFIUS to subject it to security review and determine that the acquisition posed a threat to US national security. In 2018, the case of Broadcom’s proposed takeover of Qualcomm reflected the new trend that the CFIUS has been tightening regulation on circumvention measures. In this case, when the acquiring party, Singapore’s Broadcom, went ahead with the acquisition, it took the

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initiative to relocate the company to Delaware, US in order to “evade” the likely security review.\textsuperscript{16} In the process of the review, the CFIUS not only ordered the suspension of the transaction, but also required Broadcom to report to the CFIUS before taking any further steps to relocate. On March 12, 2018, President Trump issued an executive order according to CFIUS advice, requiring Broadcom to “immediately and permanently abandon the proposed takeover” on national security grounds and prohibiting it from taking “any substantially equivalent merger, acquisition, or takeover, whether effected directly or indirectly.”\textsuperscript{17}

The new EU FISR ensures its effectiveness by explicitly authorizing member states to prevent evasion of review mechanisms and review decisions through introduction of anti-circumvention measures.\textsuperscript{18} In the case of Centros,\textsuperscript{19} the European Court of Justice (ECJ) frequently broadened interpretation of the “freedom of establishment” provided in Article 49 of the Treaty on the Functioning of the European Union (TFEU),\textsuperscript{20} so that EU member states are obliged to recognize the legal status of enterprises established under the domestic laws of other member states. EU lawmakers believed that the introduction of anti-circumvention and anti-abuse measures in FISR was particularly necessary given the risk relating to abuse of the freedom of establishment. If an enterprise established under the domestic law of a member state is owned or controlled by a foreign investor, or its investment in the EU is manipulated and does not reflect its genuine economic activities, then it constitutes an abuse of the freedom of establishment under EU law and should be covered by the

\begin{footnotes}
\footnotetext[16]{Broadcom was originally a US company based in California and was later acquired by a Singaporean company. At the time of the transaction, Broadcom was operated by dual headquarters in Singapore and California. See Amy Deen Westbrook, “Securing the Nation or Entrenching the Board: The Evolution of CFIUS Review of Corporate Acquisitions,” \textit{Marquette Law Review}, Vol.102, 2019, pp.643-700.}
\footnotetext[18]{Art. 3(6) Regulation (EU) 2019/452.}
\footnotetext[19]{EuGH, Urt. v. 9.3.1999, Rs. C-212/97, Slg. 1999, 1-1459 – Centros.}
\footnotetext[20]{The “freedom of establishment” under Article 49 of the Treaty on the Functioning of the European Union (TFEU) is the most important basic freedom in EU corporate law. See Marcus Lutter, Walter Bayer and Jessica Schmidt, \textit{Europäisches Unternehmens- und Kapitalmarktrecht}, Berlin: De Gruyter, 2012, S.54.}
\end{footnotes}
FISR mechanism.\textsuperscript{21} It is evidently clear that the new EU FISR framework was influenced by the German anti-circumvention legislation and relevant latest reforms. In principle, German security review of foreign mergers and acquisitions only apply to those carried out by non-EU investors on enterprises in Germany, while mergers and acquisitions among EU enterprises belong to the freedom of establishment or the free movement of capital. However, if there is evidence that the acquirer has abused the subject qualification or engaged in evasive behaviors, it should also be subject to FISR. In other words, even mergers and acquisitions of enterprises in Germany launched by entities within the EU might be the target of FISR.\textsuperscript{22}

\textbf{Refining review criteria: “limited certainty” of abstract principles}

The criteria are the core of the security review mechanism. However, both the “national security” principle adopted by the US and the “security or public order” principle of the EU are rather ambiguous and abstract concepts, and thus European and American lawmakers and law enforcers are all facing the task of rendering them more concrete.

