

Editorial

The EU is committed to free trade and international institutions which support global free trade. The World Trade Organization (WTO) has unequivocally and diachronically received the endorsement of the EU. One of the persistent areas in need of modernisation has been the WTO rules on industrial subsidies, on which progress remains limited. The EU recognised a regulatory gap in world trade and, to prevent competition distortions in its single market, acted swiftly to initiate a complementary tool to the established EU trade instruments to effectively address the multilateral legal framework relevant to distortive subsidies.

The Foreign Subsidies Regulation (FSR) covers all economic activities in the single market of the EU. It applies to industrial concentrations in the format of mergers and acquisitions, situations related to public, utilities and concessions procurement procedures and all has remit to all other economic situations within the single market, with the enviable task to balance open trade and inward investment and maintain an equal and level equilibrium for all economic operators within the Single Market. The EU Foreign Subsidies Regulation entered into force on 12 January 2023, and its provisions will apply from 12 July 2023. The FSR gives the European Commission the power to investigate financial contributions granted by non-EU countries to companies engaging in economic activity in the EU and, if needed, redress their distortive effects.

Before the enactment of the FSR, the EU could rely upon the WTO Agreement on Subsidies and Countervailing Measures, trade defence instruments (ie, anti-dumping and anti-subsidy investigations) and specific provisions in Free Trade Agreements (FTAs) to tackle distortions on competition caused by third countries' trade actions. These foundations were deemed inadequate to address current market dynamics and the proliferation of foreign subsidies. The EU's anti-subsidy rules, as trade defence instruments, could apply to the import of subsidised goods into the single market. However, when foreign subsidies appear as services, investments or other financial amalgams, the rules as well as the scope of the WTO Agreement on Subsidies and Countervailing Measures SCM Agreement were inapplicable, because they are limited to trade in goods. In addition, substantial divergences on the provisions on subsidies within Free Trade Agreements exist. Most FTAs provide for mere consultations in case of distortive subsidies, and only some of them proceed to regulate specific provisions prohibiting subsidies that are particularly detrimental.

The FSR consists of three instruments, all of which will be enforced by the European Commission. In particular,

1. An obligation for companies to notify to the Commission concentrations involving a financial contribution by a non-EU government where (i) the acquired company, one of the merging parties or the joint venture generates an EU turnover of at least €500 million and (ii) the foreign financial contribution involved is more than €50 million*;
2. An obligation for companies to notify the Commission regarding participation in public procurement procedures, where (i) the estimated contract value is at least €250 mil-

lion and (ii) the foreign financial contribution involved is at least €4 million per non-EU country; the Commission may prohibit award of contracts in such procedures to companies benefitting from distortive subsidies.

3. For all other market situations, the Commission can start investigations on its own initiative (*ex officio*), if it suspects that distortive foreign subsidies may be involved. This includes the possibility to request ad-hoc notifications for public procurement procedures and smaller concentrations.

A notified concentration cannot be completed, and an investigated bidder cannot be awarded the public procurement contract, while under investigation by the Commission. In the event of breach of this obligation, the Commission can impose fines, which may reach up to 10% of the company's annual aggregated turnover. The Commission can also prohibit the completion of a subsidised concentration or the award of a public procurement contract to a subsidised bidder.

The FSR grants the European Commission a wide range of investigative powers to gather necessary information, including: (i) sending information requests to companies; (ii) conducting fact-finding missions within and outside the Union and (iii) launching market investigations into specific sectors or types of subsidies. The Commission may also rely on market information submitted by companies, Member States or any natural or legal person or association.

In cases where the European Commission has found that a foreign subsidy exists and distorts the Single Market, it may counter-balance the negative effects in terms of the distortion with the positive effects of the subsidy on the development of the subsidised economic activity. If the negative effects outweigh the positive ones, the Commission may impose structural or non-structural redressive measures on companies, or accept them as commitments to remedy the distortion (eg, divestment of certain assets or the prohibition of a certain market conduct).

As a general rule, subsidies below €4 million over three years are considered 'unlikely' to be distortive, while subsidies below the EU State aid *de minimis* thresholds are considered non-distortive. In the context of notifiable concentrations and public procurement procedures, the Commission can look at foreign subsidies granted up to three years before the transaction. However, the Regulation does not apply to concentrations concluded and public procurements initiated before 12 July 2023.

In all other situations, the European Commission can look at subsidies granted in the preceding 10 years. However, the Regulation only applies to subsidies granted in the five years prior to 12 July 2023, where such subsidies distort the Single Market after the start of application.

A Draft Implementing Regulation (DIR) to the FSR has been published, clarifying the procedural steps and practicalities of the FSR system. The DIR also has two Annexes that contain standard forms detailing the extensive information that companies need to provide in the context of concentrations and public procurement.

I. Foreign Financial Contributions under the FSR

The FSR covers any form of direct or indirect contribution from non-EU governments or any public or private entity attributable to a third country. Such a contribution may be distortive where it confers a benefit not normally available on the market to a company in the EU, and where that benefit is specific to one or more companies or industries as opposed to all companies or all companies active in a particular industry.

Financial contribution under the FSR is an extremely wide-reaching concept and can take a broad range of forms, including direct grants, interest-free or low-interest loans, tax incentives (eg, exemptions/reductions), state-funded R&D, government contracts (regardless of size, whether they qualify as ‘subsidiaries’ or whether they have any nexus to the EU) and grants of exclusive rights without adequate remuneration.

