

CLIENT ALERT

European Union Political Agreement to Introduce New Tools to Scrutinize Foreign Subsidies

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On 30 June 2022, the European Parliament (the “**Parliament**”) and the Council of the European Union (the “**Council**”) reached a political agreement to introduce a new EU regulation on the control of foreign subsidies that may distort the EU internal market.¹ This marks a new step towards the implementation of the Foreign Subsidies Regulation (the “**FSR**”) advocated by the European Commission (the “**Commission**”) in May 2021.²

In essence, the FSR aims at closing a perceived “regulatory gap”, whereby subsidies granted by non-EU States go largely unchecked, while subsidies granted by EU Member States to EU companies are subject to close scrutiny pursuant to State aid rules. Under the FSR, the Commission will be empowered to (i) identify foreign subsidies received by undertakings engaging in business activities in the EU, (ii) determine whether such subsidies distort the EU internal market, and (iii) if so, impose remedies it deems adequate to restore a “level playing field”.

The scrutiny mechanism involves two notification obligations (i.e. in case of acquisition of control of an EU based company or of a participation in a public procurement procedure) as well as additional powers granted to the Commission to conduct *ex officio* market investigations.

¹ https://ec.europa.eu/commission/presscorner/detail/en/ip_22_4190.

² See Willkie’s client alert dated 7 May 2021, [here](#).

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The FSR, which will have to be approved by the Parliament and the Council, will likely enter into force by mid-2023. It is expected to have a significant impact on M&A and public procurement activities in the EU as well as on foreign undertakings that have received non-EU subsidies and are conducting business in the EU.

What foreign subsidies will be captured by the FSR?

Under the FSR, the definition of foreign subsidies is deliberately very broad. The FSR captures situations where a non-EU State (i.e. government, public entities or even State-owned/controlled companies) provides, directly or indirectly, a financial contribution which confers a benefit to a company engaging in an economic activity in the EU internal market.

In practice, foreign subsidies will include (i) the transfer of funds or liabilities, (ii) the foregoing of revenues (e.g. tax exemptions) or (iii) the provision of goods or services, or the purchase of goods or services.

A subsidy will be deemed to distort the EU internal market if it improves the competitive position of a company active in the internal market and in doing so, negatively affects competition. In the assessment, the Commission will use a balancing test. The draft FSR provides indicators, however the balancing test remains unclear at this stage. The Commission will issue guidelines on how it will assess the distortive nature of a foreign subsidy.

How will foreign subsidies be monitored?

The FSR will create three different procedures to control foreign subsidies. The first two are *ex ante* notification-based, while under the third, the Commission will be empowered with *ex officio* market investigation powers.

- **Concentrations** – (i.e. acquisitions, mergers or joint ventures) will have to be notified to the Commission if (i) the merging companies, the target or the joint-venture itself generate an EU turnover of at least EUR 500 million, and (ii) the parties received together an aggregate amount of EUR 50 million of foreign subsidies in the last three years. Note that this filing requirement applies in addition to any applicable Merger Control (e.g. under the EU Merger Regulation³) or Foreign Direct Investment filing obligations.

The procedure for those notifications will mirror what is currently applicable under the EU Merger Regulation (25 working days in phase 1, and 90 working days in phase 2). The concentration will be subject to a standstill obligation and cannot be completed until cleared by the Commission.

³ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (OJEU L 24, 29.01.2004, p. 1-22).

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The Commission may require notification of concentrations below the above-mentioned thresholds if it suspects that a distortive foreign subsidy may be involved. This is likely to create legal uncertainty, similar to what is experienced with the new Commission's guidance on the referral mechanism under the EU Merger Regulation.⁴

- **Public procurement** – bidders in public procurements will have to notify to the contracting entity of all foreign subsidies they have received if (i) the estimated contract value is at least EUR 250 million, and (ii) the bidder (including its main subcontractors and suppliers for the tender) received an aggregate amount of at least EUR 4 million by a non-EU State in the last three years.

In terms of process, the contracting authority will have 10 business days to forward the notification to the Commission. Then, the Commission will have 10 business days to declare the notification complete. Once the notification is deemed complete, the Commission will have up to 30 business days to review the foreign contribution within phase I. In case of an in-depth investigation, the Commission will have up to 130 business days to adopt its decision.

The contract cannot be awarded to the bidder until cleared by the Commission.

The Commission may also require notification, before the award of the contract, of foreign subsidies below the above-mentioned thresholds. As with the merger control tool, this is likely to lead to legal uncertainty.

- **Ex officio market investigation** – The Commission will have the power to conduct general market investigations for particular sectors or subsidies. The Commission may initiate *ex officio* investigations, on its own initiative or on the basis of a complaint from an EU Member State or company, to investigate any other market situation where foreign subsidies granted within the past 5 years may have distorted the internal market (including in relation to a closed M&A transaction or awarded public procurement contract).

The Commission will be vested with far-reaching investigative and decisional powers.

New units will be created within the Commission involving three Directorates General (COMP, TRADE and GROW) to enforce the FSR. The Commission will notably be vested with:

- **Investigation powers** – the Commission will have the power to request information from companies, to carry on investigations within the territories of the EU Member States and abroad or impose interim measures.
- **Sanction powers** – the Commission will have the power to impose fines of 10% of the aggregate worldwide turnover of the companies for failure to notify a concentration, for infringing the stand-still obligation, failure to

⁴ Commission Guidance on the application of the referral mechanism set out in Article 22 of the Merger Regulation to certain categories of cases C(2021) 1959 final [here](#).

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notify foreign subsidies in the context of a public procurement procedure, or failure to comply with a decision, with an additional periodic fine of 5% of the average daily aggregate worldwide turnover until the companies comply with their obligations. The Commission will also be able to impose fines of up to 1% of the aggregate worldwide turnover of the companies for procedural infringements (e.g. supplying incorrect, incomplete or misleading information, refusal to submit to an inspection, etc.).

- **Powers to impose commitments** – in case the Commission finds that the subsidies have distortive effects, the Commission can prohibit a transaction or the award of a public contract, or approve them subject to conditions (e.g. divestments), impose the repayment of the foreign subsidies with interest rate, or even impose specific market behaviors such as reducing capacity or market presence, limiting investments, opening access to an infrastructure or assets under fair and non-discriminatory conditions or publishing the R&D results.

Practical implications for companies doing business in the EU.

Non-EU headquartered companies doing business in the EU will face an additional regulatory burden for their M&A and public procurement activities. To the extent, such companies receive non-EU subsidies, they should start preparing now to ensure that they are ready for the entry into force of the FSR.

In particular, companies will need to maintain an inventory of all foreign subsidies they have received in the past five years (on a rolling basis), prior to the entry into force of the FSR and in the future, and assess whether they may have had a distortive effect on the EU internal market (for instance because it was not received under normal market conditions). This work will need to be undertaken for all companies belonging to the same group, regardless of whether they are directly active in the EU.

Preparing for the entry into force of the FSR will require considerable effort. This is particularly true for investment funds that will need to maintain an inventory, keep track and aggregate foreign subsidies received across of all their portfolio companies.

On the seller side, companies should be aware that this new regime will add complexity to the execution of exits, and sellers should diligence potential buyers to assess to what extent these new filing requirements affect the attractiveness of their bids.

Based on our significant experience in merger control, foreign direct investment screening and State aid matters, the Willkie European Antitrust and Competition team is well placed to assist companies in preparing for the application of this new complex legal instrument that may significantly impact their investments.

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