CTEI-2020

CTEI WORKING PAPERS

CTEI-2020-01

THE INVESTMENT SCREENING REGULATION AND ITS SCREENING GROUND "SECURITY OR PUBLIC ORDER": HOW THE WTO LAW UNDERSTANDING UNDERMINES THE REGULATION'S OBJECTIVES[a]

Jens Velten[b]

Abstract

The EU adopted Regulation 2019/452 (Regulation) as part of a more robust Common commercial policy to strengthen and defend its interests in a shifting global order. More concretely, the Regulation has two objectives: protecting domestic assets from harmful foreign investor interests, and equipping the EU with leverage to achieve more favourable treatment of EU investors abroad. Therefore, the Regulation provides Member States with an option to adopt foreign direct investment (FDI) screening mechanisms on the grounds of "security or public order". However, the Regulation misses its objectives. The Regulation's vague screening ground "security or public order" must be interpreted in accordance with WTO law. A detailed analysis finds that the relevant WTO notions of essential security interests and public order are rather narrow. The Regulation's screening ground "security or public order" therefore only allows the screening of a few, high-profile cases of FDI. Such a narrow scope undermines the Regulation's objectives.

---

[a] This paper was prepared during the author's stay as a Visiting Fellow at the Graduate Institute's Centre for Trade and Economic Integration. The author wishes to thank Prof. Joost Pauwelyn, all participants at the Geneva International Economic Law Session, in particular Weiwei Zhang, who moderated the event, as well as all other colleagues at the Centre for their valuable input.

[b] Jens Velten is a Doctoral Candidate at Leuphana University Lüneburg. He conducted main parts of his research as Visiting Scholar at Columbia Law School, New York, and as Visiting Fellow at the Centre for Trade and Economic Integration, Graduate Institute, Geneva. Jens Velten is scholar of the Studientstiftung des deutschen Volkes (German Academic Scholarship Foundation), which generously supports his research project.

CENTRE FOR TRADE AND ECONOMIC INTEGRATION (CTEI)

The Centre for Trade and Economic Integration fosters world-class multidisciplinary scholarship aimed at developing solutions to problems facing the international trade system and economic integration more generally. It works in association with public sector and private sector actors, giving special prominence to Geneva-based International Organisations such as the WTO and UNCTAD. The Centre also bridges gaps between the scholarly and policymaking communities through outreach and training activities in Geneva.

www.graduateinstitute.ch/ctei

http://graduateinstitute.ch/ctei

INSTITUT DE HAUTES ÉTUDES INTERNATIONALES ET DU DÉVELOPPEMENT
GRADUATE INSTITUTE OF INTERNATIONAL AND DEVELOPMENT STUDIES
CP 136 – CH-1211 GENÈVE 21
TÉL +41 22 908 57 00
http://graduateinstitute.ch

Introduction

Meeting rising concerns vis-à-vis third-country investors, and pursuing its interests in times of a changing geopolitical and geoeconomic order: The EU has identified the screening of foreign direct investment (FDI) as a key instrument to achieve these goals. The Regulation 2019/452, which established "a framework for the screening of foreign direct investments into the Union" (Regulation), was only a first step into this direction.[1] A new FDI screening mechanism is already under way. In a recent white paper, the Commission proposed a mechanism at EU level that addresses subsidised third-country acquisitions of EU targets.[2]

Today, the EU is confronted with the US-China trade conflict, the Chinese "Belt and Road Initiative", the societal transformation through digitalisation, and crises of multilateral organisations, to name only some challenges. Against this background, the EU is now seeking to strengthen and defend its "collective role in the world" and its "strategic autonomy".[3] As part of this strategy, the EU has also developed a more robust Common commercial policy on FDI—including the screening of FDI from third-countries.[4]

More concretely, three main concerns have caused the current prominence of FDI screening mechanisms. First, FDI might distort competition, notably if supported by the investor's home state through foreign subsidies. Secondly, the EU and Member States are increasingly adverse to FDI from states that do not reciprocate the same favourable treatment to EU investors. Thirdly, the EU and Member States are concerned that FDI might harm certain sensitive sectors if the investors pursue their own objectives that are contrary to the EU's and Member States' interests, in particular if the investors are owned or influenced by foreign governments.

Despite different positions in detail, EU lawmakers agree that these concerns must be addressed. While the Commission's proposal on subsidised foreign investments tackles the concern about competition distortions through FDI, the Regulation primarily addresses the EU's and Member States' third concern about harmful investors.[5] Moreover, the mere existence of both mechanisms is aimed at providing the EU with leverage in negotiations to

---

1 Regulation 2019/452 establishing a framework for the screening of foreign direct investments into the Union [2019], OJ L79 I/1.

2 Commission, "White paper on levelling the playing field as regards foreign subsidies" COM(2020) 253 final, pp.22–29, as module two of three modules to achieve a globally level playing field for subsidies. The proposal includes an EU interest test, according to which market distortions through foreign subsidies may be "balanced against the positive impact that the investment might have within the EU or on public policy interests recognised by the EU" (Commission, White paper on foreign subsidies, p.27).

3 EU, "Shared Vision, Common Action: A Stronger Europe: A Global Strategy for the EU's Foreign and Security Policy", pp.13, 19, and 46.

4 In the following, the term foreign investor and foreign (direct) investment is used to refer to third-country investors and investments only.

5 Commission, White paper on foreign subsidies, p.43, therefore describes both instruments as complementary mechanisms with different objectives.

increase reciprocal treatment of EU investors abroad. This contributes to attenuating the reciprocity concern.[6]

The Regulation adopts a highly deferential approach to meet the concerns about harmful investors and reciprocity. It mainly provides three options between which the Member States may choose freely. Member States may either (i) adopt no FDI screening mechanism at all, (ii) a screening mechanism on the grounds of "public policy or public security" pursuant to art.65(1)(b) of the Treaty of the Functioning of the EU (TFEU), (ii) or a mechanism on the basis of the Regulation. Only for the last option (iii), the Regulation provides certain procedural and substantial cornerstones.[7] As a consequence, harmonisation of the EU FDI screening landscape depends on the Member States' will to follow the Regulation's framework.

The Regulation's most important substantial cornerstone is the screening ground "security or public order". This cornerstone will determine the effectiveness of the Regulation and the respective Member State FDI screening mechanisms. Only if the screening ground allows significant FDI screening in the sectors that EU and Member States identified as sensitive, will the Regulation achieve its objectives.

In Part A of this paper analyses the EU's and Member States' concerns vis-à-vis foreign investors and the Regulation's objectives in more detail. It finds that the design of the Regulation is primarily shaped by the concern about harmful investor objectives in sensitive sectors. In particular, the screening ground "security or public order", by its vagueness, seems to reconcile the three discussed concepts of sensitive sectors: defence; critical infrastructure, technology, and inputs; and strategic assets.

Part B, however, argues that the scope of the screening ground is more precisely defined than expected at first sight. A closer look at the Regulation shows that "security or public order" is determined by the notions "essential security interests" and "public order" as defined in the WTO General Agreement on Trade in Services (GATS).

Accordingly, Part C defines the notions essential security interests and public order pursuant to the GATS, more concretely in its arts XIV*bis*(1)(b) Subparagraph (i) and XIV(a). Both notions, and thus the screening ground "security or public order", allow WTO Members to pursue a wide range of sectors, but their scope is significantly narrowed by the requirement of an element of threat that the individual FDI must pose to these sectors.

Applying these definitions, Part D concludes that the Regulation and its seemingly broad screening ground "security or public order" provide a narrow scope for FDI screening that is only met in a few, high-profile cases of FDI. Consequently, the Regulation does not achieve its objectives.

---

[6] S. W. Schill, "The European Union's Foreign Direct Investment Screening Paradox: Tightening Inward Investment Control to Further External Investment Liberalization" (2019) 46 Legal Issues of Economic Integration 105, 107–109; M. Martin-Prat, "The European Commission Proposal on FDI Screening", in J. H. J. Bourgeois (ed.), *EU Framework for Foreign Direct Investment Control* (Alphen aan den Rijn: Wolters Kluwer, 2020) 95, 98.

[7] J. Velten, "FDI screening regulation and the recent EU guidance: What options do member states have?", Columbia FDI Perspective No. 284 (forthcoming).

A. The Regulation's screening ground: Vague compromise to meet (diverging) concerns vis-à-vis foreign investors

The process to adopt an FDI screening regulation was initiated by the Member States France, Italy, and Germany. In two letters to the Commission in February and July 2017, the three Member States called for a stricter stance on FDI inflows.[8] In these letters and the subsequent discussions at EU level, various, often overlapping concerns vis-à-vis foreign investors were raised. They can be categorised in three groups, of which the Regulation addresses only two.

The first concern is about foreign investment distorting competition in the internal market (competition concern). If another state subsidises a foreign investment, the investor may be willing to either acquire the domestic asset for a higher, non-market price, or operate the asset after acquisition in a market distortive manner. This competition concern is not covered by the Regulation, but addressed by the Commission's proposal on subsidised foreign investment screening.[9]

Moreover, the EU and Member States are increasingly reluctant to liberalise their markets for foreign investors, while EU firms are not accorded similar treatment in these foreign investor's home states. Based on that second concern (reciprocity concern), the EU and Member States are therefore demanding reciprocity in FDI treatment. However, neither the Regulation, nor the Commission proposal on subsidised foreign investment screening make reciprocity a screening criterion.[10] Instead, the Regulation aims at signalling tighter foreign investor rules in order to provide the EU with leverage in international negotiations on more favourable treatment of EU investors abroad.[11]

Primarily, however, the Regulation addresses the third and last concern: the foreign investor pursues an objective that, if realised, harms the EU's and Member States' interests (harmful investor concern). For example, the investor may plan to transfer cutting-edge know-how to its home state bases, or to exploit rather than strengthen the acquired asset. The EU and Member States are concerned that this may harm the supply with important goods and services, and generally weaken their economies.

This harmful investor concern shaped the Regulation's design most, in particular the following four cornerstones. First, the screening should be limited to FDI, excluding portfolio investment. Only the former gives the investor a certain power to control the acquired asset, and thus enables the investor to achieve its potentially harmful objective.[12] Secondly, the EU and Member States are concerned with existing domestic assets. This is why, the Regulation

---

[8] France, Germany, and Italy, "Proposals for ensuring an improved level playing field in trade and investment" (First EU3 proposal); France, Germany, and Italy, "European investment policy: A common approach to investment control" (Second EU3 proposal).

[9] Commission, White paper on foreign subsidies, pp.22–29.

