Foreign Direct Investment Screening and National Security: Reducing Regulatory Hurdles to Investors Through Induced Reciprocity

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Abstract

An increasing number of States has adopted new or revised existing laws that establish foreign direct investment (FDI) screening mechanisms on grounds of national security. Comparing FDI screening in Germany and China as a case study, this article identifies three regulatory hurdles to investors related to such mechanisms, namely unpredictability, procedural uncertainty, and the lack of transparency in practice. Adopting the theory of induced reciprocity, this article argues that these regulatory hurdles could be reduced if symmetry constraint on national FDI screening schemes can be established between sovereign States in an international agreement. To achieve induced reciprocity between the European Union and China regarding FDI screening on grounds of national security, the EU-China Comprehensive Agreement on Investment could incorporate certain fundamental principles and regulatory objectives of EU Regulation 2019/452 Establishing a Framework for the Screening of Foreign Direct Investments into the Union as a starting point and a way forward.

Keywords

China – comparative law – European Union – foreign direct investment screening – Germany – induced reciprocity – national security

1 Introduction

In recent years, governmental intervention affecting foreign direct investment (FDI) has become increasingly frequent. Albeit acknowledging the economic

benefit of it, much light has been shed on the negative detriments of unregulated or under-regulated FDI. As a regulatory response to these perceived detriments, many host States have adopted ex-ante FDI screening regimes that aim to identify, calculate, and prevent security-related risks and implications. A rationale for establishing such regimes involves the idea that foreign control of domestic industries in sectors considered by the host State as 'sensitive' or 'strategic' may result in particular perils to national security or public interest of the host State. The perceived risks come from the fear of loss of control over domestic inputs, such as critical goods and infrastructure, or critical services and technology, to foreign hands, who may have a hidden agenda to use the newly acquired control against the interests of the host State, or foreign economic espionage.¹

According to the United Nations Conference on Trade and Development (UNCTAD), up until 2018, there have been 24 countries globally that have FDI screening mechanisms in place on grounds of national security or other essential public interests, which altogether host about 56% of global inbound FDI stock.² They include the world's biggest economies, such as China, the United States, the United Kingdom, Japan, Canada, Australia, Germany, and France.³

In the European Union (EU), in addition to the 14 Member States which have adopted FDI screening mechanisms in national law,⁴ a foreign investment review regime at the EU level has been adopted in the Regulation of 19 March 2019 Establishing a Framework for the Screening of Foreign Direct Investments into the Union (Regulation 2019/452), applicable from October 2020.⁵ Regulation 2019/452 aims to attain: (1) the harmonization of Member States' national FDI review regimes; (2) the cooperation between Member States and between Member States and the European Commission in screening FDI; and (3) the European Commission's competence in FDI screening by issuing non-binding opinions. The harmonization objective is achieved by allowing Member States to 'maintain, amend or adopt' national FDI screening mechanisms on grounds of 'security or public order', as 14 Member

1 Theodore H Moran, *Three Threats: An Analytical Framework for the CFIUS Process* (Peterson Institute for International Economics 2009) 1 ff.

2 UNCTAD, *World Investment Report 2019: Special Economic Zones* (UN Publications 2019) 93.

3 *ibid.*

4 European Commission, 'List of Screening Mechanisms Notified by Member States' (15 April 2020) <https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf> accessed 24 June 2021.

5 Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 Establishing a Framework for the Screening of Foreign Direct Investments into the Union (23 March 2019) OJ L 79 I.

States have already done so,⁶ pursuant to the substantive and procedural requirements set forth in the Regulation.⁷ Therefore, Regulation 2019/452 results in a re-delegation of competence over FDI screening back to Member States, which, according to Article 207(1) of the Treaty on the Functioning of the European Union (TFEU), was a part of exclusive EU competence over FDI as common commercial policy since 2009. The EU screening involves the Commission's ability to issue non-binding opinions to the Member State in which a third-country takeover is made or planned if the Commission considers such a takeover to likely affect projects of the Union interest on grounds of security or public order.⁸ Hence, Regulation 2019/452 falls short of establishing a genuinely independent pan-EU screening mechanism.

The global breakout of the Covid-19 pandemic has raised new concerns on public health in the FDI context. Many host States have adopted temporary measures in addition to, or formal modification of, their existing FDI screening mechanisms, in order to impose more governmental intervention and heightened scrutiny over cross-border takeovers.⁹ The EU and its Member States have become particularly vigilant over these public health concerns caused by non-EU takeovers. The European Commission in March 2020 published a communication as guidance to the Member States concerning FDI from third countries and the protection of Europe's strategic assets.¹⁰ The Commission is convinced that 'in the context of the Covid-19 emergency, there could be an increased risk of attempts to acquire healthcare capacities ... or related industries such as research establishments ...' via third-country takeovers.¹¹ Therefore, the Commission calls for those Member States which already have FDI screening in place to make full use of their screening mechanisms and 'take fully into account the risks to critical health infrastructures, supply of critical inputs, and other critical sectors'. And those Member States which have not yet adopted FDI screening mechanisms in national law should

6 European Commission (n 4).

7 Regulation 2019/452 (n 5) art 3.1.

8 *ibid* art 8.2(c).

9 For a global overview of these new measures on FDI screening, see 'Covid-19 Coronavirus Update: Global Application of Foreign Investment Control Rules' (Allen and Overy LLP, 22 May 2020) <www.allenoverly.com/en-gb/global/news-and-insights/publications/covid-19-coronavirus-update-global-application-of-foreign-investment-control-rules> accessed 24 June 2020.

10 European Commission, 'Communication – Guidance to the Member States Concerning Foreign Direct Investment and Free Movement of Capital from Third Countries, and the Protection of Europe's Strategic Assets, Ahead of the Application of Regulation (EU) 2019/452' (25 March 2020) C(2020) 1981 final.

11 *ibid* 1.

'set up a full-fledged screening mechanism ... 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...' ¹² Further, several EU Member States, *inter alia*, France, Germany, Spain, and Italy, have expanded their scope of governmental scrutiny over FDI amid the pandemic, not only to protect the public health sector from malicious foreign takeovers, but also other critical and strategic industries from hostile and predatory foreign buyers in times of a wildly fluctuating stock market.

Since 2017, governed by the Foreign Trade and Payments Act (*Außenwirtschaftsgesetz – AWG*) and its implementing Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung – AWV*), the German government has imposed an ex-ante review over non-EU takeovers of a German company in critical sectors, triggered by exceeding certain shareholding thresholds in the target company, on grounds of public order or security. Since the outbreak of the pandemic, draft amendments have been proposed to the AWG, which was passed by the Federal government on 2 April 2020 and is awaiting Parliamentary approval, and to the AWV, which was published by the Federal government on 28 April 2020. ¹³ Major modifications would include a lowered level of risks required for governmental intervention in takeovers from an 'actual threat' to an 'expected threat' to public order or security, and an expansion of critical infrastructure subject to ex-ante review in the health sector, communications infrastructure, and critical raw materials. ¹⁴ China, for its part, did not adopt new measures regarding FDI screening amid the pandemic, but a significant modification took place in March 2019 when China adopted its Foreign Investment Law. ¹⁵ The Law includes one rather succinct provision that essentially broadens the scope of ex-ante governmental review to any foreign investment projects, including cross-border takeovers, greenfield investment, and even indirect investment, as long as national security is or could be threatened. ¹⁶

¹² *ibid* 2.

¹³ Maria Brakalova, 'Covid-19 Speeds up Tightening of the German Foreign Direct Investment Rules' (Dentons, 5 May 2020) <www.dentons.com/en/insights/articles/2020/may/5/covid-19-speeds-up-tightening-of-the-german-foreign-direct-investment-rules> accessed 24 June 2020.

¹⁴ *ibid*.

¹⁵ 中华人民共和国外商投资法 (Foreign Investment Law of People's Republic of China) (Promulgated by the National People's Congress on 15 March 2019, effective on 1 January 2020).

¹⁶ *ibid* art 35.

National security review of FDI – as first practiced by the Committee on Foreign Investment of the United States (CFIUS), established in 1975 – has been later emulated by many other countries in the world, but also criticized for its protectionist abuse.¹⁷ Because of the non-defined or rather vaguely-defined notion of national security which these investment screening regimes claim to protect, they have created certain negative externalities: in cases where the review system retains broad regulatory discretion and allows arbitrary decision-making power, the system may go beyond what is necessary and may be used to protect national security at a disproportional cost. The cost entails that would-be investors might regard the review as a regulatory hurdle to comply with in the market entry scheme of the host State, and as a consequence, decide not to proceed with their investment. Therefore, national security review of FDI could become a regulatory hurdle to investors and bring a significant deterrent effect to inward FDI.

This article aims to shed some light on several outstanding issues. First, how FDI screening mechanisms on national security grounds are considered black-box regulations and are subject to concerns and criticisms over their ambiguous and capricious nature. This article argues that a significant feature of FDI screening mechanisms on national security grounds is their black-box regulatory style: the screening process can be done in arbitrary, unpredictable, non-transplant, and unaccountable ways, whereby the regulatory authority could retain an excessive amount of discretion and flexibility mandated by legislation. This is in principle achieved by adopting the term ‘protecting national security’ as the regulatory objective in national laws pertaining to FDI screening, but little or no effort is put forth to elucidate how national security is essentially interpreted. As a result, the term ‘national security’ can be excessively used or abused in national law to reject any unwanted foreign investment if deemed necessary. This leads to rising concerns and criticism over the ambiguity and capricious nature of these FDI screening mechanisms.

