

FDI SCREENING IN UKRAINE



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1. INTRODUCTION

In this report, we review international experience on FDI (foreign direct investment) screening in leading countries and the current plans to implement such system in Ukraine. We also develop recommendations on how the system should be designed.

First, we discuss what an investment screening mechanism is and how it works in the USA, Canada, Australia, and the EU. As there is variation in practices within the EU, we focus on two countries in particular: France and Germany, to highlight any such differences. Finally, we review China as one of the largest FDI recipients in the world and as a country whose investors frequently become a target for such systems.

Next, we review the attempts to implement an investment screening system in Ukraine, the current legal framework, and political commitments. The current version of the respective draft law is also discussed. We investigate such topics as the institutional structure of the responsible body, investment definition, industry and country selection, procedures, and rejection criteria. We compare them with foreign legislation and reflect on what local experts say about these provisions.

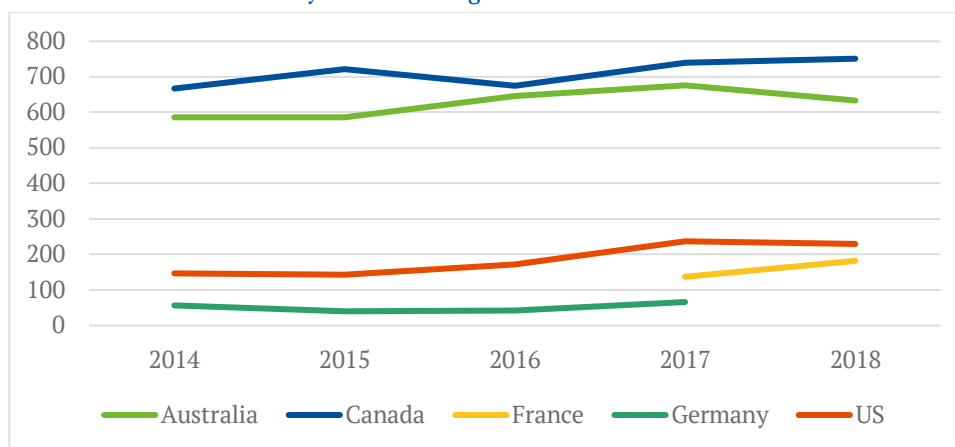
Finally, we provide recommendations on how the current draft law should be improved to both reflect best international practices and account for risks that may arise.

2. WHAT IS FDI SCREENING

Screening of incoming foreign direct investment (FDI) for possible harmful interventions is a relatively new practice in the global investment policy. So far, governments have been more concerned with attracting foreign investors by improving business climate in general and creating specific benefits. But eventually some states concluded that not all foreign money is useful. Politically, not commercially motivated money can help the source country to proceed with its political agenda that may be not in the interest of the host country.

FDI screening is a government mechanism to monitor investment inflows in certain (or all) industries and block transactions when they are considered risky. According to UNCTAD¹, during 2011-2019, at least 13 countries introduced such systems, and 15 significantly modified existing ones (usually widening the scope).

Chart 1. Cases examined by FDI screening mechanisms



¹ National security-related screening mechanisms for foreign investment. UNCTAD, Investment Policy Monitor, December 2019. https://unctad.org/system/files/official-document/diaepcbinf2019d7_en.pdf

The right to block an investment is almost a red button. It should be considered as an action of the last resort. In fact, countries rarely exercise this right. During 2016-2019, at least 20 deals exceeding \$50 million each were blocked, according to UNCTAD.² This is the minimal estimate as such decisions are not always made public. Some investments were quite substantial, and the total amount of blocked FDI reached \$162.7 billion. From that amount, the rejected investment worth \$150.6 billion occurred in 2018 alone and made up 11.6% of total global FDI in that year. See Annex 1 for more details of these cases.

The US is the most frequent blocker (13 cases out of 20 large deals, 80% of the total amount), while China is the most frequent investor country being blocked (16 cases). The largest blocked deal is the purchase of Qualcomm, an American chipmaker, by Broadcom (Singapore) for \$117 billion in 2018. However, there were some intra-developed world deals, too. For example, the US blocked German and Canadian investments, Spain blocked an investment from Italy.

More frequent outcome is the withdrawal of an application by an investor. During 2014-2018, there were 192 such cases in the US.

3. BEST PRACTICES

In recent years, many countries around the world have introduced investment screening mechanisms to monitor investment in sensitive sectors and prevent transactions that may be dangerous for national security. In this section, we consider mechanisms that were introduced in different countries around the world. We will discuss which sectors are subject to monitoring, which conditions the investment must satisfy to be monitored, and why some investment deals are not approved. We would also investigate which governmental organizations are responsible for the investment monitoring.

We will discuss how investment screening mechanism works in the USA, Canada, Australia, and the EU. As there also exists some variation within the EU, we would focus on two countries in particular: France and Germany to highlight any such differences. Finally, we included China as one of the largest FDI recipients in the world and as a country whose investors frequently become targets for such systems. As is hinted by the explanatory note for the respective draft law, Ukraine used American and European experience while drafting the law.

3.1. THE UNITED STATES OF AMERICA

Regulations, governing investment screening. The US Foreign Investment Risk Review Modernization Act (FIRRMA) of 2018 regulates investment screening in the USA. In addition, since 2018 Critical Technologies Screening program makes it compulsory to submit notice before closing investment in certain sectors.³ Executive Order 13873, “Executive Order on Securing the Information and Communications Technology and Services Supply Chain” (from 15th May 2019, promulgated in January 2021) regulates the investment of

² Ibid

³ Latham & Watkins CFIUS & US National Security Practice. CFIUS Pilot Program Makes Notifications Mandatory for Specific Areas of Critical Technology <https://www.lw.com/thoughtLeadership/lw-cfius-pilot-program-makes-notifications-mandatory-for-specific-areas-of-critical-technology>

“foreign adversaries” in the Information and Communications Technology sector.⁴ “Holding Foreign Companies Accountable” Act, which was signed into law in December 2020 regulates mandatory disclosure if the foreign government owns or controls a publicly-owned company.⁵

Industries: Investment in critical infrastructure, critical technologies⁶, businesses that have access to sensitive personal information of the US citizens, and real estate in close proximity to sensitive US government facilities. A total of 27 industries are covered by FIRRMA pilot program.⁷

Conditions under which screening occurs: Screening is mandatory for transactions in the areas of critical infrastructure or in the investment deals, in which the “foreign government or an entity acting on the behalf of a foreign government” is the investor.

