THE IMPLICATIONS OF THE NEW EU FOREIGN SUBSIDIES REGULATION AND ITS DRAFT IMPLEMENTING REGULATION FOR INVESTORS AND BENEFICIARIES

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Abstract: This article examines the notification obligations according to the draft implementing regulation of the Foreign Subsidies Regulation ("FSR"), which was implemented by the European Parliament and the Council on January 12, 2023. The draft implementing regulation establishes an extensive notification system for mergers and acquisitions (M&A) cases and public procurement, including tenders. The article outlines the main notification obligations and the required data that must be submitted to the Commission under the FSR and its draft implementing regulation.
The FSR came into effect on January 12, 2023, and will be applicable starting from July 12, 2023. As of October 12, 2023, companies are required to notify the Commission of mergers and participation in public procurement procedures when the relevant thresholds are met.
The purpose of this article is to examine the FSR and its Draft Implementing Regulation, which aim to address potential distortions in the EU internal market caused by subsidies from third countries to companies operating within the EU.
The analysis in this article is based on a review of the FSR and its Draft Implementing Regulation, and relevant legal sources. The article also considers the consultation period of the European Commission and feedback received from companies and stakeholders during the development of the draft implementing regulation. The methodology involves a detailed examination of the provisions, definitions, and notification requirements outlined in the FSR and its draft implementing regulation. The draft implementing regulation of the Foreign Subsidies Regulation presents new compliance and reporting requirements for companies operating within the EU, aiming to address potential distortions in the EU market caused by foreign subsidies. While the specific legal challenges can vary, companies and beneficiaries should be prepared for the new obligations and requirements. These include ensuring compliance, understanding the subsidy assessment criteria, cooperating with authorities during investigations, balancing transparency with the protection of confidential information, and potentially addressing legal challenges or disputes.
The implementation of the Foreign Subsidies Regulation represents a significant step in regulating third-country subsidies and promoting fair competition in the EU internal market.
Keywords: EU Law, Draft Implementing Regulation, FSR, notification obligations, M&A, public procurement.

1. INTRODUCTION

The FSR aims to fill a regulatory gap by subjecting third-country subsidies to scrutiny, an area that has previously lacked control. In contrast, subsidies granted by EU member states have been subject to rigorous oversight. Therefore, the FSR complements existing EU state aid rules governing subsidies from EU member states and extends the EU state aid regime to non-EU countries (Vejseli, IBU Journal of Law and Politics, 2023). This new regulation applies to all companies worldwide operating or intending to operate in the EU, including international groups and investment funds headquartered in the EU. The FSR encompasses a broad definition of financial contributions from third countries, which may include subsidies related to the Inflation Reduction Act in the United States (PWC Newsletter, 2023). However, it is important to note that the FSR does not seek to categorically prohibit third-country subsidies. The FSR takes effect on July 12, 2023, introducing reporting obligations for selected transactions and award procedures starting from October 2023. The Commission is empowered to review transactions to identify potential distortions arising from third-country subsidies. Non-compliance with the FSR carries significant penalties to enforce adherence to the regulation and deter activities that may result in distortions within the EU internal market.

2. THE DRAFT IMPLEMENTING FOREIGN SUBSIDIES REGULATION

The EU is currently developing an implementing regulation that provides procedural instructions to all stakeholders. The draft implementing regulation, in its draft version, underwent a consultation period during which companies and other stakeholders were invited to submit their views to the Commission until March 6, 2023 (European Commission, 2023, Public Consultation). The draft includes notification forms and explanations of the relevant procedures for notification and file inspection (European Commission, 2023, Draft Implementing Regulation). The adoption of the implementing regulation is expected in the second quarter of 2023. However, the draft implementing regulation has already faced criticism due to its high administrative burden and reporting requirements for notifying parties, as well as uncertainties surrounding the calculation of notifiable "financial contributions" to the Commission.

