

Newsletter, 28 December 2022

The European foreign subsidies regulation

Merger control, foreign investment control, and now foreign subsidies control – a new reality of control regimes in the transactional practice within the European Union

On 14 December 2022, the European Parliament and Council adopted the new regulation (EU) 2022/2560 on foreign subsidies distorting the internal market (“FSR”)¹. The FSR will complement existing merger control and foreign direct investment (“FDI”) control rules² in transactions with target companies or joint ventures registered in the EU, if at least one of the parties concerned is both engaged in economic activities in the EU and benefitted from financial contributions from outside the EU prior to the conclusion of an agreement. Comparable to EU merger control, the creation of certain types of concentrations (i.e., acquisition of control, merger and joint venture) will be subject to a notification obligation under Art. 20 (3) FSR if the relevant thresholds are met. Apart from a turnover threshold – and this is a novelty – a second threshold applies which refers to specific amounts of already granted financial contributions (EUR 50 million) from foreign countries in the last three years. In case of a notification obligation to the European Commission (“Commission”) a standstill obligation applies.

Status quo vs. the FSR

Currently, the EU internal market is safeguarded on an EU level by competition law, state aid regulations and FDI rules. Anticompetitive effects to the internal market caused by mergers and acquisitions in- and outside of the EU are tackled by EU and national merger control regimes (which take into account the market position of the undertaking concerned). Any form of state aid, respectively subsidies from public sources within the EU, are monitored by EU state aid law. National FDI screening regimes in the hands of the EU Member States monitor transactions with non-EU/EFTA or non-Member State investors that possibly affect public order or security in the internal market and in the respective national markets. All

of the regimes – with the exception of state aid (which only applies to state aid from within the EU) – are having a legal effect to actions arising from in- and outside of the EU. Complementary to the above, the scope of the FSR is to additionally address direct or indirect distortions caused by foreign subsidies from outside the EU with actual or potential negative effects to competition in the internal market.

The regime of the FSR will apply from 12 July 2023 onwards. Concentrations for which the agreement has already been concluded (i.e. signed), the public bid has been announced or a controlling interest has been acquired before 12 July 2023, are exempted from the scope of application. The notification obligation as such will be effective only three months later on 12 October 2023.³

Notification obligation

A notification obligation under Art. 20 (3) FSR exists, if a proposed transaction falls within the definition of a concentration under the FSR (which is defined similar to EU merger control, including acquisitions of control, mergers and the creation of a full function joint venture),

1. if the **acquired undertaking** or one of the **merging undertakings** (in case of a merger) or the **joint venture** (including their respective subsidiaries due to the consideration of the entire economic entity within the definition of the term “undertaking”) is established in the EU and generated an aggregated turnover in the EU of at least **EUR 500 million** in the preceding financial year (which is calculated similar to the EU merger control rules), and
2. the **relevant parties to the transaction** – including the acquirer(s) and the joint venture partners – received a combined **aggregated financial contribution from third countries** of more than **EUR 50 million in the last three calendar years**.

¹ [Regulation \(EU\) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market.](#)

² See [Commeo Newsletter of 30/11/2022](#).

³ Art. 54 and 53 (3) FSR.

Whilst the turnover threshold is calculated in accordance with familiar EU merger control rules, the second threshold requires a rather complex assessment.

The new threshold in detail: financial contributions from a third country in the amount of EUR 50 million in the last three years

First of all, the **relevant parties** for the calculation of **financial contributions received from third countries** vary depending on the form of concentration. In case of an acquisition of control, the relevant parties are the acquirer or acquirers and the target. When the concentration fulfills the condition for a merger in the sense of the FSR, the merging undertakings are relevant. In case of the foundation of a joint venture, the joint venture partners and the joint venture itself are considered as relevant parties for the calculation of the financial contribution (Art. 20 (3) (b) FSR).

With respect to each undertaking concerned, the whole economic entity is relevant for the review whether and to what amount foreign subsidies have been received.

Secondly, **financial contributions** from third countries are defined by Art. 3 (2) FSR as *inter alia* including

- (a) the transfer of funds or liabilities, such as 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 re-scheduling;
- (b) the foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration; or
- (c) the provision of goods or services or the purchase of goods or services;

each when **provided by third country governments and public authorities** at all levels, or foreign public or private entities whose actions can be attributed to the third country.

Having regard to the above, it seems reasonable and advisable for undertakings which are planning M&A activities within the EU to actively screen and report contributions from third countries which are possibly caught under the abovementioned definition to smoothen up future reviews of a notification obligation under the FSR.