Other conditions under which the screening can occur include transactions that result in acquiring a stake in the company that may collect sensitive personal information of Americans, or transactions that would give foreign individuals access to non-public technical information, ability to nominate people to the board of directors of the companies or give foreign investor ability any to make any decisions regarding the critical infrastructure, technologies or personal data of the citizens in the US.

Publicly listed companies in all industries must declare if they are owned or controlled by a foreign government.⁸

According to the Critical Technologies Screening Program, the declarations must be submitted by the potential investor 45 before the transaction completion date, after which the Committee on Foreign Investment would have 30 days to decide on the investment.⁹ There are several potential decisions the Committee may take: request more information, initiate a more detailed review, or clear the transaction.

⁴ UNCTAD. United States of America - new regulations tighten review of ICT transactions involving selected countries
<https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3646/united-states-of-america-new-regulations-tighten-review-of-ict-transactions-involving-selected-countries>

⁵ UNCTAD. United States of America - "Holding Foreign Companies Accountable Act" passed
<https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3631/united-states-of-america-holding-foreign-companies-accountable-act-passed>

⁶ Critical technologies include defense articles and services, civilian/military dual-use technologies, nuclear technologies, select agents and toxins and emergent and foundational technologies.

⁷ U.S. Department of the Treasury, Office of Public Affairs. Fact Sheet: Interim Regulations for FIRRMA Pilot Program
<https://home.treasury.gov/system/files/206/Fact-Sheet-FIRRMA-Pilot-Program.pdf>

⁸ UNCTAD. United States of America - "Holding Foreign Companies Accountable Act" passed
<https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3631/united-states-of-america-holding-foreign-companies-accountable-act-passed>

⁹ U.S. Department of the Treasury, Office of Public Affairs. Fact Sheet: Interim Regulations for FIRRMA Pilot Program
<https://home.treasury.gov/system/files/206/Fact-Sheet-FIRRMA-Pilot-Program.pdf>

In addition, special regulations apply in telecommunications, where since April 2020 the Committee for the Assessment of Foreign Participation in the United States Telecommunications Services Sector evaluates new investments as well as already existing licenses.¹⁰

Special regulations apply to “foreign adversaries”. Commerce Secretary has the discretion to block transactions made by “foreign adversaries” in the sector of Information and Communications Technology and Services (“ICTS”). Such transactions are blocked if they constitute an “unacceptable risk” to national or economic security, public health, or safety. The foreign adversaries include Russia, China, Iran, North Korea, Cuba, and President of Venezuela Nicolas Maduro.¹¹

Organization responsible. The Committee on Foreign Investment (CFIUS), which is chaired by the Treasury Secretary and is the part of the executive government is responsible for the review of the investment. The Committee also includes nine voting agencies and the Secretary of Labor and Director of National Intelligence as non-voting members.¹² However, since it is the part of the executive branch of government the ultimate decision-making power lies with the US President. Committee for the Assessment of Foreign Participation in the United States Telecommunications Services Sector regulates investment in telecommunications. As mentioned above, Commerce Secretary has the authority to make decisions on foreign investment.

3.2. CANADA

Regulations, governing investment screening. The Investment Canada Act primarily regulates investment screening in Canada. On March 24, 2021, the new Guidelines on the National Security Review of investment were issued.¹³

Industries. Screening may occur in any industry if the investment is above a certain threshold. The new Guidelines, however, suggest that increased scrutiny should be applied in four areas with a heightened risk, which includes investment in the companies with access to sensitive personal data, critical minerals, sensitive technologies, and investment by state-owned or state-influenced investors.¹⁴

Conditions under which screening occurs. All foreign investments which are larger than a certain threshold are subject to review. The threshold is not universal and depends on the country of origin of the investment as well as the sector in which the investment is being made. For instance, it is higher if a country of origin of the investor has a trade agreement with Canada and is lower if the investment is in the business that is

¹⁰ UNCTAD. United States of America - Foreign participation in the telecom sector under scrutiny <https://investmentpolicy.unctad.org/investment-policy-monitor/measure/3507/united-states-of-america-foreign-participation-in-the-telecom-sector-under-scrutiny>

¹¹ Ibid

¹² Georgios Dimitropoulos. National Security: The Role of Investment Screening Mechanisms https://link.springer.com/content/pdf/10.1007/978-981-13-5744-2_59-1.pdf

¹³ UNCTAD. Canada lowers FDI review thresholds for 2021 <https://investmentpolicy.unctad.org/investment-policy-monitor/measure/3629/canada-canada-lowers-fdi-review-thresholds-for-2021>

¹⁴ Ibid

significant for Canada's national or cultural heritage or in the state-owned enterprises.¹⁵ In 2021 the thresholds have been lowered for all groups.¹⁶

If the investment is subject to review, a potential investor must submit a notification to the government no later than 30 days after the agreement is made. The review process generally takes 45 days, however, the Minister may extend this period by 30 days. Further extension is possible if agreed with the investor.

Canada uses several conditions to identify whether an investment poses a threat to national security and whether it is a net benefit to Canada. The conditions relate to the benefit an investment would bring to the economy, such as increased employment, exports, competition in the industry, productivity, development of new technologies, what is the level of Canadian participation in that business, how it contributes to local economic and cultural policies, etc.¹⁷

In addition, the Guidelines from March 2021 specify that the following factors relating to national security may be considered: the potential transfer of sensitive technologies outside Canada, involvement in the manufacture or sale of defense-related goods, whether the investment will affect the supply of critical goods and services available to Canadians, whether the company will be involved in research or production of defense-related goods, whether it has an impact on the Canadian defense capabilities, critical mineral resource supply chain or critical infrastructure, whether it is possible that the investment would enable foreign surveillance; the effect the investment has on Canadian foreign relations, whether the investment involves "illicit actors" such as terrorist organizations, organized crime or corrupt foreign officials; whether the investment gives access to sensitive personal information, such as health-related, biometric data, financial data, geolocation, access to personal information and any personal data of the government officials.¹⁸

In addition, a review of an investment may take place if it may pose a threat to national security. Such review is possible even after the investment has been completed.

