

EU FOREIGN SUBSIDIES REGULATION

On 10 November, the European Parliament adopted the Regulation on foreign subsidies distorting the internal market (the Regulation) enabling the European Commission (the Commission) to take measures against market-distorting subsidies from non-EU countries. The Commission would be empowered to intervene in takeovers of EU companies or public procurement bids when they are supported by subsidies from third countries.

GENERAL BACKGROUND

On [5 May 2021](#), the Commission tabled a proposal for a Regulation on foreign subsidies distorting the internal market providing for a set of tools aiming at levelling the playing field for all companies operating in the single market that receive financial support from non-EU countries. The Regulation was deemed necessary, given that to date only aid granted by EU Member States has been subject to the EU State aid rules and, therefore, scrutinised by the Commission. On 30 June 2022, the three EU institutions concluded their negotiations agreeing on the [final text](#) of the Regulation with relatively minor amendments made by the European Parliament and Council that do not alter the scope of the Commission's proposal.

The Regulation would give the Commission exclusive competence to assess the existence of distortive foreign subsidies in transactions and public tender bids. Although primarily aimed at foreign (non-EU) companies, it will give the Commission powers to intervene in M&A transactions by both EU and foreign acquirors involving EU targets and both EU and foreign bidders in EU public procurement exercises where the acquirors or bidders (or members of their group) have received "financial contributions" from third countries which the Commission judges to be a distortive subsidy.

DEFINITION AND SCOPE OF FOREIGN SUBSIDIES

The Regulation provides that a foreign subsidy exists "where a third country provides, directly or indirectly, a financial contribution which confers a benefit on an undertaking engaging in an economic activity in the internal market." The definition of a financial contribution is broad and includes: i) the transfer of funds or liabilities (e.g., capital injections, grants, loans); ii) the foregoing of revenue that is otherwise due (e.g., tax exemptions); iii) the provision or purchase of goods or services; or iv) the granting of special or exclusive rights without adequate remuneration (in each case, regardless of whether the "financial

Key issues

- A new layer of scrutiny is added with respect to transactions or public procurement bids in the EU;
- It concerns both EU and non-EU undertakings having received "financial contributions" from third / non-EU countries;
- New requirement to notify transactions where the turnover of the EU target exceeds EUR 500 million and where the undertakings concerned have received financial contributions of EUR 50 million or more from third countries in the preceding three financial years;
- Bidders in EU tenders for contracts worth EUR 250 million or more that have received financial contributions of EUR 4 million or more from third countries must provide information on foreign subsidies to the relevant contracting authority, which must in turn inform the Commission;
- Commission can intervene in transactions or tenders below these thresholds on its own initiative;
- Additional powers for the Commission to take interim measures and to impose commitments and fines.

contribution" involves any element of subsidy and whether or not the transaction is on arm's length terms)

When referring to a third country, this includes: the central government and public authorities at all other levels and any foreign public entity; and any private entity, in either case whose actions can be attributed to the third country

FOREIGN SUBSIDIES ASSESSMENT PROCESS

Indicators

In order to determine the existence of distortive effects of foreign subsidies on the internal market, the Regulation provides for a non-exhaustive set of indicators including the amount and nature of the subsidy, the level and evolution of economic activity of the subsidy's recipient on the internal market, or the purpose and conditions attached to the foreign subsidy.

Foreign subsidies not exceeding EUR 4 million over three consecutive financial years should be deemed unlikely to distort the internal market, while foreign subsidies below EUR 200,000 over any consecutive period of three financial years shall not be regarded as distortive.

In addition, the Regulation provides for an indicative list of foreign subsidies that are most likely to have distortive effects on the internal market such as aid granted to an undertaking in financial difficulty or directly facilitating a concentration; unlimited guarantees for debts or liabilities; export financing measures in contravention of the OECD Arrangement on officially supported export credits; or support enabling the submission of an unduly advantageous tender.

Balancing test

When assessing whether a financial contribution from a third country distorts the internal EU market, the Commission shall balance any positive effects of the foreign subsidy on the market against the negative effects in terms of distortion in the internal market. To that end, the Regulation calls the Commission to put forward guidelines as to the application of the balancing test and regularly update it based on its enforcement practice taking into account broader positive effects in relation to the relevant EU policy objectives. Regarding public procurement, the Regulation provides that the Commission should consider the availability of alternative sources of supply for the goods and services concerned.

Commitments and redressive measures

In view of remedying a distortion caused by a foreign subsidy, the Commission may impose redressive measures or accept commitments offered by the undertaking under investigation. A non-exhaustive list of such measures includes the divestment of certain assets, repayment of the foreign subsidy to the third country with an interest rate, reducing the capacity or market presence, the publication of R&D results, offering third party access or even requiring the undertakings to dissolve the concentration.