The FIRRMA in the US does not directly define the concept of “national security”; rather it factorizes the concept into a series of indicators which determine whether a deal poses a threat to national security or not: 1) whether a covered transaction involves a country of special concern; 2) the potential national security-related effects of the cumulative control of, or pattern of recent transactions involving, any one type of critical infrastructure, energy asset, critical material, or critical technology by a foreign government or foreign person; 3) whether any foreign person engaging in a covered transaction with a US business has a history of complying with US laws and regulations; 4) the control of US industries and

\textsuperscript{21} Begründung Nr. 10 COM(2017) 487 final.
\textsuperscript{22} Common forms of abuse of subject qualifications or evasive behaviors are: direct purchasers, in addition to the M&A transactions involved, do not engage in any real independent economic activities, or have no corresponding business premises, personnel or equipment within the EU, which demonstrates their continued existence. See Zhang Huailing, “Germany’s Foreign M&A Security Review: Reform Contents and Legal Responses,” pp.57-71.
commercial activity by foreign persons as it affects the capability and capacity of the US to meet the requirements of national security, including the availability of human resources, products, technology, materials, and other supplies and services; 5) the extent to which a covered transaction is likely to expose, either directly or indirectly, personally identifiable information, genetic information, or other sensitive data of US citizens to access by a foreign government or foreign person that may exploit that information in a manner that threatens national security; and 6) whether a covered transaction is likely to have the effect of exacerbating or creating new cybersecurity vulnerabilities in the US or is likely to result in a foreign government gaining a significant new capability to engage in malicious cyber-enabled activities against the US, including such activities designed to affect the outcome of any election for federal office.23

The new EU FISR framework took “security or public order” as the principle without directly defining it, with the principle’s connotations and its applicable scope subject to judicial review by the European Court of Justice. It has been a common legislative challenge for lawmakers of the EU and its member states to make the principle concrete and specific enough to ensure its applicability in individual cases. The Foreign Trade and Payments Ordinance of Germany adopts the regulatory mode of “general clause + non-exhaustive enumeration” to ensure the applicability of the principle of “public order and security.” Apparently, the EU lawmakers followed the German pattern. According to the new EU FISR mechanism, in determining whether a foreign direct investment is likely to affect security or public order, its potential effects on the following aspects should be considered: 1) critical infrastructure, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defense, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure; 2) critical technologies and dual use items as defined in Council Regulation (EC) No.428/2009,

23 Sec. 1702(c) FIRRMA.
including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies; 3) supply of critical inputs, including energy or raw materials, as well as food security; 4) access to sensitive information, including personal data, or the ability to control such information; or 5) the freedom and pluralism of the media, which is not mentioned in the draft legislation of the new EU FISR framework.  

**Investor nationality: a factor for legalizing policy objectives**

As an explicit manifestation of specifying their policy objectives into legal provisions, both the US and the EU have introduced nationality as a factor into their FISR regimes, aiming to distinguish foreign investments and apply different criteria accordingly. Notably, the definition of “nationality” varies in the US and the EU context in terms of substance and textual representation, which need to be examined and addressed differently.

The US FISR mechanism has the most explicit and comprehensive interpretation of the nationality factor with a strong bias against China. FIRRMA incorporates many aspects of the factor into the FISR mechanism. First of all, the concept of “country of special concern” is introduced and applied as a factor in determining whether a particular investment project threatens US national security. Second, in defining “foreign entities,” the US authorities would take into account their relationship with foreign governments and whether the investment would help implement the foreign government’s national strategy. Meanwhile, “foreign government-controlled transaction” has been broadly defined, covering all transactions that could result in the control of any US business by a foreign government or an entity.