3. CONCENTRATIONS

The draft implementing regulation introduces a comprehensive reporting system for parties involved in a notifiable concentration. This applies when financial contributions received by all group entities worldwide over the past three years exceed a certain threshold. However, the parties are not required to assess whether the financial contributions are distortive, anti-competitive, or linked to the internal market before making the notification. The responsibility to evaluate these aspects lies with the Commission (T-648/19, *Nike Netherlands & Converse Netherlands v European Commission*, EU:T:2021:428).

One major criticism from companies and other stakeholders regarding the notification requirements and the data to be reported to the Commission is the practical challenge of monitoring and registering all foreign financial contributions received by worldwide group companies.

4. DEFINITION OF "FINANCIAL CONTRIBUTION" ACCORDING TO FSR

The term "financial contribution" differs from the definition of "foreign subsidy" in the FSR (European Commission, Recital 11 FSR). The FSR does not explicitly define the term "contribution." It does, however, define "foreign subsidy" as "*a financial contribution provided directly or indirectly by a third country, conferring a benefit and limited to one or more undertakings or industries*. *These conditions are cumulative*" (European Commission, Recital 11 of FSR). The term "foreign subsidy" carries the same meaning as the EU term "state aid" under Article 107 TFEU. Any financial contribution that fails the private-investor test is categorized as state aid or foreign subsidy depending on which Regulation is applicable at the case at hand (T-597/19, *Helsingin kaupunki v Commission*, ECLI:EU:T:2022:554). The key difference is that state aid is prohibited, while foreign subsidies are allowed but subject to notification to the Commission (European Commission, Recital 12 FSR). According to the FSR, the "financial contribution" does not undergo an *ex-ante* assessment under competition law. It is a static amount that must be declared by the notifying parties, regardless of its potential anti-competitive nature or failure of the private-investor test. The Commission is responsible for evaluating the conformity of the financial contribution with the internal market and determining whether it qualifies as a foreign subsidy under the FSR. However, the parties may indicate in the notification form, which is attached to the draft implementing regulation, which contributions can be considered compatible with the internal market. The final result of the assessment, however, obliges with the Commission.

5. THE *DE-MINIMIS* THRESHOLDS

Importantly, the FSR includes *de minimis* thresholds for both concentrations and public procurement procedures. Parties are not obligated to provide the Commission with any data on the financial contributions made or received by the concerned parties if the contributions fall below the thresholds stipulated in Article 20 FSR regarding concentrations and Article 28 FSR regarding public procurement procedures.

6. CONCENTRATIONS NOTIFICATION FORM

When determining if there is a distortion in the domestic market, the Commission considers different factors using indicators. These factors include the absolute size of the foreign subsidy, its proportion to the market size or investment value. For example, if a foreign subsidy covers a significant part of the purchase price in an acquisition, it is likely to cause distortion (European Commission, Recital 19 FSR). Similarly, if foreign subsidies cover a substantial portion of the estimated value of a contract in a public procurement process, they are likely to cause distortions. Subsidies granted for operating costs are more likely to cause distortions compared to those granted for investment costs. Subsidies given to small and medium-sized enterprises (SMEs) are considered less likely to cause distortions compared to subsidies given to large companies. Market characteristics and competitive conditions, such as barriers to entry, should also be taken into account. Foreign subsidies in markets with excess capacity or that encourage unnecessary investment in capacity expansions are likely to cause distortions. A foreign subsidy given to a beneficiary with low activity in the domestic market, measured by turnover achieved in the European Union, is less likely to cause distortions compared to a beneficiary with higher market activity. Generally, foreign subsidies not exceeding EUR 4 million over three consecutive years are unlikely to distort the domestic market according to the FSR. Similarly, foreign subsidies to a single undertaking that do not exceed the amount defined as *de minimis* aid (< EUR 200.000) in Commission Regulation (EU) No 1407/2013 per third country over three consecutive years are considered as not distorting the internal market under this Regulation (European Commission, Article 20 FSR).