Organizations responsible. The Ministry of Innovation, Science and Economic Development of Canada is responsible for screening most of the investment. For some investment, related to the national heritage Department of Canadian Heritage is responsible instead.¹⁹ For the investment which may pose a threat to national security, the review must be ordered by the Governor in Council. The Governor also has the power to request divestment.²⁰ The national security reviews are initiated after the consultations between the

¹⁵ Government of Canada. Thresholds for Review https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00050.html

¹⁶ UNCTAD. Canada lowers FDI review thresholds for 2021 <https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3629/canada-canada-lowers-fdi-review-thresholds-for-2021>

¹⁷ Government of Canada. An Overview of the Investment Canada Act (FAQs) https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00007.html

¹⁸ Government of Canada. Guidelines on the National Security Review of Investments https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk81190.html

¹⁹ Government of Canada. An Overview of the Investment Canada Act (FAQs) https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00007.html#q5

²⁰ Georgios Dimitropoulos. National Security: The Role of Investment Screening Mechanisms https://link.springer.com/content/pdf/10.1007/978-981-13-5744-2_59-1.pdf

Minister of Innovation, Science and Economic Development and Minister of Public Safety and Emergency Preparedness.²¹

3.3. AUSTRALIA

Regulations governing investment screening. Foreign Acquisitions and Takeovers Act of 1975 has historically regulated investment screening in Australia. From January 2021, however, significant changes to that mechanism have been implemented, when Foreign Acquisitions and Takeovers Fees Imposition Amendment Act 2020 ("Fees Amendment Act") and the Foreign Investment Reform (Protecting Australia's National Security) Act 2020 (Cth) ("FIR Act") came into force.

Industries. Screening occurs primarily of investment into 'national security business' or 'national security land'. The national security business is defined as a business in the following industries: critical infrastructure (holds assets in electricity, gas, water, or ports); telecommunications; defense, military goods or intelligence technology or critical service provider to the military; a business that has access to classified security information or personal information of defense and intelligence personnel. 'National security land' is defined as 'defense premises or land in which Commonwealth has an interest that is publicly known'.²²

Conditions under which screening occurs. Under the Foreign Acquisitions and Takeovers Act of 1975 the burden of proof that the investment is harmful lies on the government unlike in some other countries, such as Canada, where the investor must prove that their investment poses benefit.²³ The Fees Amendment Act and FIR Act, however, give more powers to the government and give more responsibilities to the investors. Investors in land or businesses that are sensitive to national security now have to seek approval from the government regardless of the value of their investment.²⁴

In addition, the government obtained the new 'call-in' power, which means that it can review 'reviewable national security actions' undertaken by businesses. The government also obtained the new 'last resort' powers, which means it may require the investor to sell the asset if national security risks connected with owning this asset by foreign investors arise, even if previously the government has approved the investment.²⁵

During the COVID-19 pandemic, a temporary threshold of 0\$ was introduced for screening, meaning that all investments had to be screened. While such threshold is removed for most industries as of January 2021, it remains in place for "sensitive national security businesses".²⁶

²¹ Ibid

²² Jones Day. Significant Changes to Australia's Foreign Investment Framework Commenced on 1 January 2021 <https://www.jonesday.com/en/insights/2021/01/significant-changes-to-australias-foreign-investment-framework-commenced-on-1-january-2021>

²³ Georgios Dimitropoulos. National Security: The Role of Investment Screening Mechanisms https://link.springer.com/content/pdf/10.1007/978-981-13-5744-2_59-1.pdf

²⁴ UNCTAD. Australia tightening of the foreign investment review framework <https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3624/australia-tightening-of-the-foreign-investment-review-framework>

²⁵ Jones Day. Significant Changes to Australia's Foreign Investment Framework Commenced on 1 January 2021 <https://www.jonesday.com/en/insights/2021/01/significant-changes-to-australias-foreign-investment-framework-commenced-on-1-january-2021>

²⁶ Ibid

Organization responsible. Foreign Investment Review Board has the power to investigate. The Treasurer has the power to make a final ruling on any given investment. The Treasurer also has ‘call-in’ and ‘last resort’ powers.

3.4. EUROPEAN UNION

The European Union has passed the EU Foreign Investment Screening Regulation in 2019 (came into force in October 2020), which establishes some common rules on investment screening, at the same time allowing member states to decide the specifics of the implementation individually. For instance, the EU regulation advises the effect of investment on which industries the member states may consider, but not requiring them to screen all investment in these industries.

Such industries include critical infrastructure (“energy, transport, water, health, communications, media, data processing or storage, aerospace, defense, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure”); critical technologies and dual-use items (“including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum, and nuclear technologies as well as nanotechnologies and biotechnologies”); critical inputs (such as those relating to raw materials, energy, and food security); sectors that provide access to sensitive information (such as personal data); media.²⁷

The EU mechanisms also ensure that member states exchange information on foreign investment with the European Commission and other member states. The European Commission and other member states may also issue a non-binding opinion on whether a project is a threat to the security of the member state or would undermine any EU-level projects.

As of February 2020, 14 EU states have implemented a national investment screening mechanism.²⁸ While they exhibit some similarities, they also have some differences. As to showcase some examples of such differences and similarities we explore investment screening mechanisms in two EU countries, France and Germany, in more detail.