[10] On the Regulation, Martin-Prat, Commission Proposal on FDI Screening, in *Bourgeois 2020*, 98.

[11] Some even argue that the Regulation primarily aims at achieving reciprocity, see J. H. J. Bourgeois and E. Malathouni, "The EU Regulation on Screening Foreign Direct Investment: Another Piece of the Puzzle", in *Bourgeois 2020*, 169, 170; S. W. Schill, "The European Union's Foreign Direct Investment Screening Paradox: Tightening Inward Investment Control to Further External Investment Liberalization" (2019) 46 Legal Issues of Economic Integration 105, 107–109. Schill calls restricting FDI inflows to in turn achieve more investment liberalization for EU investors the "screening paradox".

[12] Arts 1(1) and 2(1) of the Regulation.

only applies to foreign investment in the form of mergers and acquisitions, not investments creating new assets (greenfield investments).[13] Thirdly, the screening lies a particular focus on state-owned and subsidised investors, and thus mainly on Chinese, but also Brazilian and Russian investors.[14] To be sure, this cornerstone does not aim at the above mentioned competition concern. Rather, these state-supported investors are more likely to be guided by non-commercial, and thus potentially more harmful objectives. Fourthly and lastly, the Regulation is limited to FDI into sectors in which harmful investor objectives have potentially severe consequences (sensitive sectors).

Defining the sensitive sectors was one of the most controversial issues during the negotiations of the Regulation. It represents the trade-off between welcoming FDI to contribute to the EU's growth,[15] and other policy considerations, namely security, public order, or economic or geopolitical policy. The question is: What sectors are sensitive enough to politically justify the screening of FDI, which is generally welcome and risks to be deterred by too strict screening mechanisms? The EU lawmakers mainly discussed three concepts of sensitive sectors.

The narrowest discussed concept is the defence sector. On the one hand, a functioning defence sector is supposed to enable a state to defend itself, primarily against external threats. On the other hand, another state may use its defence capacities against the EU and its Member States. The defence sector therefore encompasses all assets that supply the military with the necessary means to fulfil these functions, in particular arms, munitions and war material.[16] This includes goods and services with both a civilian and military use (dual-use products).[17]

Another rather narrow concept of sensitive sectors consists of firms that own, operate, or produce critical infrastructure, technology, and inputs. Following the Directive 2008/114/EC, one may define this sector as comprising assets, systems, technologies, or inputs essential for the maintenance of vital societal functions, health, safety, security, economic or social well-being of people.[18]

Lastly, some lawmakers referred to the broad concept of "strategic" sectors or assets, possessing "key enabling technologies".[19] The Commission listed energy, telecommunication,

---

[13] Art.2(1) of the Regulation, defining FDI only as investments where the foreign investor makes capital available to another firm. On the distinction between FDI and greenfield investment, OECD, "Benchmark Definition of Foreign Direct Investment", 4th edn, paras 594-598.

[14] Art.4(2) of the Regulation. For the list of states in focus of the Regulation, see Martin-Prat, Commission Proposal on FDI Screening, in *Bourgeois 2020*, 96.

[15] Recital (1) of the Regulation.

[16] With this description art.346(1)(b) TFEU, based on which Member States have the right to protect their essential security interests.

[17] For a definition see art.2 point 1 of the Regulation 428/2009/EC setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items [2009] OJ L134/1.

[18] Art.2(a) of the Directive 2008/114/EC on the identification and designation of European critical infrastructures and the assessment of the need to improve their protection [2008] OJ L345/75.

[19] Commission, "Communication on Welcoming Foreign Direct Investment while Protecting Essential Interests" COM(2017) 494 final, pp.7 and 11 (welcomed in the context of enhancing reciprocity in the fields of public procurement and investment by European Council, "Conclusions of Meeting on 22 and 23 June 2017" EUCO 8/17, para.17); European Parliament, "Resolution on building an ambitious EU

transport, and space as strategic sectors.[20] France, Germany, and Italy adopted a broader understanding. They defined enabling technologies as including "technical knowledge that represents a significant advance over the status quo and has a major potential for innovation".[21] Both understandings go far beyond the defence sector, and, at least the three Member States' proposal also significantly exceeds the concept of critical infrastructure, technology, and inputs. Accordingly, the focus of the strategic asset concept is not so much on protecting vital, existing societal functions. Protecting strategic assets rather serves long-term industrial, economic, and geopolitical goals. Hence, the notion includes technologies such as artificial intelligence, robotics and big data processing, as long as they are not necessary for the defence sector or critical assets. It also entails considerations to strengthen competitive advantages in order to facilitate building globally competitive domestic firms, as well as certain sectors of specific geopolitical importance.[22]

The Regulation tried to strike a compromise between the three sensitive sector concepts by opting for the vague screening ground "security or public order", and adding a non-exhaustive list of factors that may be taken into account when assessing this ground.[23] The European Parliament's proposal to add strategic infrastructure, technology, and EU autonomy to the factor list was rejected.[24] Nevertheless, the scope of "security or public order" remains elusive. It gives each EU actor in the lawmaking process the impression that its expectations of the Regulation are met. But to what extent are the three sector concepts really covered? And what requirements must an individual FDI fulfil to fall in the Regulation's scope?

The following argues that the ground's scope is determined by the GATS, and therefore rather narrow. As a consequence, the Regulation not only fails to meet the EU's and Member States' harmful investor concern. Narrow FDI screening mechanisms will also not provide the EU with much leverage in negotiations to increase reciprocal treatment of EU investors abroad. Hence, the Regulation does also not sufficiently address the reciprocity concern.

B. The screening ground to be interpreted in accordance with WTO law

The meaning of the screening ground "security or public order" is determined by the GATS notions essential security interests and public order. Therefore, the screening ground is neither a distinct notion of Secondary European Law, nor does it refer to the TFEU ground of

---

industrial strategy as a strategic priority for growth, employment and innovation in Europe" 2017/2732 (RSP), para.20; France, Germany, and Italy, Second EU3 proposal, pp.3–4.

[20] Commission, Communication on FDI and Essential Interests, pp.8 and 11. See also the misleading 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 (FDI Screening Regulation)" COM(2020) 1981 final, in which the terms critical and strategic assets are being used as synonyms.

[21] France, Germany, and Italy, Second EU3 proposal, n.2.

[22] For a recent discussion of new, broader national security concepts in light of the current changes of geopolitical order, see A. Roberts, H. Choer Moraes and V. Ferguson, "Toward a Geoeconomic Order in International Trade and Investment" (2019) 22 Journal of International Economic Law 655, 664–669.

[23] Arts 1(1) and 4(1) of the Regulation.

[24] European Parliament, "Report on the 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" EP A8-0198/2018 amendments 39-41 on art.4(1)(a)-(c) of the Regulation.

exception “public policy or public security”.[25] This follows from the literal meaning of “security or public order”, Regulation recitals and its context.

The literal meaning of the terms security and public order reflect the GATS notions essential security interests in art.XIV*bis*(1) and public order in art.XIV(a) GATS. If the legislator had wanted to reference the TFEU notion “public policy or public security”, it would have replicated this notion in the Regulation. Indeed, the GATS notion essential security interests is also not replicated word by word. However, this replication would have caused confusion. “Essential security of its [the Member State’s] security” is a TFEU notion in art.346(1). For protecting these interests, Member States are entitled to deviate from the Regulation.[26] Therefore, the Regulation had to choose the more neutral term “security”.

Recitals (3), (4), and (35) strongly support the conclusion from the literal meaning. In Recital (3) the Regulation mentions the screening ground “security or public order” for the first time, and for its definition refers to International economic law:

> “Pursuant to the international commitments undertaken in the World Trade Organization (WTO), in the Organisation for Economic Cooperation and Development, and in the trade and investment agreements concluded with third countries, it is possible for the Union and the Members States to adopt restrictive measures relating to foreign direct investment *on the grounds of security or public order*, subject to certain requirements.” (emphasis added)

Recital (35) more concretely states that the screening ground “security or public order” shall first and foremost “comply with the relevant requirements" of arts XIV(a) and XIV*bis* GATS. The call to comply with Union law (including not only the TFEU, but also secondary EU law) and other International economic law comes second. Moreover, this reference to other legal sources omits a reference to specific provisions of security and public order.[27] Last but not least, Recital (4) clarifies that Member States still have the right to adopt screening mechanisms based on “public policy or public security” pursuant to art.65(1)(b) TFEU. Pursuant to Recital (4), these screening mechanisms might differ from the Regulation in terms of scope.[28] Consequently, the screening ground “security or public order” must be distinct from the TFEU notion “public policy or public security”.

---

[25] R. Bismuth, "Reading Between the Lines of the EU Regulation Establishing a Framework for Screening FDI into the Union", in *Bourgeois 2020*, 103, 107; Bourgeois and Malathouni, EU Regulation on Screening FDI, in *Bourgeois 2020*, 178; C. Herrmann, "Europarechtliche Fragen der deutschen Investitionskontrolle" (2019) 22 Zeitschrift für europarechtliche Studien 429, 465.

[26] The Regulation is without prejudice to the Member States’ right to protect their essential security interests within the meaning of art.346(1) TFEU, see art.1(2) of the Regulation.

[27] Recital (35): “The implementation of this Regulation by the Union and the Member States should *comply with* the relevant *requirements* for the imposition *of restrictive measures on grounds of security and public order in the WTO agreements*, including, in particular, *Article XIV(a) and Article XIVbis of the General Agreement on Trade in Services* ... It should also comply with Union law and be consistent with commitments made under other trade and investment agreements to which the Union or Member States are parties and trade and investment arrangements to which the Union or Member States are adherents.” (emphasis added).

[28] Recital (4): “This Regulation is without prejudice to the right of Member States to derogate from the free movement of capital as provided for in point (b) of Article 65(1) TFEU. Several Member States have put in place measures according to which they may restrict such movement on grounds of public policy

Nevertheless, one may still argue that an interpretation of "security or public order" in accordance with art.65(1)(b) TFEU is necessary to ensure that the Regulation and the respective Member State mechanisms are compliant with the freedom of capital movement.[29] However, this argument neglects other grounds on which the EU can restrict the freedom of capital movement. Art.64(2) and (3) TFEU even allow the EU to restrict FDI inflows without any substantial condition.[30] An interpretation of "security or public order" in accordance with the GATS would therefore still guarantee the Regulation's compliance with the freedom of capital movement. At the same time, it even, in part, ensures compliance with other EU and Member States obligations from International economic law, for exception grounds of the latter are often drafted similarly to the WTO exceptions.[31]

Consequently, the screening ground "security or public order" must be interpreted in accordance with the GATS notions essential security interests and public order. The GATS reference therefore goes beyond simply ensuring that the Regulation, Member State screening mechanisms, and individual FDI screening comply with WTO law, or that they will prevail in WTO dispute settlement. EU and Member States may reach compliance with WTO law by many more parameters, in particular a lack of sector-specific commitments, other available grounds of exception, or a lenient burden of proof in dispute settlement. Instead, the Regulation incorporates the definition of essential security interests and public order pursuant to arts XIV(a) and XIV*bis* GATS, isolated from other GATS parameters. As a result, if foreign investors proceed against screening of their FDI, the definition of the GATS notions will be subject to review by EU and Member State courts.

