THE APPLICATION OF PUBLIC POLICY AND PUBLIC SECURITY REASONS FOR JUSTIFYING RESTRICTIONS ON FREE MOVEMENT OF CAPITAL IN THE EU

Review paper

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The paper explores public policy and public security grounds for justifying restrictions to free movement of capital in the EU, analyses the distinction between these two grounds, and discusses the limits for their application. The content of these terms is flexible and their concrete meaning is determined by the Court of Justice of the European Union. The most prominent examples of restrictions of capital movement have been golden shares. More recently, screening mechanisms that assess incoming foreign direct investment represent a significant new type of restriction of free movement of capital.

Keywords: public policy, public security, free movement of capital, FDI screening mechanisms, golden shares

1. INTRODUCTION

Free movement of capital is the only EU fundamental freedom that extends to third countries. However, current trends favour greater restriction on trade while strengthening security. What is more, the concepts of public policy and public security cannot be easily defined and their scope might be changing over time. This paper explores public policy and public security grounds for justifying restrictions to free movement of capital in the EU, analyses the distinction between these two grounds, and discusses the limits of their application. The content of these terms is flexible and their concrete meaning is determined by the Court of Justice of the European Union. Restrictions on capital movements can be categorised broadly into three types: golden shares, authorisation schemes, and screening mechanisms. The most prominent case law is analysed with a comparative view of the definitions of security exceptions within international investment law.

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2. FREE MOVEMENT OF CAPITAL EXTENDS TO CAPITAL MOVEMENTS FROM THIRD COUNTRIES

Free movement of capital is one of the four fundamental freedoms of the EU. Some call it the fourth freedom that concerns investment.[1] According to Article 63 of the Treaty on the Functioning of the European Union (hereinafter: TFEU),[2] free movement of capital also extends to capital movements between EU and third countries. Since Article 63 has direct effect,[3] individuals such as investors from third countries may rely upon it to remove any restrictions on capital movements. This feature of the extension of free movement of capital to third countries is unique among the fundamental freedoms of the EU. It allows, for example, a Chinese investor, whose foreign investment in a German company may face restrictions, to seek before a German court the removal of such restriction as contrary to EU law.

3. CAPITAL MOVEMENTS: DIRECT INVESTMENT AND OTHER CAPITAL MOVEMENTS

In EU law, there is no definition of what constitutes capital movement. This was deliberate, to allow for flexibility.[4] Directive 88/361[5] has indicative value for the purpose of defining capital movements.[6]

Investments connected with real property,[7] or the trading of shares,[8] are examples of capital movements. Most importantly for the focus of this paper, free movement of capital also covers direct investment.[9] Direct investment concerns the establishment of an undertaking as well as the acquisitions of existing undertakings.[10] Direct investment also includes participation in existing undertakings, long-term loans, and reinvestment of profits, all with the significant qualification of 'lasting economic links'.[11] Investments of all kinds are considered direct investments if they serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom,

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[1] Catherine Barnard, *The Substantive Law of the EU* (5th edn, OUP 2016) 518.
[2] Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47–390 (hereinafter: TFEU).
[3] Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* ECLI:EU:C:1995:451, para 41.
[4] Steffen Hindelang, *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law* (OUP 2009) 43-44.
[5] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, OJ L 178, 8
July 1988 (Directive 88/361).
[6] Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* ECLI:EU:C:1995:451, para 34; Case C-181/12 *Welte* ECLI:EU:C:2013:662, para 31; Joined Cases C-282/04 and 283/04 *Commission v Netherlands* ECLI:EU:C:2006:608, para 19; Case C-222/97 *Trummer and Mayer* ECLI:EU:C:1999:143, para 21; Case C-483/99 *Commission v France* ECLI:EU:C:2002:327, para 36.
[7] Case C-452/01 *Ospelt* ECR 2003 I-09743, para 7.
[8] Case C-265/04 *Bouanich* ECLI:EU:C:2006:51, para 29; Case C-174/04 *Commission v Italy* ECLI:EU:C:2005:350, para 12.
[9] Joined Cases C-282/04 and 283/04 *Commission v Netherlands* ECLI:EU:C:2006:608, para 19.
[10] Directive 88/361 Annex 1, Nomenclature, under I.
[11] Directive 88/361 Annex 1, Nomenclature, under I.

or the undertaking to which, the capital is made available in order to carry on an economic activity.[12]

Two types of investment can be distinguished: direct investment and portfolio investment. Direct investment confers the possibility of effective participation in the management and control of a company, while portfolio investment is a financial investment without the intention of influencing the management and control of the undertaking.[13]

Free movement of capital is extended to cover capital movements between EU and third countries,[14] even though those countries may restrict similar access to their own market for capital from EU Member States. This lack of reciprocity is among the main political arguments of those who argue for greater restriction of FDI. The issue of the lack of reciprocity also spurred action that resulted in a regulation on the screening of FDI into the EU.[15]

