

Publication of the European Regulation on Foreign Subsidies distorting the Internal Market



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Let's talk

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1. Introduction

The European Union (EU) State aid rules provide for limitations and notification obligations in relation to subsidies that the public administrations of EU Member States intend to grant to undertakings located in the EU. By contrast, subsidies from non-EU third States (foreign subsidies) to their undertakings active in the EU were not subject to equivalent rules. This asymmetry distorts the competition conditions of the internal market, to the detriment of undertakings of European origin, especially in the area of mergers and acquisitions (M&A) and public procurement.

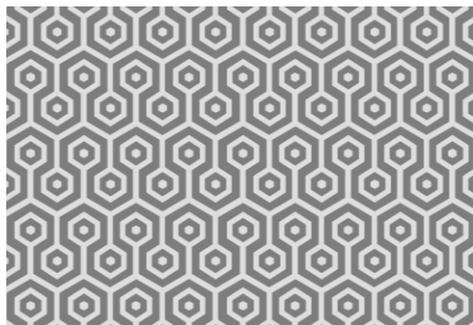
In order to put an end to this regulatory asymmetry, the European institutions have adopted Regulation (EU) 2022/2560 on foreign subsidies distorting the internal market (the Regulation)¹ (FSR or the Regulation). This Regulation has been published in the OJEU on 23 December 2022 and has entered into force on 12 January 2023.

The FSR grants the European Commission (the Commission) ver

y broad powers of intervention to prevent possible distortions of competition in the acquisition of undertakings and in public procurement arising from foreign subsidies, the latter concept possibly being interpreted broadly in line with “State aid”.

The Regulation will have a very significant impact on the design and timing of acquisitions of undertakings, mergers and joint ventures above certain thresholds. It will also affect public procurement procedures involving companies benefiting from foreign subsidies.

It is advisable for the following groups to analyse the impact of this rule on their operations: groups of undertakings that receive foreign subsidies; groups of undertakings that work with suppliers and / or subcontractors that receive foreign subsidies; undertakings that compete with others that receive foreign subsidies; trade associations that join mainly Spanish or European manufacturers; investment funds; undertakings owned by sovereign wealth funds; and third States owned undertakings.



2. Foreign subsidies subject to control

The objective of the FSR is to address market distortions caused by foreign subsidies by ensuring a level playing field. It includes three mechanisms for the control of foreign subsidies: an ex officio review mechanism; a control mechanism in the context of concentrations; and a control mechanism concerning public procurement procedures.

Like State aid rules, the FSR has included a very broad definition of foreign subsidy. For this purpose, the FSR considers as a foreign subsidy any financial contribution by a public body of a third country (or private body whose action can be attributed to the third country), including:

- 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 rescheduling;
- The foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration; or
- The provision of goods or services or the purchase of goods or services.

The FSR does not, therefore, include a concept of foreign subsidy identical to that of State aid as defined in the TFEU. But the objective of this new Regulation coincides with that of the State aid regime and it is therefore likely that the interpretation of the concept of foreign subsidy will end up being close to or even on a par with that of State aid offered by the case law of the Court of Justice of the European Union. In principle, it can cover both direct or indirect transfers of public funds and any

kind of exemptions, tax benefits or public concessions on more favourable terms. The review mechanism will be triggered if the subsidy confers an advantage on its beneficiaries and causes a distortion in the internal market. The FSR considers that foreign subsidies of less than EUR 4 million are unlikely to cause such distortion. Subsidies of less than EUR 200,000 over a consecutive three-year period do not distort the internal market within the meaning of the FSR.

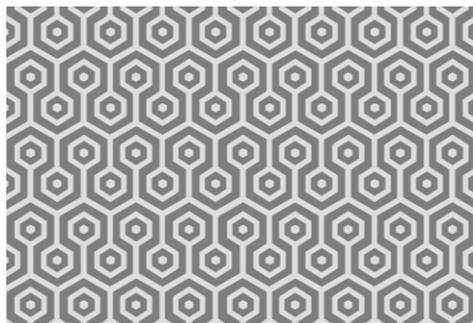
The following categories of foreign subsidies are more likely to distort the internal market: foreign subsidies granted to undertakings in difficulty; unlimited guarantees; export financing measures that are not consistent with the OECD Arrangement on Officially Supported Export Credits; foreign subsidies that directly facilitate a concentration; or foreign subsidies that enable undertakings to submit an unduly advantageous bid in a tender process.