Before defining "security or public order" accordingly, one last aspect requires attention: the prefix before the screening ground "security or public order". The Regulation allows the screening of FDI that is "*likely to affect* security or public order".[32] This prefix requires a nexus between the screened FDI and its effect on a Member State's "security or public order". It

---

or public security. Those measures … might result in a number of mechanisms which are different in terms of scope and procedure."

[29] M. Cremona, "Regulating FDI in the EU Legal Framework", in *Bourgeois 2020*, 31, 34. On the Regulation's compliance with the freedom of capital movement see, e.g. C. Herrmann, "Europarechtliche Fragen der deutschen Investitionskontrolle" (2019) 22 Zeitschrift für europarechtliche Studien 429, 441–443; J. d. Kok, "Towards a European Framework for Foreign Investment Reviews" (2019) 44 E.L. Rev. 24, 27–30.

[30] Discussing the scope of art.64(2) and (3) TFEU, S. Korte, "Regelungsoptionen zum Schutz vor Fremdabhängigkeiten aufgrund von Investitionen in versorgungsrelevante Unternehmen" (2019) WiVerw (GewA) 79, 125-127 and 130. He stresses that the EU must always respect the principle of proportionality pursuant to art.5(4) TFEU. Another ground of exception would be overriding reasons in the public interest as developed by the European Court of Justice (ECJ) in *Procureur du Roi v B and D Dassonville (C-8/74) EU:C:1974:82*; and *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (C-120/78) EU:C:1979:42*.

[31] Many of the grounds of exception in International economic law are drafted similarly or even identically to arts XIV(a) and/or XIV*bis* GATS. For instance, arts 28.3(2)(a), 28.6(b) of the EU-Canada Comprehensive Economic and Trade Agreement or arts 32.1.1 and 2, 32.2 of the US-Mexico-Canada Agreement. To be sure, the different wording, context and purpose of these International economic law provisions will usually prevent an exact same interpretation. However, a justification under the GATS may still indicate that the FDI screening will also be justified under the International economic law source at issue.

[32] Art.1(1) of the Regulation (emphasis added).

describes an element of threat. At the same time, as will be shown in Part C, an element of threat is also inherent in the GATS notions essential security interests and public order. Footnote 5 to the GATS, for instance, defines public order as a "genuine and sufficiently serious threat to a fundamental interest of society".[33] The question thus arises: In what relation are the inherent nexus of the GATS notions and the Regulation's prefix? While the term "likely to affect" must be assigned a meaning—otherwise the legislator would not have used it—, the GATS notions cannot be properly defined without their element of threat. The screening ground's prefix must therefore be read as expressing this GATS inherent nexus. This is also in line with the above explained purpose of the screening ground, namely to ensure that the FDI screening mechanisms comply with the GATS.

The screening ground's scope therefore depends on the interpretation of the GATS notions essential security interests and public order, including the nexus of threat between these interests and the individual FDI. It will be shown that both legal concepts constitute rather high thresholds for FDI to fall in the Regulation's scope.

C. Defining essential security interests and public order pursuant to the GATS

The EU and Member States will be able to meet their concerns about harmful foreign investors and reciprocity only if their FDI screening mechanisms enable them to effectively screen FDI in the sectors they deem sensitive. The scope of their mechanisms, if based on the Regulation, depends on the interpretation of the Regulation's screening ground: "security or public order". As argued above, "security or public order" must be interpreted pursuant to the GATS. The term "security" refers to essential security interests in art.XIV*bis*(1) GATS, the term "public order" to public order pursuant to art.XIV(a) GATS.

Generally, both notions are vague and address sensitive areas of WTO Member interests. This has two consequences. First, the WTO adjudicating bodies lack the means and mandate to question WTO Members' preferences in these sensitive areas. Therefore, the adjudicating bodies provide members with wide discretion for establishing arts.XIV*bis*(1) and XIV(a) GATS. This, however, is a matter of burden of proof in WTO dispute settlement. As a matter of legal obligation, every member is still bound by the GATS definition of essential security interests and public order. The Regulation incorporates this definition to define "security or public order".

Secondly and more importantly, essential security interests and public order are by definition highly member-specific. They depend on each WTO Member's specific situation, society, and risk aversion.[34] The following will therefore focus on identifying criteria that are applicable to all WTO Members for determining their essential security interests and public order. It will be

---

[33] See Footnote 5 to the GATS. An alternative probability nexus would be, for instance, "immediate threat" or merely a "risk".

[34] In contrast to the ECJ, the WTO adjudicating bodies do not conclude from the notions' context as grounds of exceptions that they have to be interpreted strictly. *European Communities - EC Measures Concerning Meat and Meat Products (Hormones)* (*EC - Hormones*) Appellate Body Report (WT/DS26/AB/R, WT/DS48/AB/R) 16 January 1998 at para.104. For the ECJ's case law see, e.g. *Association Eglise de scientologie de Paris and Scientology International Reserves Trust v Premier Ministre (C-54/99) EU:C:2000:124 at [17]* (on the former art.73d(1)(b) EC).

shown that the nexus between the covered policy objective and the individual FDI at issue is the real constraining element for defining essential security interests and public order. Both arts XIV*bis*(1) and XIV(a) GATS require the FDI to pose a certain degree of threat to the protected policy objective, in terms of probability and magnitude.[35]

Accordingly, the following analysis will show that even the broader sensitive sector concepts qualify as essential security or public order interests to some extent. The element of threat, on the other hand, constitutes a high threshold for an individual FDI to fall under arts XIV*bis* and XIV(a) GATS. As Part D will show, this limits the scope of "security or public order" for screening FDI significantly.

*1. Essential security interests: art.XIV*bis*(1) GATS*

The term "security" in the screening ground "security or public order" refers to essential security interests within the meaning of art.XIV*bis*(1) GATS.

> "Art. XIV*bis*
> Security Exceptions
> 1. Nothing in this Agreement shall be construed: …
> (b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:
> (i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;
> (ii) relating to fissionable and fusionable materials or the materials from which they are derived;
> (iii) taken in time of war or other emergency in international relations".

Instead of opening the door to broad, open-ended security concerns, art.XIV*bis*(1) GATS limits the protection of essential security interests to the narrow list of Subparagraphs (i)-(iii).[36] Even WTO Members arguing for an entirely self-judging art.XIV*bis*(1) GATS recognise that these three subparagraphs limit the member's interpretation of essential security interests.[37]

---

[35] Though related, the link "necessary to" as required by the *chapeau* of art.XIV*bis*(1)(b) and art.XIV(a) GATS between the concrete WTO member measure and the protected interests is a different issue. This link is concerned with the concrete measure, here the screening and prohibition of FDI. The necessity test depends on the individual circumstances the FDI screening and can thus not be assessed here.

[36] *Russia - Measures Concerning Traffic in Transit* (*Russia - Traffic in Transit*) Panel Report (WT/DS512/R) 5 April 2019 at para.7.65; D. Akande and S. Williams, "International Adjudication on National Security Issues: What Role for the WTO?" (2003) 43 Virginia Journal of International Law 365, 384; H. Schloemann and S. Ohlhoff, "'Constitutionalization' and Dispute Settlement in the WTO: National Security as an Issue of Competence" (1999) 93 American Journal of International Law 424, 442. For the non-disclosure of information, however, art.XIV*bis*(1)(a) GATS provides a general security exception.

[37] See, e.g. the US argumentation in *United States - Certain Measures on Steel and Aluminium Products* (*US - Steel and Aluminium Products*) US Responses of the US to the Panel's First Set of Questions to the Parties (WT/DS548) 14 February 2020 at paras 103-108 and 155-156. For recent contributions to the controversy on the WTO essential security exceptions see, e.g. M. Pinchis-Paulsen, "Trade Multilateralism and U.S. National Security: The Making of the GATT Security Exceptions" (2020) 41 Michigan Journal of International Law 109 (with a detailed discussion of the negotiation history of art. XXI GATT 1947 and 1994 from a US perspective); G. Vidigal, "WTO Adjudication and the Security

Regardless of the controversy on the provision's self-judging character, as well as issues of justiciability and burden of proof, in the Regulation the legislators referred to art.XIV*bis* GATS, and thus committed to respecting its constraining elements vis-à-vis the Regulation's addressees.

For interpreting "security or public order" in the Regulation, only Subparagraphs (i) and (ii) of art.XIV*bis*(1)(b) are relevant. Subparagraph (i) on the provisioning of military establishment addresses the EU's and Member States' interest to ensure that the investor will neither jeopardise their defence industry capacities, nor equip the investor's home state with capacities that may later be used against the EU and its Member States.[38] Moreover, all interests relating to nuclear infrastructure, technology, and inputs are covered by Subparagraph (ii). However, the interpretation of this subparagraph is relatively clear, and WTO Members seem to agree that the protection of interests relating to fissionable and fusionable materials is of every member's highest priority. This paper therefore does not further analyse Subparagraph (ii). This paper, finally, also omits an analysis of Subparagraph (iii). The Regulation is neither "taken in time of war or other emergency in international relations", nor specifically targeted at future FDI in these times.[39] Accordingly, the following focuses on defining Subparagraph (i).

It is still largely unclear how to define "essential security interests relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment".[40] The only two adjudicating body reports on a WTO security exception, *Russia - Traffic in Transit* and, very recent, *Saudi Arabia - Protection of IPR*, deal with Subparagraph (iii).[41] This subparagraph, however, addresses the most severe situation a state may be confronted with: war (or other emergency in international relations). Subparagraph (i), on the other hand, is related to military regardless of an acute emergency. Therefore, the GATS

Exception: Something Old, Something New, Something Borrowed - Something Blue?" (2019) 46 Legal Issues of Economic Integration 203.