24 Art. 4 Regulation (EU) 2019/452.
26 According to Section 1702(c) of the Foreign Investment Risk Review Modernization Act, a “country of special concern” refers to a country that has a demonstrated or declared strategic goal of acquiring a type of critical technology or critical infrastructure that would affect United States leadership in areas related to national security.
controlled by or acting on behalf of a foreign government. Moreover, the US has introduced a reporting system for Chinese investment. Not later than two years after FIRRMA came into force and every two years thereafter, the US Secretary of Commerce is obligated to submit a report to the Senate and the CFIUS on the state of foreign direct investment transactions made by Chinese entities in the US. Such report shall include 1) total foreign direct investment from China in the US, with breakdowns by value, industrial system, investment type, and government affiliation; 2) a list of companies incorporated in the US purchased through government investment by China; 3) the number of US affiliates of entities under the jurisdiction of China, the total employees at those affiliates, and the valuation for any publicly traded US affiliate of such an entity; 4) an analysis of patterns in the investments, including in volume, type, and sector, and the extent to which those patterns of investments align with the objectives outlined by the Chinese government in its Made in China 2025 plan; and 5) an identification of any limitations on the ability of the Secretary of Commerce to collect comprehensive information that is reasonably and lawfully available about foreign investment in the US from China. Finally, the US stipulates a reporting system on certain rail investments by state-owned or state-controlled entities. The US Department of Homeland Security, in coordination with the CFIUS, is required to submit a national security report to Congress. Such report is expected to assess national security risks, if any, related to investments in the US by foreign state-owned or state-controlled entities in freight rail, public transportation rail systems, or intercity passenger rail systems, analyzing how the number and types of such investments could affect any such risks.

In comparison to the US, the EU and its member states are more neutral and inexplicit when it comes to the nationality factor in the FISR framework. EU legislators emphasize that when regulators assess security risks, they should take into account “the context and circumstances of

27 Sec. 1703. FIRRMA.
28 Sec. 1719(b) and (c) FIRRMA.
the foreign direct investment, in particular whether a foreign investor is controlled directly or indirectly by the government of a third country or is pursuing state-led outward projects or programs.”29 In the legislative process, the European Parliament once proposed to take some highly targeted factors into consideration: 1) whether the foreign investor is directly or indirectly controlled by the government, state bodies or armed forces of a third country; 2) whether the foreign investor is pursuing state-led outward projects or programs and foreign government-controlled direct investments for strategic industrial goals, acquiring or transferring key enabling technologies or knowledge, supporting strategic national interests; 3) whether the sector is regarded as a strategic sector by the investors’ country of origin; 4) whether the statutes of the undertaking to which the investment is made include change of ownership clauses; and 5) whether market in the foreign investor’s country of origin is open, restricted or closed and whether there is reciprocity and a level playing field.30 The final version of the new EU FISR framework adopted a more neutral and abstract expression, that is, “In determining whether a foreign direct investment is likely to affect security or public order, Member States and the Commission may also take into account, in particular ... whether the foreign investor is directly or indirectly controlled by the government, including state bodies or armed forces, of a third country, including through ownership structure or significant funding.”31 Even such considerably more moderate expression is regarded by some scholars as explicitly targeted.32

In general, both US and EU FISR mechanisms consider the influence of third-country governments on investment as a critical factor in their security review. As the choice of factors for regulators to take into account in the criteria

29 Art. 4(2) Regulation (EU) 2019/452.
31 Art. 4 Regulation (EU) 2019/452.
of security review determines the outcome of the FISR process, the nationality factor will in effect lead to a binary division of foreign investors by US and EU regulatory authorities, and differentiated treatment in identifying the security risks of foreign investors. Law enforcement practices in the US and EU member states such as Germany indicate that mergers and acquisitions deals involving Chinese companies have been singled out as easy targets.33

**Motivations behind the Tightening of FISR**

The tightening of foreign investment security review by the US, the EU and some EU member states not only serves to cope with security threats posed by foreign investment, but also has special purposes based on their respective legal systems and regulatory environment.

**Motivations behind US tightening of FISR**

Since the promulgation of the Exon-Florio Amendment in 1988, the US FISR system has been evolving in accordance with new features in foreign investment as well as new changes in the geopolitical environment. In response to the security concerns raised by Middle Eastern sovereign wealth funds operating in the US after the September 11 terrorist attacks, the Foreign Investment and National Security Act of 2007 strengthened and expanded the authority of the CFIUS and stipulated the factors to be considered in foreign investment security review. After more than a decade, it was given the following considerations that the US FISR regime was further strengthened.