The DIR explains that, for those foreign financial contributions that are presumed to have distortive effects (eg, loans, tax exemptions, capital injections, fiscal incentives or contributions in kind), companies are required to provide even more detailed information in their notifications than for other contributions, including whether the contribution conferred a benefit to their business in the EU (eg, if they were granted on normal market conditions) – which can be very complex to assess.

II. The Investigative Instruments under FSR

1. Mandatory Pre-Authorisation

Companies engaging in (a) M&A activity or (b) a public procurement procedure in the EU triggering the thresholds in the FSR will be required to submit formal notifications and await approval.

a. Filing Obligation for M&A Transactions

Transactions meeting the following (cumulative) thresholds will need to be notified to the European Commission:

- i. Turnover threshold: the turnover of the target (in case of acquisitions), the JV (for creation of a JV) or one of the parties (for mergers) in the EU was at least €500 million in the last financial year; and
- ii. Financial contribution threshold: the undertakings concerned (eg, the acquirer and the target, the merging entities or the JV and its parents) received ‘financial contributions’ of more than €50 million from non-EU governments or State-owned entities in the three years prior to the notification.

As a result, companies contemplating M&A transactions must consider FSR compliance alongside merger control and foreign direct investment reviews. This means that FSR will need to become part of due diligence, and FSR clearances may need to be added to the list of regulatory conditions precedent, to be considered in the context of deal timing and break fees and to be built into representations and warranties, as well as disclosure schedules.

b. Filing Obligation for Public Tenders

Companies must notify the European Commission if they engage in public tenders in the EU, and the following (cumulative) thresholds are met:

- i. Contract value: the contract value is not less than €250 million or, in cases where the tender is divided into lots, the aggregate value of the lots applied for is not less than €125 million; and
- ii. Foreign financial contributions: the bidding party (including its subsidiaries and/or holding company) and its main subcontractors (or suppliers) received aggregated foreign financial contributions of not less than €4 million in the three years prior to the notification. Bidding parties that received aggregate foreign financial contributions of less than €4 million must submit a declaration setting out all foreign financial contributions received and confirm that they fall below the threshold.

Failing to report foreign financial contributions or benefiting from distortive subsidies could result in disqualification from a public tender.

2. General Tool for Investigating All Other Market Situations

As of 12 July 2023, the European Commission will have powers to conduct *ex officio* investigations into all potentially distortive foreign subsidies. The Commission's *ex officio* powers are very broad, and permit the Commission to investigate support granted by third countries to companies up to 10 years before the start of the investigation (but not more than five years prior to the application of the FSR). The Commission will also be able to request an ad-hoc notification for transactions and public procurement procedures that do not meet the thresholds, but in relation to which it suspects that the companies concerned received foreign subsidies three years prior to concentration/tender submission.

III. The European Commission's Information-Gathering Powers

To assist its investigations, the EC can gather information by issuing requests for information, interviewing natural or legal persons and conducting dawn raids both within and outside of the EU. Although there is no process for formal complaints under the FSR, competitors may well make submissions to the EC concerning alleged foreign financial contributions received by other companies active in their field of operation.

Whether triggered by third-party submission or the EC's own monitoring, if a company were to receive a request for information, gathering the necessary information and financial data could be a significant task. In the case of a refusal to supply information, the EC is able to take a decision based on the facts available to it – which may be less favourable to the company than if it had provided the information.

IV. The European Commission's Enforcement Powers

If companies breach the standstill obligation by concluding or failing to notify a notifiable concentration, the EC may impose a fine of up to 10% of their aggregate turnover in the preceding financial year. The EC also has powers to subject companies to fines of up to 1% of global turnover and periodic penalty payments of up to 5% of the average daily aggregate turnover for each working day of delay, where companies supply incorrect, in-

complete or misleading information.

Following an in-depth investigation, the EC can adopt (i) a no objection decision; (ii) a commitments/redressive measure decision or (iii) a decision prohibiting a concentration or the award of a public contract. Redressive measures and commitments can be structural (eg, unwind an acquisition, divest assets or reduce capacity or market presence), or behavioural (eg, offer access to or licence infrastructure on FRAND conditions, publicise R&D results, repay foreign subsidies with interest or adapt the governance structure).

The EC may allow a transaction it would otherwise prohibit under the FSR based on a balancing of negative and positive effects (an option that is not available under the EU merger control rules, for instance). A positive effect could relate to an EU policy objective (eg, environmental protection, digital transformation, creating jobs, promotion of R&D).

The FSR and the DIR provide for a relationship between trade defence instruments and compliance. The FSR provides for the compliance of the implementation of its provisions with EU law, the WTO Agreement and other commitments made under other EU and Member State trade and investment agreements. Part of the compliance exercise is the commitment that no action can be taken under the FSR which would amount to a specific action against a subsidy as defined in the WTO SCM Agreement and granted by a third country which is a member of the WTO. Thus, the FSR affords a precedence for the provisions of the WTO SCM Agreement. However, the WTO SCM Agreement is only applicable to specific subsidies, ie, subsidies specific to an enterprise or industry or group of enterprises or industries. The DIR would need to examine the relationship between the application of the FSR and available trade instruments under international law and in relation to FTAs with substantive provisions on distortive subsidies.

Professor Christopher Bovis FRSA