Explanations as to why the free movement of capital was extended, unilaterally, to third countries range from calling it a necessity to considering it a huge political mistake, or even an editorial mishap.[16] Some argue that by extending the free movement of capital to third countries, the EU lost a potential bargaining chip.[17] In the current state of affairs, such a view would surely be prominent. Hindelang acknowledges that there is no common market with third countries, that the EU does not share a monetary union with third countries, and that there is no condition of reciprocity for capital movements from the EU towards third countries. Yet, he insists that the free movement of capital must be extended to third countries because the EU is an open economy which seeks to avoid being considered as 'Fortress Europe' and there are economic benefits of such liberalisation of capital movements.[18] The greatest argument for the unilateral extension of free movement of capital to third countries is thus that FDI from third countries stimulates growth of the EU economy, regardless of how the third country treats investment from the EU. Whatever the historical reason for extending the application of free movement of

[12] Directive 88/361 Explanatory notes, under Direct investment.
[13] Case C-135/17 *X* ECLI:EU:C:2019:136, para 26; Joined Cases C-282/04 and 283/04 *Commission v Netherlands* ECLI:EU:C:2006:608, para 19.
[14] TFEU, Article 63(1): 'Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited'.
[15] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ L 79I , 21.3.2019, p. 1–14. (The regulation on the screening of FDI into the EU); Régis Bismuth, '*Screening the Commission's Regulation Proposal Establishing a Framework for Screening FDI into the EU*', European Investment Law and Arbitration Review, vol. 3, (2018), pp. 45-60, 48; Giani Pandey, Davide Rovetta and Agnieszka Smiatacz, '*How Many Barriers Should a Steeple Chase Have? Will the EU's Proposed Regulation on Screening of Foreign Direct Investments Add Yet More Delaying Barriers when Getting a Merger Deal through the Clearance Gate, and Other Considerations*' 2019, Global Trade and Customs Journal, volume 14, issue 2 pp. 56 – 65, 56.
[16] Hindelang (n 4) 25.
[17] Hindelang (n 4) 27.
[18] Hindelang (n 4) 28.

capital movements between EU and third countries, it is true, as Hindelang notes,[19] that the EU retains certain leverage over other countries through the opportunity to use derogations from the free movement of capital in relation to third countries.[20]

4. FREE MOVEMENT OF CAPITAL AND FREEDOM OF ESTABLISHMENT

Direct investment has aspects that qualify it as both capital movement covered by Article 63 TFEU and as establishment, covered by Article 49 TFEU.[21]

The CJEU has approached the issue of distinguishing between free movement of capital and freedom of establishment in multiple ways. In some cases, it applied the provisions of free movement of capital without elaborating why it did not consider the provisions on freedom of establishment.[22] In other cases, the CJEU said that the facts concern both free movement of capital and freedom of establishment, which are parallel in application. In such circumstances, the CJEU would not consider freedom of establishment because restrictions on establishment are a direct consequence of obstacles to the free movement of capital, to which they are inextricably linked.[23] Finally, the CJEU in certain newer cases applied the 'centre of gravity' approach. This means that the CJEU tries to determine whether the facts of the case point more to the application of the provisions on the free movement of capital or to those on freedom of establishment. Then, the CJEU applies only the provisions of the one freedom to which the circumstances of the case point.[24] The relationship between free movement of capital and freedom of establishment is still not completely clear.[25] The debate on the relationship between the two freedoms is 'one of the most controversial disputes' in EU law.[26]

However, freedom of establishment, unlike free movement of capital, does not extend to third countries. Freedom of establishment therefore cannot provide protection for investors from third countries making a foreign direct investment (hereinafter: FDI) in the EU. Thus, we can see a potential loophole. If the CJEU does not want to deal with a particular problematic FDI from a third country, it could decide that the issue concerns freedom of establishment and is therefore outside the scope of EU law. However, that

[19] Hindelang (n 4) 30.
[20] TFEU, Article 64(2): 'Whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible and without prejudice to the other Chapters of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt the measures on the movement of capital to or from third countries involving direct investment — including investment in real estate — establishment, the provision of financial services or the admission of securities to capital markets'.
[21] Hindelang (n 4) 81.
[22] For a discussion of cases where the freedom of establishment was not even considered, see Hindelang (n 4) 91.
[23] Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326, para 56; Case C-483/99 *Commission v France* ECLI:EU:C:2002:327, para 56; Case C-463/00 *Commission v Spain* ECLI:EU:C:2003:272, para 86.
[24] Case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* ECLI:EU:C:2006:544, paras 31-33.
[25] Barnard (n 1) 527.
[26] Hindelang (n 4) 81.

would leave Article 63 TFEU, which undoubtedly includes direct investment and applies to third countries, without meaning.[27]

5. FREE MOVEMENT OF CAPITAL AND PAYMENTS

Free movement of payments (cross-border payments) is an ancillary freedom to the other freedoms because it represents remuneration for services or goods. [28] If free movement of payments is applicable, then the application of free movement of capital is excluded.[29] Sometimes, it is not easy to determine whether the issue concerns free movement of payments or free movement of capital. An example is the *Verkooijen* judgment.[30] The CJEU had to determine whether dividend payments represent capital movements or whether they are a payment for owning capital and therefore concern free movement of payments. The CJEU stated that dividend payments are not explicitly listed in the nomenclature annexed to Directive 88/361 as a form of movement of capital.[31] However, the CJEU concluded that dividend payments are necessarily connected to the acquisition of shares, and therefore themselves represent movement of capital.[32]