Even if a subsidy falls into one of the categories most likely to distort the market, undertakings under review may provide evidence and arguments to prove that the subsidy does not distort the internal market or that the positive effects of the subsidy may outweigh its negative effects.

3. Monitoring mechanisms

Unlike the rules concerning the control mechanism for foreign direct investment in Spain or other Member States, which empower national bodies, the powers on the control of foreign subsidies lie exclusively with the Commission (subject to review by the Court of Justice of the European Union).

The FSR provides the Commission with three mechanisms for monitoring foreign investments: (i) two mechanisms are based on prior notification by the beneficiary undertaking; and (ii) the third is the power to investigate such foreign subsidies ex officio.



3.1. Mandatory prior notification by undertakings involved in concentration

Drawing on the European Merger Control³ Regulation, the FSR imposes a prior notification obligation on undertakings receiving foreign subsidies regarding concentrations above certain thresholds.

Acquisition of undertakings, mergers and the creation of joint ventures above the following thresholds must be notified to the Commission under the FSR²:

- The acquired undertakings or joint venture generate a turnover in the EU of at least EUR 500 million; and,
- The undertakings involved in the transaction were granted combined foreign financial contributions exceeding EUR 50 million in the three financial years immediately preceding the concentration.

Implementation of the concentration must be suspended pending clearance by the Commission. The Commission's clearance deadlines are aligned with those already in place for concentrations subject to merger control (25 working days or 90 working days, depending on the complexity of the issues raised by the transaction). The possibility to pre-notify the concentration to the Commission is also foreseen.

Future Commission practice will determine the concrete impact of this new regime on the timing of such corporate transactions.

3.2. Mandatory pre-notification by undertakings submitting bids in public procurement procedures

Moreover, undertakings receiving foreign subsidies will be required to make a notification under the FSR to the contracting authority / entity concerning their bids in public tenders, provided that the following cumulative requirements are met:

- That the estimated value of the contract is at least EUR 250 million (in case the contract is divided into lots, that the undertaking bids for lots worth at least EUR 125 million); and,
- The bidder, including its subsidiary companies without commercial autonomy, its holding undertakings and, where applicable, those of its main subcontractors and suppliers⁴, was granted foreign financial contributions of at least EUR 4 million in the three years prior to notification.

The contracting authority / entity shall transfer the notification to the Commission. The deadline for the Commission to take a decision ranges from 20 working days for cases that do not require a thorough investigation to a maximum of 110 working days (extendable by a further 20 working days). During this period, the tenderer may continue the procurement procedure, but shall not award the contract until the decision on this foreign subsidy control procedure has been taken.

3.3. Concentrations and procurement procedures below the thresholds

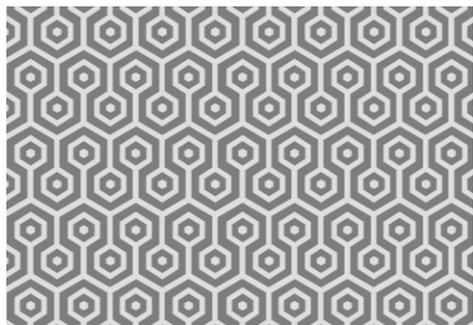
The Commission will also have the power to require notification of concentrations / procurement awards in public procurement procedures below the thresholds set out in the FSR where it suspects that the undertakings concerned have obtained a competitive advantage through a foreign subsidy.

3.4. Ex officio investigation mechanism

On the other hand, the Commission will also have full powers to investigate ex officio foreign subsidies received when it has suspicions that they may have the effect of distorting the internal market.

3. Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (available via the following [link](#))

4. For the purposes of the FSR, a subcontractor or supplier shall be considered to be the main subcontractor or supplier where its participation ensures the provision of elements essential to the performance of the contract and, in any event, where the economic part of its contribution exceeds 20 % of the value of the bid submitted.



The ex-officio investigation would be launched on its own motion or following a complaint received by Member States or third parties concerned (aggrieved undertakings or associations). The Commission may treat the complaint confidentially.

This ex officio power of investigation extends even to mergers already implemented and tenders already awarded. The Commission notes that it will be particularly interested in acquisitions of strategic assets (such as critical infrastructure) and innovative technologies.

