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EU Regulation on Foreign Subsidies: the new powers of the Commission as regards M&A transactions and Public Tenders

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01. Introduction

On January 12, 2023, the EU Regulation n. 2022/2560 on foreign subsidies distorting the internal market ("**FSR**") entered into force. The FSR is a new legislative tool combining elements of State aid, merger control, public procurement and trade defence provisions, which empowers the European Commission ("**EC**") to carry out *ex ante* suspensory reviews of public tender procedures and M&A and JV transactions involving companies that have been granted subsidies by extra-EU countries ("**foreign subsidies**").

More specifically, the FSR entrusts the EC with the duty to control foreign subsidies, also *ex officio*, and establishes:

- i. A prior notification obligation – on the merging parties, the undertaking(s) acquiring control and the economic operators participating in the public tender,¹ including the main subcontractors and suppliers – in relation to M&A transactions and public procurement bids involving undertakings that receive foreign financial contributions above certain thresholds, and
- ii. A prohibition to close notifiable transactions or award the contract in public bids until the EC has rendered its final decisions (standstill obligation).

The EC may launch investigations as of July 12, 2023 and notification and standstill obligations will become effective as of October 12, 2023. Therefore, undertakings have few months to:

- i. Put in place a system to monitor and quantify foreign financial contributions at group level;
- ii. Check whether they meet the notification thresholds under the FSR by conducting an audit of foreign financial contributions they have been granted with, at group level, since July 2018 to cover the relevant EC review period, and
- iii. Assess whether the above financial contributions qualify as foreign subsidies and may have distortive effects and/or positive effects that could be invoked.

02. EC's tools and thresholds

Under the FSR, the EC has been granted with three main tools to control foreign subsidies. The first tool applies to mergers, acquisitions and the creation of joint ventures, the second to public tenders, while the third covers both fields by allowing the EC to act on its own initiative, also through market investigations.

As per the M&A notification tool, it provides for a new mandatory and suspensory review process in case of mergers, acquisitions or creation of full-function JVs. Concentrations that meet the two thresholds below are subject to the notification and standstill obligations:

¹ Economic operators participating in a public procurement procedure shall notify the contracting authority/entity, which shall transfer the notification to the EC. Should the notification thresholds not be met, the undertakings concerned should still list in a declaration all foreign financial contributions received and confirm that they are not notifiable under the FSR.

- Turnover threshold – depending on the case, at least one of the merging undertakings, the acquired undertaking or the joint venture shall be established in the EU and shall generate an aggregate turnover of at least EUR 500 million in the EU; and
- Financial contribution threshold – the undertakings concerned (e.g., the acquirer and the target, the merging entities or the JV and its parent companies) were granted combined aggregate foreign financial contributions of more than EUR 50 million from third countries over the three years preceding the conclusion of the agreement or the acquisition of a controlling interest (Articles 20 ff. FSR).

Given the lack of a worldwide combined turnover threshold, it may well be that transactions that will not trigger a merger control filing obligation under the EU Merger Regulation will still be subject to a notification requirement under the FSR.

As with the EU merger control process, the Commission will have 25 working days ("**WD**") from the filing of a complete notification to review the transaction in Phase 1 and 90 WD from the opening of a Phase 2 in-depth investigation to adopt a decision. This period shall be further extended by 15 WD where the undertaking concerned offers commitments.

Pursuant to Article 28 FSR, the public procurement notification tool applies to undertakings engaged in relatively large public tenders in EU Member States (i.e., involving public procurement contracts worth at least EUR 250 million) that have been granted aggregate foreign financial contributions of at least EUR 4 million per third country. The relevant companies shall include the bidder, its subsidiaries and holding company, as well as the main subcontractors and suppliers involved in the same tender, which must notify the EC all foreign financial contributions received in the three years preceding their participation in the tender. Where a public procurement procedure is divided into lots, notification is required if the aggregate value of the lots for which the undertaking concerned is bidding exceeds EUR 125 million.

Investigations in public procurement cases can take up to 130 WD. During the preliminary review (20 WD from the notification, which may be extended by 10 WD) and the in-depth investigation (110 WD from the notification, with a potential extension of 20 WD), the contract cannot be awarded to any company, including, arguably, those which are not subject to an investigation.

The EC may also request notifications of below-the-thresholds concentrations and public procurement cases before implementation/awarding on suspicion that foreign subsidies have been granted to the undertakings concerned.

Under the FSR, the EC may also (i) investigate foreign financial contributions ex officio to assess if there is a distortive non-EU subsidy and (ii) impose remedies (e.g., recovery of aid, divestments, access commitments). The EC can assess subsidies granted up to 10 years before the beginning of the investigation, including in the five years preceding the FSR's effective date. There is no deadline for the EC to complete its investigation (Articles 9 ff. FSR).