6. THE RESTRICTIONS ON FREE MOVEMENT OF CAPITAL

All restrictions on movement of capital between Member States and between Member States and third countries are prohibited.[33] Restrictions are measures taken by the Member States which hinder the movement of capital.[34]

Article 63(1) TFEU broadly prohibits three kinds of national measures. First, there are measures which directly discriminate. Direct discrimination is based on nationality. A typical example of direct discrimination was that involving a Portuguese prohibition which precluded investors from other Member States from acquiring more than a certain number of shares in Portuguese undertakings.[35]

The second type of prohibited restrictions are those which discriminate indirectly. Free movement of capital prohibits not only overt discrimination based on nationality but all

[27] The same conclusion on the relationship between free movement of capital and other freedoms was reached by Advocate General Stix-Hackl in her Opinion in Case C-452/04 *Fidium Finanz AG* ECLI:EU:C:2006:182, para 74: 'If reliance on Article 56 EC [Article 63 TFEU] in relation to undertakings in third countries were automatically to be ruled out whenever another fundamental freedom is involved because of the subject matter in question, the guarantees provided by the free movement of capital would be meaningless'.
[28] Joined Cases 286/82 and 26/83 *Luisi and Carbone v Ministero del Tesoro* ECLI:EU:C:1984:35, para 21.
[29] Hindelang (n 4) 50.
[30] Case C-35/98 *Verkooijen* ECLI:EU:C:2000:294.
[31] Case C-35/98 *Verkooijen* ECLI:EU:C:2000:294, para 28.
[32] Case C-35/98 *Verkooijen* ECLI:EU:C:2000:294, paras 29-30.
[33] TFEU, Article 63(1).
[34] Case C-478/98 *Commission v Belgium* ECLI:EU:C:2000:497, para 18.
[35] Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326, para 40.

covert forms of discrimination which lead to the same result.[36] A residence requirement amounts to indirect discrimination because it dissuades persons who are not residents of the Member State in question from engaging in investments and other capital movements.[37]

Finally, there are measures which do not discriminate either directly or indirectly. These are restrictions which apply 'without distinction' to residents and non-residents, but they do deter access to the market.[38] Therefore, the third type of restrictions which Article 63(1) TFEU prohibits are all restrictions that hinder market access. The upside of the non-hindrance or market access test is that it helped to truly establish the internal market of the EU. The downside is that the test is broad. Member States may feel that their social and economic order is under threat by potentially extensive deregulation caused by the prohibition of all measures which hinder market access.[39]

6.1. Three important types of restrictions on free movement of capital: golden shares, authorisation schemes, and screening mechanisms

Golden share and authorisation scheme cases have provided essential clarification on the application of justification grounds of public policy and public security. Further, the very definitions of public policy and public security, as well as the conditions for their application, have all been developed within the case law concerning golden shares and authorisation schemes. Lastly, screening mechanisms have been established in the majority of EU Member States in recent years. There is a general fear of Chinese takeovers of European 'champions' or technologically advanced companies by non-EU investors. This was recently coupled with more anxiety caused by the pandemic, particularly in view of protecting certain critical infrastructure, such as healthcare, from foreign influence. The reality may or may not corroborate these fears, but they influence the legislative effort. A recent example is the Regulation on the screening of foreign direct investment into the EU,[40] which tries to set common rules for the screening mechanisms of the Member States.

6.1.1. Golden shares

Golden shares are a significant example of a measure that does not discriminate either directly or indirectly but still restricts capital movements.[41] These cases involve shares

[36] Case C-279/93 *Finanzamt Köln-Altstadt v Schumacker* ECLI:EU:C:1995:31, para 26.
[37] Case C-370/05 *Festersen* ECLI:EU:C:2007:59, para 25.
[38] Case C-98/01 *Commission v United Kingdom* ECLI:EU:C:2003:273, para 47.
[39] Hindelang (n 4) 121.
[40] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ L 79I , 21.3.2019, p. 1–14 (The regulation on the screening of FDI into the EU).
[41] For example, Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326; Case C-483/99 *Commission v France* ECLI:EU:C:2002:327; Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328; Case C-463/00 *Commission v Spain* ECLI:EU:C:2003:272; Case C-98/01 *Commission v United Kingdom* ECLI:EU:C:2003:273;

that give special rights to their holder. In many instances, the government creates a golden share in order to retain influence in a company even after selling the majority of the company's shares. Golden shares, vested by law, allow their holder to have special rights that ordinary shares do not convey. In this way, the holder of the golden share (the government) can exercise control that is greater than the quantity of the stake it holds in the company. Golden shares can take many forms, allowing the holder to appoint members of the board(s) or requiring approval of the government for major transactions involving the company. Golden shares (or a single golden share) can also give the government the right to participate in the business decisions of the company.