38 Art.4(1)(b) and (c) of the Regulation.

39 For this temporal element in art.XXI(b)(iii) of the General Agreement on Tariffs and Trade of 1994 (GATT 1994) see *Russia - Traffic in Transit*, Panel Report at paras 7.69-76 and 111-125. Namely the Regulation did not target the Covid-19 or any similar crisis. Moreover, one may argue that an "other emergency in international relations" requires a conflict between states (*Russia - Traffic in Transit*, Panel Report at paras 7.73 and 76), whereas the Covid-19 crisis is rather a global health crisis and therefore is better addressed under public order.

40 So far, this question has been at issue only once when Sweden invoked art.XXI(b)(ii) of the former GATT 1947 to impose a quota on leather, plastic, and rubber boots. WTO Members did not reach a conclusion, and Sweden eventually took back the measure. (Sweden, "Sweden-Import Restriction on Certain Footwear", Notification to the Council L/4250).

41 *Russia - Traffic in Transit*, Panel Report at para.7.27 (on art.XXI(b)(iii) GATT 1994), and *Saudi Arabia - Measures concerning the Protection of Intellectual Property Rights* (*Saudi Arabia - Protection of IPR*) Panel Report (WT/DS567/R) 16 June 2020 (on art.73(b)(iii) of the Agreement on Trade-Related Aspects of Intellectual Property Rights [TRIPS]). The latter largely upholds the latter, and repeatedly emphasises the agreement of the vast majority of the (third) parties to the dispute. The current WTO dispute on US duties on steel and aluminium products also deals with Subparagraph (iii), in the realm of art.XXI GATT 1994, see *United States - Certain Measures on Steel and Aluminium Products* (*US - Steel and Aluminium Products*) US Second Written Submission (WT/DS548) 17 April 2020 at para.29.

imposes additional requirements, most importantly a link between the specific service a WTO Member measure aims to protect and the essential security interest at issue ("relating to").

Adapting the analytical framework applied in the above-mentioned panel reports accordingly, the following will first define "services as carried out directly or indirectly for the purpose of provisioning a military establishment". The section will proceed to define the term essential security interests including the necessary link "relating to" to the protected interest in Subparagraph (i).[42] Given the lack of case law and scholar contributions, the article will propose own definitions for key elements of Subparagraph (i). They are based on the means of interpretation as provided by arts 31-32 of the Vienna Convention on the Law of the Treaties, namely literal meaning, context, and object and purpose.

a) Services carried out directly or indirectly for provisioning military establishment

Subparagraph (i) protects essential security interests "relating to the supply of services as carried out directly or indirectly for the purpose of the provisioning a military establishment". It will be shown that the interpretation of each central element, at least in part, hinges on individual WTO Member preferences. Nevertheless, the elements also allow to define a hard core and more remote services falling under Subparagraph (i).

Starting from the literal meaning, the central notion of Subparagraph (i) "military establishment" stands for the organised body of a country's armed forces comprising its personnel and premises.[43] "Provisioning" this military establishment means supplying it with the "necessary resources" to fulfil its functions.[44] Both the concrete military functions and the necessary resources can only be defined by the WTO Member itself. The most prominent, generally accepted function is the defence from external threats, traditionally war. To fulfil this function, some states choose to provide their military establishment with cutting-edge warfare technologies, while others rely on non-military resources. Hence, the definition of both military establishment and provisioning hinges on non-universal, individual WTO Member preferences.

The same is valid for the last element of Subparagraph (i). The term "the supply of services as carried out *directly or indirectly for the purpose of* provisioning a military establishment" opens the door to an indefinite range of services.[45] "Indirectly" may include any purpose even remotely related to the provisioning of a military establishment. It thus depends on each WTO Member to define a sufficiently indirect relationship.

---

[42] *Saudi Arabia - Protection of IPR*, Panel Report at para.7.242. This paper does not assess the necessity element in the *chapeau* of art.XIV*bis*(1)(b) GATS, see n.35.

[43] According to A. Stevenson and L. Brown, *Shorter Oxford English Dictionary on Historical Principles*, 6th edn (Oxford: Oxford University Press, 2007), pp.866 and 1781, an establishment is "an organised body maintained for a state purpose", "the … personnel of a regiment, ship, etc."; as well as "[a]n institution or business; the premises or personal of this". Military describes "[*t*]*he* armed forces; or soldiers generally" (emphasis in the original).

[44] Stevenson and Brown, *Shorter Oxford English Dictionary*, p.2384.

[45] M. Hahn, "Vital Interests and the Law of GATT: An Analysis of GATT's Security Exception" (1991) 12 Michigan Journal of International Law 558, 585 and 590, who also argues that the interpretation of direct and indirect is not more complicated than defining "likeness" (arts I(1), XVII GATS) or "nullification" and "impairment" (art.XXIII(3) GATS).

Consequently, the Subparagraph (i) is very open to individual WTO Member preferences. Nevertheless, WTO Members will agree that Subparagraph (i) encompasses neither just any service however indirect its relation to military establishment is, nor just any purportedly military function or necessary resource to fulfil this function. At the same time, all WTO Members will agree to a hard core of services that fall under Subparagraph (i), while other services are more remotely linked to military establishment.[46]

Three factors determine whether a service belongs to the hard core or is more remote to Subparagraph (i). The factors result from the definitory space that each of the three central elements of Subparagraph (i) leaves to the WTO Members.

First, an establishment constitutes a military establishment if it fulfils a *military function*. The less traditional or universal the military function at issue is, the less WTO Members will agree that a military establishment evidently needs to be provisioned with services to fulfil this function (military function factor). Secondly, provisioning a military establishment means to provide the establishment with the *necessary resources* to fulfil its function. Hence, the less important the resource that a service should provide is to fulfil the military function, the less members will agree that the resource clearly falls in the scope of Subparagraph (i) (necessary resources factor). Thirdly, the service at issue must be carried out *directly or indirectly* for provisioning the military establishment. Accordingly, the more indirectly the service at issue is related to the specific military function and resource, the less members will agree that the link between the service and the provisioning of the military establishment is sufficiently established (direct relation factor). The less a service fulfils these three factors, the more it becomes remote from the hard core of services.

The example of maintenance services for tanks illustrates the application of the three factors. Tanks are used, inter alia, to defend a state against external aggressions, namely war. They therefore serve the most traditional military function (military function factor). Moreover, in warfare tanks are a crucial resource to fulfil the military function of defending a state in case of war (necessary resources factor). Finally, maintenance of tanks is directly related to providing the military with tanks (direct relation factor). Hence, the maintenance services of tanks are hard-core services of Subparagraph (i). On the other hand, a much larger group of services will be more remote to the hard core of Subparagraph (i). Dual-use services, for instance, will usually fulfil the direct relation factor less, since they are also or even primarily carried out for a civilian purpose.

Nevertheless, as long as a service fulfils all three defining elements, the service falls under Subparagraph (i), whether belonging to the hard core of Subparagraph (i) or more remote. This distinction between hard- and non-hard-core services, however, becomes crucial when taking into account the relation to the overarching motive of art.XIV*bis*(1)(b) GATS: essential security interests.

---

[46] In *Russia - Traffic in Transit*, Panel Report at paras 7.135-136, the panel hold that Russia acted in circumstances that were "very close to the 'hard core' of war or armed conflict". Accordingly, under the *chapeau*, Russia did not need to establish its essential security interests too specifically.

b) *Relating to essential security interests*

Pursuant to art.XIV*bis*(1)(b)(i) GATS, the service provisioning military establishment must relate to essential security interests. This requirement demonstrates the fundamental difference between Subparagraph (i) on the one, and Subparagraph (iii) on the other hand.

In time of war or other similar emergency, Subparagraph (iii) allows a WTO Member to restrict trade in a particular service even if the service is in no functional relationship with the member's essential security interests. A WTO Member could, for instance, ban all trade with a certain state to end any interaction between both states' nationals and thereby preventing terrorism and extremism.[47] In the *chapeau*, the WTO Member would have to cursorily establish why the prevention of terrorism and extremism is essential to its security and why a complete trade ban was necessary to pursue this essential security interest.[48]

Under Subparagraph (i), however, the term relating to requires an additional step that connects Subparagraph (i) with the *chapeau* term essential security interests. The WTO Member must establish why there is a relationship between the essential security interest and the specific service that provisions a military establishment. Otherwise, art.XIV*bis*(1)(b) GATS would cover any non-hard-core services. WTO Members could restrict trade in nearly every service and therefore frustrate their GATS rights and obligations. The purpose of Subparagraph (i)-(iii), to narrow essential security interests to an exhaustive list, would fail.

In the WTO adjudicating case law, the term relating to has been defined as a "close and genuine relationship".[49] Applied to Subparagraph (i), the covered services must thus have a close and genuine relationship to the essential security interest at issue. In Subparagraph (i) this relationship can generally take two forms.[50] On the one hand, a state's essential security interests may be affected because the supply of a service carried out for the military is disrupted, so that the service cannot provision the state's own military establishment anymore (first scenario). On the other hand, essential security interests of one state (State A) may be undermined because the service at issue provisions another state's (State B) military establishment (second scenario). In the second scenario State A may for example take export control measures to prevent the transfer military know-how to State B.

In both scenarios the close and genuine relationship between essential security interests and a service provisioning a military establishment only exists if a service is so important for the provisioning of a military establishment that, if taken away (first scenario) or added (second scenario), an essential security interest of the WTO Member is affected, in other words:

---

47 This was Saudi Arabia's intention in *Saudi Arabia - Protection of IPR*, Panel Report at para.7.284-285.

48 In *Russia - Traffic in Transit*, Panel Report at paras 7.138-139; *Saudi Arabia - Protection of IPR*, Panel Report at para.7.285-287, the necessity test was reduced a test of good faith and thus a plausibility control.

49 E.g. *China - Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum* (*China - Rare Earths*) Appellate Body Report (WT/DS431/AB/R, WT/DS432/AB/R, WT/DS433/AB/R) 7 August 2014 at para.590 (on art.XX(g) GATT 1994). That definition is usually complemented by the suffix "of ends and means", since the adjudicating bodies were interpreting the links between WTO Member measures and the ends as provided by art.XX GATT 1994.

50 "In relation to" describes any kind of connection or relation, and is also defined as "as regards", which in turn is defined as "concerning" or "with respect to" (see Stevenson and Brown, *Shorter Oxford English Dictionary*, pp.2519 and 2511).

threatened.[51] Before assessing this element of threat, a WTO Member must identify the supposedly affected essential security interests.

