

European Commission proposes new Regulation on foreign subsidies

In brief

On 5 May 2021, the European Commission ("**Commission**") published a proposed **Regulation**, along with an **impact assessment report**, aiming to address potential distortions caused by foreign subsidies in the Single Market ("**Proposed Regulation**"). This Proposed Regulation will create substantial new obligations for companies if adopted in its current form. There are three new obligations in particular to be aware of:

1. The Commission will have the ability to initiate ex officio reviews of foreign subsidies in the preceding 10 years, meaning companies may have to comply with requests for information (RFIs) and be subject to inspections. In addition, the Commission may conduct inspections **both in the EU and outside the EU** (subject to certain conditions).
2. Companies may have to notify the Commission of any transaction financed by foreign subsidies. This filing obligation is in addition to any applicable merger filing requirements at the EU level or at the national level (see proposed thresholds below).
3. Any company wanting to participate in any public procurement in the EU with a value greater than EUR 250 million will have to notify the Commission prior to submitting its tender offer and to provide a substantial amount of information about **all** foreign financial contributions received in the past three years. The Commission can also intervene in procurement processes with a value below these thresholds on an ex officio basis.

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Key takeaways

The Proposed Regulation as drafted introduces an additional regulatory requirement for companies doing business in Europe. Inevitably, it will increase the regulatory risk and burden for companies that are active in the EU and have received foreign (i.e., non-EU) subsidies. Notably for M&A transactions involving EU targets and non-EU companies that have benefited from foreign subsidies, preclosing (i.e., suspensory) hurdles may now include: (i) the new mandatory filing obligation under the Proposed Regulation; (ii) the "existing" merger control filing obligation at the EU or the Member State national level; and (iii) foreign investment filing obligations at the EU Member State level.

Outside of the sphere of M&A, the Proposed Regulation will increase regulatory scrutiny for international companies active in the EU. Companies will need to review carefully whether they have been in receipt of any foreign subsidy in the past 10 years and assess the residual risk of an ex officio Commission investigation, as well as ensuring compliance with EU public procurement processes to the extent relevant.

At this stage, the Proposed Regulation is still a proposal and is subject to review and subsequent amendments from the European Parliament and the Council of the European Union. The ordinary legislative process to adopt the Proposed Regulation is unlikely to be concluded before the end of 2022.

In the meantime, it is important for companies to engage with the Commission and make their views known. The Commission is seeking feedback until **30 June 2021**, which you can submit [here](#). Please reach out to your Baker McKenzie lawyers for more information and for assistance to submit feedback.



In more detail

Scope of the Proposed Regulation

1. Broad definition of "foreign subsidies"

The Proposed Regulation targets "foreign subsidies," which are defined as non-EU third country financial contributions conferring a benefit to an undertaking engaged in an economic activity in the internal market, and that are limited to one or several individual undertakings or industries. There is, therefore, the potential for all kinds of measures to be within scope.

For example, a financial contribution may consist in the transfer of funds or liabilities (e.g., capital injections, grants, loans, loan guarantees, fiscal incentives), the foregoing of revenue that is otherwise due, or the provision of goods or services or the purchase of goods or services. Such financial contribution may be provided by the following:

- central government and government authorities at all other levels
- foreign public entities whose actions can be attributed to the third country
- any private entity whose actions can be attributed to the third country, taking into account all relevant circumstances

Such foreign subsidies will be scrutinized where they may distort the internal market in the EU. A distortion on the internal market would be deemed to exist where a foreign subsidy would be liable to improve the competitive position of the undertaking concerned in the internal market and where, in doing so, it actually or potentially negatively affects competition on the internal market. The Commission may consider certain criteria when assessing whether there is a distortion, such as the amount and nature of the subsidy or the purpose and conditions attached to the subsidy.