The CJEU has consistently ruled that golden shares are contrary to the free movement of capital. Often, golden shares were deemed to go beyond what is necessary to secure the legitimate aim; for example, the right to control possible mergers or takeovers by a golden share held by the Dutch government in the privatised postal company KPN goes beyond what is necessary to guarantee a universal postal service.[42] The golden share case of *Commission v Portugal*[43] was the first to establish the market access test regarding free movement of capital.[44]

Most of the cases concerning golden shares were handed down around the turn of the century.[45] However, according to a report prepared for the Commission, golden shares are still applied in Belgium, France, Poland and Slovenia.[46] We may add Croatia to this list. The Commission referred the case of golden share law regarding INA to the CJEU in 2017, claiming that the golden share dissuades foreign investment in INA and therefore represents a restriction on free movement of capital.[47] Croatia amended the INA law in 2019 but left many special rights still reserved for the government.[48] The Croatian government stated the need to ensure the supply of energy and the safety of energy infrastructure as legitimate goals of public security.[49] This seems like an effort to frame the amended INA law within the jurisprudence of the CJEU, particularly with the golden share case of *Commission v Belgium*, the only instance where the CJEU allowed golden

Case C-282/04 *Commission v Netherlands* ECLI:EU:C:2006:608; Case C-112/05 *Commission v Germany* ECLI:EU:C:2007:623; Case C-212/09 *Commission v Portugal* ECLI:EU:C:2011:717.

[42] Case C-282/04 *Commission v Netherlands* ECLI:EU:C:2006:608.

[43] Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326.

[44] Hindelang (n 4) 119.

[45] To mention again a few of the most important ones: Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328; Case C-282/04 *Commission v Netherlands* ECLI:EU:C:2006:608; Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326.

[46] Commission, 'Review of national rules for the protection of infrastructure relevant for security of supply: Final Report', EUR 2017.5032 EN, table on page 13.

[47] Commission, Referral to Court Art. 258, infringement number INFR(2014)4235, TFEU IP/17/1949.

[48] Zakon o privatizaciji INA - Industrije nafte d.d. NN 32/02, 21/19; old and new versions of the INA law, along with the Government's reasoning for the changes, are available (in Croatian) at https://esavjetovanja.gov.hr/Econ/MainScreen?EntityId=9991 accessed 7 August 2021.

[49] Prijedlog zakona o izmjeni i dopuni zakona o privatizaciji ina- industrija nafte d.d., s konačnim prijedlogom zakona, under II (in Croatian) https://esavjetovanja.gov.hr/Econ/MainScreen?EntityId=9991 accessed 14 April 2020.

shares to continue to exist.[50] Even though the modified golden share INA law continued to exist, the Commission closed the case soon afterwards.[51] We can thus assume that the amendments were coordinated with the Commission.

We will not know what the CJEU thinks on the matter, because the case is not being pursued further by the Commission. Since the Croatian government retained significant special rights in INA, it is my view that the continued existence of golden shares in INA suggests that the Commission is willing to allow greater restrictions of FDI than it did in the past.

6.1.2. Authorisation schemes

Another example of restrictions that hinder market access are authorisation schemes. They are significant as a tool which Member States may use to restrict the free movement of capital, often affecting foreign direct investment from third countries. Authorisation schemes require an individual to obtain approval for investment from the bodies of a Member State. These schemes were already addressed by the CJEU in earlier, significant cases regarding free movement of capital, the *Bordessa*[52] and *Sanz de Lera*[53] cases. In both cases, a rule required prior authorisation for the export of coins, banknotes or bearer checks. Likewise, in both cases the CJEU ruled that a simple prior declaration would suffice, and that requiring prior authorisation goes beyond what is necessary. Therefore, a system of prior authorisation could not be justified.
Authorisation schemes may be utilised to restrict investments in companies and shares. In this context, the CJEU stated that the provisions of national law subjecting foreign direct investment to prior authorisation is a restriction on capital movements.[54] Nevertheless, the CJEU stated that authorisation schemes can be justified if the reason is to protect the provision of services in the public interest or strategic services.[55]

6.1.3. Screening mechanisms

We can add screening mechanisms as perhaps currently the most prominent form of restricting FDI from third countries into the EU. Many EU Member States have set up screening mechanisms in recent years.[56] Besides, the regulation on the screening of FDI has been fully operational since October 2020.[57] Member States organise their screening mechanisms in different ways. Some opt for a general law applicable potentially to any

[50] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328.
[51] Commission, Closing of the case, infringement number INFR(2014)4235, memo MEX/19/2110.
[52] Joined Cases C-358/93 and C-416/93 *Bordessa* ECLI:EU:C:1995:54.
[53] Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* ECLI:EU:C:1995:451, para 41.
[54] For example, Case C-54/99 -54/99 *Église de scientologie* ECLI:EU:C:2000:124, para 14.
[55] Case C-483/99 *Commission v France* ECLI:EU:C:2002:327, para 43.
[56] Currently, eighteen Member States have notified the existence of mechanisms for screening FDI. A list is available at: https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf accessed 8 August 2021.
[57] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ L 79I , 21.3.2019, p. 1–14. (The regulation on the screening of FDI into the EU).