First, Washington’s concern about losing its superiority in science and technology has led to a major change in its attitude toward freedom of cross-border capital movement. For a long time, it had been a consensus

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33 In 2018, the German Federal Ministry for Economic Affairs and Energy successively intervened the acquisitions of Germany’s Leifeld Metal Spinning AG and 50Hertz Transmission GmbH by Chinese enterprises. The former is also the only foreign M&A so far that has been vetoed by the German ministry through the national security review process.
for American political and industrial elites that foreign investments were beneficial to the US economy and that the US innovation model would always carry the day in free market competition. However, such consensus and confidence no longer exist. US Senator John Cornyn, who was sponsor of FIRRMA, stated: “China has weaponized [investment] in order to vacuum up US industrial capabilities from American companies that focus on dual-use technologies. China seeks to turn our own technology and know-how against us in an effort to erase our national security advantage.”34 US lawmakers believe that the old FISR regime failed to adequately address new and potential threats posed by foreign investment to US scientific and technological superiority, which is considered the foundation of US military and national security. For example, foreign investors, even without obtaining control of the target company, could still have access to specific information or influence decision-making relating to the use, research and development of critical technologies.35 FIRRMA has expanded the definition of “national security” from traditional national defense to the fields of economic and technological security, justifying and institutionalizing the unilateralist and protectionist policies embodied in “America First.”

Second, in response to the rapid growth of Chinese strategic investment in the US, Washington has streamlined the organizational procedures and increased special funding for the CFIUS to strengthen its security review capabilities. In recent years, the number and complexity of the transactions reviewed by the CFIUS have both increased substantially, particularly those that have entered the investigation process (up to 70% of all transactions reviewed in 2017) and those that have received mitigation measures or prohibitions after review (about 20% in 2017).36 Therefore, the CFIUS needs more time and resources to perform its duties. The American prejudice that Chinese investment comes with political intentions is deeply

34 Rachel H. Boyd, “FIRRMA: Buy American Products, or Bye American Products.”
35 Ibid.
rooted. Even before FIRRMA was enacted, the US had already tightened security review in practice against so-called national security threats posed by Chinese investors. Statistics show that, between 2008 and 2016, the CFIUS reviewed a total of 364 M&A transactions, and only two of them were prohibited, while in 2018 alone President Trump vetoed two M&A transactions, both of which concerned Chinese companies investing in US technology companies. Aiming to strengthen the US regulatory authorities’ capability in collecting information and performing reviews over foreign investors, FIRRMA expanded the authority of the CFIUS, extended its review period, enhanced its organizational and financial supports, and created the reporting system on Chinese investment. Among them, the nationality factor as reflected in the review criteria and the reporting system would undoubtedly strengthen the ability of the CFIUS to scrutinize Chinese companies’ investment in the US.

Third, the US has sought to strengthen international cooperation with allies and partners in the field of cross-border investment security review. FIRRMA explicitly requests that “the President should conduct a more robust international outreach effort to urge and help allies and partners of the United States to establish processes that are similar to the Committee on Foreign Investment in the United States to screen foreign investments for national security risks and to facilitate coordination.” In addition, the CFIUS Chairperson, “in consultation with other members of the Committee, should establish a formal process for the exchange of information … with governments of countries that are allies or partners of the United States … to protect the national security of the United States and those countries.”

40 Sec. 1702(b)(6) FIRRMA.
41 Sec. 1713 FIRRMA.
mechanism should help “facilitate the harmonization of action with respect to trends in investment and technology that could pose risks to the national security” of the US and its allies and partners, “provide for the sharing of information with respect to specific technologies and entities acquiring such technologies,” and “include consultations and meetings with representatives of the governments of such countries on a recurring basis.”