Further, as a result of these black-box regulations, to what extent and in what ways these FDI screening mechanisms on national security grounds could generate regulatory hurdles and impose a deterrent effect to foreign investors. This article compares the national security review regimes of FDI in Germany and in China as a case study in order to demonstrate three main

17 On this matter, see for instance José E Alvarez, ‘Political Protectionism and United States International Investment Obligations in Conflict: The Hazards of Exon-Florio’ (1989) 30(1) *Va J Intl L* 1; W Robert Shearer, ‘The Exon-Florio Amendment: Protectionist Legislation Susceptible to Abuse’ (1993) 30(4) *Hous L Rev* 1729; Kevin McGill, ‘Selling Away Our Oil: Protectionism and the True Threat Raised by CNOOC’s Attempted Acquisition of UNOCAL’ (2007) 23(3) *Ga St U L Rev* 657.

regulatory hurdles to foreign investors in both review systems, namely unpredictability, procedural uncertainty, and the lack of transparency in practice. Germany and China are chosen to be the subjects of study because, despite the prosperous bilateral investment flows, there is an underlying concern that the national security review that has been adopted both in Germany and in China either has become a protectionist tool, or potentially leaves some room for protectionist abuse, and may eventually harm bilateral investment relations. A comparative methodology is adopted to support an argument that, although disparities between the two States in national law and practice are observed with regard to their respective FDI screening mechanisms, the two different systems emanate similar and converging problems, which could imply a bilateral solution.

Last but not the least, a policy solution to the problems identified above will be proposed. This article adopts the theory of reciprocity, whereby positive reciprocity can be induced by the creation of mutually binding and symmetrical constraints between parties. The identified regulatory hurdles in national FDI screening can be reduced if newly negotiated bilateral investment treaties (BITs) can provide reciprocal constraints on FDI screening to the contracting parties. Positive reciprocity is termed as 'cooperative reciprocal tendencies' where one party's actions are always reciprocated by a counterparty's amicable and cooperative reaction, as opposed to negative reciprocity, where retaliation takes place.¹⁸ Positive reciprocity can be achieved in different ways, one of which is to induce positive reciprocity by establishing 'symmetry constraint'.¹⁹ Symmetry constraint provides a set of binding rules applicable to each party that compels the parties into mutual cooperation rather than retaliation.²⁰ When positive reciprocity is induced by symmetry constraint, it is then termed as induced reciprocity.²¹

In the field of FDI screening, a cooperative strategy of each sovereign State would suggest minimized regulatory hurdles imposed on foreign investors by national FDI screening, which would lead to the free flow of capital, bilaterally or multilaterally – an optimal outcome with the most payoffs to all States involved. Whilst a retaliatory strategy of a State would suggest an increasingly broadened scope of FDI screening in domestic law and more frequent use or abuse of its FDI screening in practice, leading to the proliferation of tit-for-tat

18 Ernst Fehr and Simon Gächter, 'Fairness and Retaliation: The Economics of Reciprocity' (2000) 14(3) *J Econ Perspec* 159, 159–60.

19 Francesco Parisi, 'The Cost of the Game: A Taxonomy of Social Interactions' (2000) 9(2) *Eur J L & Econ* 99, 105.

20 *ibid.*

21 *ibid.*

protectionist investment policies internationally, which is an outcome that is inferior for all States involved. To achieve cooperation and avoid retaliation, international investment agreements, in which a number of restrictions and requirements on the contracting States' capacity and capability to screen FDI on national security grounds is stipulated as treaty obligations, can serve as symmetry constraints to achieve induced reciprocity. From an EU perspective, Article 207(1) TFEU, which entered into force in 2009, has included FDI in the common commercial policy, resulting in a vertical shift of competence over FDI from the Member States to the EU, including the conclusion of investment treaties with third countries.²² This shift of competence post-Lisbon forms the basis of a unified BIT between the EU and China, namely the EU-China Comprehensive Agreement on Investment (CAI). Therefore, to achieve induced reciprocity between an EU Member State and China regarding their national FDI screening schemes, the CAI could provide an overarching framework of FDI screening for the contracting parties to comply with. Dedicated provisions on FDI screening in the CAI could incorporate certain fundamental principles and regulatory objectives embodied in the provisions of Regulation 2019/452 on the harmonization of Member States' national FDI screening schemes.

To build up these arguments, the remainder of this article is arranged as follows: Section 2 takes a brief inventory of the notion of national security in the FDI screening mechanisms of some of the world's major economies in order to demonstrate that there is a significant level of ambiguity in those legislations. Section 3 conducts a case study, comparing the national security review regimes of Germany and China in order to unveil the similarities and differences of the two systems in law and practice; it also identifies three regulatory hurdles to foreign investors in both review systems, namely unpredictability in substantive provisions, the lack of procedural certainty, and the lack of transparency in practice. Adopting the theory of reciprocity, Section 4 proposes that in order to achieve induced reciprocity regarding FDI screening between an EU Member State and China, the CAI could serve as an effective and mutually binding agreement that imposes a number of requirements and restrictions as treaty obligations on the regulatory autonomy of EU Member States and China in FDI screening. Section 5 concludes.

22 Axel Berger, 'The China-EU Investment Agreement Negotiations: Rationale, Motivations, and Contentious Issues' in Yuwen Li, Tong Qi and Cheng Bian (eds), *China, the EU and International Investment Law: Reforming Investor-State Dispute Settlement* (Routledge 2020) 13.

2 FDI Screening on Grounds of National Security: Regulation in a Black Box

National security review regimes of FDI have been widely adopted. Those host States with national security review mechanisms in place not only include countries with a tradition to place heavy regulation on FDI but also those that generally adopt a rather permissive and liberal stance on FDI. In principle, these FDI screening mechanisms put cross-border mergers and acquisitions as opposed to greenfield investment subject to governmental review, most predominantly based on grounds of national security but also including other alternatives such as public order, security, or safety.

A most prominent example is the United States, whereby an inter-departmental agency established since 1975, the CFIUS, would review foreign takeovers of US companies based on national security concerns, reach mitigation agreements with investors that impose conditions or modifications to the proposed transaction, and, if necessary, recommend to the President to downright prohibit the deal.²³ National security is construed as an open-ended term so as to include (but is not limited to) considerations relating to 'homeland security' and 'critical infrastructure'.²⁴ These security-related terms, however, are also open-ended and lack further definitions.²⁵

Another example is China's national security review regime established in 2011, which is regarded to have largely emulated the CFIUS review process and hence mirrors the US review in many regards, such as a two-tiered review procedure and an inter-ministerial review board.²⁶ In the same vein, the notion of national security in China's review regime is left undefined in legislation. This invites speculation that China's true intention of establishing a review of its own might be retaliation, as China's timing of announcing its national security review was suspect, especially because it occurred right after a number

23 The law currently governing the CFIUS review process is the Defence Production Act of 1950 (United States) § 721, as amended by Foreign Investment Risk Review Modernization Act of 2018 (United States) 50 USC § 4565.

24 *ibid* § 4565 (a)(1).

25 The term 'critical infrastructure', for example, is defined as '... systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security', *ibid* § 4565 (a)(5).

26 Yuwen Li and Cheng Bian, 'A New Dimension of Foreign Investment Law in China – Evolution and Impacts of the National Security Review System' (2016) 24(2) *Asia Pac LR* 149, 174.

of failed Chinese takeovers of US companies took place due to regulatory and political setbacks in the United States.²⁷

The EU holds a long tradition of a liberal takeover market. Guaranteed by Article 63 TFEU, the free movement of capital rule, no restrictions on capital movements are allowed unless justified, not only between Member States but also between Member States and third countries. Member States are allowed to deviate from this treaty obligation in rare and exceptional circumstances, which may be justified, for example, on grounds of protecting their essential security interests in accordance with Article 346 TFEU or public policy or public security as provided for in Article 65(1)(b) TFEU.²⁸

Notably, Regulation 2019/452 only reiterates that Member States may deviate from the free movement of capital rule if it is a matter of protecting 'security and public order' and falls within the scope of Article 65(1)(b) TFEU. But it falls short of giving the term 'security and public order' any further definition.²⁹ Therefore, 'public policy or security', pursuant to Article 65(1)(b) TFEU, and 'security and public order', pursuant to Regulation 2019/452, seem to be interchangeably used in EU law strictures as a justification for Member States' FDI screening mechanisms, both of which remain essentially undefined in EU law. As a result, Member States still retain a considerable amount of legislative discretion in interpreting public order, security, safety, or other semantic alternatives they deem appropriate.

Amongst EU Member States with FDI screening mechanisms in place, France, for example, purports to protect its national interests against detrimental foreign takeovers of French companies of strategic importance, which encompasses public order, public safety, and the national defence interests of France.³⁰ No further stipulation is provided in legislation with regard to how public order and public safety are construed in the foreign takeover context. Germany, on the other hand, protects its essential security interests, public policy or public security against foreign control of a German company, and public policy and security are defined as 'within the meaning of Articles 36, 52(1) and

27 Souvik Saha, 'CFIUS Now Made in China: Duelling National Security Review Frameworks as a Countermeasure to Economic Espionage in the Age of Globalization' (2012) 33(1) *Nw J Intl L & Bus* 199, 217.

28 Art 346 TFEU guarantees Member States prerogatives in adopting measures it considers necessary for the protection of the essential interests of its security. Art 65(1)(b) TFEU guarantees Member States' prerogatives to take measures to restrict the free flow of capital if justified on grounds of public policy or public security.