2. Which foreign subsidies are likely to be caught?

The Proposed Regulation contains some **red flags** (i.e., foreign subsidies most likely to distort the internal market), but also a **safe harbor**:

Red flags (non-exhaustive list)	Safe harbor
<ul style="list-style-type: none"> • foreign subsidies granted to a company likely to go out of business in the short or medium term in the absence of any subsidy (unless there is a restructuring plan that is capable of leading to the long-term viability of that undertaking and includes a significant own contribution by the undertaking) • foreign subsidies in the form of an unlimited guarantee for debts or liabilities of the undertaking, that is to say without any limitation as to the amount or the duration of such guarantee • foreign subsidies directly facilitating a concentration • foreign subsidies enabling an undertaking to submit an unduly advantageous tender, on the basis of which the undertaking would be awarded the public contract 	<ul style="list-style-type: none"> • Foreign subsidies below EUR 5 million over any consecutive period of three fiscal years are unlikely to distort the internal market (versus a much lower threshold of EUR 200,000 that was initially proposed in the White Paper and that reflects the general de minimis threshold for State aid granted by EU Member States).

The Commission's new investigatory powers

The Member States will have no role in examining foreign subsidies. The Proposed Regulation involves enforcing all components at EU level. The Commission's new investigatory powers are described in more detail below for (i) ex-officio reviews, (ii) concentrations and (iii) public procurements.

1. Ex officio reviews

The Commission will have the power to initiate ex officio reviews of foreign subsidies, based on any source of information regarding alleged distortive foreign subsidies.



In doing so, the Commission may issue RFIs and may conduct inspections **both in the EU and outside the EU**. Investigations outside the EU will nevertheless be subject to the following conditions:

- i. the third country must have been notified and must have agreed to the inspection
- ii. the undertaking concerned must have agreed to the inspection

Based on its preliminary review (of which the maximum possible length is unclear), the Commission may, where it considers that there are sufficient indications that an undertaking has been granted distortive foreign subsidies, adopt a decision to initiate an in-depth investigation. In-depth investigations may result in the imposition of redressive measures or the adoption of a decision with commitments.

While the Proposed Regulation does not have retroactive effect, it would apply to foreign subsidies granted in the 10 years prior to a review being initiated, starting from the Proposed Regulation's entry into force.

The Commission has the ability to launch market investigations of entire sectors if it has reasonable suspicion that foreign subsidies are distorting the internal market. The Commission also has the ability to investigate transactions and public procurement bids below the relevant thresholds triggering a specific review (see below). This enables the Commission to conduct investigations on its own initiative, in far reaching ways. It is unclear how these new powers may be used in practice.

2. M&A transaction reviews

The Proposed Regulation introduces a new review process for M&A transactions possibly involving distortive foreign subsidies, which is separate from the existing EU merger control filing regime. Assuming the thresholds below are met, a transaction would have to be notified to and approved by the Commission.

A transaction will be notifiable under the Proposed Regulation where both of the following apply:

- (a) The **target** or at least one of the merging undertakings is established in the EU and generates an aggregate turnover in the EU of at least EUR 500 million
- (b) The undertakings concerned received from third countries an **aggregate** financial contribution in the **three calendar years** prior to the notification of more than EUR 50 million.

In the creation of a **joint venture**, a concentration will be notifiable where both of the following apply:

- (a) The joint venture itself or one of its parent undertakings is established in the EU and generates an aggregate turnover in the EU of at least EUR 500 million.
- (b) The joint venture itself and its parent undertakings received from third countries an **aggregate** financial contribution in the **three calendar years** prior to notification of more than EUR 50 million.

In each case, the second threshold is defined by the financial contribution. As such, a filing obligation may be created for businesses that have significant dealings with third countries, including public bodies and potentially private businesses. This would apply even in circumstances when the dealings are on purely commercial terms. Furthermore, the EUR 50 million financial contribution threshold is an **aggregate** threshold, so could be triggered if a number of different countries make contributions.

Furthermore, the test for joint ventures, as drafted, would include joint ventures whose activities are wholly outside the EU, if one parent is active inside the EU. As such, just as is the case with the EUMR, we may see joint ventures notified even when they will have no activity within the EU.

The suggested timeline for a concentration notification under the Proposed Regulation is similar to the timeline that applies to merger control investigations under the EU Merger Regulation. The Commission would have 25 working days to review the notified transaction (Phase I) once it is deemed that the notification is complete. However, it may take several months to provide the necessary information for the notification to be declared complete and for the review period to start. This review period can be extended by a further 90 working days (Phase II). If the parties offered commitments, the Phase II review period will be extended by a further 15 working days. In addition, the Phase II review period can be extended by a further 20 working days at the request of the notifying parties and of the Commission, if the notifying parties agree. After its investigation, the Commission may issue: (i) a no objection decision; (ii) a decision with commitments; or (iii) a decision prohibiting the concentration.