Essential security interests are evidently narrower than mere security interests,[52] and are as such about maintaining the "quintessential functions of the state".[53] In other words, essential security interests circumscribe the interests of protecting a state's territory and population from external threats, and maintaining law and public order vis-à-vis internal threats.[54] However, the latter only refers to a "breakdown" of law and public order.[55] Art.XIV*bis*(1) GATS is no general law and order exception.[56] Another often proposed substantiation of essential security interests as only non-trade or non-economic interests fails to provide additional substance.[57] Categorising an interest as a non-trade objective depends on the perspective as exporter or importer. For example, import controls to rebalance a foreign trade deficit may be invoked to address geopolitical concerns of power relations between the states at issue and thus non-trade interests. Even in economic theory, where the distinction between economic and non-economic interests originates, non-economic interests are recognised as overlapping with other categories.[58]

---

[51] Other authors deduce an element of threat from the *chapeau* alone, see T. Cottier and P. Delimatsis, "Article XIV*bis* GATS", in R. Wolfrum, P.-T. Stoll and C. Feinäugle (eds), *WTO - Trade in Services: Max Planck Commentaries on World Trade Law* (Leiden: Martinus Njihoff Publishers, 2008), para.20 and as part of a good faith reading of "as it considers necessary" in art.XXI(b) GATT 1994, D. Akande and S. Williams, "International Adjudication on National Security Issues: What Role for the WTO?" (2003) 43 Virginia Journal of International Law 365, 389-390.

[52] E.g. H. Schloemann and S. Ohlhoff, "'Constitutionalization' and Dispute Settlement in the WTO: National Security as an Issue of Competence" (1999) 93 American Journal of International Law 424, 445.

[53] *Russia - Traffic in Transit*, Panel Report at para.7.130.

[54] *Russia - Traffic in Transit*, Panel Report at para.7.130.

[55] *Russia - Traffic in Transit*, Panel Report at para.7.135.

[56] As will be shown in Section 2., even the broader art.XIV(a) GATS provides no general law and order exception, implied by *United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (*US - Gambling*) Panel Report (WT/DS285/R) 10 November 2004 at paras 6.466-467; upheld by *United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (*US - Gambling*) Appellate Body Report (WT/DS285/AB/R) 7 April 2005 at paras 296 and 298.

[57] *Russia - Traffic in Transit*, Panel Report at para.7.79. Many authors also draw this distinction, e.g. Cottier and Delimatsis, Article XIV*bis* GATS, in *Wolfrum et al. 2008*, para.1; and D. Akande and S. Williams, "International Adjudication on National Security Issues: What Role for the WTO?" (2003) 43 Virginia Journal of International Law 365, 390 ("purely economic reasons"). See also the EU's argument in *United States - Certain Measures on Steel and Aluminium Products* (*US - Steel and Aluminium Products*) EU Replies to the Questions from the Panel (WT/DS548) 14 February 2020 at para.255 (also "purely economic reasons").

[58] P. Delimatsis, *International Trade in Services and Domestic Regulations: Necessity, Transparency, and Regulatory Diversity* (Oxford: Oxford University Press, 2007), p.47; M. Krajewski, *National Regulation and Trade Liberalization in Services: The Legal Impact of the General Agreement on Trade in Services on National Regulatory Autonomy* (The Hague: Kluwer Law International, 2003), pp.12 and 18. The former cites A. V. Daerdorff, "The Economics of Government Market Intervention, and Its International Dimension", in M. C. E. J. Bronckers (ed.), *New directions in international economic law: Essays in honour of John H. Jackson* (The Hague: Kluwer Law International, 2000) 70, 73 and 77-78. See also the US list of national security definitions of several WTO Members, which all contain economic elements, *US - Steel and Aluminium Products*, US Responses of the US to the Panel's First Set of Questions to the Parties at Questions 74(d)-(f), paras 333-345.

Thus, essential security interests are interests to maintain the quintessential functions of the state in their internal and external dimension. This definition provides a wide frame for WTO Members' determination. But once determined, these interests become the benchmark to assess whether the services provisioning military establishment pose a threat to essential security interests.[59]

At this point, the distinction between the hard and non-hard-core services of Subparagraph (i) developed in Subsection a) becomes relevant. In case of a hard-core service, the WTO Member will not need to specify the element of threat. These services are already sufficiently closely related to essential security interests. However, the more a service becomes remote from the hard core of Subparagraph (i), the higher the threshold for establishing the element of threat becomes.

This paper proposes three cumulative criteria of threat. They follow from the requirement of a genuine and sufficiently serious relationship between the essential security interest and the non-hard-core service of subparagraph (i). The public order exception in art.XIV(a) GATS gives further context to the criteria's definition. Footnote 5 to the GATS explicitly demands a "genuine and sufficiently serious threat [that must be] posed to one of the fundamental interests of society". Art.XIV*bis*(1)(b) GATS, on the other hand, lacks such provision and addresses more sensitive interests of WTO Members than art.XIV(a) GATS. Accordingly, the three criteria of threat will be similar to but less demanding than in the public order exception.[60]

First, the service at issue must contribute to the invoked military function, which in turn must contribute to the essential security interest identified by the WTO Member. Otherwise, there would be no causal relationship between service, military function and the essential security interest at issue.

Secondly, the service must be irreplaceable or significantly difficult to replace. This criterion is not met if another available service can fulfil the same function, or another service provider can supply the same or an equally effective service, either directly or through training in a reasonable amount of time. The criterion's rationale is slightly different for the two scenarios covered by Subparagraph (i). In the first scenario, the state will still be capable of provisioning its military establishment to the extent itself deemed necessary because it can turn to another service or service supplier. In the second scenario, State B may use the service at issue for its military, but may equally use another service or service supplier. It is thus not *because of* the service at issue that State A's essential security interests are threatened.

Thirdly, there must be a certain probability that the threat materialises. Again, this element has slightly different meanings depending on the threat scenario at issue. In the first scenario, a sufficient relation between the essential security interest and the military establishment is only established if the supply of the service at issue is at risk. There must be a certain probability for the service supply to be interrupted or severely malfunction, and thus for the military establishment to fulfil its function. In the second scenario, on the other hand, there must be a certain probability that State B will get access to and use the service at issue to the

---

[59] Similarly, in *Saudi Arabia - Protection of IPR*, Panel Report at para.7.281, the panel used the essential security interests as benchmark for the necessity test.

[60] For the detailed definition of public order, see Section 2.

detriment of State A's essential security interests. This criterion lowers "genuine threat" element known from Footnote 5 to the GATS to a minimum threshold of probability.

The burden of proof to establish these elements of threat increases the more the service a WTO Member wants to protect becomes remote from the hard-core services protected by Subparagraph (i).

Consequently, the essential security exception in art.XIV*bis*(1)(b) GATS provides significant limits to WTO Members, and thus to FDI screening according to the security element of the Regulation's notion "security or public order". The security element's scope is mainly determined by Subparagraph (i), which differentiates between a hard core and more remote services to provision military establishment. For FDI in firms that provide non-hard-core military infrastructure, technology and inputs, the investor must in fact threaten the military function and essential interest at issue. This is especially relevant for FDI in firms providing dual-use items and technology. Part D will analyse the test's impact on the Regulation's scope in more detail.

2. Public order: art.XIV(a) GATS

The element of public order in the screening ground "security or public order" refers to the notion public order in art.XIV(a) GATS. Its meaning is also vague, but substantiated in Footnote 5:

> "The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society."

Hence, in contrast to art.XIV^{bis}(1)(b) GATS, the GATS explicitly provides two distinct defining elements for interpreting public order: fundamental interests of society and a genuine and sufficiently serious threat.[61] As in the panel report *EU – Energy Package*, these will guide the following discussion.[62] Similar to the hands-off approach for interpreting essential security interests, the GATS provides the WTO Members with wide discretion on determining fundamental interests of society, whereas the real constraining element is that of a genuine and sufficiently serious threat.

---

[61] This definition replicates the ECJ's definition of "public policy or public security" pursuant to art.65(1)(b) TFEU, see *Scientology EU:C:2000:124 at [17]* (on the former art.73d(1)(b) EC) which was already developed in *R. Rutili v Ministre de l'intérieur (C-36/75) EU:C:1975:137 at [28]*, and thus before the GATS entered into force. N. Diebold, "The Morals and Order Exceptions in WTO Law: Balancing the Toothless Tiger and the Undermining Mole" (2008) 11 Journal of International Economic Law 43, 62–63, therefore concludes that EU and WTO law should be interpreted analogously. However, the much higher degree of integration in the EU also requires a much narrower interpretation of its grounds of exception than the less integrated, intergovernmental WTO.

[62] *European Union and its Member States - Certain Measures Relating to the Energy Sector* (*EU - Energy Package*) Panel Report (WT/DS476/R) 10 August 2018 at para.7.1153. The parties' appeal to this report is suspended due to the current impasse of the Appellate Body. In the only Appellate Body report on art.XIV(a) GATS so far, such a detailed analysis could be neglected, since the interests at issue also fell under the other element in art.XIV(a) "public morals", to which Footnote 5 to the GATS does not apply (*US - Gambling*, Appellate Body Report at para.298).

a) Fundamental interests of society

Following Footnote 5 to the GATS, WTO Members must first of all pursue a fundamental interest of society. This notion underwent some precision in the disputes *US - Gambling* and *EU - Energy Package*.[63]

The WTO adjudicating bodies held that the concept of fundamental interests of society "can vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values".[64] The definition of fundamental interests of society may thus differ not only among, but even within WTO Members.[65] Moreover, members only have to establish a minimum level of clarity why a certain interest should constitute a fundamental interest of society.[66] Member policies and laws may serve as indications.[67] Accordingly, in *EU - Energy Package* the panel took into account TFEU provisions and Commission communications seeking to secure energy supply for the EU's population.[68]

At the same time, case law only offers a few limits to the deferential understanding of fundamental interests of society. First and foremost, the WTO adjudicating bodies, referring to Footnote 5 to the GATS, hold that the public order exception is no general law and order exception.[69] Moreover, in contrast to public morals, which is about a community's "standards of right and wrong conduct",[70] public order is concerned with the impact on the society's functioning.[71] More concretely, the panel in *EU - Energy Package*, focusing on the functionality criterion, argued that disruptions of energy supply are "potentially having severe social,

---

[63] The WTO adjudicating system does not follow legally binding precedents. Nevertheless, Appellate Body reports de facto have a similar status, and, less so, non-appealed panel reports; see, e.g. *United States - Final Anti-dumping Measures on Stainless Steel from Mexico* (*US - Stainless Steel*) Appellate Body Report (WT/DS344/AB/R) 30 April 2008 at paras 158-162; with a critical discussion J. Pauwelyn, "Minority rules: precedent and participation before the WTO Appellate Body", in H. P. Olsen, J. Jemielniak and L. Nielsen (eds), *Establishing judicial authority in international economic law* (Cambridge: Cambridge University Press, 2016) 141, 143 and 170-172.