29 Regulation 2019/452 (n 5) explanatory note (4) and art 3.1.

30 Monetary and Financial Code of France, art L. 151-3.

Article 65(1)' of TFEU.³¹ While a direct reference to EU law in the German review regime could be deemed as an 'apparent and in principle, laudable' attempt at satisfying the EU law requirements, it remains unconvincing that the German review regime has made any substantial limitations to the scope of its regulatory freedom because 'by incorporating the EU law limitations by reference, the law becomes neither more transparent nor predictable'.³²

It has become clear that the notion of national security is widely adopted in national law by many host States to justify their interventionism in cross-border takeovers, but at the same time it remains largely undefined or loosely defined. The host State either makes little explanation to the notion of national security in national law, such as China and the United States, or distinguishes essential security interests and other public security and interests in domestic law but still leaves much margin in defining the latter, such as France and Germany. Arguably, the host State deliberately leaves national security undefined in its FDI screening systems in order to be able to retain a considerable level of regulatory autonomy in practice. National security could thus only be understood and interpreted by the review agency on a case-by-case basis and adapt to the particular circumstances of a transaction at issue. But the ambiguity of the notion of national security has rendered the FDI screening mechanism in national law notorious for its lack of legal certainty and predictability.

Because of the ambiguous nature of the notion of national security in these FDI screening regimes, the regime might have been, in some cases, excessively used or even abused by host States to achieve not only the protection of essential security interests or public interests, but also other hidden strategic, geo-political or economic alternatives via an opaque reference to national security.³³ Many host States retain the power to block foreign investment on national security or related grounds without clarifying 'what national security means and how, when and in relation to whom this threat is assessed'.³⁴ The ambiguity in law also results in the fact that the review administration would have ample amount of regulatory discretion in practice. Hence, the review

31 Foreign Trade and Payments Act (Außenwirtschaftsgesetz – AWG) (6 June 2013) (Federal Law Gazette [BGBl] Part I, 1482) § 4(1)4.

32 Till Müller-Ibold, 'Foreign Investment in Germany: Restrictions Based on Public Security Concerns and Their Compatibility with EU Law' in Christoph Herrmann and Jörg Philipp Terhechte (eds), *European Yearbook of International Economic Law 2010* (Springer 2010) 121.

33 Cheng Bian, *National Security Review of Foreign Investment: A Comparative Legal Analysis of China, the United States and the European Union* (Routledge 2020) 231.

34 Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia 2018) 449.

procedure may be subject to arbitrary decision-making and non-transparency and produce outcomes that are difficult to predict.³⁵ National security review of FDI might thus become black-box regulation that entails an underlying concern of protectionism and a significant deterrent effect to would-be investors because of the increased transactional costs they have to face.

3 National Security Review of FDI in Germany and China Compared: A Case Study

As a result of the black-box style regulation, national security review of FDI could engender a number of negative externalities and regulatory hurdles for investors. To demonstrate three main regulatory hurdles foreign investors may face, namely unpredictability, procedural uncertainty, and the lack of transparency in practice in the EU-China context, this Section compares the national security review regimes of FDI in Germany and in China as a case study. Despite the prosperous bilateral investment flows, there is an underlying concern that the national security review that has been adopted both in Germany and in China either has become a protectionist tool or, at the very least, leaves room for protectionist abuse, and may eventually harm bilateral investment relations. Presumably, the Germany-China scenario would also apply to the relations between any other EU Member State with an existing or prospective FDI screening mechanism and China.

3.1 *A Starting Point*

Germany and China have a close relationship in cross-border investment. In 2017, German companies invested USD 1.54 billion in China, which ranked tenth among countries/regions investing in China.³⁶ From 1987 to 2017, the aggregate stock of German FDI in China reached USD 29.72 billion, which positions Germany ninth among countries/regions and first among EU Member States investing in China.³⁷ Meanwhile, in 2017, recorded Chinese FDI in Germany was EUR 1.8 billion. From 2000 to 2017, the aggregate stock of Chinese FDI in Germany was EUR 20.6 billion, which puts Germany second only to the UK as the largest destination of Chinese FDI in the EU.³⁸

35 *ibid* 449–50.

36 Ministry of Commerce of China, 'Statistical Bulletin of FDI in China 2018' (2018) 25.

37 *ibid* 35.

38 Thilo Hanemann and Mikko Huotari, 'EU-China FDI: Working Towards Reciprocity in Investment Relations' (MERICS and Rhodium Group, May 2018) 31–32 <www.merics.org/sites/default/files/2018-08/180723_MERICS-COFDI-Update_final_o.pdf> accessed 24 June 2021.

Contrary to the remarkably high volume of bilateral investment stock, Chinese investors and their investments made headlines in Germany with their hearty appetite as of late, and they seem to have become increasingly unpopular, as mounting opposition within Germany begins to come to the fore. Chinese FDI flow to Germany fluctuated at one to two billion EUR from 2011 to 2017, with one exception of 2016, which was a historical record of nearly EUR 11 billion.³⁹ In 2016, Germany became the largest EU Member State recipient of Chinese FDI, accounting for 31% of Chinese investment in Europe,⁴⁰ which was made possible by the landmark Chinese Midea acquisition of German Kuka Robotics for EUR 4.5 billion. Acquisitions made by Chinese investors in Germany are covered by the media on a weekly basis, featuring examples of Chinese companies taking over German industrial leaders and national champions, such as Chinese HNA's acquisition of Deutsche Bank's nearly 10% accumulated shares in 2017⁴¹ and Chinese Geely's acquisition of Daimler's nearly 10% stake at USD 9 billion in 2018 – the biggest Chinese investment in Europe in history so far.⁴²

Apart from the tremendous size of Chinese takeovers in Germany, it is more of the sectoral distribution of these acquisitions that startled German policymakers. From 2000 to 2014, the overwhelming majority of Chinese FDI in Germany was in the form of mergers and acquisitions (82%), which were driven by the zest for purchasing advanced technology, know-how and reputable brands of German companies in sectors of strategic importance, inter alia, advanced industrial machinery and equipment (42.3%), automotive (31.1%), information and communication technology (6%), and renewable energy (5%).⁴³ The growing Chinese interest in German companies has fuelled

39 Shuwen Bian and Oliver Emons, 'Chinese Investments in Germany: Increasing in Line with Chinese Industrial Policy' in Jan Drahokoupil (ed), *Chinese Investments in Europe: Corporate Strategies and Labour Relations* (European Trade Union Institute 2017) 159.

40 Thilo Hanemann and Mikko Huotari, 'Record Flows and Growing Imbalances: Chinese Investment in Europe in 2016' (MERICS and Rhodium Group, January 2017) 8 <www.merics.org/sites/default/files/2018-07/MPOC_3_COFDI_2017_web.pdf> accessed 24 June 2021.

41 'China's HNA Becomes Deutsche Bank's Biggest Shareholder' (*BBC News*, 3 May 2017) <www.bbc.com/news/business-39788959> accessed 24 June 2021.

42 'China's Geely Buys a \$9 Billion Stake in Daimler Stake' (*Bloomberg*, 23 February 2018) <www.bloomberg.com/news/articles/2018-02-23/china-s-geely-is-said-to-be-buying-9-billion-stake-in-daimler> accessed 24 June 2021.

43 Thilo Hanemann and Mikko Huotari, 'Chinese FDI in Europe and Germany – Preparing for a New Era of Chinese Capital' (MERICS and Rhodium Group, June 2015) 16–18 <https://rhg.com/wp-content/uploads/2015/06/ChineseFDI_Europe_Full.pdf> accessed 27 May 2020.

a long-standing concern, which is in line with concerns raised on a larger scale, that the sale of core European industrial technology to Chinese buyers and Chinese acquisitions in European critical infrastructure, such as energy and electricity grids, transportation hubs, and cyber networks, may result in significant security-related detriments to the EU.⁴⁴

As a direct regulatory response to these national security concerns, governmental interference has become more frequent. An increasing number of deals proposed by Chinese buyers faced governmental review in Germany based on grounds of public order or security. Since the highly publicized acquisition of Kuka by Midea was reviewed and cleared by the German Federal Ministry for Economic Affairs and Energy (Bundesministerium für Wirtschaft und Energie – BMWi), several publicly known Chinese takeovers were reviewed by the BMWi but were eventually not successful due to mounting regulatory or political objections. These included the abandoned Chinese Fujian Grand Chip Investment Fund's acquisition of German Aixtron, the abandoned China State Grid Cooperation's bid for German 50Hertz, and the abandoned Chinese Yantai Taihai's bid for German Leifeld.⁴⁵

The regulatory means the German government was able to adopt to intervene in these Chinese takeover projects is stipulated in the AWG and its implementing AWW.⁴⁶ It was in 2003 when the German government first imposed restrictions on foreign takeovers of German manufacturers of military weaponry, war material and cryptographic systems after several high-profile takeovers of German companies in the defence sector by US buyers.⁴⁷ Seen as a rudimentary revision of the law, the 13th Amendment to the AWG enacted in February 2009 extended the scope of examinations to acquisitions in all sectors by non-EU/EFTA investors *ex post* on grounds of public order or security.⁴⁸ In July 2017, the German Federal government adopted the 9th Amendment to the AWW,⁴⁹ which substantially toughened the review regime

44 *ibid* 39–41.

45 These cases are elaborated in *infra* Section 3.5.

46 Foreign Trade and Payments Act (n 31); Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung – AWW) (2 August 2013) (Federal Law Gazette [BGBl] Part I, 2865).

47 Florian Stork, 'A Practical Approach to the New German Foreign Investment Regime – Lessons to be Learned from Merger Control' (2010) 11(2) German Law Journal 260, 261; Ruediger Theiselmann, 'Außenwirtschaftsrecht and Corporate Investments in Germany – New Hurdles for Investors' (2009) 10(11) German Law Journal 1495, 1495–96.