4. Corrective measures and imposition of sanctions

The Commission shall impose corrective measures to remedy the distortion in the internal market caused or likely to be caused by a foreign subsidy. The undertakings under investigation may also submit commitments to remedy fully and effectively the distortion in the internal market. As in competition law investigations, remedies or commitments may take the form of: access to infrastructure; refraining from certain investments; disclosure of research and development results; divestment of certain assets; or repayment of the foreign subsidy. In the case of concentrations, the Commission may go so far as to prohibit them or order their dissolution. It may also prohibit the contract from being awarded to the operator receiving the subsidy (if the contract has not yet been awarded and notification has not been required).

The Commission may require the foreign subsidised undertaking to inform the Commission of concentrations it intends to carry out, or bids it intends to submit in public tenders, for a certain period of time.

The Commission has the power to impose fines or periodic penalty payments in cases where an undertaking

fails to comply with remedial measures, or where the information requested is not provided in a timely manner, or is incomplete, incorrect or misleading.

Failure to comply with a Commission decision setting out corrective measures to remedy the market distortion or failure to comply with notification obligations can lead to the imposition of fines of up to 10% of annual turnover.

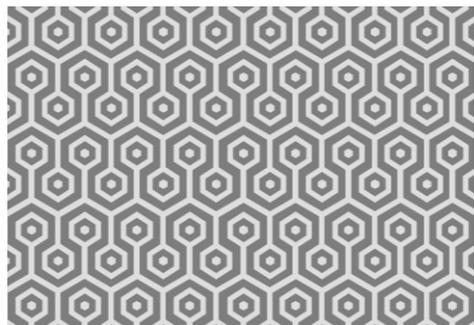
As in competition proceedings, the Commission may send requests for information to the undertakings under investigation or to third parties in order to obtain a better understanding of the subsidies granted, as well as carry out inspections. Penalty payments of up to 1% of total turnover are foreseen for failure to comply with the Commission's requests, for providing incorrect or misleading information or for impeding the Commission's inspections. In addition, each day's delay in providing correct information may result in a periodic penalty payment of up to 5% of the daily turnover for each day of delay.

5. Future guidelines and implementing acts.

It is envisaged that the Commission will adopt implementing acts, e.g. on notification forms, procedural details, deadlines, etc. As usual, once the Commission gains experience from the implementation and application of the FSR, it is foreseen that guidelines will be issued to complement the FSR.

6. Timeline

The FSR entered into force on 12 January 2023, but will apply from 12 July 2023. The merger notification and procurement regime will be mandatory for undertakings from 12 October 2023. The Commission will also be able to investigate foreign subsidies granted in the five years prior to its date of application, i.e. from 12 July 2018.



7. Conclusions and recommendations

The FSR grants new powers to the Commission to analyse and impose restrictions on foreign subsidies granted to companies operating in the EU. In the case of concentrations, it introduces an additional notification obligation (in addition to competition and foreign investment control) that may impact on the conditions and closing date of the transaction. In public procurement, it may influence the criteria for awarding contracts and requires the inclusion of new compliance measures for companies receiving foreign subsidies. It is advisable that undertakings entering into contracts with the public administration, as well as investment funds and undertakings planning to negotiate mergers, acquisitions or joint ventures, take the following actions in the coming months:

- Determine whether they are recipients of foreign subsidies, their amount and impact on the internal market. It should be borne in mind that this analysis will be carried out at the undertaking group level and that it may have a particularly relevant impact when a sovereign wealth fund holds a stake in the undertaking. It should not be forgotten to extend this analysis to main suppliers and subcontractors. If applicable, the new administrative burdens generated by

this rule should be defined and an action plan established to comply with them, causing as little disruption to their operations as possible.

- Assess whether their competitors are recipients of foreign subsidies. If so, define the advantages that this new regime brings them and establish an action plan to make the most of them. Business associations of Spanish or European manufacturers could play a role as interlocutor of the sector's common requests before the Commission in this area.

In any case, one of the most relevant questions raised by this rule is the extent to which non-EU third countries granting aid will be able to raise barriers to the practical enforcement of this rule, as well as the reciprocal measures that could be triggered. This potential lack of cooperation from the recipient companies or from third countries could affect the quality of the data on the basis of which the Commission will take its decisions. It could also hamper investigative measures, as well as the effective collection of fines or the implementation of any corrective measures that might be imposed. The FSR provides for the adoption of bilateral agreements with third countries to solve these potential conflicts.