For the effective application of Article 20 FSR, it is imperative to establish a consistent interpretation of the concept of a "single undertaking".

7. "UNDERTAKING" IN STATE AID LAW

It should be noted that the notion of an "undertaking" within the meaning of EU State aid law means any undertaking which is engaged in an economic activity (ECJ (2006), Judgment of 23.03.2006, C-237/04). An affirmation of a market connection usually arises when the activity in question is not exclusively conducted by a government entity and could potentially be undertaken by a private company. The presence of a profit motive is not necessary for the activity to be considered economic (ECJ (2004), Judgment of 16.03.2004 – C-264/01).

Under State aid law, any illicit financial assistance that is deemed incompatible with the internal market must be retrieved from the recipients who have derived benefits from it, with the aim of reinstating fair competition (European Commission, Commission Notice on the recovery of unlawful and incompatible State aid, OJ (2019), C 241/1, p.85 and subs.). The beneficiary of such aid may encompass the specific legal entity that directly received the assistance, or it may extend to multiple legal entities if they function as a cohesive economic entity. This is determined by the existence of a controlling share among these entities, while the European Union recognizes the Commission's broad discretion in determining whether these entities should be treated as an integrated economic unit or regarded as legally and financially independent entities for the purpose of applying State aid regulations (*DSG V Commission*, T-234/95; T-371/94 and T-394 *British Airways v Commission*).

8. "UNDERTAKING" IN MERGER CONTROL

In relation to mergers or concentrations, however, the term "single undertaking" is used by the FSR. In this regard, the meaning of "single undertaking" should be understood based on the interpretation of EU merger control provisions and case-law:

The term "single undertaking" in the context of mergers or concentrations refers to the concept of treating a group of companies involved in a merger or acquisition as a single economic entity. This concept is important in determining whether a concentration would significantly impede competition in the European Union (EU) market.

According to EU merger control regulations, specifically Article 3(4) of the EU Merger Regulation (EUMR), concentrations that involve the acquisition of control over a "single undertaking" must be notified to the European Commission for review and approval. The term "undertaking" refers to an economic entity engaged in economic activity, which can be a single company **or** a group of companies acting as a single entity.

The interpretation of the term "single undertaking" has been developed through case-law by the European Court of Justice (ECJ). In its landmark judgment in the case of *Akzo Nobel v. Commission* (*AKZO Chemie BV v Commission*, C-62/86, ECLI:EU:C:1991:286) the ECJ clarified that the notion of a "single undertaking" encompasses a parent company and its wholly-owned subsidiaries, treating them as a single economic entity for the purposes of competition law. This means that when assessing the impact of a concentration on competition, the Commission considers the combined market shares and effects of the merging companies as a single entity rather than treating them as separate entities.

Subsequent cases, such as the Airtours (*Airtours v Commission*, T-342/99, ECLI:EU:T:2002:146) and *Tetra Laval/Sidel* (ECJ, C-12/03 P, ECLI:EU:C:2005:87) cases, further reinforced the concept of the "single undertaking" and emphasized that control over the target company is a key factor in determining whether a concentration falls within the scope of the EUMR.

Against this background, the term "single undertaking" in merger control regulations and ECJ case law refers to the treatment of a group of companies, including the acquiring entity and its subsidiaries, as a single economic entity when assessing the competitive effects of a merger or acquisition in the EU market.

The calculation and application of the *de-minimis* threshold specified in Article 20 of the FSR becomes more complicated due to these arguments. It is necessary therefore to carefully evaluate which entity or group of companies can be considered a "single undertaking" under the provisions of the EU merger regulation and its case-law when the *de-minimis* amount is granted.