48 Investors from the European Free Trade Association (EFTA) area are considered EU investors in the German review. See AWW (n 46) art 55(2).

49 *Neunte Verordnung zur Änderung der Außenwirtschaftsverordnung* (9th Amendment to the Foreign Trade and Payments Ordinance) (18 July 2017).

by widening the scope of review and adopting a stricter review procedure. As a result, non-EU/EFTA investors who acquire 25% or more shares in a German company in several infrastructure and IT sectors that are deemed particularly sensitive are subject to *ex ante* notification requirements with the BMWi, and extensions of review time periods are introduced.⁵⁰ It is believed that the 9th Amendment is a regulatory initiative for stronger investment control to protect against the buy-up of German advanced technology companies by non-EU/EFTA investors and a direct response to the upsurge in Chinese investment in Germany, particularly after the Kuka case.⁵¹

Since the promulgation of the 9th Amendment of the AWW there have been disgruntled voices regarding the lack of effectiveness of the law, as it might still be too lenient to foreign investors. In December 2018, by enacting the 12th Ordinance amending the AWW, the German government intensified the review criteria by lowering the threshold of review from the previous 25% to 10% of shares in a German company which operates in military equipment, IT security, and specified critical infrastructure, including the software that operates it.⁵² It is reported that the latest amendment was indeed triggered by the failed acquisition of the German power grid operator 50Hertz, which was proposed by the Chinese State-owned State Grid Corporation. The German government did not have the regulatory power to intervene in the deal because the Chinese bidder proposed to acquire 20% of the shares in the German target, which was below the previous 25% threshold.⁵³ The German government therefore lowered the threshold for review in order to make similar acquisitions in the future subject to review. The German government chose to toughen its review twice in 18 months; both to a large extent were triggered by Chinese investment, indicating the German government's wariness of Chinese investment in particular.

50 AWW (n 46) arts 55 and 59.

51 Tobias Heinrich, Lars Ole Petersen and Sabine Kueper, 'German Government Tightens Rules for German Investment Control Covering M&A Transactions by Foreign Acquirers' (White and Case, 26 July 2017) <www.whitecase.com/publications/alert/german-government-tightens-rules-german-investment-control-covering-ma> accessed 24 June 2021. The Kuka case will be elaborated in *infra* Section 4.5.

52 AWW (n 46) as amended by *Zwölfte Verordnung zur Änderung der Außenwirtschaftsverordnung* (12th Amendment to the Foreign Trade and Payments Ordinance) (19 December 2018) art 56.

53 Juliane Hilf and others, 'Minority Acquisitions Targeted by New German Foreign Investment Rules' (Freshfields Bruckhaus Deringer, 29 December 2018) <http://knowledge.freshfields.com/en/Global/r/3878/minority_acquisitions_targeted_by_new_german_for_ign> accessed 24 June 2021.

China, for its part, has established a national security review system of its own in 2011, envisaged in the Notice of the General Office of the State Council on the Establishment of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (Notice 2011),⁵⁴ and the Provisions of the Ministry of Commerce (MOFCOM) on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (Provisions 2011).⁵⁵ China's review is believed to have emulated the process of the CFIUS and thus assimilates the US review in many regards, i.e. a two-tiered review process and an inter-agency review body.⁵⁶ This invites speculation that China's true intention of establishing a review of its own might be retaliation because China's announcement of its national security review came after a number of failed Chinese takeovers of US companies due to regulatory and political setbacks in the United States on national security grounds.⁵⁷ Others questioned the vagueness in the law, for example, the undefined purview of 'national security', which would result in excessive regulatory discretion and the potential to be capriciously implemented in practice.⁵⁸ The Foreign Investment Law (FIL) of China, promulgated in March 2019, includes one article pertaining to China's national security review, reiterating that 'China establishes a national security review system to review any foreign investment that endangers or might endanger national security'.⁵⁹ Because of the lack of operability of this provision in the FIL, China's national security review currently in effect still relies on Notice 2011 and Provisions 2011.

Against the background of the prosperous bilateral investment flows, there is an underlying concern that the national security review adopted both in Germany and in China either has become a protectionist tool, or potentially leaves some room for protectionist abuse, and may eventually create a

54 国务院办公厅关于建立外国投资者并购境内企业安全审查制度的通知 (Notice of the General Office of the State Council on the Establishment of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors) (Promulgated by the General Office of the State Council on 3 February 2011, effective on promulgation) (Notice 2011).

55 商务部实施外国投资者并购境内企业安全审查制度的规定 (Provisions of the Ministry of Commerce on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors) (Promulgated by the Ministry of Commerce on 25 August 2011, effective on 1 September 2011) (Provisions 2011).

56 Li and Bian (n 26) 174.

57 Saha (n 27) 217.

58 Vivienne Bath, 'Foreign Investment, the National Interest and National Security – Foreign Direct Investment in Australia and China' (2012) 34(1) Syd L R 5, 6.

59 Foreign Investment Law of China (n 15) art 35.

detering effect that negatively impacts the bilateral investment relation. To this end, by conducting a comparative analysis, the following Sub-Sections proceed to examine to what extent and in which ways the national security review of Germany and China respectively creates ambiguities and unnecessary hurdles to investors, especially with regard to factors considered during review, transactions subject to review, the review procedure, and review in practice.

3.2 *Factors Considered During Review*

The German review does not refer directly to ‘national security’; instead, it considers whether acquisitions by non-EU/EFTA investors threaten the public order or security of Germany.⁶⁰ ‘Public order or security’ is defined by reference to Article 36, Article 52(1) and Article 65(1) of the TFEU.⁶¹ The fact that public order or security is not further clarified by German law but that reference is made to pertinent terminology in the TFEU is an apparent attempt to put German law in line with EU law requirements.⁶² However, some doubts are raised about this approach in German law due to its insufficient level of deference to EU law requirements.⁶³

China’s review system purports to protect the national security of China, but is absent of further indication on the interpretation of the very concept. Instead, China’s review provides a list of factors that must be taken into consideration during a review, namely the influence of the proposed transaction on national defence security, the influence on ‘the stable operation of the national economy’, the influence on ‘the basic social order’, and the influence on the capacity of research and development of China’s key technologies involving national security.⁶⁴ Judging from the language adopted, it appears that the criteria provided leave leeway for interpretation in the course of enforcement, and the difference between national security and economic interests is not well articulated.⁶⁵ This could lead to excessive regulatory discretion and the potential for arbitrary enforcement of the review in practice.

In comparison, both the German review and the China counterpart seem to deliberately avoid a conclusive definition of their security-related concerns in

⁶⁰ AWG (n 31) sec 5(2).

⁶¹ *ibid* sec 4(1)4.

⁶² Müller-Ibold (n 32) 120–21.

⁶³ *ibid* 121.

⁶⁴ Notice 2011 (n 54) art 2.

⁶⁵ Kevin B Goldstein, ‘Reviewing Cross-Border Mergers and Acquisitions for Competition and National Security: A Comparative Look at How the United States, Europe, and China Separate Security Concerns from Competition Concerns in Reviewing Acquisitions by Foreign Entities’ (2011) 3(2) *Tsinghua China Law Review* 215, 237.

order to retain ample discretion in practice. This might create some hardship for foreign investors to understand and comply with the law and subject foreign investors to a significant level of uncertainty.

3.3 *Transactions Subject to Review*

The German review includes a cross-sectoral review and a sector-specific review. In the cross-sectoral review, the BMWi examines acquisitions of German companies by non-EU/EFTA residents based on potential threats to public order or security.⁶⁶ In principle, a direct or indirect acquisition of 25% or more of shares in a German company by a non-EU/EFTA investor, regardless of the sectors involved, is subject to review.⁶⁷ Acquisitions and their relevance to national security are to be examined, and to be prohibited if necessary, *ex post* official, which means investors in principle do not bear any antecedent responsibilities to notify the authorities. Pursuant to the 12th Ordinance amending the AWV, non-EU/EFTA takeovers of 10% or more of the shares in a German company in six sectors that are considered particularly sensitive are subject to *ex ante* written notification obligations for both the foreign acquirer and the domestic target.⁶⁸

The six particularly sensitive sectors include:

- Critical infrastructures (energy, information technology, telecommunications, transportation and traffic, health, water, nutrition, finance and insurance industry),⁶⁹
- Development of software used to operate critical infrastructures,
- Telecommunication surveillance,
- Provider of cloud computing services with access to certain infrastructures,
- Provider of telematics infrastructure,
- Media industry that shapes public opinion on particular topicality and far-reaching impact.⁷⁰

In the sector-specific review, the BMWi examines whether the essential security interests of Germany are endangered if a non-German resident directly or indirectly acquires more than 10% of shares in a German company involving weapons or other military goods, and products with IT security functions related to the processing of confidential government information.⁷¹

66 AWV (n 46) art 55(1).

67 *ibid* art 56(1)2.

68 *ibid* art 56(1)1.

69 This is defined by the Act on the Federal Office for Information Security (14 August 2009) (Federal Law Gazette, BGBl Part I, 2821), last amended by art 1 of the Act of 23 June 2017 (Federal Law Gazette, BGBl Part I, 1885) sec 2(10).

70 AWV (n 46) art 55(1).

71 *ibid* arts 60(1) and 60 a(1).