3.4.1. FRANCE

Regulations governing investment screening While France follows the EU-level regulations, it has adopted several new laws in the recent years: Décret n° 2019-1590 du 31 décembre 2019 relatif aux investissements étrangers en France – effective since April 2020; and a new decree and ministry order effective from August 2020 (Décret et Arrêté du 22 Juillet 2020 relatif à l'abaissement temporaire du seuil de contrôle des investissements étrangers dans les sociétés françaises dont les actions sont admises aux négociations sur un marché réglementé).^{29, 30}

²⁷ 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
<https://eur-lex.europa.eu/eli/reg/2019/452/oj>

²⁸ UNCTAD. National security-related screening mechanisms for foreign investment: an analysis of recent policy developments
https://unctad.org/system/files/official-document/diaepcbinf2019d7_en.pdf

²⁹ Dentons. New French Foreign Investments Screening Scheme <https://www.dentons.com/en/insights/alerts/2020/september/18/new-french-foreign-investments-screening-scheme>

³⁰ Dentons. France - New Foreign Direct Investment Regulation as of April 1, 2020
<https://www.dentons.com/en/insights/alerts/2020/march/27/france-new-foreign-direct-investment-regulation-as-of-april-1-2020>

Industries: Before 2020 screening has been limited to investment in the companies related to national defense and security (broadly defined). However, as of April 2020, it has been expanded to cover 20 different sectors including agriculture, political and general press publications, and energy sector, transport, utilities, electronic communications, etc.³¹ ³² Later, due to the COVID-19 pandemic, the list was further extended to include investment in the public health sector and R&D in biotechnologies.³³

Conditions under which screening occurs: The investment is screened if it is made by a foreign investor in a business in one of the sensitive industries, which acquires either more than 25% of capital or voting rights in the company located in France or acquires control of the company or its branch. Since July 2020, the 25% threshold has been lowered to 10% for French listed companies. However, for these investments special ad hoc procedure applies, and the investors are exempt from filing the full application if they had notified the French Ministry of Economy and Finance at least 10 business days before the transaction.³⁴ As a part of the application, the investor has to notify the government of whether he has any ties to the foreign government (of the country outside of the EU).³⁵

Interestingly, for the purpose of screening the EU investors are not considered “foreign”, while French nationals, whose tax residence is abroad are. It is enough for the foreign investor to belong to any part of the “chain of control”, for the investment to be subject to screening, it is not necessary that he or she is investing directly.

A foreign investor must notify the French Ministry of Economy and Finance of his intent before investing, after which the Ministry has 2 months to respond. However, the Ministry must provide the first preliminary response within 30 business days, indicating whether the investment is not subject to screening, is subject to screening but is authorized without any further investigation, or whether they require additional time to complete a full investigation. If the investor does not comply with the regulation, the Ministry may apply a range of sanctions, such as suspending voting rights, prohibiting the distribution of the dividends, a criminal conviction for up to 5 years in prison, monetary fines, and declaring transaction void.³⁶

Organization responsible. French Ministry of Economy and Finance must be notified about the investment and is handling the approval process.

3.4.2. GERMANY

³¹ Ibid

³² UNCTAD. National security-related screening mechanisms for foreign investment: an analysis of recent policy developments https://unctad.org/system/files/official-document/diaepcbinf2019d7_en.pdf

³³ Dentons. New French Foreign Investments Screening Scheme <https://www.dentons.com/en/insights/alerts/2020/september/18/new-french-foreign-investments-screening-scheme>

³⁴ Ibid

³⁵ UNCTAD. France expands and clarifies its FDI screening regime <https://investmentpolicy.unctad.org/investment-policy-monitor/monitor/measures/3468/france-expands-and-clarifies-its-fdi-screening-regime>

³⁶ Dentons. France - New Foreign Direct Investment Regulation as of April 1, 2020 <https://www.dentons.com/en/insights/alerts/2020/march/27/france-new-foreign-direct-investment-regulation-as-of-april-1-2020>

Regulations governing investment screening: Two main regulations governing the screening process and foreign investment control more generally are the Foreign Trade and Payments Law (Außenwirtschaftsgesetz) and the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung)

Industries: Currently investments in 27 sectors are subject to monitoring, including in high technologies (for instance, space industry, IT products for cybersecurity, nuclear and quantum technology, etc.), agricultural areas of more than 10 000 hectares, news, and media companies, etc.³⁷

Conditions under which screening occurs: Any investor, which has a higher share of foreign ownership than a certain threshold must notify the German Ministry for Economic Affairs and Energy.³⁸ There are different thresholds of the share of foreign ownership in an investment for it to be monitored depending on the sector. For instance, in defense, critical infrastructure, and encryption the threshold is 10%, in agriculture and high-tech industries the threshold is 20%, etc.³⁹ The Ministry has 2 months after being notified to open investigation and during this time the transaction cannot be completed. If the government has not opened an investigation the approval to complete the transaction is assumed to be granted, however, the government still has up to five years after the transaction is completed to start an investigation.⁴⁰

Similarly to France, Germany has in recent years expanded the criteria for investment to be screened. For instance, in 2020 the criteria were tightened, and it is now enough for an investment to pose a “probable risk” to the national security rather than an actual risk as was the case before.⁴¹

Organizations responsible: German Ministry for Economic Affairs and Energy has the authority to open an investigation into foreign investment.⁴²

3.5. CHINA

Regulations, governing investment screening. While some regulations on foreign investment existed in China before, they were significantly changed in the new National Security Review Law, which came into power in January 2021 and is viewed by some experts as retaliation against similar measures adopted by the US and other Western countries.⁴³ Since 2011, foreign investment was regulated by the Circular of the General Office of State Council on the Establishment of Security Review for the Merger and Acquisition of Domestic Enterprises by Foreign Investors.

³⁷ UNCTAD. Germany amends its FDI screening regime <https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3551/germany-amends-its-fdi-screening-regime>

³⁸ Pinsent Masons. Germany's foreign investment regime <https://www.pinsentmasons.com/out-law/guides/germanys-foreign-investment-regime>

³⁹ UNCTAD. Germany amends its FDI screening regime <https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3551/germany-amends-its-fdi-screening-regime>

⁴⁰ Pinsent Masons. Germany's foreign investment regime <https://www.pinsentmasons.com/out-law/guides/germanys-foreign-investment-regime>

⁴¹ Ibid

⁴² Ibid

⁴³ Orange Wang. China's national security screening rules for foreign investments enter force <https://www.scmp.com/economy/china-economy/article/3118371/chinas-national-security-screening-rules-foreign-investments>

Industries. The new regulations list the following industries that are subject to screening: military, national defense, key agricultural product, energy and resources, infrastructure, transportation, financial services, informational technology, cultural products, major equipment manufacturing, and “other key services”. Such definition of industries is somewhat vague as it is unclear what is meant by “key” as it is not defined explicitly in the law.⁴⁴ The new regulations state that the investment in the financial market will be described in the separate regulations, however, such regulation is not released yet.