The FSR also includes a general market investigation tool that the EC may use *ex officio* in a wide range of market situations (Article 36 FSR). The EC may open investigations over foreign subsidies' regimes whenever it suspects that they may affect the operation of companies established or active in the EU. Examples may include subsidised investments in the energy sector or the provision of subsidised loans to companies active in the EU.

03. The notion of foreign subsidies

The FSR provides a very broad definition of foreign subsidy. For a measure to qualify as foreign subsidy, four cumulative conditions shall be met, which are akin to those provided under the EU state aid regime, as included in brackets below (Article 3 and recitals 11 to 15 of the FSR).

Nevertheless, under the FSR, companies are required to notify all support measures that qualify as “*foreign financial contributions*” – i.e. all measures that meet only the first condition below – regardless of whether they fulfil the other conditions or not and, thus, they constitute “*foreign subsidies*”. It would then be for the EC to establish whether the relevant measures qualify as “*foreign subsidies*”. Hence, foreign financial contributions will be subject to a wider *ex ante* scrutiny than support measures under the EU state aid regime.

The notion of foreign subsidy encompasses:

1. “[F]inancial contribution[s]”, which is a very broad notion covering, *inter alia*, the transfer of funds or liabilities,² the foregoing of revenue that is otherwise due³ and the provision or purchase of goods or services (aid [...] in any form whatsoever);
2. “[P]rovided directly or indirectly by a third country” (imputability and state resources), which, in turn, includes the central government and other public authorities, as well as state-owned enterprises and private entities whose actions can be attributed to the third country.
3. Which “confer[...] a benefit to an undertaking engaging in an economic activity in the internal market” which “could not have been obtained under normal market conditions”, a requirement that should be determined, *inter alia*, on the basis of comparative benchmarks, including the investment practice of private investors (the market economy operator principle).
4. And which are “limited, in law or in fact, to one or more undertakings or industries” (selectivity), i.e., they target one or a limited number of undertakings or sectors.

04. Distortion in the internal market and balancing test

Once the existence of a foreign subsidy is established, the EC shall assess, on a case-by-case basis, whether it distorts the internal market by improving the competitive position of the undertaking concerned. For that purpose, Articles 4 and 5 of the FSR provide a number of presumptions and a non-exhaustive list of indicators.

The latter include the amount and nature of the subsidy, the characteristics of the undertaking, markets and sectors concerned, the level and evolution of the economic activity of the beneficiary on the internal market, the purpose and conditions attached to the foreign subsidy and its use on the internal market.

As per the indicative list of categories of foreign subsidies that are most likely to distort the internal market (negative presumptions), they encompass subsidies granted to undertakings in difficulty, directly facilitating a concentration or enabling the submission of an unduly advantageous tender, as well as unlimited

²E.g., capital injections, grants, loans, loan guarantees, fiscal incentives, the setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps or rescheduling.

³E.g., tax exemptions or the granting of special or exclusive rights without adequate remuneration.

guarantees for debts or liabilities and export financing measures in contravention of the OECD Arrangement on officially supported export credits.

An absolute presumption of non-distortion of competition is, instead, established in respect to *de minimis* aid – i.e., where the total amount of a foreign subsidy to an undertaking per third country does not exceed EUR 200.000 over any period of three fiscal years.

Foreign subsidies are also unlikely to cause distortions in the internal market where the total amount per undertaking does not exceed EUR 4 million over any consecutive period of three years or where it is aimed at making good the damage caused by natural disasters or exceptional occurrences.

Under Article 6 FSR, should a distortion in the internal market be established, just like with the compatibility assessment under the EU State aid regime, the EC shall perform a balancing test to weigh negative and potential positive effects of the foreign subsidy, including those related to the policy objectives of the Union.

05. Redressive Measures, Commitments and Fines

Where the negative effects outweigh the positive ones, Article 7 of the FSR empowers the EC to prohibit the transaction or the award of the contract, or otherwise to impose redressive measures/accept commitments that fully and effectively remedy the distortion actually or potentially caused by the foreign subsidy in the internal market.

A non-exhaustive list of such measures and commitments, which encompasses both structural and behavioural remedies, includes the divestment of assets, a reduction of capacity or market presence, changes to the governance structure, requiring to dissolve closed concentrations, repaying the foreign subsidy, granting third parties access to infrastructures, etc.

The EC may also impose fines for (i) procedural infringements such as breaches of the prior notification and stand-still requirements (up to 10% of the aggregate worldwide turnover of the undertakings concerned at group level, plus default interest for each working day of delay), and (ii) incorrect, incomplete or misleading information (up to 1% of the above aggregate turnover), as well as periodic penalty payments (Articles 17, 26 and 33).

EU, Antitrust and Regulation Department

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