Pursuant to China's national security review, the Joint Conference, an ad hoc agency led by National Development and Reform Committee (NDRC) and MOFCOM and other relevant ministerial departments convened on a case-by-case basis, is established to assume the review process.⁷² The sectors subject to the review encompass:

- National defence security, including foreign takeovers of the military industry and entities peripheral to major or sensitive military facilities,⁷³
- Agriculture, energies and resources, infrastructure, transportation, key technology, and the manufacture of major equipment, whereby foreign investors aim to obtain control of the domestic target company.⁷⁴

In the second category, a foreign investor becomes the controlling shareholder of the domestic target entity when a direct or indirect acquisition of 50% or more shares in the target company is sought, or when the total shares held by a foreign investor after a takeover account for less than 50% but the voting power it holds could have a material impact on important matters of the target company.⁷⁵

In comparison, the transactions subject to review between Germany and China exhibit two differences. In terms of the sectors subject to review, as opposed to the German counterpart, China does not define infrastructure and key technology, rendering these two categories as open-ended terms. In terms of the threshold that triggers a review, China's control element (50%) is much higher than the German counterpart (10% and 25%), which would be easily circumvented if a foreign investor chooses to keep its shares in a Chinese company just below 50%. In another scenario where the threshold is not met but a de facto control might be sought in the target company, either the foreign investor has to prove otherwise, or the Joint Conference must identify that a de facto control by the foreign investor is indeed sought after in order to initiate a review. Because of the arbitrary nature of the de facto control element, it increases the unnecessary workload and misallocates the regulatory resources of the ad hoc Joint Conference.⁷⁶ This could have been avoided by simply providing a lower quantitative control threshold in China's review.

⁷² Notice 2011 (n 54) art 3(1).

⁷³ *ibid* art 1(1).

⁷⁴ *ibid*.

⁷⁵ *ibid* art 1(3).

⁷⁶ Xingxing Li, 'National Security Review in Foreign Investments: A Comparative and Critical Assessment on China and US Laws and Practice' (2016) 13 *Berkeley Bus L Rev* 255, 291; Meichen Liu, 'The New Chinese Foreign Investment Law and Its Implication on Foreign Investors' (2018) 38(2) *Nw J Intl L & Bus* 285, 300.

3.4 *Review Procedure*

In the cross-sectoral review, from the date on which the BMWi receives the notification (for transactions in the six particularly sensitive sectors) or it obtains knowledge of the signing of the acquisition agreement (other than transactions in the particularly sensitive sectors), the BMWi may initiate a review within three months.⁷⁷ Once such a decision is made within three months, the BMWi will require both transacting parties to submit relevant documentation. Upon receiving a full set of documentation, the BMWi will open a four-month review.⁷⁸ In the sector-specific review, acquisitions are subject to *ex ante* notification obligations to the BMWi for approval.⁷⁹ Upon receipt of the acquirer's written notification, the BMWi must reach a decision on whether to initiate a review within three months.⁸⁰ In the event that a review is to be opened, after the full set of documentation has been collected, the BMWi will open the review procedure, which must be concluded within three months.⁸¹

For those involved, extensive documentation is expected to be submitted to the BMWi, which may require considerable effort.⁸² The period for the submission of documents has no statutory deadline; this means the process could in reality take months, if not years, to be completed. The formal review procedure is also subject to suspension if 'the BMWi conducts contract negotiations with parties involved, e.g. to explore how to guarantee public order and security from the perspective of the BMWi'.⁸³ As a result, 'the proceedings are not ultimately time-limited – even in theory'.⁸⁴

The BMWi can prohibit an acquisition after the formal review, issue orders to restrict or modify the acquisition, or grant approval if no public order or security implications are involved.⁸⁵ After the 9th Amendment of the AWV, the issuance of a prohibition or orders of restriction no longer requires the consent of the entire Federal Government. The BMWi alone may block or modify proposed transactions upon completion of the review.⁸⁶ This leads to

77 AWV (n 46) art 55(3).

78 *ibid* art 59(1).

79 *ibid* art 60(3).

80 *ibid* art 61.

81 *ibid* art 62.

82 Florian Becker and Bärbel Sachs, 'Stricter Rules for Foreign Direct Investment – An Overview of the Changes and Their Possible Practical Impact on Transactions' (Noerr, 12 July 2017) <www.noerr.com/en/newsroom/News/stricter-rules-for-foreign-direct-investment.aspx> accessed 24 June 2021.

83 AWV (n 46) art 59(2).

84 Becker and Sachs (n 82).

85 AWV (n 46) art 59(1).

86 *ibid* art 59(3).

concerns about whether the exceptional character of restrictions or prohibitions of a foreign takeover is undermined. Ultimately, all final decisions made by the BMWi are subject to judicial recourse.

In China's review procedure, the foreign investor bears the obligation to file a voluntary application for review to the NDRC prior to the completion of the transaction.⁸⁷ Other third-party stakeholders may also suggest that the NDRC initiates a review procedure.⁸⁸ From the day on which a foreign investor files a voluntary application with the NDRC, the latter will have to make a decision on whether to initiate a review in 15 working days.⁸⁹ In the event that the NDRC decides to initiate a review according to either investor's voluntary filing or a third-party's suggestion, the NDRC will submit a review request to the Joint Conference within five working days.⁹⁰ Upon receipt of the review request from the NDRC, the Joint Conference first conducts a 30-working-day general review, followed by a 60-working-day special review if there are still unresolved national security risks regarding the transaction under review.⁹¹ Hence, the entire review procedure could last for up to 110 working days from the day on which a foreign investor files a voluntary application, which in principle equals at least 154 calendar days.

The final results of a review could be either clearance or rejection. Alternatively, if the Joint Conference still faces 'major disputing divergence' with regard to the case under review after completion of the entire review procedure, it is required to refer the issue to the State Council for a final decision.⁹² All decisions made from the review are final and exclude any administrative or judicial recourse.⁹³ The possibility for foreign investors to be able to seek administrative or judicial review concerning the outcome of the national security review made by the executive branch in the host State enhances accountability.⁹⁴ It provides an important, and oftentimes the only channel to

87 Provisions 2011 (n 55) art 1. Pursuant to Notice 2011 and Provisions 2011, MOFCOM was the agency that was responsible for the receipt of applications for review submitted by foreign investors. Pursuant to the Notice of the NDRC No 4 (April 2019), the NDRC now supersedes the MOFCOM for accepting investors' filings for review as a result of 'adjustment of departmental responsibilities'. NDRC, '中华人民共和国国家发展和改革委员会公告2019年第4号 (NDRC Announcement No 4 2019)' (30 April 2019).

88 Notice 2011 (n 54) art 4(2).

89 Provisions 2011 (n 55) art 6.

90 Notice 2011 (n 54) art 4(1).

91 *ibid* art 4(3).

92 *ibid*.

93 Foreign Investment Law of China (n 15) art 35.

94 OECD, 'Guidelines for Recipient Country Investment Policies Relating to National Security' (25 May 2009) <www.oecd.org/investment/investment-policy/43384486.pdf> accessed 24 June 2021.

ensure the integrity, objectivity and due process of the national security review regime. Therefore, China's national security review regime may suffer from a lack of accountability for its exclusion of judicial review in comparison with the German counterpart.

China's review might also be subject to some additional delay. Criticism and concerns have been raised about various aspects of the legal and institutional deficiencies of China's review, not in the least concerning the necessity of a separate and additional national security review in China's FDI regulatory regime that is already considered rigorous and multi-layered.⁹⁵ Until 2017, all foreign takeovers in China were subject to a case-by-case review, which must be decided in 30 days after MOFCOM (or a Department of Commerce at the provincial level) receives the full set of the required documents.⁹⁶ If a foreign investor intends to acquire shares in a Chinese listed company on the Chinese stock market, the acquisition is subject to a series of stringent qualifications, restrictions, and approval, including, for instance, another 30-day case-by-case review by MOFCOM.⁹⁷ The law does not specify, however, whether these multifaceted review mechanisms are conducted in parallel or subsequently. In the latter case, the total review process could become even longer than 154 calendar days, which would add an additional layer of delay to the transaction as a whole.

3.5 *Review in Practice*

There have been no official rejections of takeovers rendered by the BMWi so far. This suggests that the German review is conducted with caution in practice and that official prohibition of transactions is rare and exceptional. Although no official objection has been found, some informal and hidden barriers exist, which may bring unexpected and additional restrictive effects to foreign investment. Information which is publicly available about the following cases demonstrates how Chinese investors have been subject to such informal barriers.

Chinese Midea's acquisition of German cutting-edge robotics manufacturer Kuka in 2016 became the largest transaction by a Chinese investor in Germany up until that point, a transaction that invited intensive publicity and media coverage and generated widespread policy debate in Germany. When Kuka

95 Bath (n 58) 6.

96 关于外国投资者并购境内企业的规定 (2009) (Provisions on the Takeover of Domestic Enterprises by Foreign Investors) (Promulgated by Ministry of Commerce on 22 June 2009, effective on promulgation) (2009 Revision) art 6.