COMMISSION'S REVIEW

The Commission would have three options to intervene i) following the notification of a concentration; ii) after the notification related to a public tender; and iii) on its initiative.

Concentrations

As noted in our [briefing](#) on the Commission's proposal, one of the key novelties of the Regulation is that it would create a new mandatory review process in case of a merger, acquisition or the creation of a full-function joint venture. If the relevant thresholds are met, transactions would have to be notified to the Commission in advance and could not be closed until the Commission has completed its review (stand-still obligation).

The Regulation sets out the following thresholds triggering such notification to the Commission:

- one of the companies (*i.e.*, at least one of the merging undertakings, the acquired undertaking, or the joint venture) is established in the EU and generates an aggregate turnover of at least EUR 500 million in the EU; and
- the undertakings concerned received from third countries combined aggregate financial contributions of more than EUR 50 million in the preceding three financial years.

Considering the absence of a worldwide combined turnover threshold, there may be transactions which will not trigger a merger control filing under EU's Merger Regulation but will still be subject to a notification related to foreign subsidies review.

By defining the second threshold by reference to the amount of financial contribution (rather than the value of any subsidy that arises from such a contribution), the Regulation would create new filing obligations for any EU or non-EU undertaking engaging in M&A transactions involving EU targets if it (or a member of its group) receives financing from one or more third countries, regardless of whether this financing is qualified as a foreign subsidy or not.

Similar to the EU merger control process, the Commission would have 25 working days after receipt of a complete notification to review the transaction, which could be extended by 90 working days in case the Commission opens an in-depth investigation. This period would be further extended by 15 working days where the undertaking concerned offers commitments.

The Commission may request prior notification of any non-notifiable transaction at any time prior to its implementation if it "*suspects that the undertakings concerned may have benefitted from foreign subsidies*" in the previous three years. The Regulation provides for the Commission to issue guidance on the application of this provision given its broad and generic scope.

Public procurement

Distortive foreign subsidies for the purposes of public procurement procedures are those that "*enable an undertaking to submit a tender that is unduly advantageous in relation to the works, supplies or services.*"

Undertakings participating in EU tenders involving procurement contracts worth at least EUR 250 million that have been granted aggregate financial contributions of at least EUR 4 million per third country in the three financial years prior to notification must provide any information related to the financial aid received to the relevant contracting authority. The latter must inform the Commission.

If a public procurement procedure is divided into lots, notification is required if the aggregate value of the lots for which the undertaking is bidding exceeds

EUR 125 million. Main subcontractors and suppliers will also be obliged to notify their participation in tenders.

Again, by defining the second threshold by reference to the amount of financial contribution (rather than the value of any subsidy that arises from such a contribution), the Regulation would create new filing obligations for any EU or non-EU undertaking seeking to bid in an EU public procurement if it (or a member of its group) receives financing from one or more third countries, regardless of whether this financing is qualified as a foreign subsidy or not.

The Commission, in turn, shall carry out a preliminary review within 20 working days after receipt of a complete notification (extendable by 10 working days) and may adopt a decision closing the in-depth investigation no later than 110 working days after it received the notification (with a potential extension of 20 working days).

As in the case of concentrations, the Commission reserves the right to request the notification of the foreign financial contributions received by an undertaking in any non-notifiable public procurement procedure, if it suspects that the undertaking may have benefitted from foreign subsidies.

The Regulation recognises that framework agreements are used exactly because they constitute an efficient and flexible procurement process. In view of retaining this flexibility, it clarifies that the obligation to notify foreign financial contributions should be limited to the procedure preceding the conclusion of framework agreements and should not apply to contracts based on framework agreements.

Ex officio review

The Commission will have the power to examine information on its own initiative, when assessing allegedly distortive foreign subsidies, carrying out a two-stage review process. There will be a preliminary review, mainly consisting of requests for information and inspections. If the Commission were to conclude at the end of the preliminary review that there are sufficient indications that an undertaking has been granted a distortive foreign subsidy, it will open an in-depth investigation. During the in-depth investigation, it further assesses the foreign subsidy by requesting additional information and if it finds that the foreign subsidy in question distorts the internal market it may impose redressive measures or accept commitments.

The Commission may also decide to take interim measures in case it considers that there is a risk of "*serious and irreparable damage to competition on the internal market.*" The interim measure may consist of the redressive measures mentioned above. No interim measures may be taken for public procurement procedures though.

In order to gather the relevant evidence, the Commission may conduct inspections both within and outside the EU. Inspections in the territory of a third country would require the undertaking's prior consent as well as official notification to and consent by the relevant government. It remains to be seen to what extent third countries would grant such consent for inspections in their territory.

Fines

The Commission may impose:

- fines up to 10% of the undertakings' worldwide aggregate turnover (e.g., in case the undertakings intentionally or negligently fail to notify a transaction or implemented it in breach of the stand-still);
- periodic penalty payments not exceeding 5% of the average daily aggregate worldwide turnover for infringements such as providing incorrect or misleading information.