The change of regulations was also accompanied by significantly shrinking a so-called “negative list” – a list of restrictions and prohibitions on foreign investment in specific industries: the number of restrictions and prohibitions decreased from 40 to 33 nationwide and from 37 to 30 in China’s Free Trade Zones. The new regulations removed prohibitions on foreign investment in some industries, such as internet services, movie theatres, brokerage agencies, sales of game equipment, as well as lifting the restrictions on several financial services.⁴⁵

Conditions under which screening occurs. The new regulations stipulate that both direct and indirect investment can be screened, as well as greenfield investment. There is no threshold of the share of foreign ownership the investment in the military or national defense must have for it to be subject to the review.⁴⁶ In other industries, the investment is subject to screening if the foreign company has “actual control” in the investment, which is defined as either owning 50%+ of equity rights or having a significant impact on board or shareholder resolutions or other matters (which include business decision making, human resources, finance, and technology).⁴⁷

The review process consists of 3 stages. First, the Working Office determines whether a certain investment should be subject to a security review. This decision must be made in 15 working days. If the Working Office decides to conduct a security review, a general review must take place within 30 working days. After that, the Working Office may either approve a transaction or order to proceed with the special review which can take up to 60 working days and can be extended.⁴⁸

Foreign enterprises that were established before the new rules came into place have 5 years transitional period.⁴⁹ In Free Trade Zones, which include Shanghai, Guangdong, Tianjin, and Fujian somewhat modified measures are in place.

The organization responsible Since 2011 Ministry of Commerce is responsible for the coordination of the review of investment that may pose a threat to national security, but other government agencies may also be

⁴⁴ Baker McKenzie. China enacts new foreign investment security review measures
<https://www.bakermckenzie.com/en/insight/publications/2021/01/china-enacts-new-foreign-investment-security>

⁴⁵ Kong Tuan Yuen and Li Yao. China’s New National Security Screening Rules on Foreign Investment
<https://research.nus.edu.sg/eai/wp-content/uploads/sites/2/2021/02/EAIC-24-20210204-1.pdf>

⁴⁶ Lester Ross, Kenneth Zhou, Tingting Liu. China’s New Foreign Investment Security Review Measures
<https://www.wilmerhale.com/en/insights/client-alerts/20201222-chinas-new-foreign-investment-security-review-measures>

⁴⁷ Ibid

⁴⁸ Baker McKenzie. China enacts new foreign investment security review measures
<https://www.bakermckenzie.com/en/insight/publications/2021/01/china-enacts-new-foreign-investment-security>

⁴⁹ The U.S. Department of State. 2021 Investment Climate Statements: China
<https://www.state.gov/reports/2021-investment-climate-statements/china/>

involved in the process. According to the new regulations, a new Working Office must be set up, jointly led by the National Development and Reform Commission and the Ministry of Commerce.

4. UKRAINIAN AGENDA

4.1. COMMITMENT

Ukraine has **no legal obligations** to adopt an FDI screening mechanism. It is not mentioned neither in the Constitution nor in the Codes. It is not part of any international agreements. For instance, the EU started implementing union-wide screening system (on top of the national ones), but the corresponding regulation 2019/452 was adopted in 2019, i.e. after the Association Agreement between the European Union and the European Atomic Energy Community and their member states, from one side, and Ukraine, on the other side, was signed and became effective.

However, Ukrainian officials made statements and adopted legal documents that support the **political will** to establish such a system. On the national level, “the absence of a mechanism for evaluating (screening) foreign direct investment in assets that are of strategic importance for the national security of Ukraine” is mentioned as one of risk factors in the Strategy of economic security of Ukraine 2025⁵⁰.

On the international level, “Ukraine is committed to passing legislation thus establishing a robust investment screening process” in the Joint Statement on the U.S.-Ukraine Strategic Partnership⁵¹ made upon President Volodymyr Zelenskiy’s visit to US President Joe Biden on September 1, 2021. It may be related to the fact that the US has openly opposed the acquisition of Motor Sich by Chinese investors, and FDI screening mechanism could prevent such a transaction.

Two precedents are responsible for the urgency. First, **Russian capital** has been present in various industries of the Ukrainian economy, including critical sectors⁵². Second, an investment screening system could prevent modern day purchases such as **Motor Sich**, an aircraft engine maker that de-facto is a defense-related producer that became private⁵³.

There is also one prominent foreign case that is very relevant for Ukraine. In 2021, Transmashholding (Russia) almost bought strategic plant that produces navy motors Bergen Engines (Norway) for \$180 million⁵⁴. The deal was stopped last minute only after media and civil society raised voice, and only after that security analysts, then ministry of defense and finally the government itself. The key reasons to that failure were: a) Bergen engines was owned by Rolls-Royce (UK), so Norwegian government did not see it as its own priority,

⁵⁰ Presidential decree 347/2021 on the decision of the National Security and Defense Council of Ukraine
<https://www.president.gov.ua/documents/3472021-39613>

⁵¹ Joint Statement on the U.S.-Ukraine Strategic Partnership
<https://www.whitehouse.gov/briefing-room/statements-releases/2021/09/01/joint-statement-on-the-u-s-ukraine-strategic-partnership/>

⁵² Russian economic footprint in Ukraine <https://ces.org.ua/russias-economic-footprint-in-ukraine/>

⁵³ Chinese economic footprint in Ukraine <https://ces.org.ua/en/chinese-money-in-ukraine-en/>

⁵⁴ Norway Halts Sale of Bergen Engines to Russian Conglomerate
<https://www.maritime-executive.com/article/norway-blocks-sale-of-bergen-engines-to-russian-conglomerate>

b) it was a distressed asset close to bankruptcy, c) Norway had no properly established FDI screening mechanism in place.

4.2. THE DRAFT LAW

The initial version was presented in May 2020 as a preliminary draft developed by the Ministry of Economy. American and European experience was used while drafting the document. The actual draft law was approved by the Cabinet of Ministers and submitted to the Verkhovna Rada in February 2021⁵⁵. The only major upgrade was a substantial extension of the list of strategic industries.

The ministry then presented the draft to business associations in Ukraine, such as American Chamber of Commerce (ACC) and European Business Association (EBA), among others, to get feedback. Business representatives were concerned with rather broad scope of the draft law (in terms of industries). Also, businessmen indicated that criteria for both the determination of whether an investment should be screened and whether an investment should be allowed are not clearly stated. Finally, the lack of responsibility of the commission for misconduct was also noted.