97 外国投资者对上市公司战略投资管理办法 (2015) (Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors) (Promulgated by MOFCOM on 28 October 2015, effective on promulgation) art 12.

received a bid by the Chinese home appliance maker Midea of EUR 4.5 billion, the deal faced overwhelming objection among policymakers, the public, and even Kuka's management and supervisory board and shareholders.⁹⁸ The sale of a German industrial icon to China, the loss of advanced technology to a Chinese investor who might fulfil a political goal in accordance with the national 'Made in China 2025' campaign, and the imbalance of market access between Germany and China were the main focuses of the opposition. The BMWi reviewed the deal, reportedly with great precaution, and eventually cleared the deal. But the German government's permissive position in dealing with foreign takeovers of German companies in the high-tech sector received substantial dissatisfaction from the public.⁹⁹

Another equally high-profile but unsuccessful deal in 2016 was the proposed takeover of Aixtron, a German semiconductor manufacturer, by the Chinese Fujian Grand Chip Investment Fund. The deal was subject to review by the BMWi and gained clearance. The BMWi decided later, for the first time in history, to rescind the approval and re-opened the review after 'receiving previously unknown security-related information', which happened after the deal was blocked by the US President because Aixtron also operated in the United States and had a US subsidiary.¹⁰⁰ The Chinese buyer eventually abandoned the deal prior to a second official decision to be delivered by the BMWi.¹⁰¹ In this case, the BMWi seems to have invoked its authority to re-open a review previously completed simply because of the emergence of new information which the foreign investor could not have anticipated or had any control of. This raises some concerns about the lack of predictability of the German review, and whether any transactions previously approved would gain immunity for a revisit in the future.

In July 2018, China State Grid Cooperation offered approximately EUR 1 billion for 20% of shares in 50Hertz, a German high-voltage energy network operator. The German government viewed the target company as a critical infrastructure operator and feared that Chinese control of it would have

98 'Midea-Kuka: A Blueprint for Chinese Outbound Investment' (Freshfields Bruckhaus Deringer) <www.freshfields.com/en-gb/what-we-do/case-studies/midea-kuka-case-study/> accessed 24 June 2021.

99 Martin Kothé, 'Increased Opposition to Chinese Acquisitions in Germany' (FTI Consulting, 7 January 2016) <<https://ftiinsights.com/increased-opposition-chinese-acquisitions-germany/>> accessed 24 June 2021.

100 Guy Chazan, 'Germany Withdraws Approval for Chinese Takeover of Tech Group' (*Financial Times*, 24 October 2016).

101 Maria Sheahan, 'China's Fujian Drops Aixtron Bid After Obama Blocks Deal' (*Reuters*, 8 December 2016).

ramifications for national security.¹⁰² The German government, however, was not able to intervene in the deal directly at the time because the threshold for a review was not met. Instead, the German State bank KfW bought 20% of the shares and excluded the Chinese bidder, which was made possible by 50Hertz majority shareholder's right of first refusal.¹⁰³ This failed deal was sensitive for a few reasons, *inter alia*, the State-owned identity of the buyer and the target as a critical infrastructure operator. The deal also resulted in the 12th Ordinance amending the AWV to lower the review threshold from the previous 25% to the current 10%.

In August 2018, the BMWi reviewed the bid made by Yantai Taihai, a Chinese nuclear equipment manufacturer, to Leifeld, a German machine tool manufacturer with advanced technology, and made its decision to block the deal, citing security-related concerns about the Chinese bidder's involvement in the nuclear sector.¹⁰⁴ The Chinese bidder indicated at the last minute it would withdraw its offer and avoided the expected official issuance of an objection by the German Government. Still, this is the first time in history that the German Government planned to use its veto power to reject a foreign takeover.

The above cases provide a glimpse of how the German review works in practice, based on publicly accessible information, and only represents a small sample of transactions that have been subject to review in the past. Judging from these examples, the energy sector and advanced manufacturing and machinery are the most popular assets in Germany that Chinese investors are keen to purchase, but at the same time the sale of these assets are subject to the most intensive government scrutiny. In all these unsuccessful transactions, the German government did not use its statutory veto power to block the deals, but instead expressed opposition through unofficial and political channels that eventually led to the Chinese investors' abandonment of the deals. The succession of these high-profile deals invites the suspicion that the German review is probably 'a populist kneejerk reaction' to rapidly growing investment from China.¹⁰⁵

¹⁰² Arno Schuetze and Gernot Heller, 'Germany Nears Investment in 50Hertz to Fend off China's State Grid' (*Reuters*, 19 July 2018).

¹⁰³ Zak Bentley, 'Germany Blocks China State Grid Bid for 50Hertz, Citing "National Security" Fears' (*Infrastructure Investor*, 27 July 2018) <www.infrastructureinvestor.com/germany-blocks-china-state-grid-investment-50hertz-citing-national-security-fears/> accessed 24 June 2021.

¹⁰⁴ Gernot Heller, 'Berlin Signals Readiness to Use New Takeover Veto After Chinese Bid for Leifeld' (*Reuters*, 1 August 2018).

¹⁰⁵ Kothé (n 99).

In comparison, China's national security review is infamous for its secrecy. Since the effectuation of China's review in 2011, there has been no disclosure except for one publicly known case that has undergone review. There has been so far no information on any foreign takeover that has been blocked based on national security grounds, at least not to the knowledge of the public. In August 2019, Yonghui Supermarkets, a foreign-invested enterprise in China of which 20% of the shares are owned by its biggest shareholder – the Hong Kong based Dairy Farm Company Limited – was required by the NDRC to file a national security review prior to the completion of its acquisition of 40% of shares of Zhongbai Group, a retail company owned by the municipal Wuhan State-Owned Assets Supervision and Administration Commission.¹⁰⁶ In December 2019, Yonghui announced that it would drop its bid and abandon the deal altogether, without disclosing whether its decision was made as a result of the NDRC's intervention.¹⁰⁷ The case has perplexed the public for the lack of a legal basis, as retail falls outside of China's sectors subject to review, but the NDRC was still able to request a review without giving any specific grounds for its standing. This case indicates that China's review can in practice go far beyond codified law and operate in inconsistency with the law. The opaque and arbitrary functioning of China's Joint Conference has left the public in the dark for years, pondering how the review has been processed. As what is perceived as a 'dormant regime',¹⁰⁸ China's review regime emanates black box regulation with little transparency and predictability. This might create a negative regulatory impact on businesses in practice as foreign investors may see the review as an additional regulatory hurdle for market access. Therefore, the review may come at the expense of deterring potential foreign investors.

3.6 *The Regulatory Hurdles in Both Review Regimes*

Following the comparative assessment above, three regulatory hurdles in the review systems of Germany and China can be identified: the lack of predictability in the interpretation of substantive law, the lack of procedural certainty, and the lack of transparency in practice.

106 Scott Yu and others, 'National Security Review in China: Ready to Embrace a Change?' (*Lexology*, 26 September 2019) <www.lexology.com/library/detail.aspx?g=86ef3e49-2be7-43a8-9277-cfae899fc14a> accessed 27 May 2020.

107 Ding Yi, 'Yonghui Drops Plans to Increase Stake in Chinese Retailer After National Security Probe' (*Caixin*, 17 December 2019) <www.caixinglobal.com/2019-12-17/yonghui-drops-plans-to-increase-stake-in-chinese-retailer-after-national-security-probe-101495178.html> accessed 24 June 2021.

108 Li (n 76) 266.

With regard to the lack of substantive predictability, the term ‘national security’ in China’s review, or its alternative ‘public order or security’ in the German review, is loosely defined and therefore subject to significant leeway in interpretation. China adopts a much higher threshold to trigger a review, which is also not quantitatively definite compared to the German review. This contributes to lowered predictability in the interpretation of substantive law.

In terms of the lack of procedural certainty, the German review procedure is ultimately not time-limited because of the possibility of statutory suspension, and previously cleared decisions might be rescinded and revisited based on unpredictable grounds. Foreign takeovers in China might be subject to additional delay due to multiple review processes. These would result in a lack of legal certainty in the review procedure.

Both the review bodies of Germany and China are not subject to any information disclosure requirements, leading to a concern over non-transparency. The lack of transparency in the enforcement of the review might create hidden barriers in practice. Many examples of unsuccessful foreign takeovers did not result from statutory review, but resulted instead from informal and murky impediments to foreign investment. The most common hidden barrier is observed when ‘elected officials have sometimes used their right of free expression in a way that may have discouraged would-be investors.’¹⁰⁹ As a result, foreign investors are pressured and therefore deterred by the mere prospect that their investment may not be politically welcome in the host State and therefore decide to abandon the deal altogether to avoid ruffling the authorities and risking its reputation as a threat to national security.

These regulatory hurdles in the national security review could entail serious implications. It might first and foremost cast a deterrent effect to potential foreign investment. It would also compromise the legitimacy of the national security review of foreign investment, as the regulatory objective of the review is to protect national security, but not to unnecessarily impede the free flow of capital. And the third implication relates to the potential for an even more toughened stance on Chinese investment in Germany in the future, which might be followed by China’s retaliatory agenda to impose elevated scrutiny of German investment in China.

109 OECD, *International Investment Perspectives: Freedom of Investment in a Changing World* (OECD 2007) 62.

4 Achieving Induced Reciprocity on FDI Screening Between the EU and China in the Framework of the CAI

4.1 *Negative Reciprocity and Its Implications for FDI Screening*

Reciprocity in its semantic sense means that people frequently react more nicely and more cooperatively in response to a friendly counterpart, while, in response to a hostile counterpart, their actions tend to be more contemptible accordingly.¹¹⁰ The former situation in which cooperative reciprocal responses are expected is termed as 'positive reciprocity', while the latter is termed as 'negative reciprocity', 'retaliation', or 'retribution'.¹¹¹ For a simpler explanation, reciprocity suggests 'returning like behaviour'.¹¹²

Negative reciprocity is one of 'the oldest principles' and 'an ancient custom of retaliation' in international affairs.¹¹³ A most recent case in point is the ongoing US-China economic antagonism that begins with tariffs and trade barriers imposed on each other and has escalated into a trade war over time. In international investment relations, each nation aims at maximizing its own national interests and protecting its national security, without considering whether a mutually desirable outcome, that is a minimization of market access barriers and a maximization of investment liberalization at the international level, could be achieved or not. Meanwhile, in order to ensure that foreign investors are treated no more favourably in a host State than how nationals of the host State and their outbound investment are treated abroad, one State has the incentive to retaliate, or to fear that others might retaliate. As a result, a State may opt for non-cooperative behaviour by continuing to adopt new domestic measures or to revise existing ones to exert greater governmental restrictions over market access of FDI.