Considerations behind EU tightening of FISR

In comparison to the US, the EU is more open toward foreign direct investment in terms of its legal institutions. In recent years, the rapidly increasing Chinese direct investment into the EU and several symbolic M&A cases has encouraged the EU and its member states to tighten their FISR mechanisms. Statistics show that China’s direct investments into the EU increased by 77% to 35 billion euros in 2016, meanwhile the direct investments of 28 EU member states into China fell to approximately 8 billion euros. More specifically, most of the Chinese investments have flowed to Western European countries with a stable political-economic environment and a full-fledged business-friendly regulatory setting like the UK, Germany and France. The Chinese investments also have tended to concentrate on sectors like infrastructure construction (including transportation, utilities, etc.), information and communications technology, and automobiles. However, as Chinese enterprises have made major inroads into a series of large-scale M&A cases, most notably Midea’s acquisition of KUKA and Geely’s purchase of Daimler shares, attitudes of the public, the industrial community and the political circle in EU member states such as Germany, France and Italy toward Chinese investment have all witnessed major changes. These changes are directly reflected in the tightening of their FISR mechanisms. While they tighten their domestic FISR mechanisms, these countries are also vigorously pushing forward the reform of FISR at the EU level. The following are their main considerations.

42 Sec. 1713 FIRRMA.
First, the rapidly growing Chinese investments involving critical infrastructure and controversial cases have raised concerns that they might damage the EU’s core interests. As a survey report by the European Commission shows, although traditional foreign investors like those from the US and Japan still hold a dominant position (accounting for 80% of total foreign investment), the number of M&A cases and volume of total assets involved have increased rapidly in the investments made by emerging investors such as China. For example, the assets of EU companies purchased and controlled by Chinese companies only amounted to about 16 billion euros in 2012, but this number rose sharply to about 160 billion euros in 2016, accounting for 3% of total foreign investment received, whereas investments from Russia and India both accounted for only 0.5%. In addition, state-owned enterprises have been an important driving force behind China’s investment activities in the EU. Since 2000, state-owned or state-shareholding enterprises (in which more than 20% of the shares are held by the state) have participated in more than 60% of China’s total investment in Europe. This ratio has declined in the past three years, but remained above 50% in 2017 and the first quarter of 2018.44

On September 13, 2017, Jean-Claude Juncker, then President of the European Commission, proclaimed in a speech: “… we are not naïve free traders. Europe must always defend its strategic interests.” He proposed a new EU framework for investment screening, and declared: “If a foreign, state-owned, company wants to purchase a European harbor, part of our energy infrastructure or a defense technology firm, this should only happen in transparency, with scrutiny and debate.”45 In response to the challenge of Chinese foreign investment, the Federation of German Industries (BDI) issued its China policy report in January 2019 which positioned China as a “systematic competitor” and argued that there was a competition between two models, namely between

China’s state-controlled economy and Europe’s free market economy. The EU has adopted a new FISR framework as a legal tool to address new security challenges. Then EU Trade Commissioner Cecilia Malmström said after the adoption of the new framework by the European Parliament that “we have to address the concerns about the security risk posed by certain investments in critical assets, technologies and infrastructure,” adding that “Member States and the Commission will have a much better overview of foreign investments in the European Union and, for the first time, will have the possibility to collectively address potential risks to their security and public order.”

Second, EU authorities intend to create a cooperation mechanism at the EU level, and coordinate the FISR activities of member states with those of the European Commission to eliminate doubts about the legitimacy of member states’ legislative powers. The new EU FISR framework defines its legislative basis as a “common commercial policy.” The Lisbon Treaty, which came into force in 2009, incorporates foreign direct investment into the EU’s common commercial policy. According to Article 3 of the Treaty on the Functioning of the European Union, the EU has exclusive powers on common commercial policies. However, the academic community is still debating over whether the EU has exclusive powers on FISR. Even if FISR belongs to the EU’s exclusive functions, the EU did not exercise such power from 2009 to 2019, while some EU member states have enacted or amended their respective domestic FISR laws and regulations. In order to coordinate all FISR activities, and eliminate disputes between the EU and member states concerning the FISR power, some EU member states including France, Germany and Italy proposed to establish a unitary FISR regime at the EU level. On September 13, 2017, the European Commission promulgated the

Chinese home appliance maker Midea Group’s planned purchase of German factory robot manufacturer Kuka AG was given the green light by the German government in 2016, but this and other large-scale M&A cases by Chinese investors have changed attitudes of EU member states toward investment from China.