Businessmen that were interviewed during the research raised even more concerns. Most of them stated that Ukraine does not need the FDI screening mechanism, at least in the form suggested in the draft law. According to them, the system creates risks of additional compliance burden, corruption, and manual control. See Chapter 4.4 for more details on risks.

A further passing of the draft was not successful. In May 2021, the Chief Scientific and Expert Department issued a conclusion, where, while generally supporting the idea to establish such a system, pointed out some serious legal shortcomings. Based on that conclusion, the Committee on economic development recommended to include the draft in the Parliament agenda, but upon adopting it in the first reading, to return it to the Cabinet for further elaboration. It was indeed included in the Parliament agenda in June.

But eventually, the draft law was withdrawn on September 7, 2021. Considering the recent commitments given by the President on that topic, it may just mean that an updated version of the draft is expected.

⁵⁵ Draft law on foreign investments in industries that present strategic significance for the national security of Ukraine
http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=70997

4.3. SYSTEM ARCHITECTURE

4.3.1. INVESTMENT DEFINITION

The draft law defines seven types of transactions involving a strategic asset and a foreign investor that would be the subject of the new regulation. Depending on the type, different thresholds are applied: 10%, 25%, 50% and 75%. For the most common transaction, a purchase of a share in a company, **the threshold is set at 25%**. This corresponds to the blocking share according to Ukrainian legislation: the minimal share that allows an owner to block significant actions of other owners (such as increasing capital size to squeeze out minor shareholders or company's liquidation).

This is in line with what other countries have in their respective laws. Usually, the threshold is 25% or 33%. In some countries it is 10% or even 5% (Australia). In some countries the threshold depends on the industry and factors (such as whether a company is publicly traded, as in the case of Hungary).

In absolute terms, there is **no minimal limit** on investment. Experts explain this by the following. The minimal meaningful value would depend on the industry and in fact is hard to determine. In some industries, it could be quite small, because a company does not have to be large to possess, for example, some unique technologies. Some defense-related research institute may be worth a relatively modest amount (provided that for some technical reasons it bypassed the industry filter).

Some countries have another filter. The US and Canada put a perspective acquisition under scrutiny if an investor is a **state-owned or state-influenced** body or company (irrelevant of the industry, as discussed in the next chapter). The rationale behind is the following. State-owned enterprises usually do not pursue only commercial goals (profit making), but also political ones. Some states extensively use them as a policy tool.

4.3.2. INDUSTRIES

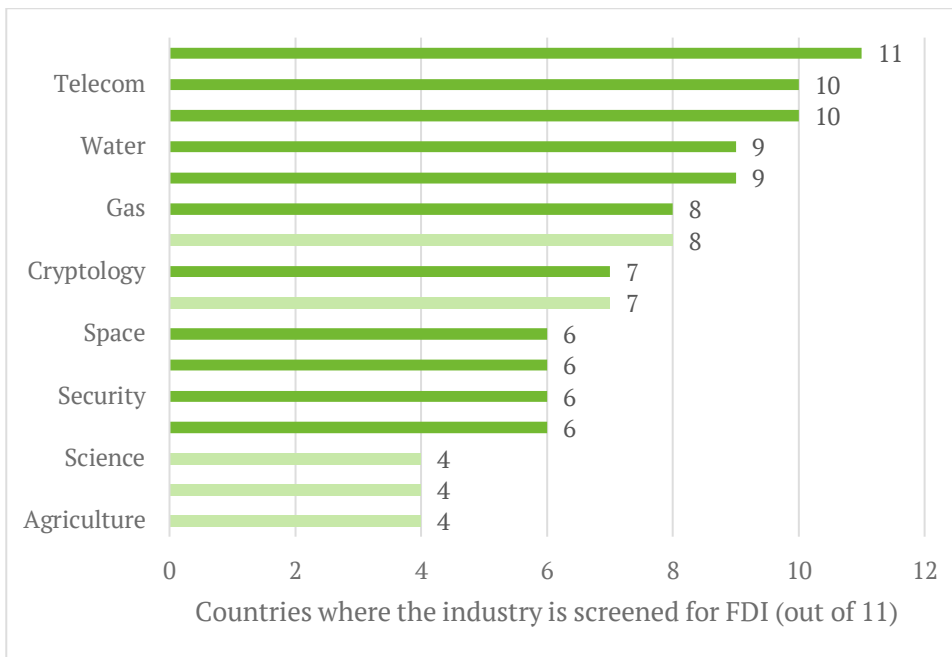
Industry selection directly affects how much administrative burden is levied to both state agencies and businesses. Therefore, there should be a balance between the system's efficiency in preventing harmful investments and administrative burden.

In Ukraine, there is a list of "strategic industries". The initial version of the draft law contained only defense, telecommunications, and finance. The version that was passed to the Parliament contained a much more **extensive list**, which included all natural monopolies and related industries, and also media. Experts explain such an extension by their importance for national security and by current and possible Russian capital presence in those industries. However, the financial sector was excluded for some reason.

An expert we talked with suggested a very precise definition of the criterion for 'critical'. Critical are the industries where a cessation of service provision would create much more losses for consumers than for enterprise owners. For example, when a shoe factory stops working, there is enough competition on the market to compensate for this loss. On the other hand, if a public utility company (provider of water, sewage, gas, or electricity), or a large bank stop working, this could create tremendous problems for both the society and businesses.

Ukraine's selection of strategic industries is approximately in line with what other countries choose to protect from possibly harmful foreign intervention (see Annex 2 for details). There are two notable exceptions, namely finance (which was included to the initial version of the draft law) and information technologies (except cryptology, which is a separate field). The government should consider including at least finance in the list.

[Chart 2. Industries under FDI screening](#)



Source: UNCTAD, CES. More saturated color means that the industry is in the Ukrainian list of strategic industries

But the name of the list and the selection of industries may be confusing because there are other similar definitions in the legislation. And the situation may become even more confused since the parliament is going to pass the draft law on the critical infrastructure⁵⁶, that advance further than screening draft and is considered less politically sensitive. At last, there were no systematic approach to defining the list of industries. It looks like various ministries and agencies stated their suggestions and they were aggregated.