FDI.[58] Some Member States have screening laws for particular sectors (such as energy or telecommunications),[59] while Germany, for example, combines both cross-sectoral and sector-specific screening.[60] Finally, a small group of EU Member States does not have any screening mechanism in place that could restrict FDI, including countries such as Sweden and Croatia.

The regulation on the screening of FDI into the EU mentions factors that may be taken into consideration in determining whether a foreign direct investment is likely to affect 'security or public order'.[61] The regulation sets some basic rules that screening mechanisms must adhere to, but a final decision on screening any FDI rests with the Member States. This regulation recognises particular 'projects or programmes of Union interest' which are those 'which involve a substantial amount or a significant share of Union funding, or which are covered by Union law regarding critical infrastructure, critical technologies or critical inputs which are essential for security or public order'.[62] Therefore, the regulation on the screening of FDI into the EU also shows a certain connection between the notions of security, public order, and critical infrastructure and technologies.

7. JUSTIFICATION GROUNDS FOR RESTRICTIONS OF FREE MOVEMENT OF CAPITAL

Screening laws, authorisation schemes or golden shares are restrictions of free movement of capital and need to be justified. Two categories of justification grounds exist: those laid down in the TFEU itself and those developed by the CJEU in its case law.

7.1. The justification ground developed by the CJEU

Restrictions on free movement of capital, imposed by Member States, can be justified. The CJEU has held that so-called overriding reasons in the public interest can serve as justifications.[63] Overriding reasons in the public interest are also known as objective

[58] An example is the Slovenian law of 2021 which seems to be heavily influenced by the Regulation on the screening of FDI into the EU: Zakon o interventnih ukrepih za omilitev in odpravo posledic epidemije COVID-19 (ZIUOOPE), Official Journal No. 80/20 (adopted 29 May 2020, in force as of 31 May 2020).

[59] An example of this approach is the Netherlands, which contains screening mechanisms in its laws regarding gas, telecommunication, and electricity. An overview of the notified laws can be seen at https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf accessed 8 August 2021.

[60] An overview of the German screening mechanism is available at https://www.bmwi.de/Redaktion/EN/Artikel/Foreign-Trade/investment-screening.html accessed 8 August 2021.

[61] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ L 79I , 21.3.2019, p. 1–14 (hereinafter: Regulation on the screening of FDI into the EU), Article 4.

[62] Regulation on the screening of FDI into the EU, Article 8(3).

[63] For example, Case C-271/09 *Commission v Poland* ECLI:EU:C:2011:855, para 55; Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326, para 49.

justifications[64] or mandatory requirements.[65] The CJEU has put forward certain requirements for the application of this justification ground, repeated in more or less the same fashion in its case law. These overriding reasons in the public interest can be broadly chosen by the Member State.

For example, in the context of a direct investment restriction, the CJEU has accepted that the guarantee of a service of general interest, such as a universal postal service, may constitute an overriding reason in the general interest capable of justifying an obstacle to the free movement of capital.[66] Other acceptable reasons may be preserving the effectiveness of fiscal supervision[67] or combating tax avoidance.[68] However, purely economic grounds can never serve as such justifications.[69] Further requirements are that there is no harmonising measure that deals with the same issue[70] and that the restriction does not directly discriminate.[71] The CJEU stressed that such restrictions to free movement of capital must be construed strictly.[72]

However, the proportionality test is where most restrictive measures fail.[73] We can consider the proportionality test as two questions. First, is the measure suitable for achieving the aim?[74] For example, is a total ban on direct investment in a strategic infrastructure[75] suitable for achieving greater national energy security? If the measure is suitable, we proceed to examine whether the measure is necessary, or if are there less restrictive measures possible.[76] A system of prior authorisation can be used only if a less restrictive measure, particularly *ex post facto* authorisation, cannot be used.[77]

So, the requirements for the successful justification of a restriction on free movement of capital (in the context of mandatory requirements) are: a legitimate aim (which is not purely economic), that there is no harmonisation measure on that issue, that the measure

[64] Case C-573/12 *Ålands vindkraft* ECLI:EU:C:2014:2037, para 75.
[65] Case C-120/78 *Rewe-Zentral AG* ECLI:EU:C:1979:42.
[66] Case C-282/04 C*ommission v Netherlands* ECLI:EU:C:2006:608, para 38.
[67] Case C-386/04 *Centro di Musicologia Walter Stauffer* ECLI:EU:C:2006:568, para 47; Case C-326/12 V*an Caster* ECLI:EU:C:2014:2269, para 46.
[68] Case C-282/12 *Itelcar* ECLI:EU:C:2013:629, para 35.
[69] Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326, para 52.
[70] Case C-282/04 *Commission v Netherlands* ECLI:EU:C:2006:608, para 32.
[71] Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326, para 50; Hindelang (n 4) 258.
[72] Case C-242/03 *Weidert* ECLI:EU:C:2004:465, para 20.
[73] Armin Cuyvers, 'Free Movement of Capital and Economic and Monetary Union in the EU' in Ugirashebuja E., Ruhangisa J.E., Ottervanger T., Cuyvers A. (eds.) *East African Community Law: Institutional, Substantive and Comparative EU Aspects* (*East African Community Law: Institutional, Substantive and Comparative EU Aspects,* Brill Nijhoff, 2017, 410-432, 415.
[74] An example of a national measure that failed, according to the CJEU, on multiple accounts: Case C-463/00 *Commission v Spain* ECLI:EU:C:2003:272, paras 68-80.
[75] In *Essent*, the concern was a Dutch law which prohibited privatisation of electricity and gas distribution system operators: Case C-105/12 *Essent and Others* ECLI:EU:C:2013:677.
[76] Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* ECLI:EU:C:1995:451, para 26.
[77] Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* ECLI:EU:C:1995:451, para 27; Case C-367/98 *Commission v Portugal* ECLI:EU:C:2002:326, para 50.