Proposal for a Regulation Establishing a Framework for Screening of Foreign Direct Investments into the European Union. The European Parliament and the European Council quickly approved the new FISR framework in just over a year. Based on this regulation, the EU FISR framework has formed a dual-track system involving both the review mechanisms of member states and that of the European Commission. By setting up contact points and establishing secure information sharing channels, the European Commission and the member states can carry out cooperation in FISR activities with greatly enhanced efficiency. In addition, the explicit authorization for EU member states to create or reform their respective FISR mechanisms has also eliminated doubts about member states’ legislative powers.

Third, the EU is seeking to strengthen FISR cooperation with “like-
minded third countries” and employ the FISR mechanism as a legal tool to promote reciprocity of market access. The EU’s new FISR framework encourages member states and the European Commission to work with “like-minded” sovereign regulators to strengthen the effectiveness of the FISR framework in dealing with those foreign investments that may impact public order and security. In addition, in the China-EU investment agreement negotiations, the EU and its member states have employed FISR intervention as a legal tool to achieve reciprocity of market access.\textsuperscript{51} EU legislators clearly pointed out that the EU’s unequal relationship with certain third countries in the field of investment justified the introduction of the EU’s new FISR framework. As far as China is concerned, the European Commission stated in \textit{EU-China: A Strategic Outlook}, which was published in March 2019, that “China’s proactive and state-driven industrial and economic policies such as ‘Made in China 2025’ aim at developing domestic champions and helping them to become global leaders in strategic high-tech sectors,” but China protects its domestic enterprises through “selective market opening, licensing or other investment restrictions,” such as “creating joint ventures with local companies or transfer of key technologies to Chinese counterparts.” Accordingly, the European Commission included its desire of “achieving a more balanced and reciprocal trade and investment relationship” with China in its “10 concrete actions.”\textsuperscript{52} The Federation of German Industries also believes that “all companies in the G7 countries face the same trade and investment barriers in China” and thus advocates that the EU and Germany take more active measures to strengthen cooperation with other free and open economies.\textsuperscript{53}

In general, the US and the EU share common ground in institutionalizing their policy objectives, stressing organizational and capability enhancement of existing regulatory authorities, safeguarding their strategic interests, and


\textsuperscript{53} “China – Partner und Systemischer Wettbewerber,” BDI, January 10, 2019.
strengthening international cooperation. At the same time, the US FISR’s political intention is more explicit and apparent, while the EU is still struggling to find a legislative basis for its FISR framework which can fill the vacuum caused by the lack of a unified regulatory regime.

**Addressing the Increasingly Complicated Overseas Investment Environment**

In principle, the US and the EU FISR frameworks are aimed at investments from all third (or non-EU) countries, but their intention to restrict particularly Chinese investment is more than obvious. These FISR mechanisms, as a result of legislating economic policies, have had and will continue to have negative impacts on Chinese companies’ investments into high-tech fields in the US and the EU.54 The impacts are mainly reflected in the following three aspects.

First, the tightening of FISR mechanisms in the US and the EU is threatening the implementation of the “go global” efforts by Chinese enterprises and the Made in China 2025 plan. The policy changes in the US and the EU will lead to a sharp rise in security review risks for Chinese companies (especially state-owned enterprises) in overseas investment. Also, these changes render Chinese companies more vulnerable to politically-driven security measures. Since the US and the EU are key destinations for China’s outbound investment, the tightening of their FISR mechanisms will bring adverse impact on the progress of the “go global” attempts by Chinese enterprises. This tendency has not only been reflected by some highly representative M&A cases which underwent heavy security review due to Chinese participation, but has also been demonstrated in the sharp decline of China’s total direct investment in the US and the EU in the past three years. From 2017 to the first half of 2019, China’s direct investment in the US and the EU experienced a precipitous fall to only $5.39 billion and 17.3 billion euros respectively in 2018, a reduction of 40%

compared to 2017 and even 60% compared to 2016. Since the reform of the FISR mechanism, the review of foreign investment controlled or supported by the state into areas of critical technologies and infrastructure has been considerably tightened, and transactions of this nature account for a large part of China’s investment in the US and the EU.

