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ALERT MEMORANDUM

# EU Regulation on Distortive Foreign Subsidies Set for Adoption

*13 July 2022*

On 30 June 2022, the EU institutions reached political agreement on a new regulation which will allow the European Commission to control non-EU government subsidies given to businesses active in the EU (the "Regulation").[1] First announced in May 2021, the proposed Regulation is likely to be adopted later this year, to take effect by mid-2023.

The agreed text closely follows the Commission's proposal, with the same broad scope of application and the same monetary thresholds for triggering the mandatory merger review regime. In addition, it refines the thresholds for the public procurement review regime and provides further clarity on how to assess distortive foreign subsidies.

This alert memo summarizes the key provisions of the new Regulation and updates our previous coverage of the proposal. It also discusses some practical steps to help businesses prepare.


If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors.

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## *Ex Ante* Notification Regimes for Mergers and Public Tenders

The Regulation establishes mandatory notification regimes for businesses that have received financial contributions from a non-EU government, when participating in certain large mergers or public tenders.

| | Thresholds | Procedure |
|---|---|---|
| **Mergers** | • The acquired business, one of the merging businesses, or (once created) the joint venture, is established in the EU and has EU turnover of at least € 500 million, and<br>• The parties to the transaction (*e.g.*, the buyer(s) and the target) received financial contributions from non-EU states exceeding € 50 million in the last three years. | • Suspensory review<br>• Procedure mirrors EU merger control: pre-notification is followed by a Phase 1 review (25 working days), and possible Phase 2 (90 working days) |

[1] In practice, the Regulation will apply to non-EEA public subsidies, as the EU's regime to regulate aid granted by its Member States applies across the EEA (*i.e.*, the EU and Iceland, Norway, and Liechtenstein).

| | Thresholds | Procedure |
|---|---|---|
| **Public tenders** | • The contract value of the tender is at least € 250 million or greater; <u>and</u><br>• In cases where the tender is divided into lots, the aggregate value of the lots applied for is at least € 125 million or greater; <u>and</u><br>• The bidding party and its main subcontractors and suppliers received financial contributions of at least € 4 million or greater from a single non-EU country in the last three years. | • Suspensory review (but contract can be awarded to non-subsidized best bidder in certain cases)<br>• Preliminary review period (20 days), with possible in-depth review (110 days)<br>• Bidding parties falling under the € 4 million threshold still need to declare their non-EU financial contributions received and confirm they are under the threshold |

## *Ex Officio* Investigation Regime

The Regulation empowers the Commission to proactively investigate financial contributions to assess if there is a distortive non-EU subsidy and impose remedies (*e.g.*, repayments, divestments, access commitments). The Commission can investigate subsidies granted up to 10 years prior, including in the five years preceding the Regulation's effective date (this retroactive period was 10 years in the Commission's initial proposal). There is no legal deadline for the Commission to complete its investigation.

## Definition of subsidy

The Commission will assess if there is a "subsidy", which is defined as (a) a financial contribution; (b) which is provided by a non-EU state; (c) which confers a benefit on the recipient; and (d) which is selective *i.e.*, limited to one or more businesses or industries.

<u>Financial contribution</u>. "Financial contribution" is broadly defined and covers any transfer of funds, forgoing of revenues, or provision or purchase of goods and services. The agreed text clarifies that this could include special or exclusive rights granted without adequate remuneration.

<u>Provision by non-EU State</u>. Based on EU State aid precedent, the support would be attributable to a non-EU government if it was involved in the decision to grant this support, regardless of whether the support was provided by a public or private entity. This is assessed based on all relevant circumstances, including the grantor's governing structure and activities, its interactions with government bodies, and the prevailing legal and economic environment of the state where the beneficiary operates.

<u>Benefit</u>. The support will not confer a benefit if it is provided in line with normal market conditions. This is assessed based on comparative benchmarks, such as the investment practice of private investors, the rates of financing obtainable on the market, the tax treatments for similarly situated companies and normal remuneration for the goods or services transferred.

<u>Selectivity</u>. The support will not be selective if it is available to all firms in the economy (including after satisfaction of objective and non-

discriminatory criteria that are consistent with the scheme's objectives).

## Assessment of Distortion and Balancing Test

Before imposing redressive measures, the Commission should determine if the foreign subsidy (a) has distortive effects in the EU market and (b) if there are counterbalancing positive effects.

Distortive effects. A subsidy is distortive if it could improve the business's competitive position in the EU. Certain forms of support are "*most likely*" to be distortive, namely (a) aid to ailing firms outside a viable restructuring plan; (b) unlimited guarantees; (c) support for a specific merger or public tender; and (d) certain export financing (this last category is an addition to the Commission's proposal). The agreed text defines two *de minimis* thresholds: foreign subsidies shall not be distortive if the total amount received by the beneficiary did not exceed € 200,000 per non-EU country in any three year period, and are "*unlikely*" to be distortive if they did not exceed € 4 million in any three year period (this threshold was € 5 million in the Commission's proposal). A subsidy may not be distortive if it is aimed at repairing damage caused by natural disasters or exceptional occurrences.

Balancing test. The Commission may consider any positive effects on the subsidized economic activity, which may mean that no or less onerous redressive measures are required. The agreed text clarifies that broader positive effects on "policy objectives" (particularly those of the EU) are also relevant, such as environmental protection or the promotion of R&D or social standards.

## Enforcement Powers

The Commission will have sweeping powers to remedy distortive effects, including through: (a) prohibiting the merger transaction or public contract award; (b) structural remedies (such as capacity reductions or divestments); and (c) behavioral remedies (such as access commitments for infrastructure, the publication of R&D results, or a repayment of the subsidy). The agreed text adds further possible remedies in the form of governance structure changes and an obligation to inform the Commission of future M&A or public tender bids. The Commission may impose fines of up to 10% of global turnover for non-cooperation, such as a failure to notify relevant mergers or public tender bids or to provide required information.

### What can businesses do to prepare?

- Set up reporting to gather information on all forms of "financial contributions" received from non-EU governments in past years (since at least 2020) and going forward.
- Where possible, prepare documentation showing that such contributions are made on market terms (such as a fairness opinion, independent expert report, or institutional investment guidelines for sovereign bodies).
- When the financial contribution is not made on market terms, critically review the most important contributions to ensure:
  - Possible public policy justifications (such as environmental protection, R&D, social standards, *etc.*), preferably with positive effects in the EU; and
  - Limited negative effects on competition in the EU.

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