For example, some countries like Canada apply the screening mechanism to all industries. The rationale behind this is following. Apart from the usual suspects such as public utilities and other natural monopolies, there could be small monopolies that nevertheless may create crucial dependance for other industries. An expert gave an example of chlorine detergent for water treatment. It is not a natural monopoly, but if there would be only one producer and it ceases production, water treatment would stop on the national scale. And such a monopoly could arise anytime, and one cannot account for such events in a law.

4.3.3. COUNTRIES

Usually, FDI screening mechanisms are **not designed to protect from specific countries**. No states with the most sophisticated FDI screening mechanisms have such a discrimination. The Ukrainian government also drafted the law with that in mind. There are four rationales behind this.

First, bilateral investment treaties usually envisage that every party should provide an investment regime at least as favorable as provided to third parties. Thus, any discriminatory laws will contradict international agreements that are superior to national legislation, according to the Constitution of Ukraine. In case of Russia, the BIT between the Ukrainian and Russian governments⁵⁷ have such regulations, too. The treaty may be canceled, but a party should inform another party 12 month prior to the end of the current period (now

⁵⁶ Draft law on critical infrastructure http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=71355

⁵⁷ Russian Federation - Ukraine BIT (1998) <https://investmentpolicy.unctad.org/international-investment-agreements/treaties/bilateral-investment-treaties/2859/russian-federation---ukraine-bit-1998->

five years). Such an action would have an asymmetric impact since the stock of inward FDI (\$895 million) is much larger than outward stock (\$68 million).

Second, experts say that prejudices against the very particular countries should be implemented rather as sanctions. Currently, only one country has a special status. The Russian Federation has been acknowledged as an aggressor and an occupant by the Ukrainian law.⁵⁸ During 2014-2015 and in 2017 Ukraine introduced and further extended the list of Russian individuals and companies that cannot have business in Ukraine. However, Ukraine lacks the general framework for sanctions. The corresponding law was drafted⁵⁹ by the Parliament members earlier.

Third, using offshore jurisdictions, front people and other instruments that prevent ultimate beneficiary identification makes chasing the very particular countries not feasible. Sometimes FDI is even able to mimic national investment and bypass any screening mechanism. As various states tighten control for ultimate beneficiaries' identification, it is becoming harder, but it is still possible.

Fourth, Ukraine is not a superpower to label a country (except for the obvious case of Russia). Ukraine is a neutral country that do not engage in world conflicts. However, an expert put forth an idea that some internationally recognized list could be made, like the lists market economies or offshore jurisdictions. However, so far no such list has been suggested.

4.3.4. RESPONSIBLE AGENCY

According to the draft law, a newly created inter-agency commission will be responsible for the implementation of the FDI screening. However, no further details are given since they will be defined later in bylaws developed by the Cabinet of Ministers.

For example, in most developed countries, a ministry responsible for economic development performs that role. In the United States, there is a dedicated body, The Committee on Foreign Investment (CFIUS), but it is part of the executive government, and the final rejection decision is made by the President. In Australia, the FDI Review Board is responsible, but the final decision is made by the Treasurer (Minister of Finance).

Experts say that in Ukraine, the status of the responsible body should be higher. A newly created agency may lack capacity to do the job effectively. Instead, this function should be given to an existing body with real power. One option is the Cabinet itself, with the Ministry of Economy responsible for the analytical support. Another option could be the Antimonopoly committee (AMCU), the only special body envisaged by the Constitution. In fact, as the case of the Motor Sich at certain stages demonstrated, AMCU de-facto attempted to perform exactly this function.

⁵⁸ Law on the peculiarities of the state policy to ensure the state sovereignty of Ukraine in the temporarily occupied territories in Donetsk and Luhansk regions <https://zakon.rada.gov.ua/laws/show/2268-19>

⁵⁹ Draft law on principles of sanction policy of Ukraine https://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?id=&pf3511=71291

4.3.5. PROCEDURE DETAILS

Except for definitions and the list of industries, there are too few details in the law itself. The draft law is very short, only 3.5 thousand words. To compare, the EU regulation (declared as a framework) has 7.3 thousand words, the respective American law contains 25 thousand words.

The criteria for rejection, which is one of the critical components of the system, will be developed and approved by the Cabinet of Ministers. The draft law authors have the following explanation for this. Since Ukraine has little experience in FDI screening, it would be more convenient to implement changes ad-hoc, adopting the system to new circumstances and market peculiarities.

In terms of procedures, the draft law outlines the list of documents that should be included in an application. Also, there is a 45-calendar day period during which the case should be considered. If no assessment is provided, the application gets approved automatically. This is in line with the review period in other countries. In the United States, the review takes up to 30 days, in Canada — 45 days, in China, France and Germany — 60 days. Some countries allow for extension. Ukraine would not.

4.4. RISKS

The system raises at least **four** concerns. First, an additional bureaucratic burden may discourage investors from making new brownfield FDI, which is scarce in Ukraine. Overall, inward FDI stock in Ukraine is about \$70 billion, or \$1700 per capita, which is several times smaller than in the neighboring European countries. In 2020, the inflow was negative.

Second, the system can create corruption risks. Ukraine is already a corrupt state, it ranks 117 (out of 180 countries) with the score 33 (out of 100, with higher scores meaning more corruption) in the Corruption Perception Index by Transparency International⁶⁰. The presence of an additional government body that will have the right to block deals may create an incentive for officials to accept bribes to approve investments or at least to accelerate the process. Some experts argue that the system does not differ from other mechanisms of government regulation and does not create specific risks. The existing anti-corruption measures should be applied.

Third, the system can create the risks of international arbitration. Before making an investment, an investor spends on research, due diligence and other preparations. If an investment application gets rejected by an FDI screening agency, especially if the rules are not clear and the decision is biased, investors can potentially sue a country. Ukraine has bilateral investment treaties with most countries in the world, including all major FDI source countries.

Fourth, big Ukrainian business (known as oligarchs) may use imperfections of legislation process to fine-tune the law (now or later) in such a way, that the system will serve their interests and limit the competition from the foreign capital (during privatization, buying private assets or other activities).

The current version of the draft law increases these risks due to possibly weak institutional capacity and inefficient procedures — these are still to be designed.