Second, the US and the EU FISR mechanisms are in danger of causing “functional alienation.” First, as a “super poison pill” against unilateral and hostile takeovers based on the interests of the target company’s board of directors rather than the interests of shareholders, the FISR mechanism greatly weakens the restrictions on company management in potential takeovers and undermines the corporate governance structure. For example, in the aforementioned Broadcom’s proposed takeover of Qualcomm, the board of directors of the target company unilaterally applied to initiate a national security review of the transaction, a rarity in everyday business, and ultimately relied on the power of the regulatory authorities to repel the acquisition. The case sparked doubts in the academic community whether the review power by the CFIUS is a “useful weapon” for national security guarantees, or whether it can be misused as a “protective shelter” for the interests of the board of directors of the target company.55 Second, in the context of the “America First” protectionist policy, the FISR authorities may adopt a broader understanding of national security threats, which in practice may easily become a pretext to protect domestic enterprises.

Third, the US and the EU regard FISR as a legal tool in their negotiations on investment agreements. Over the years, the US and the EU have always claimed that China places excessive legal and policy restrictions for foreign investment, and that they are unfairly treated by the less open Chinese market,56 thus justifying their own legal restrictions on

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56 In the statement on China-EU investment agreement negotiations, the Federation of German Industries emphasized that China should open its market on a reciprocal basis and give German companies the same treatment as Chinese domestic enterprises. See “Anforderungen an ein Investitionsabkommen zwischen der EU und China,” August 1, 2018, https://bdi.eu/publikation/news/anforderungen-an-ein-investitionsabkommen-zwischen-der-eu-und-china.
foreign investors. At present, China is negotiating trade and investment agreements with the US and the EU, who have adopted FISR legislation as a tool to exert pressure on China. Trump, who has cited national security concerns as an excuse for imposing tariffs, may use the FISR mechanism as a bargaining chip in the trade frictions with China.\(^5^7\) On the eve of the 2019 China-EU summit, Juncker stated: “Our aim is to focus on achieving a balanced relation, which ensures fair competition and equal market access.”\(^5^8\)

Against the background of uncertainties in Sino-US economic and trade disputes, China urgently needs to take effective measures to address the short-term impacts and long-term influence of US and EU FISRs, while protecting the legitimate rights and interests of investors in the process of further opening up.

First and foremost, judicial relief procedures should be initiated to respond to US and European regulatory authorities’ restrictions on legitimate rights of Chinese corporations. Established rule of law and a neutral judiciary are key motives behind Chinese investment in the US and the EU. When Chinese investment and transactions are restricted or even completely rejected by US and European regulatory authorities on national security grounds, Chinese enterprises should actively seek legal remedies, especially judicial remedies, to review the legitimacy and constitutionality of administrative measures through the existing legal safeguard system in the host country. The FISR mechanisms of both the US and the EU recognize the judicial relief system to varying degrees. Prior to the promulgation of FIRRMA, the US did not stipulate how foreign investors could have access to judicial relief for the decisions of the CFIUS and the President. The conclusions reached and the actions taken by the President were not subject to judicial review, which led to over-politicization of and absence of judicial restrictions on the decision-making of US regulatory authorities.

\(^{57}\) Rachel H. Boyd, “FIRRMA: Buy American Products, or Bye American Products.”

This situation was gradually changed after the Ralls case. Ralls Corporation, a US subsidiary of the Chinese company Sany Group, filed a lawsuit against the CFIUS and the President’s transaction ban, based on the US Constitution. The court ultimately ruled that such executive order violated the due process as guaranteed by the Constitution, and the defendant shall provide Ralls Corporation with non-confidential documents involved in the issuance of the injunction. The case not only had a significant positive impact on the judicial practices of US security review, but also became a driving force for FIRRMA’s recognition of justiciability concerning the procedural legitimacy of security review by regulatory authorities. Similarly, the new EU framework regulation stipulates that foreign investors and invested companies in the EU have the right to obtain administrative and judicial relief for the decisions of the regulatory authorities of member states. Accordingly, EU member states have an obligation to establish specific legal remedies in their domestic laws.