9. PUBLIC PROCUREMENT NOTIFICATION FORM

According to Article 28 of the FSR, the notification thresholds for public procurement procedures are as follows:

- The estimated net contract value is equal to or greater than EUR 250 million, and
- The financial contributions to the tender participants, including their subcontractors, amount altogether to or exceed EUR 4 million per third country.

In contrast to the FSR provisions applicable to concentrations, which explicitly include a de minimis threshold of EUR 200.000 to a single undertaking, the FSR does not specify any *de minimis* threshold in the public procurement notification form. This means that the company must monitor and register all contributions made to the notifying parties and their subcontractors participating in the public procurement procedure. It should be noted that only the contributions to those subcontractors or suppliers are considered where their participation ensures key elements of the contract performance and, in any case, where the economic share of their contribution exceeds 20% of the value of the submitted tender (Article 29, paragraph 5 FSR).

10.ATTRIBUTALIBITY TO THE STATE

To determine the extent to which a state contribution is attributable to the state, the state aid jurisprudence can be considered. It examines "*whether the public authorities must be regarded as having been involved, in one way or another, in the adoption of those measures*" (ECJ, *France v Commission*, C-482/99, para 52, ECLI:EU:C:2002:294). For instance, if a guarantee scheme has been approved by a supervisory board of a privately held company whose members are appointed by the government, the guarantee can be considered "attributable" to the state and therefore constitutes state aid (ECJ, *Commerz Nederland NV v Havenbedrijf Rotterdam NV*, C-242/13, ECLI:EU:C:2014:2224).

11.REFERENCE PERIOD

Concerning concentrations, Section 5.1 of Annex 1 of the Draft Implementing Regulation stipulates that the reporting obligations refer to the three financial years preceding the conclusion of the agreement.

Regarding public procurement procedures, all financial contributions that meet the criteria outlined in Annex 2 must be notified. These contributions should have been granted to the notifying parties within the three-year period preceding October 12, 2023, and should fall under any of the specified categories or pertain to operating costs (European Commission, Recital 19 of FSR).

As stated in Section 5.1 of Annex 1 and 3.1 of Annex 2, the Foreign Subsidies Regulation encompasses a foreign financial contribution once the recipient legally qualifies to receive it from a third country, regardless of the actual disbursement of the funds.

12.RESULTS

The analysis of the FSR and its Draft Implementing Regulation revealed several key findings. Firstly, the FSR introduces a comprehensive reporting system for notifiable concentrations and public procurement procedures. Parties involved in a notifiable concentration are required to report financial contributions received by all group entities worldwide over the past three years, meeting specific thresholds. The FSR also establishes notification thresholds for public procurement procedures, considering the estimated net contract value and financial contributions to tender participants.

The definition of "financial contribution" under the FSR differs from the definition of "foreign subsidy." While the FSR does not explicitly define "contribution," it defines "foreign subsidy" as a financial contribution provided by a third country, conferring a benefit to one or more undertakings or industries. The FSR, however, does not categorically prohibit third-country subsidies but requires notification to the Commission. The responsibility for evaluating the conformity of financial contributions with the internal market lies with the Commission.

The FSR incorporates *de minimis* thresholds for both concentrations and public procurement procedures. Parties are not obligated to provide data on financial contributions falling below the specified thresholds. The notification requirements and data to be reported to the Commission pose practical challenges, particularly in monitoring and registering all foreign financial contributions received by worldwide group companies.

For the effective application of Article 20 FSR, it is imperative to establish a consistent interpretation of the concept of a "single undertaking". A “single undertaking” which received foreign subsidies above the thresholds, will be considered as the beneficiary of a foreign subsidy according to the FSR. However, when considering redressing potential distortions of competition on the internal market caused by foreign subsides, the relevant EU legal framework appears to be State aid law (and not merger control) and therefore, the actual beneficiary must be identified. Given that the jurisdiction of the FSR is confined to the European Union, the initial step entails verifying whether the legal entity involved in the notified merger or acquisition has received a foreign subsidy, either directly or indirectly. If the said legal entity has directly received a foreign subsidy, it establishes the necessary connection with the concentration in question. However, if the legal entity itself has not directly received a foreign subsidy, a more in-depth analysis is required to evaluate the existence of the requisite nexus with the notifiable concentration.