⁶⁰ Transparency International. Ukraine country data <https://www.transparency.org/en/countries/ukraine#>

4.5. ALTERNATIVES

An obvious alternative is to keep the status quo, i.e. do not establish any FDI screening mechanism and allow for free investment flows. Some experts say that it would be enough. First, companies in the defense industry are state-owned and are not for sale. Second, critical infrastructure is either state owned or private but is still not for sale. However, there is no guarantee that at least private owners will not be willing to sell assets in the future.

Another possible alternative is to initially prevent foreigners from investing in certain industries. Some experts argue that it would be “more honest” and would prevent investors from sunk costs (market research, investment site search, due diligence, and other preparations). Others argue that this approach is too radical since it would completely prevent the industries from innovation-oriented FDI. This would apply even to the defense sector where modernization is urgently needed to make the sector competitive on the international market.

Another expert suggests that it could be beneficial to not prevent FDI from flowing to specific sectors using administrative instruments, but to create additional incentives (of regulatory, fiscal, or other nature) to attract them to the industries where they are most welcome.

One more alternative is to focus on corrosive capital that is already here. But since no new legislation would have a backward force, the issue is tricky. Experts name a few possible options, from brute nationalization (that could even be somehow justified because many respective assets were state-owned before) to buyout at public expense or some other forms of a peaceful exit. Again, the issue remains very sensitive and does not reduce the risks of new corrosive investments.

5. CONCLUSIONS

Ukraine needs an FDI screening mechanism. Ukraine has even more reasons to have it because it has already faced the consequences of corrosive capital owning and controlling critical enterprises and industries. The risks of politically motivated money flowing from other non-democratic states intensify the urgency. However, the draft law developed by the government does not seem to be accounting for all nuances.

The status of the responsible body should be upgraded. It should not be a newly created underfinanced organization with limited institutional capacity and authority. The Cabinet of Ministers should have the right to block potentially harmful investments, and the Ministry of Economy should provide the analytical support. Other ministries responsible for the industries under screening should be involved, too (Ministry of Defense, Ministry of Internal Affairs, Ministry of Energy, and Ministry of Infrastructure).

All relevant procedures and especially criteria for investment rejection should be explicitly written in the FDI screening law. The current version of the draft law provides a general framework. The only details it contains are the list of strategic industries, the investment definition, and the documents required to make an application. The other parts lack elaboration and cannot be addressed with bylaws, as this would create additional corruption risks which are already high in Ukraine.

The list of industries must be falling under screening should be modified such that it will be based on some clearly defined criteria. Also, the list of industries should include finance. Government plans to eventually sell the largest Ukrainian bank, PrivatBank, to a private investor, increase the risks of eventually losing control over the banking system. Among the 20 largest deals blocked by screening systems in other countries, three

were related to financial services. The largest was a takeover of MoneyGram (USA) by Ant Group (financial subsidiary of Alibaba Group from China).

There should also be another cross-industry filter. The screening authority should have the right to check all investments made by state-controlled bodies, as the US and Canada do. State-owned enterprises usually do not pursue only commercial goals (profit making), but also political ones. Some states extensively use them as a policy tool; such investments must be thoroughly checked for risks.

The last, but not the least is the general context of reforms and trust to authority. FDI screening is rather advanced instrument that could be easily manipulated if not accompanied by fighting with corruption, reforms of courts and law enforcements agencies, enforcing rule of law and better protection of property rights.

6. ANNEXES

















6.1. NOTABLE FDI REJECTIONS

Year	Asset	Host country	Buyer	Buyer country	Amount, \$ million	Sector
2016	Philips	USA	(consortium)	China	3 300	Tech
2016	GCS Holdings	Taiwan/USA	Xiamen Sanan Integrated Circuit	China	226	Tech
2016	Aixtron	Germany/USA	Fujian Grand Chip	China	723	Tech
2017	Cree, Wolfspeed	USA	Infineon Technologies	Germany	850	Tech
2017	Lattice Semiconductor Corporation	USA	Canyon Bridge Capital Partners	China	1 300	Tech
2017	HERE International	Netherlands	Navinfo + consortium	China	330	Tech
2017	Cowen Group	USA	CEFC China Energy	China	100	Finance
2018	MoneyGram International	USA	Ant Small & Micro Financial Services Group	China	1 200	Finance
2018	UDC Finance	New Zealand	HNA Group	China	460	Finance
2018	Cogint	USA	BlueFocus International	China (HK)	100	Data
2018	Xcerra	USA	Unic Capital Management	China	580	Tech
2018	Qualcomm	USA	Broadcom	Singapore	117 000	Tech
2018	Aecon Group	Canada	CCCI	China	1 500	Construction

2018	Rand Refrigerated Logistics	Australia	CC Logistics	China (HK)	203	Transport
2018	Recurrent Energy	USA	Shenzhen Energy	China	232	Energy
2019	Abertis Infraestructuras	Spain	Atlantia	Italy	19 000	Infra-structure
2019	APA Group	Australia	CK Asset Holdings	China (HK)	9 800	Utilities
2019	Lixil Group	Japan	Grandland Holdings Group	China	527	Building materials
2019	Avista Corp	USA	Hydro one	Canada	5 000	Utilities
2019	Grindr	USA	Beijing Kunlun Tech	China	245	Tech & data

Source: UNCTAD

6.2. INDUSTRIES UNDER FDI SCREENING

	Defense				Critical infrastructure										Tech		Sum
																	
Austria	√			√	√	√		√	√					√			7
Canada	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	16
China	√	√	√		√	√	√	√	√	√	√	√	√			√	13
France	√	√	√	√	√	√	√	√	√					√			10
Germany	√				√	√		√	√	√	√	√	√	√	√		10
Hungary	√	√	√		√	√	√		√	√	√						9
India	√	√		√				√	√	√		√				√	8
Italy	√		√		√		√	√	√	√	√				√	√	10
Japan	√			√	√	√	√	√		√	√	√				√	11
Russia	√	√		√		√	√	√	√		√	√	√			√	11
Ukraine	√	√	√	√	√	√	√	√	√			√				√	11
US	√	√	√		√	√	√	√	√	√					√		10
TOTAL	12	8	7	7	10	10	9	11	11	8	7	7	4	4	4	7	

Source: UNCTAD, CES