does not cause direct discrimination, and that it is proportionate (necessary and suitable). These conditions are also important for some of the Treaty-based justifications.

7.2. TFEU-based justification grounds and limitations

The treatment of investment from third countries is not identical to the treatment of investment from other EU Member States, as a reading of Article 63(1) TFEU itself would suggest. There are two reasons for this. Firstly, there are limitations set out in the TFEU that apply only regarding third countries. Secondly, the CJEU has stated that a Member State may be able to demonstrate that a restriction on capital movements to or from third countries is justified for a particular reason which would not be a valid justification for a restriction of capital movements between Member States.[78] Barnard interprets this as meaning that the CJEU 'might be more lenient in respect of accepting the justifications' on restrictions of capital movements with third countries.[79]

Besides Article 65 TFEU, there are a few other TFEU-based justification grounds which only apply to capital movements to and from third countries. These justify restrictions on capital movements that existed before a certain date[80] or give the EU the right to adopt measures concerning capital movements with third countries.[81] Further, Article 75 TFEU provides a justification ground for measures which restrict capital movements for the purpose of fighting terrorism and related activities. These justification grounds will not be discussed further.

In order to apply any of the Article 65 TFEU justification grounds, the conditions set out in Article 65(3) TFEU must be satisfied. The measures and procedures must not constitute arbitrary discrimination or a disguised restriction on free movement of capital. There is a number of justification grounds specified in the TFEU, although the most important is that last part of Article 65(1)(b) which allows Member States to take measures which are justified on the grounds of public policy or public security.

7.3. Public policy and public security as justification grounds in Article 65(1)(b) TFEU

The justification grounds of public policy and public security operate in much the same manner as was previously discussed regarding the justification grounds developed by the CJEU. Two cases before the CJEU can take us closer to understanding the concepts of public policy and public security within the free movement of capital.

[78] Case C-446/04 *Test Claimants in the FII Group Litigation* ECLI:EU:C:2006:774, para 121.
[79] Barnard (n 1) 541.
[80] TFEU, Article 64(1).
[81] TFEU, Articles 64(2), 64(3), 65(4).

7.3.1. The *Église de scientologie* case

A French law required prior authorisation in the case of a foreign investment that represents a threat to public policy or public security, among other reasons. The Court first stated that a system of prior authorisation of foreign direct investments is a restriction on the free movement of capital.[82] The Court set out the basic principles for the application of justification grounds of public policy and public security. Member States are free to determine the requirements of public policy and public security in the light of their national needs, but these requirements must be interpreted narrowly and there must be some control by Community (EU) institutions.[83]

In regard to the meaning of the notions of public policy and public security, the Court stated that 'Public policy and public security may be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society'.[84] Interestingly, the Court here did not distinguish between public policy and public security but considered them together. Those derogations, the Court continued, must not serve purely economic ends and a person affected by a restrictive measure must have access to legal redress.[85] The principle of proportionality has to be satisfied as well.[86] In these two paragraphs, the Court set out the basic conditions for the application of the public policy justification grounds. Then, the Court observed that prior authorisation can be justified, particularly in cases of public policy or public security, because it is difficult to identify and block capital once it has entered a Member State, as is the case with foreign direct investment.[87] The French measure was too general because it required prior authorisation for every foreign direct investment and the measure also lacked a detailed definition. Investors do not know in which specific circumstances prior authorisation would be required.

In my view, another way the Court could have found the measure not justified is to refer to the principle of proportionality. The measure in question goes beyond what is necessary by being too broad and vague. In any case, the Court has opened the door to allow systems of prior authorisation for foreign direct investment to be justified on the grounds of public policy and public security. However, the Court did not provide definite guidance on what public policy or public security is, especially since it considered the two together without differentiation.