International society is witnessing a rising trend of investment protectionist regulatory movements. According to UNCTAD, in 2018, 55 countries introduced 112 new national measures affecting foreign investment, of which 31 of them were related to new restrictions and regulations imposed on the market entry of FDI, and 16 were of a neutral or indeterminate nature. Together they accounted for more than 41% of the total new national policy measures adopted.¹¹⁴ This ratio is the highest since 2003, indicating a significant global

¹¹⁰ Fehr and Gächter (n 18) 159.

¹¹¹ *ibid* 160.

¹¹² Francesco Parisi and Nita Ghei, 'The Role of Reciprocity in International Law' (2003) 36(1) *Cornell Intl LJ* 93, 94.

¹¹³ Parisi (n 19) 106.

¹¹⁴ UNCTAD (n 2) 84.

trend in the upsurge of market access restrictions.¹¹⁵ Notably, these newly adopted restrictive and regulatory measures in national law ‘were mainly based on national security concerns about foreign ownership of critical infrastructure, core technologies, elements of the defence sector, sensitive business assets or residential property’.¹¹⁶ UNCTAD identified that, up until 2018, there were 24 countries globally that have FDI screening mechanisms in place on grounds of national security or other essential public interests, but altogether they host about 56% of global inbound FDI stock.¹¹⁷

Not only has an increasing number of States introduced market entry restrictions on national security grounds in national law, but these FDI screening mechanisms have also been deployed more frequently in practice. In 2018, nine cross-border takeovers on the global scale have either been blocked because of official government objection or discontinued because of regulatory or political pressure on the basis of national security, which, as according to UNCTAD, was three times more than the number in 2017, and amounted to an aggregated value of USD 153 billion.¹¹⁸

International investment agreements (IIAs) position the screening of FDI as a national prerogative when a host State’s domestic measures to regulate the market entry of FDI is justified on grounds of national security. IIAs that adopt a ‘controlled entry model’ either do not include provisions on the admission of investment, or they include the admission of investment that is fully subject to the laws and regulations of the host State.¹¹⁹ And IIAs that adopt a ‘full liberalization model’ extend national treatment to the admission of foreign investment, granting foreign investors pre-establishment national treatment in combination with a negative list approach in which States make reservations and exceptions that do not apply to the national treatment.¹²⁰ The full liberalization model, however, does not go very far because pre-establishment national treatment in IIAs in principle allows exceptions and reservations that are often times stipulated at great length. In either of the two models, the protection of national security is considered as a legitimate prerogative reserved to the host State to regulate the admission of investment. This means, under the current IIA framework, national security review of foreign investment is

¹¹⁵ *ibid.*

¹¹⁶ *ibid.*

¹¹⁷ *ibid* 93.

¹¹⁸ *ibid* 91.

¹¹⁹ Ignacio Gomez-Palacio and Peter Muchlinski, ‘Admission and Establishment’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) 240.

¹²⁰ *ibid* 242–43.

subject to a unilateral stipulation of the host State and no binding obligation in investment treaties is provided.

This is also the case for EU IIAs, which tend to adopt national treatment in both pre-establishment and post-establishment phases combined with a negative list approach. National security review of foreign investment is stipulated as an existing non-conforming measure and therefore excluded from the coverage of the treaty. The EU-Canada Comprehensive Economic and Trade Agreement (CETA), for example, excludes the Investment Canada Act and its implementing Investment Canada Regulations, the principal legislations establishing the FDI screening mechanism of Canada, from the application of pre-establishment national treatment.¹²¹ The same reservations are made to EU Member States' national laws, which set up ex-ante examination procedures to foreign investment.

Therefore, without any international law liabilities, each sovereign State, as a self-interested party, tends to opt for retribution rather than cooperation as a dominant strategy against other States when it comes to its domestic FDI screening scheme. Each nation is driven by a self-interested incentive to erect investment-restrictive-measures in domestic law to serve short-term interests, such as protecting national security or other alternative domestic policy objectives. This leads to a negative-sum game on the international arena. Meanwhile, States are often times ignorant of, or reluctant to pursue, long-term interests such as the free flow of capital across national borders, which is only achievable by cooperation of all States involved.

The rules of reciprocity have become a constantly cited justification and rationale for protectionist and populist movements, contending that restrictive measures on cross-border trade, investment and people movement need to be adopted in domestic policies because of other countries' preceding restrictive behaviour as such.¹²² China has made this argument particularly relevant in the context of FDI because China places heavy regulation on inbound FDI in domestic law but at the same time maintains the world's second largest source of outbound FDI, investing in countries and regions that adopt no or few restrictions on FDI – in particular the EU – hence the lack of positive reciprocity.¹²³ Market entry is heavily regulated in China's FDI regime: Despite continuous domestic reform over the course of the last 40 years,

121 Comprehensive Economic and Trade Agreement Between Canada, of the One Part, and the European Union and Its Member States, of the Other Part (signed 30 October 2016) (CETA) OJ L 11, 23–1079, Annex I, Schedule of Canada, Reservation I-C-1.

122 Adam S Chilton, Helen V Milner and Dustin H Tingley, 'Reciprocity and Public Opposition to Foreign Direct Investment' (2017) 47 BJ Pol S 1.

123 *ibid* 3.

foreign investment is still prohibited or restricted for market access in certain sectors.¹²⁴ Foreign takeovers in China were subject to case-by-case approval until 2017, regardless of the size and sector of the transaction,¹²⁵ in addition to a national security review in specified strategic sectors. As a result, in comparison with Chinese investors who face few takeover restrictions abroad, foreign investors in China do not enjoy the same level of liberal treatment. These China-specific concerns have indeed become an often-cited narrative for a justification of the EU's adoption of Regulation 2019/452.¹²⁶

4.2 *Induced Reciprocity as a Means to Achieve Positive Reciprocity*

Positive reciprocity can be achieved in several ways, including through perfect incentive alignment, symmetry constraint, and role reversibility.¹²⁷ When positive reciprocity is induced by the establishment of symmetry constraint, it is termed as induced reciprocity.¹²⁸ Symmetry constraint refers to 'a successful binding of each player's strategy to that of his opponent', which applies to and bounds both parties equivalently in a bilateral setting.¹²⁹ Eliminating the possibility of unilaterally retaliatory outcomes as a result of the establishment of symmetry constraint, induced reciprocity shifts potential 'mutual defection strategies' towards 'optimizing cooperation' between parties.¹³⁰ When symmetry constraint is established, for example, by the conclusion of international agreements, sovereign States as signatory parties are obligated to conform their post-contractual behaviour to the negotiated terms of those international agreements, leading to an outcome of induced reciprocity.

Induced reciprocity has proven to be attainable in international society on many occasions, and international trade is one such prominent example. Before the establishment of the General Agreement on Tariffs and Trade (GATT) 1947, international trade was in a status of anarchy, and trading nations had fallen into a long-standing tariff war, where one State raised its tariff on

124 外商投资准入特别管理措施（负面清单）（2019）（Special Administrative Measures (Negative List) for Admission of Foreign Investment）（Promulgated by the National Development and Reform Commission and Ministry of Commerce on 30 June 2019, effective on 30 July 2019）.

125 Provisions on the Takeover of Domestic Enterprises by Foreign Investors (n 96) art 6.

126 Hanemann and Huotari (n 38). European Commission, 'Commission Staff Working Document – Accompanying the Document: Proposal for a Regulation of the European Parliament and of the Council Establishing a Framework for Screening of Foreign Direct Investments into the European Union' (13 September 2017) SWD(2017) 297 final, 2–3.

127 Parisi (n 19).

128 *ibid* 105.

129 *ibid*.

130 *ibid*; Parisi and Ghei (n 112).

imports to protect its domestic producer, which led to a higher tariff from its trading partners for the same reason and for a retaliatory purpose. Against this background, the GATT 1947 was initially established as an agreement to eliminate tariffs between signatory States.¹³¹ Since then, international trade law has successfully created a regime of induced reciprocity which significantly reduces domestic trade barriers of various forms, leading to multilateral trade liberalization in the forum of the World Trade Organization (WTO).

In the field of investment law, although a multilateral investment agreement has failed on several attempts, BITs 'have filled the remaining gap by serving as a substitute for genuine multilateralism' as 'BITs order international investment relations on the basis of general principles that are relatively uniform across the myriad number of bilateral treaty relationships'.¹³² The hardship in international investment governance regarding national FDI screening, however, is that BITs either do not contain market access provisions at all, or they provide market access commitments that do not go very far. As a result, FDI screening remains to be a national prerogative of the host State. Without an effective international law constraint over FDI screening in national law, market access barriers to foreign investment on national security grounds and investment protectionism continue to sprawl.

4.3 *The EU Regulation for the Screening of FDI into the Union*

Regulation 2019/452 has established a framework of FDI screening on grounds of security or public order from both substantive and procedural aspects for Member States to abide by. The recommended sectors subject to review include (but are not limited to) critical infrastructure,¹³³ critical technologies and dual use items,¹³⁴ supply of critical inputs, sensitive information, and the plurality of the media.¹³⁵ The review should defer to a set of procedural principles such as transparency, non-discrimination (equal treatment between third countries), explicit timeframes for review, protection of confidential information, and accountability (possibility to judicial recourse).¹³⁶ The framework set forth in Regulation 2019/452 accords with international best practice, as

¹³¹ Robert O Keohane, 'Reciprocity in International Relations' (1986) 40(1) IO 1, 1.