[64] *EU - Energy Package*, Panel Report at para.7.1153; and *US - Gambling*, Panel Report at para.6.461.

[65] *US - Gambling*, Panel Report at para.6.461, explicitly acknowledges the sensitivity for WTO Members to define public morals and public order.

[66] *EU - Energy Package*, Panel Report at para.7.1153.

[67] *EU - Energy Package*, Panel Report at para.7.1154, and *US - Gambling*, Panel Report at paras 6.466-467, upheld by *US - Gambling*, Appellate Body Report at paras 296 and 298.

[68] *EU - Energy Package*, Panel Report at para.7.1154 and n.1923, e.g. art.194 TFEU and Commission, "Communication European Energy Security Strategy" COM(2014) 330 final.

[69] Implied by *US - Gambling*, Panel Report at paras 6.466-467, emphasising that public order refers only to fundamental interests of society, "as reflected in public policy and law"; upheld by *US - Gambling*, Appellate Body Report at paras 296 and 298.

[70] *US - Gambling*, Panel Report at para.6.465, upheld by *US - Gambling*, Appellate Body Report at paras 296 and 298.

[71] Accordingly, the WTO adjudicating bodies held that the prevention of underage and pathological gambling tended to fall under public morals, while organised crime were rather a matter of public order. The prevention of money laundering and of fraud schemes might fall under both concepts. See *US - Gambling*, Panel Report at para.6.469; upheld by *US - Gambling*, Appellate Body Report at paras 296 and 298-299).

economic and, ultimately, political consequences". The security of energy supply hence constituted a fundamental interest of society.[72]

Beyond these limits developed by case law, several other criteria are discussed constraining WTO Members in determining their fundamental interests of society. As will be shown, only two criteria offer real substantiation.[73]

First of all, one may not compare art.XIV(a) GATS with the *ordre public* (Civil law) or public policy (Common law) exception in International private law (IPL).[74] According to the IPL exception, jurisdictions have the right to deny recognition or enforcement of a judgment from another jurisdiction if it would violate a fundamental principle of their legal order.[75] The comparison between IPL and GATS exceptions may certainly demonstrate that the international legal order knows very deferential concepts of grounds of exception.[76] For a parallel interpretation, however, the similarities are too little. The IPL exception protects fundamental legal, value-based principles, whereas the public order exception in art.XIV(a) GATS seeks to ensure the functioning of a society from a more practical perspective. If an *ordre public* interest is violated pursuant to IPL, for art.XIV(a) GATS there must still be a severe impact on the society's functioning.

Moreover, as argued in the context of art.XIV*bis*GATS, the consideration that public order only covered non-trade or non-economic objectives fails to offer any real additional substance.[77] Instead, public order is a "catch-all term" for all vital interests of society.[78] As such, art.XIV(a) GATS may overlap, but is not overridden by other grounds of exception, especially essential security interests, and health and environmental interests in arts XIV*bis*(1)(b) and XIV(b) GATS. In particular, one may not distinguish between state interests and art.XIV*bis*(1)(b) GATS on the one hand, and societal interests and art.XIV(a) GATS on the other hand. State and societal interests are too deeply intertwined, and the exhaustive list in art.XIV*bis*(1)(b) GATS would

---

[72] *EU - Energy Package*, Panel Report at paras 7.1154.

[73] G. M. Grossman, H. Horn and P. C. Mavroidis, "National Treatment", in H. Horn and P. C. Mavroidis (eds), *Legal and Economic Principles of World Trade Law: Economics of Trade Agreements, Border Instruments, and National Treasures* (Cambridge: Cambridge University Press, 2013) 205, 318, argue that public order is the most encompassing expression negotiators could choose, and that "any regulatory intervention is presumably done to serve public order". This understanding would equate public order with public interest and thus contradict Footnote 5 to the GATS.

[74] T. Cottier, P. Delimatsis and N. Diebold, "Article XIV GATS", in *Wolfrum et al. 2008*, para.22; Krajewski, *National Regulation*, p.158.

[75] *D Krombach v A Bamberski (C-7/98) EU:C:2000:164 at [37]*, on the Convention on Jurisdiction and the Enforcement of Judgments.

[76] Similarly, but leaving further parallels open, N. Diebold, "The Morals and Order Exceptions in WTO Law: Balancing the Toothless Tiger and the Undermining Mole" (2008) 11 Journal of International Economic Law 43, 57 and 64-65.

[77] L. Bartels, "The Chapeau of the General Exceptions in the WTO GATT and GATS Agreements: A Reconstruction" (2015) 109 American Journal of International Law 95, 95; Cottier, Delimatsis and Diebold, Article XIV GATS, in *Wolfrum et al. 2008*, para.1; P. C. Mavroidis, *The General Agreement on Tariffs and Trade: A Commentary* (Oxford: Oxford University Press, 2005), p.181.

[78] Cottier, Delimatsis and Diebold, Article XIV GATS, in *Wolfrum et al. 2008*, para.24, use "catch-all term" to express that public order includes all other interests protected in art.XIV(a) GATS, including public morals.

overly limit WTO Members' rights to protect state interests.[79] While WTO Members will usually opt to invoke the more specific provisions arts XIV*bis*(1)(b) and XIV(b) GATS with more lenient requirements, the Regulation preferred the catch-all term public order as its screening ground.

The first criterion that really substantiates the notion fundamental interests of society to some extent directly follows from the functional character of public order. The more people are affected by the disruption of an interest, the more important this interest may be, indicating a fundamental status for the society as a whole.[80]

A second criterion substantiates fundamental interests of society negatively by carving out the interest to attain or enhance trade autonomy, for example reducing the dependency on the importation of a certain service by protecting its domestic production. The sensitive sector concept of strategic sectors pursues that interest to some extent. The WTO was created to enhance, not reduce international trade. If the grounds of exception to the GATS legitimised the protection of trade autonomy, they would allow WTO Members to pursue interests that their obligations were supposed to prohibit. Protecting trade autonomy as a public order interest is hence not only fundamentally opposed to the WTO's spirit,[81] but would also undermine the WTO Member's rights and obligations.[82] This negative criterion does, however, not apply to a case where trade autonomy is only a means to ultimately achieve another objective that is covered by art.XIV(a) GATS.

Consequently, WTO adjudicating bodies are generally right in deferring the definition of fundamental interests of society mostly to WTO Members. This deferential approach reflects the GATS's nature as a multilateral agreement mostly concerned with negative integration.[83] WTO Members have the right to determine their own level of protection of the interests listed in art.XIV GATS.[84] This rationale particularly applies to public order as a diverse, dynamic concept of which the meaning obviously depends on the society that lives in the public order at issue. The GATS, and more broadly the WTO, lack the means and mandate to determine such content multilaterally. Nevertheless, WTO Members must provide minimum clarity why

---

[79] *Contra* Cottier, Delimatsis and Diebold, Article XIV GATS, in *Wolfrum et al. 2008*, para.22; and Krajewski, *National Regulation*, p.158.

[80] N. Diebold, "The Morals and Order Exceptions in WTO Law: Balancing the Toothless Tiger and the Undermining Mole" (2008) 11 Journal of International Economic Law 43, 61–62.

[81] H. Schloemann and S. Ohlhoff, "'Constitutionalization' and Dispute Settlement in the WTO: National Security as an Issue of Competence" (1999) 93 American Journal of International Law 424, 444.

[82] Of course, WTO Members are still entitled to pursue such objectives. For example, the US and China are currently decoupling their economies (see A. Roberts, H. Choer Moraes and V. Ferguson, "Toward a Geoeconomic Order in International Trade and Investment" (2019) 22 Journal of International Economic Law 655, 669 and 673-674). However, they may do so only as long as their measures do not violate their GATS obligations, or a specific provision allows them to (e.g. art.XIX GATT 1994, Agreement on Safeguard Measures).

[83] Delimatsis, *Trade in Services and Domestic Regulation*, p.85 and n. 5; P. C. Mavroidis, "Highway XVI re-visited: the road from non-discrimination to market access in GATS" (2007) 6 World Trade Review 1, 11–12, and J. P. Trachtman, *The international economic law revolution and the right to regulate* (London: Cameron May, 2007), p.641.

[84] *US - Gambling*, Panel Report at para.6.461, confirmed in the realm of art.XX(a) GATT 1947 by *European Communities - Measures Prohibiting the Importation and Marketing of Seal Products* (*EC - Seal Products*) Appellate Body Report (WT/DS400/AB/R, WT/DS401/AB/R) 22 May 2014 at para.5.200.

an interest is fundamental, essential, vital for the functioning of society, in that the interest's disruption may have severe economic, social consequences, inter alia by affecting a large number of people. The interest of trade autonomy is not covered.

As even these constraining criteria leave wide discretion to WTO Members, the scope of public order and thus of the public order component in "public order or security" is, as for the determination of security, mostly determined by the element of threat.

b) Genuine and sufficiently serious threat

Protecting a fundamental interest to society only constitutes a public order interest pursuant to Footnote 5 to the GATS if it is subject to a genuine and sufficiently serious threat. This second element is the actual threshold for a WTO Member to establish public order.

The panel report *EU - Energy Package* is so far the only case law on the notion genuine and sufficiently serious threat, and provides valuable guidance. It even dealt with, among other measures, a narrow version of an FDI screening mechanism. Russia challenged an EU certification requirement for foreign controlled natural gas transmission operators (TSOs) that is satisfied if the undertaking "will not put at risk the EU's security of energy supply".[85] As the panel found the certification requirement to violate commitments to national treatment of some Member States, the EU invoked art.XIV(a) GATS as a ground of exception. It argued that a foreign controlled TSO generally posed a genuine and sufficiently serious threat to the EU's security of energy supply, since the home state government might have the incentive and means to "require or induce foreign controlled TSOs" to disrupt its gas supply.[86] This argument mirrors the EU's and Member States' concern about the home state government's influence behind foreign investors. The panel rightly concluded that this argument refers to the element of genuine threat.[87]

In the abstract, the panel interpreted the notion of genuine threat as "a real, true and authentic possibility" that the purported threat materialises.[88] According to the panel, a (clearly) imminent threat or a "significant degree of likelihood" would set the threshold too high.[89] "Mere conjecture or speculation", "an imaginary or very remote risk", and "entirely hypothetical" would, on the other hand, constitute low degrees of likelihood.[90] The panel also held that a higher level of seriousness of the threat might reduce the required threshold of likelihood.[91]

The panel went on to apply these defining criteria rather cursorily. It proceeded in three steps to assess the EU's argument that foreign governments may instrumentalise TSOs to threaten

---

[85] Arts 11(2) and 10(4)(b) of the Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L211/94.