7.3.2. The *Commission v Belgium* case

Notions of public security and public policy seem always to go in pairs as justification grounds for infringements of the fundamental freedoms. We can ask ourselves what the

[82] Case C-54/99 *Église de scientologie* ECLI:EU:C:2000:124, para 14.
[83] Case C-54/99 *Église de scientologie* ECLI:EU:C:2000:124, para 17.
[84] Case C-54/99 *Église de scientologie* ECLI:EU:C:2000:124, para 17.
[85] Case C-54/99 *Église de scientologie* ECLI:EU:C:2000:124, para 17.
[86] Case C-54/99 *Église de scientologie* ECLI:EU:C:2000:124, para 18.
[87] Case C-54/99 *Église de scientologie* ECLI:EU:C:2000:124, paras 19-20.

distinction is between the two. The judgment in the *Commission v Belgium,*[88] besides shedding some light on the matter of public security, remains the only instance where a golden share measure was successfully justified by a Member State.

Two laws of Belgium vested in the State golden shares in two companies operating energy infrastructure. The Minister of Energy was given the right to oppose certain decisions which 'affect the national interest in the energy field' and, further, the minister had the right to appoint two representatives of the government to the board of directors of the companies.[89] Those representatives could propose the annulment to the minister of certain decisions.[90] However, the representatives of the government would sit on the board only in a non-voting advisory capacity and they had a time limit of four days to apply to the minister for an annulment of a decision of the board of directors.

The Court stated that certain concerns may justify golden shares in undertakings which were privatised if those undertakings are active in fields involving the provision of services in the public interest or strategic services.[91] The Court said that '*public-security* considerations which may justify an obstacle to the free movement of goods include the objective of ensuring a minimum supply of petroleum products at all times' by referring to the *Campus Oil* case,[92] and continued that the same reasoning applies to obstacles to the free movement of capital, which also has a justification ground of public policy.[93] It then invoked the *Église de Scientologie* case, stating that public security may be relied on only if there is a genuine and sufficiently serious threat. In conclusion, the Court found that the measure was justified on the grounds of public security. The measure was limited only to certain decisions[94] and was also limited in time and subject to judicial appeal while also being an ex-post control of the company's decision.[95] These characteristics distinguish the Belgian laws from the (too broad) French laws in the *Église de scientologie* ruling.

[88] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328.
[89] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328, para 8.
[90] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328, para 9.
[91] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328, para 43.
[92] Case C-72/83 *Campus Oil* ECLI:EU:C:1984:256. This older case clarified the notion of public security. The case concerned a provision of Irish law which required traders in petroleum to buy at a government-fixed price from the state-owned Irish refinery. The Court stated that in this case only the concept of public security is relevant, and not that of public policy. Petroleum products are of fundamental importance for a country's existence, dramatically adding that 'all its institutions, its essential services and even the survival of its inhabitants depend upon them'. The aim of ensuring a minimum supply of petroleum products is 'transcending purely economic considerations and thus capable of constituting an objective covered by the concept of public security'. The Court thus explained the specific term of public security in greater detail. It set a high bar, by requiring that public security concerns the country's existence, the security of the population, and the functioning of its institutions.
[93] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328, para 46 (emphasis added).
[94] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328, para 50.
[95] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328, para 52.

7.4. What is a genuine and sufficiently serious threat to a fundamental interest of society?

In order to be able to invoke public policy and public security justification grounds, a Member State has to prove a certain objective which belongs to the domains of public policy and public security of that Member State. From the perspective of public policy and public security, we can look at the objectives to be achieved as the fundamental interests of society. These fundamental interests of society include the minimum supply of petroleum products[96] or the minimum supply of gas in the event of a threat.[97] More generally, the objectives of public policy and public security concern the security of the energy sector.[98] Non-energy matters, such as the minimum supply of telecommunication services[99] or the need to ensure continuity in public services,[100] can also give rise to public policy and public security concerns.

The activity of placing a direct investment itself does not constitute a sufficiently serious threat to the public policy or security of a Member State; only certain kinds of direct investments originating from abroad, such as those in the services in the public interest or defence sectors, may amount to such a threat.[101] Other factors need to point to the existence of a genuine and sufficiently serious threat, as the act of investment itself will not suffice. [102]

Public policy and public security can be consistently found as justification grounds within all the fundamental freedoms. However, I can identify differences between the concept of public policy in the area of, for example, free movement of persons and that in the area of free movement of capital. The magnitude of a threat to society posed by an individual in the case of free movement of persons is fundamentally different from a threat to the energy infrastructure or telecommunications in the case of free movement of capital. In my view, we could distinguish the freedoms' approaches to public policy by saying that the free movement of persons' approach focuses on the 'personal conduct of the individual concerned',[103] while the public policy concept in the domain of the free movement of capital focuses on the object of capital movement (such as critical infrastructure) at least as much as on the person of the investor.

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[96] Case C-72/83 *Campus Oil* ECLI:EU:C:1984:256.
[97] Case C-503/99 *Commission v Belgium* ECLI:EU:C:2002:328.
[98] Case C-244/11 Commission v Greece, ECLI:EU:C:2012:694, para 39.
[99] Case C-463/00 *Commission v Spain* ECLI:EU:C:2003:272, para 71.
[100] Case C-463/00 *Commission v Spain* ECLI:EU:C:2003:272, para 70.
[101] Hindelang (n 4) 236.
[102] Case C-326/07 *Commission v Italy* ECLI:EU:C:2009:193, para 48.
[103] As formulated in Article 27 of Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States amending Regulation (EEC) No 1612/68 and repealing Directives 64/221/EEC, 68/360/EEC, 72/194/EEC, 73/148/EEC, 75/34/EEC, 75/35/EEC, 90/364/EEC, 90/365/EEC and 93/96/EEC, OJ L 158, 30.4.2004, p. 77–123.