¹³² Stephan W Schill, *The Multilateralization of International Investment Law* (CUP 2009) 363.

¹³³ Including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, sensitive facilities, and land and real estate critical for the use of above infrastructure. Regulation 2019/452 (n 5) art 4.1.

¹³⁴ Including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies. Regulation 2019/452 (n 5) art 4.1.

¹³⁵ Regulation 2019/452 (n 5) art 4.1.

¹³⁶ *ibid* art 3.

recommended by the OECD Guideline relating to national security investment policies, emphasizing non-discrimination, transparency/predictability, regulatory proportionality, and accountability.¹³⁷

One of the motivations for the promulgation of Regulation 2019/452 was to level the playing field between EU investors abroad and third-country investors at home, as the EU deemed that there is a lack of reciprocity on market access between the EU and its major trading partners such as the United States and China, which have FDI screening mechanism in place.¹³⁸ The EU, guaranteed by its constitutional order that envisages the free movement of capital rule, laid down in Article 63 TFEU and is applicable not only between Member States but also to third-countries, had a relatively disadvantageous position in negotiating BITs with other economic powers. This is because third countries have already been granted better market access conditions in the EU, in contrast to EU investors in third countries who face various market access restrictions.¹³⁹ Hence there was a lack of incentive and necessity for third countries to offer better market access conditions to EU investors when third countries negotiate trade and investment agreements with the EU. Regulation 2019/452, as a result, in addition to creating a defensive mechanism to protect the EU internal market from malicious foreign takeovers, could serve as a 'bargaining chip' for the EU in trade and investment agreement negotiations, and achieve positive reciprocity on market access between the EU and the negotiating counterparty.¹⁴⁰

4.4 *Achieving Induced Reciprocity on FDI Screening in the EU-China CAI*

To achieve induced reciprocity, a legal constraint should be established to mutually bind EU Member States and China that leads them from mutual defection to cooperation with regard to their national FDI screening schemes. The EU and China have 'concluded in principle' the negotiation of a BIT, namely the CAI, in December 2020, but the process is still far from being completed towards final ratification. Once it is ratified, the CAI will replace the existing 26 BITs individual EU Member States have concluded with China. The CAI is comprehensive and ambitious in many aspects, covering

¹³⁷ OECD (n 94).

¹³⁸ Gisela Grieger, 'EU Framework for FDI Screening' (European Parliamentary Research Service, 17 April 2019) <[http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/614667/EPRS_BRI\(2018\)614667_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/614667/EPRS_BRI(2018)614667_EN.pdf)> accessed 24 June 2021.

¹³⁹ Stephan W Schill, 'The European Union's Foreign Direct Investment Screening Paradox: Tightening Inward Investment Control to Further External Investment Liberalization' (2019) 46(2) LIEI 105, 115.

¹⁴⁰ *ibid.*

unprecedented issues between the EU and China, such as improved market access conditions, which transcends what traditional BITs offer and shifts the paradigm to a global new-generation BIT.¹⁴¹

To this end, the CAI could be an ideal platform to establish a binding commitment between EU Member States and China towards induced reciprocity in the field of FDI screening. This could be achieved by the inclusion of dedicated treaty provisions in the market access chapter of the CAI regarding the substantive and procedural margins of national FDI screening schemes. It will effectively create a mutually binding force on the regulatory autonomy of EU Member States and China to address security-related concerns in domestic FDI screening schemes and bring an international rule of law to the contracting parties, leading to induced reciprocity in the field of FDI screening.

Should that be the case, such treaty provisions regarding FDI screening in the CAI could be negotiated anew and from scratch, be based on the national law of a negotiating party, or take into account relevant regional or international rules or guidelines. To negotiate these treaty provisions anew would be a considerably onerous and time-consuming task. And to adopt entirely the FDI screening scheme of China or an EU Member State in the CAI would presumably encounter political resistance or opposition from other negotiating parties. Therefore, it seems that to take into account well-established regional or international rules or guidelines on FDI screening would be an optimal option as it will be most efficient and gain political acceptance from both contracting parties of the CAI. Regulation 2019/452 would be a readily available reference in drafting FDI screening-related provisions in the CAI, which, at the very least, will not likely receive much objection from EU Member States as they already have to comply with Regulation 2019/452.

Therefore, FDI screening-related provisions in the CAI could incorporate certain fundamental principles and regulatory objectives embodied in the provisions of Regulation 2019/452 on the harmonization of Member States' national FDI screening schemes. By assimilating the harmonization provisions of Regulation 2019/452, the CAI would subject EU Member States and China to the same level of harmonization requirements that EU Member States already have to comply with under Regulation 2019/452. That being said, the proposed provisions on FDI screening in the CAI should only uphold a politically acceptable and flexible level of limitations on the host State's autonomy in addressing national security concerns and adopt a regime of

141 Wenhua Shan and Lu Wang, "The China-EU BIT and the Emerging "Global BIT 2.0" (2015) 30(1) ICSID Rev 260.

procedural certainty and credibility rather than making far-reaching substantive harmonization.

This article proposes the stipulation of a Section, namely National Measures Pertaining to the Screening of FDI on Security-Related Grounds, in the market access chapter of the CAI. The provisions of this Section should reflect certain fundamental principles and regulatory objectives of Regulation 2019/452: *inter alia*, the host State's right to regulate in FDI screening,¹⁴² the principle of predictability,¹⁴³ a clearly and narrowly defined sectoral scope for review,¹⁴⁴ procedural certainty and transparency,¹⁴⁵ and accountability of the host State.¹⁴⁶

Tentatively, National Measures Pertaining to the Screening of FDI on Security-Related Grounds in the market access chapter of the CAI could be stipulated as follows:

1. The host State's right to regulate:

This Agreement acknowledges domestic measures of China and the Member States of the EU pertaining to an *ex ante* investment screening mechanism on grounds of national security and public order, including the legislation, modification and implementation of such measures, as legitimate regulation and a national prerogative of the contracting parties, provided that these measures are stipulated according to the provisions of this Section.

2. Predictability:

Measures relating to the screening mechanism shall accord with the principle of predictability. Contracting parties shall prescribe the circumstances that trigger a review, the grounds for review, and detailed procedural rules.

3. Sectors subject to review:

The sectoral scope of review should be explicitly prescribed in national law, with a narrow focus on the security-related impacts on critical infrastructure, critical technologies, the security of supply of critical inputs, access and control of sensitive information, and plurality of the media. Pure economic considerations should not be justified as a legitimate cause for investment screening on national security grounds.

¹⁴² Regulation 2019/452 (n 5) art 3.1.

¹⁴³ *ibid* art 3.2.

¹⁴⁴ *ibid* art 4.1.

¹⁴⁵ *ibid* arts 3.2 and 3.3.

¹⁴⁶ *ibid* art 3.5.

4. Certainty and transparency:

Measures relating to the screening mechanism shall accord with the principle of procedural certainty. There should be a definite timeframe for the review procedure which is not subject to temporal suspension. The review should also set out quantifiable monetary or shareholding thresholds that trigger a review. Measures relating to the screening mechanism shall be transparent to investors. Adequate public disclosure of the aggregate outcome of the review from the host State is also encouraged.

5. Accountability:

Measures relating to the screening mechanism shall accord with the principle of accountability. Contracting parties should provide the possibility of effective judicial recourse to aggrieved investors so as to hold the review agency accountable for its decisions made and ensure that the domestic judicial system could have an impact.

5 Conclusion

This article contends that a possible way to address the regulatory ambiguity in law and potential protectionist abuse in practice regarding the national security review of foreign investment is to create positive reciprocity between sovereign States, which can be induced by providing symmetry constraints to State parties – a mutual binding that leads to cooperation rather than retaliation. To illustrate how this argument could be applied in practice, this article compares Germany and China as a case study, and comes to a proposition that the EU-China CAI could become an ideal forum to establish a common ground between EU Member States and China. It can provide a means to work towards induced reciprocity with regard to FDI screening by stipulating FDI screening-related provisions in the CAI. Between the EU and China, FDI screening on national security grounds should reflect international best practice, move towards positive reciprocity, and avoid any ‘tit-for-tat’ protectionist misuse.

If positive reciprocity can be induced between an EU Member State and China with regard to their FDI screening on national security grounds in the context of the EU-China CAI, the same argument could be extended to any other States at the bilateral level. BITs remain a desirable and practical platform to address the topic of FDI screening and introduce the impact of international rule of law to national government’s ability to screen FDI on grounds of national security. Newly negotiated BITs, therefore, could become a starting point to include the topic of FDI screening. Once a successful and

legally binding commitment to restrict the host State's autonomy to screening FDI is provided for in a BIT, the contracting States will no longer be able to excessively use or abuse the review system as 'black-box' regulation to intervene with FDI. In order to achieve such an objective, newly negotiated BITs could include a set of predetermined guiding principles for the contracting States to abide by, *inter alia*, regulatory proportionality, predictability, transparency and accountability. This could also be achieved by the incorporation of relevant international best practice in BITs, for example, a direct reference to the OECD Guidelines for Recipient Country Investment Policies Relating to National Security for the contracting States to comply with.¹⁴⁷ Certainly, due to the fact that the topic of national security remains a core issue of State sovereignty, the level of political willingness of the contracting States to cooperate remains a decisive factor in the success of any future international investment law-making in this regard.

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¹⁴⁷ OECD (n 94).