Request for notification

The FSR also includes a possibility for the Commission to request a notification under Art. 21 (5) FSR for concentrations at any time prior to their implementation even if the concentration does not meet the thresholds of the FSR (so-called **ex-officio review**). The Commission can explicitly request such review when it suspects that foreign subsidies may have been granted to the undertakings concerned in the last three years before the signing of an agreement.

Review of the financial contributions received under the regime of the FSR (substantive test)

Within its review whether or not to clear a proposed concentration, the Commission will at first assess whether the received financial contributions qualify as a **foreign subsidy**. A foreign subsidy exists, if a financial contribution provided by a third country confers a benefit for an undertaking that is engaged in economic activity in the internal market and when its contribution is limited, in law or in fact, to one or more undertakings or industries (Art. 3 (1) FSR).

Subsequently, the Commission will assess (taking into account benefits and disadvantages of a foreign subsidy) whether such foreign subsidy **may distort competition in the internal market** (test relating to Art. 19 FSR and Art. 4-5 FSR). A **distortion is deemed to exist** when the foreign subsidy is liable to improve the competitive position of an undertaking and actually or potentially negatively affects competition in the internal market. The relevant criteria to consider are the amount and nature of the foreign subsidy, the situation of the undertaking and the relevant markets in which it has been granted, and the level of economic activity in the EU besides to the purpose and conditions of the granting.

(a) A **distortion is likely** if the **foreign subsidy is directly granted for the facilitation of the concentration**. Besides, unlimited guarantees, subsidies outside of the scope of OECD rules and such enabling an undertaking to submit unduly advantageous tenders or restructurings of ailing companies without a reasonable restructuring plan are deemed likely to distort competition in the internal market.

(b) A foreign subsidy is **unlikely to distort competition in the internal market** if the total

amount of received foreign subsidies by an undertaking are below EUR 4 million.

- (c) Foreign subsidies are considered **not to distort competition in the internal market** if they remain below the *de minimis*-threshold (usually EUR 200.000 in three years per third country) or if they are aimed at “*making good the damage caused by natural disasters or exceptional occurrences*”. The latter exemption clearly seems to have been included corresponding to the various measures against the consequences of COVID-19 and the Ukraine crisis (see Art. 4 (2)-(4) FSR).

Procedure

Once a notification is filed to the Commission, the **Phase I-proceeding** – which is handled separately from a possible merger control proceeding before the Commission – will take **25 working days** after submission of a complete notification. If the Commission does not clear the proposed transaction within that timeframe, it will open a **Phase II-proceeding** with a review period of **90 working days**. The Phase II-proceeding be expanded by another 15 working days in case the parties offer commitments (i.e., the repayment of foreign subsidies, access for third parties to assets, adaption of a governance structure, reduction of market presence or divestments). The Commission has already announced a draft implementing regulation for 2023 with further guidelines on the notification procedure and notification form. In case of a violation of the **standstill obligation**, which applies until clearance has been obtained in case of a notification obligation, the transaction is considered null-and-void and **fines up to 10% of the aggregated turnover in the preceding business year** can be imposed. In addition, a fine of up to 1% might be invoked if, for example, misleading information has been provided to the Commission. The **investigatory powers** under the FSR are very extensive (with inter alia the power for investigations in third countries with the consent of the government and the respective party). The Commission is allowed to decide on the basis of the facts available if an undertaking does not comply with requests of informatory or investigatory nature (Art. 16 FSR).

A regulation with three pillars

Apart from the notification obligation for concentrations – which is only one of the three pillars of the FSR against distorting foreign subsidies – the Commission is, as a **second**

pillar, empowered to review all kinds of foreign subsidies also outside of transactions (Art. 9 FSR). As a **third pillar**, public bids above EUR 250 million must be notified to the Commission if the bidder received financial contributions of more than EUR 4 million in the last three years from the same foreign country (Art. 28 FSR).

Commentary

The new FSR-regime is a further example of the emerging trend towards an increased control of investments from third countries in the EU. Companies involved in transactions will see the FSR-regime, in addition to the already existing merger and investment control regimes, primarily as an additional bureaucratic hurdle. However, it is important that companies in M&A transactions include the examination of a notification obligation under the FSR in their checklists. How many procedures will actually be covered by the FSR remains to be seen in practice. So far, the Commission is only expecting a double-digit number of procedures per year.



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