The expression 'genuine and sufficiently serious threat to a fundamental interest of society' is used in other areas of EU law.[104] Beyond EU law, the 2002 Bilateral Investment Treaty between Korea and Japan defines the *public order* exception also as a genuine and sufficiently serious threat to a fundamental interest of society.[105] Article XIV(a) of the General Agreement on Trade in Services empowers member states to adopt measures to protect public morals or to maintain public order.[106] 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.[107]

We can conclude that the expression 'genuine and sufficiently serious threat to a fundamental interest of society' is used to define public policy and public security in EU law, as well as public order in certain instruments of international investment law. However, the precise meaning of the definition is subject to the interpretation of the appropriate legal authorities.

8. CONCLUDING REMARKS

Public policy and public security, as previously discussed, must be interpreted strictly. But how strictly should we define them? Is public policy the 'minimal conditions that make possible the existence of the legal order'?[108] Such a strict definition would preclude using public policy in the context of screening foreign direct investment in all cases except when a State can show that an investment endangers the very existence of its legal order, and not merely that it has certain negative effects. So, we can probably safely conclude that the strictness itself is (and should be) a flexible notion, depending on the area of the EU law where the concept of public policy is applied.

On the other hand, should the French government be able to block the foreign acquisition of a private domestic company which produces dairy products?[109] The French regime on the control of FDI included the notion of economic patriotism (*patriotisme économique*), as the Decree from 2014 is called, which requires prior authorisation in certain cases of foreign investment.[110] Is the secured domestic supply of dairy products also an objective

[104] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) OJ L 24, 29.1.2004, p. 1–22 (Merger control regulation) contains public security as one of the legitimate interests of its Article 21. The definition of *public security* in this context is again a 'genuine and sufficiently serious threat to a fundamental interest of society: Decision of 5 December 2007 relating to a proceeding pursuant to Article 21 of Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings C(2007)5913 final (COMP/M.4685 - Enel/Acciona/Endesa) paras 57, 105.

[105] Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia 2018) 80.

[106] WTO GATS: General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994), Article XIV(a).

[107] Footnote original 5 to Article XIV(a) GATS.

[108] Tena Hoško, '*Public policy as an exception to free movement within the Internal Market and the European judicial area: A comparison*' Croatian Yearbook of European Law & Policy, volume 10, 2014, pp. 189-213.

[109] Financial Times 'De Villepin stands by calls for 'economic patriotism' (22 September 2005) https://www.ft.com/content/028bacac-2b94-11da-995a-00000e2511c8 accessed 20 November 2019.

[110] Esplugues (n 105) 411-412.

covered by public policy or public security? This is not likely. The strictness of interpretation, therefore, should vary somewhere between these two extreme notions, as a matter of survival of the legal order of a State and the ensured supply of yoghurt.

In my view, public policy has a further deterrent effect even when not invoked. Foreign companies may reduce their investments so that they do not raise public policy concerns in the host State. Further, foreign investors may also abandon an attempted investment if they get a signal from the State in question that their investment is unwanted even before a formal decision is made.[111] The likelihood of raising such concerns depends on how strictly public policy is interpreted and what control over the meaning of public policy the EU institutions have.

In conclusion, public policy and public security are used to justify restrictions on capital movements, but their content remains flexible. Economic calculations by the State might lie in the background of FDI screening, often merely cloaked in considerations of public policy and public security. It is thus understandable that FDI which may cause economic or social disturbance can be subject to screening. However, FDI contributes to growth, technological progress and employment in the receiving country. Therefore, blocking FDI and restricting free movement of capital should be done on the rarest of occasions, if at all, and always with a view to respecting genuine issues of public policy and public security.

[111] Bismuth (n 15) 54.

PRIMJENA JAVNOG PORETKA I JAVNE SIGURNOSTI KAO OSNOVA ZA OPRAVDANJE OGRANIČENJA SLOBODE KRETANJA KAPITALA U EU

Rad istražuje javni poredak i javnu sigurnost kao osnove za opravdanje ograničenja slobode kretanja kapitala u EU, analizira razliku između ovih dviju osnova te raspravlja ograničenja njihove primjene. Sadržaj pojmova javnog poretka i javne sigurnosti je fleksibilan te njihovo točno značenje utvrđuje Sud Europske Unije. Najistaknutiji primjer ograničenja kretanja kapitala bile su zlatne dionice. U novije vrijeme, mehanizmi za provjeru ulaznog stranog izravnog ulaganja predstavljaju novu vrstu ograničenja slobodnog kretanja kapitala.

Ključne riječi: javnio poredak, javna sigurnost, sloboda kretanja kapitala, sustav provjere stranih izravnih ulaganja, zlatne dionice

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