The Proposed Regulation also enables the Commission to request prior notification of any non-notifiable transaction, at any time prior to its implementation if the Commission suspects that in the previous three years the undertaking or joint venture may have benefited from foreign subsidies.



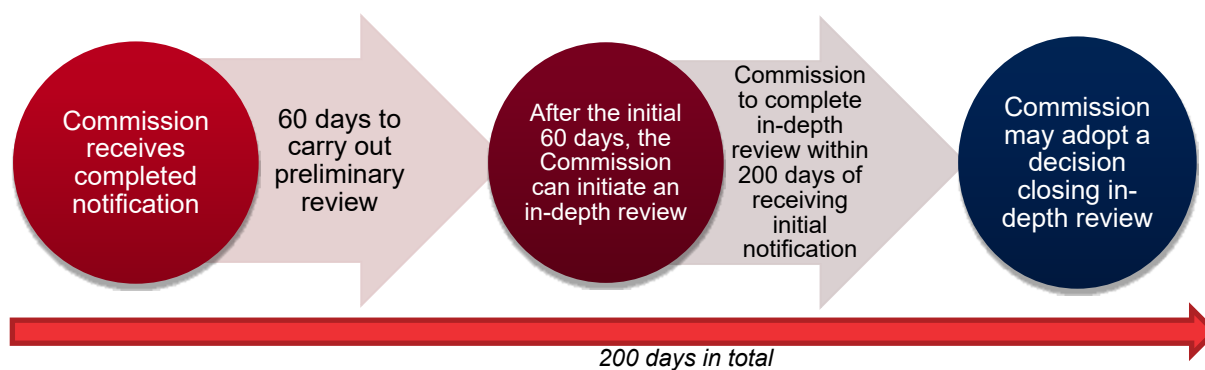
3. Public procurement reviews

The Commission may also review foreign subsidies that may cause or risk causing a distortion in public procurement procedures. This would be the case for example where the foreign subsidy would enable a company to submit a tender that is unduly advantageous in relation to the works, supplies or services concerned.

In practice:

- the obligation to notify applies prior to submitting a tender or a request to participate in a public procurement where the estimated value of that public procurement is equal or greater than EUR 250 million
- the companies concerned will need to notify the contracting authority or entity of **all** foreign financial contributions received in the **three years** preceding the notification (or confirm in a declaration that they did not receive any)

The contracting authority or entity will transfer the notification to the Commission. The timeframe for the Commission to carry out its review is as follows (please note that at this stage it is unclear whether the Proposed Regulation refers to calendar or working days):



During both the preliminary review period and in-depth review period, the evaluation of the tenders in the public procurement procedure may continue but a contract may not be awarded before the review periods set out above expire (or the Commission issues a decision). After its investigation, the Commission may either: (i) issue a decision with commitments (which will not result in a modification of the initial tender submitted by the undertaking); (ii) adopt a decision prohibiting the award of the contract to the undertaking concerned; or (iii) issue a no objection decision.

Redressive measures, commitments and fines

The Commission can impose structural and behavioral measures on an undertaking in order to remedy any distortion caused by the subsidy. The undertaking can also offer commitments to remedy the distortion, including the repayment of the subsidy to the party or country that granted it, together with interest.

If, in any of the above proceedings (ex officio, concentrations or public procurements) the companies intentionally or negligently supply incorrect, incomplete or misleading information, documents or answers, or refuse to submit to inspections or breaks seals, the Commission can impose a fine amounting to a maximum of 1% of the aggregate turnover of the undertaking concerned in the preceding business year.

If a company does not comply with a decision with commitments, the maximum fine is increased to 10% of the aggregate turnover of the company concerned in the preceding business year.

The Commission can also impose periodic penalty payments of up to 5% of the average daily aggregate turnover of the company concerned. Please note that at this stage it is unclear whether the Proposed Regulation refers to the global aggregate turnover of the undertakings concerned.



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