[86] *EU - Energy Package*, Panel Report at paras 7.1170-1172.

[87] *EU - Energy Package*, Panel Report at para.7.1172.

[88] *EU - Energy Package*, Panel Report at para.7.1168.

[89] *EU - Energy Package*, Panel Report at paras 7.1166-1168.

[90] *EU - Energy Package*, Panel Report at paras 7.1167–1168 and 1189. On the difference between threat and risk in general in international law, N. Tsagourias, "Risk and the Use of Force", in M. Ambrus, R. G. Rayfuse and W. Werner (eds), *Risk and the regulation of uncertainty in international law* (Oxford: Oxford University Press, 2017) 13, 15.

[91] *EU - Energy Package*, Panel Report at para.7.1169.

the EU's security of energy supply. First, it held that a foreign government had an incentive to induce firms controlled by its citizens to undermine the EU's security of energy supply.[92] Secondly, TSOs had a critical role for the EU's energy supply. Hence, the failure of one TSO to comply with its obligations had an impact on the EU's energy security as a whole.[93] Thirdly, a foreign government had "the means to require or induce" firms controlled by its citizens to comply with its own rather than the firm's commercial interests or legal obligations under EU law.[94] Mostly relying on these inferences and without demanding much evidence by the EU, the panel found a genuine threat that foreign governments required or induced foreign TSOs to undermine the EU's security of energy supply.[95]

Following the structure of Footnote 5 to the GATS, the panel then assessed whether the EU established a sufficiently serious threat. The panel held that this element required a threat of a certain magnitude or gravity.[96] It added that natural gas was far less fungible than oil, and that its supply infrastructure was fixed and of a finite quantity. Accordingly, if only one TSO interrupted its gas supply, the consequences would be significant.[97] Therefore, a sufficiently serious threat was established.

The panel's definition of threat as a real, true, and authentic possibility of a certain magnitude or gravity seems appropriate in the context of art.XIV(a) GATS, but further precision is necessary.

First of all, it is uncertain whether WTO adjudicating bodies will adhere to this very lenient and cursory interpretation of genuine threat when confronted with a different set of facts. In principle, it is appropriate in the WTO context to set the probability threshold not too high. The few information exchange mechanisms and obligations between WTO Members may sometimes even justify to rely on inferences and assumptions.[98] Otherwise, the public order exception may become a merely theoretical defence. Nevertheless, a genuine threat must require more than a causal relationship between the cause and the potential harm exists; in the *EU - Energy Package* example, a government's possibility to induce a foreign investor and the investor's possibility to disrupt natural gas supply through the acquired asset. Moreover,

---

92 The EU only invoked two historical examples in which foreign governments took a similar measure: an oil embargo by the Organization of Arab Petroleum Exporting Countries 1973 and the interruption of gas supplies to Ukraine in 2006 and 2009 (*EU - Energy Package*, Panel Report at para. 7.1174). In both situations, however, the states interfered in "their" firm's export of domestic products, not in a domestic firm's overseas production. Only the latter would match the allegation at issue, that a foreign investor threatens the EU's energy security.

93 *EU - Energy Package*, Panel Report at para.7.1181.

94 *EU - Energy Package*, Panel Report at paras 7.1186-1187.

95 It is important to note that, for the case at issue, the lenient interpretation of genuine threat had only limited consequences. The EU could not show that it took similar measures against domestic TSOs with business activities abroad. Such domestic TSOs are, however, as susceptible to foreign government influence as foreign investors. The panel therefore concluded that only addressing foreign TSOs was arbitrary, and hence rejected the EU's defence under the *chapeau* of art.XIV(a) GATS; see *EU - Energy Package*, Panel Report at para.7.1253. This final conclusion might have affected the panel's generous application of its "threat" definition elements

96 *EU - Energy Package*, Panel Report at paras 7.1163 and 1195.

97 *EU - Energy Package*, Panel Report at para.7.1199.

98 See art.XIV*bis*(1)(a) GATS on the non-disclosure of information for essential security interests.

WTO adjudicating bodies may not generally accept the argument that any foreign investor may be induced by its home state government to harm a certain host state interest, and thus poses a threat to a fundamental interest of society. This reasoning would legitimise mistrust against foreign investors as a rule, and as a consequence undermine the GATS.

The notion sufficiently serious relates to both magnitude and gravity. The former describes an element of quantity, the latter a quality requirement. Both aspects are interrelated and important to limit the broad, deferential definition of fundamental interest of society. A certain magnitude is, for instance, reached if a large number of people are affected by the threat. To establish a certain level of gravity, the possible harm to the fundamental interest of society must be of a high intensity; in case of energy security, for example, the complete stop of energy supply. The panel rightly applied both elements when finding that TSOs relied on fixed infrastructure for a finite quantity of natural gas at a given time. An interruption of natural gas supply by one single TSO (quality) would thus affect large parts of the population and industry (quantity).[99]

The natural gas example indicates a criterion for the seriousness of a threat for cases in which the threat scenario is to (not) having access to a particular product. If the service of fundamental interest to society is supplied by a firm holding a monopoly or large portion of market shares, a disruption of this firm's supplies will automatically have severe consequences.[100] By definition, a monopoly holding firm has large market power that may not or only with great effort be substituted by another supplier—for legal, natural, or economic reasons. Particularly relevant in the FDI screening context are economic monopolies due to cutting-edge technologies, as well as natural monopolies because of capacity constraints for supply infrastructure. In the electricity, natural gas, petroleum, and water sector, for instance, suppliers rely on single transmission systems such as pipelines or grid. In all these cases of monopolies, the consumer's accommodation with the service of fundamental interest is contingent on the monopolist supplying this service. Once the monopolist stops its supply, the consumer is deprived of the service. This effect lasts as long as the firm resumes the supply, since, in a monopolistic market, alternative suppliers do not exist. These considerations also apply to suppliers who hold a large portion of market shares. Therefore, in case an FDI threatens the supply with a service of fundamental interest to society, the seriousness of the threat may be presumed if the acquired domestic asset holds a monopoly or a large portion of market shares.

Consequently, the meaning of the defining elements—a real, authentic, and true possibility and a certain magnitude or gravity—has to be taken seriously.[101] Both elements are

---

[99] *EU - Energy Package*, Panel Report at para.7.1199.

[100] See J. Wolff, *Ausländische Staatsfonds und staatliche Sonderrechte: Zum Phänomen "Sovereign Wealth Funds" und zur Vereinbarkeit der Beschränkung von Unternehmensbeteiligungen mit Europarecht* (Berlin: Berliner Wissenschafts-Verlag, 2009), pp.190–191, on the notion of "public policy or public security" pursuant to art.65(1)(b) TFEU.

[101] Given the broader context of public order in art.XIV(a) GATS, one may argue that the above developed, rather strict definition ignores other, more suitable gateways to limit the WTO Members' use of the public order exception. The WTO adjudicating bodies seem to prefer the *chapeau* of art.XIV GATS as a constraining element, *EU - Energy Package*, Panel Report, see n.95; and *US - Gambling*, Appellate Body Report at para.369 (both on art.XIV(a) GATS); as well as *EC - Seal Products*, Appellate Body Report at paras 5.338-339 (on art.XX(a) GATT 1994). However, this approach only creates new

substantiated by one criterion respectively that is particularly relevant in the FDI screening context. In case the threat is allegedly posed by potential home state government influence on an investor, the threat is not genuine simply because of the home state government's possibility to exert the influence. Rather, this possibility to influence must be complemented by an element of probability that the government will in fact exert the influence. In case of a threat posed by a firm that supplies a product of fundamental interest to society, a threat's seriousness may be presumed, if the firm holds a monopoly or a large portion of market shares.

In sum, the foregoing analysis demonstrates that WTO law is rather open to different, even broad member definitions of essential security interest and fundamental interest of society. However, the real threshold is constituted by an element of threat, which is much higher for public order than essential security interests within the meaning of art.XIV*bis*(1)(b)(i) GATS. As will be shown in the following part, this significantly limits the scope of Member State FDI screening mechanisms pursuant to the Regulation.

D. Interpreting "security or public order" in accordance with the GATS: Only few, high-profile cases of FDI in sensitive sectors covered

The above developed definitions of the GATS notions essential security interest and public order now allow to assess the scope of FDI screening mechanisms based on the Regulation' s screening ground "security or public order".

The security element of "security or public order" is mainly determined by art.XIV*bis*(1)(b) Subparagraph (i) GATS, and thus describes interests relating to provisioning a military establishment. There is a hard core of products[102] that the Member States may protect under Subparagraph (i) without having to meet any further substantial conditions. The hard core consists of products directly related and indispensable to defending a state against external threats. The less a product fulfils the above defined military function, necessary resources, and direct relation factors, the more remote the product becomes from the hard core of Subparagraph (i) and the more requirements must be met for the product to fall under this subparagraph. Most importantly, the Member State must establish a minimum threshold of threat. The product must contribute to a military function and to the protection of the invoked essential security interest, it must be irreplaceable or significantly difficult to replace, and there must be a certain probability that the threat will materialise.

The element of public order protects the Member States' fundamental interests of society. This concept is much broader than essential security interests. Member States may pursue a wide range of policy objectives. Similarly to art.XIV*bis*(1)(b) GATS, the main constraining element is that the interest at issue must be subject to a genuine and sufficiently serious threat by the individual FDI at issue. In other words, there must be a real, authentic and true

problems. Most importantly, it generally raises the threshold for WTO Members to invoke art.XIV(a) GATS even in cases where the requirements of public order are evidently met.

[102] For these summarising remarks the term "products" is used instead of "services". The Regulation and thus the security element of its screening ground apply to not only services, but all products an FDI target may produce.

possibility that the FDI harms the interest at issue by a certain magnitude or gravity. This element of threat is considerably higher than the minimum threshold known from the non-hard-core products in art.XIV*bis*(1)(b) GATS.