Besides, investors should incorporate the risks of FISR into their overall trading arrangements. The tightening of US and EU FISR legislation has led to a surge in legal risks and transaction costs as regulatory authorities are more likely to intervene in investment transactions on the grounds of “national security” or “public order and security.” In 2018, the Yantai Taihai Group’s acquisition of Leifeld in Germany became the first foreign merger and acquisition transaction vetoed by the German BMWi since 2004. In the same year, AT&M’s acquisition of German aerospace supplier Cotesa was approved only after seven months of review procedures. In response, Chinese companies should fully factor in the legal risks of security review in their transaction arrangements, and should take the approval or non-initiation of review by regulatory authorities as a precondition for any contract to become effective, delivered or revoked. During the performance of contractual obligations, the risk of substantial prolonging of review period and how the starting point of the review period is identified by regulatory authorities should be fully considered, and the subject that bears the obligation to apply for security review should be clearly defined. In
addition, the contract should have a clear ex-ante agreement on the sharing of liabilities and risks in cases where transactions are not approved or only approved with conditions.59

Finally, China should insist on the path of comprehensive reform and opening-up and actively promote negotiations on a bilateral investment agreement with the EU. International cooperation constitutes a major part of the reform of FISR frameworks in the US and the EU, which lays down a series of systems and mechanisms for establishing and strengthening cooperation with “like-minded” countries in the field of FISR. In the context of current Sino-US trade frictions, the Trump administration disregards facts and accuses China of reneging on its promises and undermining the core demands of the US in bilateral economic and trade negotiations. In this regard, China should be more active in promoting negotiations with the EU on a comprehensive investment agreement to jointly address the challenges of trade unilateralism and protectionism. So far, China has held more than 20 rounds of investment agreement negotiations with the EU, and held multiple discussions on market access, investment protection, sustainable development, national treatment and other common concerns, but their positions on many core issues are still quite divergent.60 In this context, Chinese legislators should focus on comprehensive reform and opening-up, make adjustments to the existing foreign investment laws and regulations, respond to the EU’s concerns, and provide momentum for China-EU investment agreement negotiations. The EU has also demonstrated its strong political will to conclude an investment agreement with China. In EU-China: A Strategic Outlook, the conclusion of bilateral agreements on investment by 2020 is explicitly included in the “10 concrete actions.”61 The Chinese side should also actively promote the conclusion of the investment agreement negotiations with the EU.

61 EU-China: A Strategic Outlook, Joint Communication to the European Parliament, the European Council and the Council.
agreement to provide institutional arrangements for reducing legal risks of security review facing Chinese investment in Europe, and create a favorable international environment for the final settlement of China-US trade frictions.

**Conclusion**

The tightening of FISR systems in both the US and the EU is based on the systematic adjustment of their China policies. Whether it is to amend the existing FISR mechanism or to create a new regulatory regime, it in effect provides a legal cover for protectionist policies and a shield for domestic critical infrastructure and key technological assets from the so-called “threat” of Chinese investments. In terms of institutional content, the US and the EU have been trying to achieve a rebalance of economic openness and national security by expanding the scope of FISR. Strengthening FISR and introducing anti-circumvention measures aims to unveil the legal appearance of cross-border M&A transactions. The refining of review criteria seeks to provide “limited certainty” for the abstract standards of “national security” or “public order and security,” while investors’ nationality is a key factor for US and European lawmakers to legalize policy objectives. Objectively, the US and the EU’s tightening of FISR has the effect of echoing with each other, which will have a tremendous impact on investment from Chinese enterprises. In order to respond effectively, Chinese companies should actively use the existing legal remedy mechanism of the host country to challenge the legality of politically-driven review decisions, while incorporating the legal risks of security review into investment and transaction arrangements. At the government level, China should actively promote negotiations with the EU on a comprehensive investment agreement, and create a favorable legal environment of overseas investment for Chinese enterprises to “go global.”