The preamble of the FSR provides an illustrative example, emphasizing that the pricing of goods and services which are not in line with market conditions, can confer a benefit (European Commission, Recital 13 FSR). Furthermore, it states in broader terms that "*the benefit conferred by a financial contribution may be passed to an undertaking engaging in an economic activity in the Union*". (European Commission, Recital 13 FSR). Consequently, although a legal entity may not have received a foreign subsidy directly, it could have indirectly benefited from such a subsidy due to the advantageous transfer of value from another legal entity within the unified economic entity that did receive a foreign subsidy (*Ahlborn/Maczkovics*, Competition Policy International, 2023).

13.CONCLUSION

The draft implementing regulation of the foreign subsidies regulation is part of the European Union's efforts to address potential distortions in the EU market caused by foreign subsidies granted to companies operating within the EU. While the specific legal challenges can vary depending on the content and scope of the draft regulation, there are some potential areas of concern for companies and beneficiaries:

The draft implementing regulation may introduce new compliance obligations and reporting requirements for companies operating within the EU. This could involve providing detailed information about any foreign subsidies received and their potential impact on the EU market. Companies would need to ensure that they have robust internal processes to monitor, document, and report any relevant information accurately.

The draft regulation may establish specific criteria and thresholds for assessing whether a foreign subsidy is distortive to the EU market. Determining these criteria and thresholds could be challenging, as they may involve complex economic and legal analysis. Companies and beneficiaries would need to understand these criteria and assess the potential impact on their operations.

The draft implementing regulation may grant authorities the power to investigate potential breaches of the foreign subsidies regulation. This could involve conducting detailed inquiries, requesting information from companies, and imposing penalties for non-compliance. Companies and beneficiaries would need to be prepared to respond to investigations and cooperate with the authorities.

Further, companies may have concerns about disclosing sensitive business information or trade secrets during the investigation or reporting process. Balancing the need for transparency and the protection of confidential information could be a legal challenge for companies.

Lastly, companies or beneficiaries who believe they have been unfairly affected by the implementation of the foreign subsidies' regulation may seek legal remedies. This could involve challenging the validity or interpretation of the regulation, appealing decisions made by authorities, or engaging in dispute resolution mechanisms. Ensuring access to legal remedies and effective legal representation is crucial for companies facing potential disputes.

It will be impossible for companies to guarantee the 100%-completeness and accuracy of all responses and information required under the Draft Implementing Regulation and its annexes due to the difficulties outlined above. Therefore, the Commission should consider these difficulties when assessing the fine when undertakings "*intentionally or negligently, supply incorrect or misleading information*" (Art. 26 (2) FSR) or regarding the incompleteness of a notification under Art. 6 (4) draft implementing regulation. Maybe a solution would be the Commission to consider only the undertaking's reasonable efforts and significant pieces of information which were not submitted to the Commission. The fine, i.e., penalty in case of notification violations according to the FSR may reach even 10% of the aggregate turnover of the undertaking concerning the preceding financial year of the undertaking (Art 17 FSR).

The draft implementing regulation of the Foreign Subsidies Regulation presents new compliance and reporting requirements for companies operating within the EU, aiming to address potential distortions in the EU market caused by foreign subsidies. While the specific legal challenges can vary, companies and beneficiaries should be prepared for the new obligations and requirements. These include ensuring compliance, understanding the subsidy assessment criteria, cooperating with authorities during investigations, balancing transparency with the protection of confidential information, and potentially addressing legal challenges or disputes. The implementation of the Foreign Subsidies Regulation represents a significant step in regulating third-country subsidies and promoting fair competition in the EU internal market.

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