Accordingly, an FDI screening mechanism based on the Regulation's screening ground "security or public order" allows the screening of three groups of FDI. First, Member States may widely screen FDI into firms that produce, possess or operate (together in the following: provide) goods, services, infrastructure, technology, or inputs directly related to and indispensable for hard core military functions. Secondly, the screening ground encompasses FDI into firms whose business purpose is more remotely related to hard core military functions if the FDI fulfils a minimum requirement of threat. Thirdly, Member States may screen FDI into firms providing infrastructure, technologies, or inputs that constitute a fundamental interest of society if the FDI poses a genuine and sufficiently serious threat to this interest.

With these three groups in mind, the discussion can now turn to more concretely analyse the scope of Member State FDI screening mechanisms pursuant to the Regulation. As analysed in Part A, the EU lawmakers disagreed on what sectors were sensitive enough to politically justify FDI screening. Adopting the elusive screening ground "security or public order" without complementing it by an exhaustive list of sensitive sectors, the Regulation may seem to effectively cover FDI in all three discussed concepts of sensitive sectors. The following proves this assumption to be wrong.

1. Defence sector

At first sight, the screening ground "security or public order" widely covers the defence sector. In fact, the defence sector seems to coincide with the security element of the screening ground, as defined in accordance with art.XIV*bis*(1)(b) GATS. The defence sector is certainly covered as far as it includes the hard-core, WTO-widely recognised military functions. FDI into firms providing infrastructure, technology, or inputs that directly provision and are indispensable for the recognised military functions, is widely covered. In these cases, even a remote, abstract risk suffices to screen, ultimately prohibit an investment. The hard core of the defence sector includes, for instance, firms that produce ammunition or tanks, possess technology exclusively applied for such production, or supply respective maintenance services.

However, for screening FDI into firms providing more remote assets to the hard core of military functions, namely dual-use items and technology, the Member State has to meet a higher threshold. In these cases, the Member States must first invoke a specific essential security interest. The Member State then needs to establish a threat to the security interest. The asset of the domestic target, for instance a specific technology or service, must contribute to a certain military function which protects or threatens the essential security interest, and the asset must be irreplaceable or significantly difficult to replace by another asset. Lastly, the Member State must establish a certain probability that the envisaged threat scenario will materialise.

For example, the Member State may be concerned about an FDI in a firm developing artificial intelligence applications to identify specific persons by certain character traits from large databases. These applications are also, but not only used for military intelligence. The Member State is afraid that the foreign investor uses its influence on the acquired domestic

firm to transfer the artificial intelligence application to its home state facilities. In this case, the Member State will probably have difficulties to establish even the minimum criteria of threat. To meet the first and third criterion, the Member State must establish a certain probability that the FDI will cause harm to a concrete military function. These criteria are not met, as long as the Member State has no concrete reason to expect that either the acquired firm will cease to supply the artificial intelligence application to the Member State, or that the foreign investor will make the application available to its home state which may then use it against the Member State. Moreover, the Member State must establish that no other equally effective application is available to it or the investor's home state, depending on the threat scenario. The alternative artificial intelligence application may also be supplied by a supplier from another state if the Member State can expect reliable supply.

This example highlights the obstacles the Member States face when they want to screen a concrete FDI in a non-hard-core defence sector, especially the dual-use item sector. FDI into a domestic asset providing products or technologies with indirect links to military functions and abstract risk scenarios will often not meet the screening ground's standards.

2. Critical infrastructure, technology, and inputs

The second concept of sensitive sectors discussed for FDI screening consists of domestic firms providing critical infrastructure, technology, and inputs. As defined in Part A, these assets are essential for the maintenance of vital societal functions, health, safety, security, economic or social well-being of people. As far as this includes the defence sector, the above analysis applies. For all other interests, the public order element of the Regulation's screening ground decides to what extent the Regulation covers the sectors of critical infrastructure, technology, and inputs.

The definition of critical infrastructure, technology, and inputs essentially mirrors the functional definition of fundamental interests. The Member States may therefore pursue a wide range of interests falling under the second group of sectors, for instance securing energy supply, health services, telecommunication infrastructure, data storage and processing facilities and services. All these interests are, however, only covered insofar as they are protecting the essential, basic needs of the population.

The constraining effect of this reservation manifests itself in the second defining element of public order. The FDI into a firm must threaten the fundamental interests of society in a way that the essential, basic needs of society are affected. The threat's first element, genuine, already sets a relatively high threshold compared to the concerns at issue. Concrete facts will often not be available to prove a real possibility for the threat to materialise. Shareholder resolutions that prove an investor's plan to harm a public interest are unlikely, for example the agreement to transfer critical technology know-how after the FDI. Similarly, earlier experiences will often lack, for instance that the investor at issue transferred know-how, or that the home state government induced the investor at issue to harm the FDI host state. Moreover, an investor A or foreign government B once having posed a threat to a fundamental interest of society does not establish that investor C or foreign government D will do the same. Such general mistrust in foreign exporters and their governments is not covered by "security or public order" interpreted in accordance with the GATS.

Combined with the second public order element, sufficiently serious threat, the threshold becomes even higher. An FDI into a sector of fundamental interest of society that only affects the sector to a small extent will not pose a sufficiently serious threat. For example, if a foreign investor acquires only one of many hospitals in a city, the inhabitants' health will still be sufficiently protected in case the investor stops providing health services in this specific hospital. FDI in firms holding monopolies, however, will often result in sufficiently serious threats if the firms provide products that are fundamental to society. Therefore, "security or public order" widely covers FDI in natural monopoly, such as water, gas, electricity grid operators, as well as technological monopoly sectors, including certain artificial intelligence and robotics applications, provided a genuine threat is established.

Consequently, the screening ground 'security or public' significantly covers the policy objective to protect critical infrastructure, technology, and inputs. Individual FDI, however, will often not pose a threat to this sector, except for FDI into firms holding a monopoly or a large portion of market shares. The Regulation will thus only allow screening of a few, high-profile FDIs.

3. Strategic assets

The broadest concept of sectors some EU lawmakers are considering sensitive enough to politically justify FDI screening consists of domestic firms providing strategic assets. Assets are strategic if the EU or Member States consider them important for their long-term industrial, economic, or geopolitical strategy. This assessment includes considerations to strengthen certain geopolitically important sectors, and secure competitive advantages in order to facilitate building globally competitive domestic firms. In contrast to the other two concepts of sensitive sectors that widely coincided with the distinction between security and public order, the categorisation of strategic assets is more complex. At least as far as strategic assets include the defence sector and critical assets, these are covered by the above analysis.

Following a broad security understanding, one may consider the geopolitical dimension of strategic assets to fall under the security element. However, security within the meaning of the GATS is no open-ended concept, but exhaustively defined in the subparagraphs of art.XIV*bis*(1)(b) GATS. The security element in "security or public order" only covers geopolitical interests as far as they relate to assets provisioning military establishment. Broader geopolitical interests may instead constitute fundamental interests of society and thus qualify as a public order interest. Nevertheless, in both cases the FDI must constitute a threat to the interest at issue. As shown in Section 2., Member States will very often not meet the threshold of threat, even less so in the context of abstract geopolitical interests and risks.

Moreover, all broad interests characterising the concept of strategic assets, industrial, economic, competitive, and geopolitical interests, want to at least in part strengthen or defend the autonomy of the EU. As far as such autonomy means an autonomy from trade flows, the consideration is not protected by the GATS grounds of exceptions, and thus not covered by "security or public order". If the trade autonomy interest ultimately serves another, more concrete interest, it is protected by "security or public order", as far as this other interest falls under the narrower concepts of sensitive sectors.

Apart from this, Member States may protect strategic assets as a fundamental interest of society. Here, the same difficulties to establish a threat apply as laid out for critical

infrastructure, technology, and inputs. Insofar, the scope of "security or public order" is thus also reduced to a few, high-profile cases of FDI.

4. The Screening ground "security or public order": compromise with a limited scope

This detailed assessment showed the scope of FDI screening mechanisms based on the screening ground "security or public order" seems broad, but in fact is rather narrow. The screening ground allows to screen FDI in many of the sensitive sectors that were discussed by the different EU lawmakers. It encompasses even economic and geopolitical considerations, though excluding the interest of attaining or enhancing trade autonomy, which will often be behind concerns about the transfer of cutting-edge know-how. However, only rarely will a concrete FDI threaten these important interests in a way that meets the threshold of "likely to affect security or public order". This second element reduces the seemingly broad screening ground to a much narrower condition for FDI screening that is met in a few, high-profile cases of FDI.

As a result, screening FDI in accordance with the Regulation seems a realistic option for only two groups of FDI targets. The first group of FDI targets consists of firms providing infrastructure, technology, or inputs that directly provision and are indispensable for generally recognised military functions. FDI into firms providing dual-use items is omitted in this group, and remains difficult under the Regulation. The second group of relevant FDI screening targets holds monopolies or large parts of market shares in a certain sensitive sector, for any disruption of their production will usually have a large effect in quantity and quality. However, the Member State must establish a real possibility that this threat scenario materialises.

Conclusion: The WTO understanding undermines the Regulation's objectives

All in all, the Regulation therefore does not achieve its objectives. As analysed in Part A, the Regulation was adopted to meet two of the EU's and Member States' concerns vis-à-vis foreign investors. First, the Regulation should equip the EU and Member States with the necessary means to protect themselves against foreign investors who pursue objectives that, if achieved, harm the EU's and Member States' interests in certain sensitive sectors. Secondly, the EU and Member States sought to tighten rules for foreign investors in order to achieve leverage in negotiations on more reciprocity in FDI treatment.

Part D concluded that the Member State FDI screening mechanisms based on the Regulation allow FDI screening only for a few, high-profile cases. This reduces the EU's and Member States' room for manoeuvre to meet their concern about harmful foreign investor objectives significantly. Having such a limited scope, the Regulation also provides little leverage to achieve more favourable FDI treatment for EU investor from certain trading partners, in particular China. Hence, the Regulation misses both objectives to a large extent.

In the future, the EU should therefore focus on more concrete and effective regulation of FDI inflows. At least from an EU law perspective, the EU has the flexibility to do so[103]. The current proposal for the screening of subsidised FDI is a first step. Another approach may be more

[103] Art.64(2) and (3) TFEU allow the EU to restrict the freedom of capital movement without any substantial condition. In case of a "step backwards" in liberalisation, the Council must adopt such measures unanimously.

sector-oriented, taking certification requirements for FDI in the natural gas sector based on energy security as an example. This will allow the EU and its Member States to not only meet their concerns vis-à-vis foreign investors, but also to play their "collective role in the world".[104]

[104] EU, Global Strategy, p.13.