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MEMBER STATES ACCESS OF BLOCKING FOREIGN INVESTMENTS

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Introduction

In February 2022 the Budapest High Court requested an opinion from the Court of Justice of the European Union (the "Court") on a case relating to an acquisition of a Hungarian entity active within the sector of extraction of construction aggregates (case C-106/22 – Xella Magyarország).

The Advocate General has on 30 March 2023 submitted its proposal for a decision to the Court. The opinion of the Advocate General is not binding to the Court and a final decision by the Court has not yet been made.

The specific question that the Budapest High Court wanted the Court to guide upon was, whether the EU regulation prevents the Hungarian FDI regime in blocking a foreign investment made by an EU/EFTA entity having an ultimate owner located outside the EU/EFTA.

The Case in question

The situation leading the Hungarian High Court to approach the Court was a contemplated transaction whereby a Hungarian target company, owner of a quarry in Hungary, was to be acquired by a German entity, ultimately owned by an entity located in Bermuda.

Hungarian law requires that acquisitions made by a foreign investor of Hungarian strategic entities are notified to the Hungarian Minister of Innovation and Technology (the "Minister"). Given the indirect foreign shareholding of the acquirer and that the target was considered a strategic entity in accordance with Hungarian law the acquisition was notified to the Minister.

The Minister made the decision to block the acquisition by a decision of 30 December 2020. The decision was based on the assessment, that it could harm Hungarian national interest if an entity indirectly owned by a Bermudian entity acquired a Hungarian entity active within the field of extraction of construction aggregates.

Further the Minister stated that within the field of production of construction aggregates, a significant market share was already owned by foreign entities.

The decision made by the Minister was challenged before the Budapest High Court by the target Xella Magyarország.

The Advocate General's Comments

The Relation between the Common Commercial Policy and the FDI Screening Regulation

The first comment made by the Advocate General was that the European Union – as a starting point - has the exclusive jurisdiction to make decisions in relation to the Regulation (EU) 2019/452 (the "FDI Screening Regulation") as a result of the common commercial policy within the European Union. However, the FDI Screening Regulation has given back the competences to the Member States on making decisions relating to national FDI screenings – including the question regarding how to handle indirect ownership.

Direct contra Indirect Acquirers of Targets

Next the Advocate General concluded that the overall purpose of any FDI Screening Regulation is to clear foreign investors. On the other hand, the FDI Screening Regulation imposes no limitations on how investments are structured.

According to the Advocate General the decisive thing should be who will ultimately acquire control over the EU undertaking. The direct acquirer as such should be without relevance. The reason for this conclusion was that if the FDI Screening Regulation only covered the direct acquirer it would be easy to circumvent the FDI Screening Regulation and thus potentially undermine the objective of screening for foreign direct investments. It would make the regime illusory as the acquisition could be structured in way of inserting an EU/EFTA entity as the direct acquirer and thus a FDI screening would not be necessary.

The conclusion of the Advocate General was that the FDI Screening Regulation may prevent an acquisition by an entity located outside EU/EFTA if the investment is considered a threat to national security or public interests and this is justified based on the circumstances behind the transaction. With reference to this the Advocate General stated *"... what is the difference between a third-country investor acquiring control over a strategic EU undertaking directly from abroad or through another EU undertaking?*".

Restrictions, ultimately the blocking of an investment, of foreign investments are possible if they can be justified based on whether there are legitimate reasons to secure public interest and if such restrictions are *appropriate* and *necessary* for the protection of such public interests. The assessment on whether restrictions are appropriate and necessary falls to the national court in the Member States. Thus, the Advocate General did not comment on whether the actual blocking was appropriate.

Defining National Security and Public Order

Each Member State may define what is considered critical and setup up the required restrictions to protect such critical activities. It is generally acknowledged that what is a critical activity may differ from Member State to Member State.

The Hungarian FDI regime has been built to (i) prevent speculative acquisitions in sectors deemed strategic to the Hungarian economy particularly given the COVID-19 pandemic, and (ii) protect the security of supply, i.e., in the case in question the supply of sand, gravel, and clay in Hungary.

The Advocate General acknowledged that protection the supply of certain raw material could potentially justify limitations for foreign investments, particularly during crisis, e.g., COVID-19 or the war in Ukraine, to secure national security or public interests.

It was noted though by the Advocate General, that protection of the Hungarian economy would not be an accepted interest to protect under a foreign direct investment screening.

Further, the Advocate General noted that the target in question is a producer of only 0.52 % of the Hungarian national production of sand, gravel, and clay and it was not clear, why a foreign ownership of the target in question would threaten the national supply when 90 % of the production was already sold to the acquirer.

Those comments indicate that the Advocate General does not agree on the assessment of the target being critical and a blocking being required.

The final decision on the lawfulness of the blocking is to be made by the Budapest High Court based on the final decision received from the Court. Accordingly, it is left to the Budapest High Court to decide if the target was really a critical asset and if less restrictive measures than blocking the acquisition could have ensured the security of supply.

It is unknown when the Court will take the decision and when the Budapest High Court will make their decision.

Our Comments

The positions made by the Advocate General is in line with the practice already seen and known under the Danish FDI regime. It is from a Danish perspective clear, that the regime covers both direct and indirect acquisitions of control. Thus, the Advocate General's proposal for a ruling will not change the current practice in Denmark.

The Advocate General also emphasized that the Member States are allowed to put up restrictions for foreign investments, however the restrictions may only be imposed towards critical assets and in any case such restrictions need to be appropriate and necessary in order to secure national security. This is due to the fact that broader restrictions placed on foreign investors would be considered as a potential restriction of the free movement within EU.

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If you have any questions or require further information regarding any of the above, please do not hesitate to contact us.

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