COMMISSION'S DELEGATED ACTS, IMPLEMENTING ACTS AND GUIDANCES

The final text of the Regulation includes several provisions granting the Commission the power to put forward delegated and implementing acts as well as guidance to specify points that require further clarification.

More specifically, the Commission is empowered to adopt delegated acts for the purposes of modifying by up to 20%, if necessary, the notification thresholds or reducing the timeline for preliminary review and in-depth investigation.

Further, the Commission will adopt implementing acts specifying the form, content and procedural details of the notifications. The Commission's implementing act presenting the notification form and procedural details would have to be adopted by the Regulation's date of application.

In addition, the Commission will have to issue guidelines on the application of several provisions related, for example, to the indicators, the application of the balancing test and the review of non-notifiable transactions.

TRANSITIONAL PROVISIONS

Although the Regulation has no retroactive effect, it shall apply to foreign subsidies granted in the five years prior to the date of its application, where such foreign subsidies distort the internal market after the start of the application of the Regulation. This five-year period will be limited to three in the case where foreign financial contributions were granted to an undertaking notifying a transaction, or financial contributions in the context of a public procurement procedure pursuant to the Regulation.

The Regulation shall not apply to:

- concentrations for which the agreement was concluded, the public bid was announced, or a controlling interest was acquired before the date of application of the Regulation; and
- public procurement contracts that have been awarded, or procedures initiated before the date of application of the Regulation.

PRACTICAL IMPLICATIONS

This Regulation is a major change in the field of State aid control extending the scope of the EU legislation and the relevant powers of the Commission beyond the EU territory. To date, under the WTO Agreement on Subsidies and Countervailing Measures, the EU only has had the possibility to initiate State-to-State dispute settlement against certain foreign subsidies granted by WTO members and limited to goods. With the entry into force of the Regulation foreign companies wishing to invest in the EU will be indirectly forced to comply

with the EU State aid and public procurement rules, especially given that the Commission will be entitled to impose redressive measures.

The Regulation will also affect EU companies which operate outside the EU but wish to expand in the EU by acquisition or wish to participate in EU public procurement. They will also be subject to the Regulation if they or members of their group receive foreign contributions.

In practical terms, this Regulation adds an additional filing obligation (alongside any applicable merger control or FDI review) with respect to transactions or public procurement bids involving financial contribution provided by third countries. This notification obligation will result in additional costs, delays and disclosure requirements on these companies and could undermine deal certainty in cases where commitments may need to be offered. Even financial contributions on arm's length commercial terms would have to be taken into account for the above referred thresholds, bringing likely many transactions within the scope of this new filing requirement. Companies would have to already design compliance programs in view of the Regulation's adoption and be ready to identify financial contributions from third countries.

Acquirors or bidders in a procurement will need to be able to calculate the aggregate amount of the "financial contributions" from third countries received by them or members of their group in the last three financial years to determine whether they exceed the specified thresholds (and, if they do, the filing may require further details of the financial contributions received). Therefore, they will need to be able to identify (and calculate the value of) a wide range of transactions with foreign states and entities with links to foreign states, including sales or purchases of other goods or services (including financial services) even if those transactions are on arm's length terms. All transactions with a relevant entity falling within the definition of "financial contribution" will count for these purposes based on the gross amount or value received, regardless of whether the transactions involve an element of subsidy. This could be a challenging, and in some cases impossible, exercise both for many foreign companies and for many EU companies with operations outside the EU.

The guidance that will be issued by the Commission will certainly shed light on the process and the factors that the Commission will take into consideration in its assessment. Nevertheless, investors that have received or will be receiving any financial contributions from non-EU countries would have to conduct a detailed assessment of the risks that a potential transaction or bid in the EU may entail before proceeding with an investment decision or tender application. This will require a review of any financial contributions from third countries and an assessment of any contributions which might be considered to have a distortive effect.

NEXT STEPS

The Regulation is subject to approval by the Council, which is expected to occur in the coming weeks. Once approved by both institutions, the new Regulation will enter into force on the 20th day following that of its publication in the Official Journal of the European Union.

The Regulation will apply six months after its entry into force, *i.e.*, around mid-2023, while the notification obligation described above will apply nine months after its entry into force, *i.e.*, during Q3 2023.

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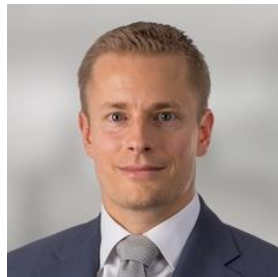
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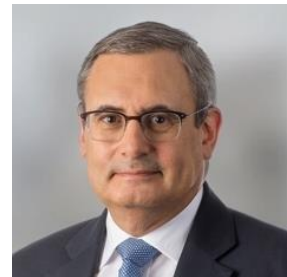
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