Reflecting On 12 Months Of The EU Foreign Subsidy Regime

By **Tobias Caspary and Valeri Bozhikov** (September 27, 2024)



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The notification obligations under the European Union's Foreign Subsidy Regulation will, on Oct. 12, have been in force for one year,[1] providing an opportune time to look back and reflect.[2]

In this time, the European Commission has published guidance and finally provided clarity on its understanding of the term "distortion" under the foreign subsidy regime, or FSR.[3]

This article's purpose is twofold. It will detail what the regime entails, providing an overview of the commission's practice to date, and it will also offer practical takeaways for practitioners.

What the FSR Regime Entails

The FSR constitutes a trade policy instrument aimed at addressing a perceived legislative gap: namely, the control of non-EU subsidies that distort competition in the EU's internal market, which fall outside the otherwise overarching EU state aid rules, and thereby undermine its level playing field, particularly regarding the efficient allocation of capital.

The FSR regime requires businesses to notify the commission and obtain prior clearance for certain transactions and public procurement procedures. It also allows the commission to open ex officio investigations into potentially distortive non-EU subsidies.

Commission's Practice to Date

What has happened within the enforcement landscape in the past 12 months? Within the first hundred days, the commission had prenotification discussions in the context of 53 deals, only 14 of which led to a formal notification.[4] This shows that the commission is also willing to decline jurisdiction, which is a positive development.

The commission opened five in-depth investigations under the FSR, of which four are in the area of procurement procedures and one in the area of concentrations.[6]

In February, the commission created an entirely new directorate for FSR matters within its directorate-general for competition. The new directorate K is headed by a senior and experienced state aid official, Karl Soukup, who is also still acting director of directorate-general for competition's horizontal state aid directorate H (general scrutiny and enforcement).

Three units have been allocated to the new directorate. It is encouraging that the commission has deployed such important resources, enabling it to review cases swiftly.

On June 10, the commission opened its first concentration-related in-depth investigation under the FSR. It did so after finding, in its preliminary review, sufficient indications that at least one of the parties to the notified concentration had been granted a foreign subsidy

that distorts the internal market.

The procurement-related investigations always concerned Chinese bidders: trains in Bulgaria, solar panels in Romania[5] and wind turbines in Bulgaria, France, Greece, Romania, Spain and Germany.[7]

While the investigation regarding Germany appears to be ongoing, none of the other investigations resulted in a final decision by the commission, as the bidders preempted this by walking away from the bids in question.

Interestingly, the commission itself came under scrutiny in China by the launch of a sort of tit-for-tat investigation by the Ministry of Commerce.[8] The commission's reaction was unsurprising: "The EU's rules to fight unfair foreign subsidies don't specially target China, as companies are exposed to being probed regardless of their seat or nationality."[9]

Following the first dawn raid on-site inspection that the commission conducted under the FSR in late April, the raided company, active in security equipment, unsuccessfully applied for an interim order to the General Court of the EU to temporarily suspend a commission's production order for mailboxes stored on servers in China.

This was in the context of a continued inspection — the so-called continuation of the dawn raid at the commission's premises pursuant to Article 14(3) of the FSR.[10]

Guidance Document

Additionally, some open procedural questions relating to the FSR have been clarified in the meantime. The commission's guidance document of July 26 offers some clarification on how it understands the term "distortion" in both merger control and public procurement contexts, namely under Articles 4(1), 6 and 27, respectively.

Distortion in FSR Merger Control Context

Where a foreign subsidy offers a benefit to an undertaking, it is considered a distortion if it actually or potentially negatively affects competition in the EU internal market. The competitive position of an undertaking can be improved directly by a foreign subsidy given to an EU entity active in the internal market, but also indirectly, e.g., in the case of cross-subsidization.

As far as the actual or potential negative effect on competition is concerned, such effects can be found regarding any activity in which the beneficiary engages in the internal market.

Negative effects might also be found, in view of Recital 6 of the FSR, where foreign subsidies lead to an unlevel playing field, i.e., when they unduly alter the chances of succeeding in the market.[11]

To determine the presence of distortion, the commission will first consider if the subsidy is capable of improving the competitive position of a given undertaking in the internal market and, if so, seek to determine whether there are any actual or potential negative effects on competition in the internal market as a result.

The commission may conclude that the foreign subsidy meets the distortion test. This may be either by establishing that it falls among those most likely to distort competition in the internal market and the undertaking under investigation — not offering, under Article 5(2),

convincing information why it does nevertheless not distort the internal market. Or it might be pursuant to a determination based on indicators such as those listed in the second sentence of Article 4(1), when it then moves to the balancing test under Article 6.

Distortion in FSR's Procurement Context

Two cumulative conditions must be met:

- The tender submitted by the subsidized entity must be unduly advantageous in relation to the works, supplies or services concerned; and
- There must be a link between the granting of the subsidy and the tender.

Balancing Test

Under the balancing test of Article 6, the commission will consider whether the distortion can be counterbalanced by positive effects on the "development of the relevant subsidized economic activity on the internal market," while considering "broader positive effects in relation to the relevant policy objectives, in particular those of the Union," including, e.g., considerations relating to a high level of environmental protection, social standards, and promotion of research and development.

The commission's guidance states that foreign subsidies qualifying as among the most likely to distort under Article 5 are less likely to be outweighed by positive effects than foreign subsidies for which distortion was determined, based on the indicators of the second sentence of Article 4(1).

Distortion in the Internal Market and Distortion of Competition

Under EU state aid rules, there is a distortion of competition under Article 107(1) of the Treaty on the Functioning of the EU, when the state grants a financial advantage to an undertaking in a liberalized sector with actual or potential competition. Aid that relieves the beneficiary of expenses it would otherwise have had to bear in the course of its day-to-day business operations is normally considered as distorting competition.

Conversely, under the FSR, there is no presumption of a distortion of the internal market just because the beneficiary of a foreign subsidy is economically active in a liberalized sector.

Rather, the distortion can either be based on the presumption of Article 5 — foreign subsidies most likely to distort — or on indicators such as those listed in Article 4(1):

- Amount and nature of the foreign subsidy;
- Situation of the beneficiary, including its size and the markets or sectors concerned;
- Beneficiary's economic activity in the EU; and
- Subsidy's purpose, conditions and use in the EU.

Practical Takeaways

The FSR is a novel regime and the commission's practice and available guidance are still

scarce.

In the meantime, clients may need help to assess whether FSR notifications will be required for planned merger and acquisition or procurement activity. They should screen for foreign financial contributions received and include them in internal registers.

They should also assess any FSR risk for specific transactions or public procurement procedures, and consider whether any clauses in M&A agreements need to be marked up to address the latter.

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[1] Regulation (EU) 2022/2560 of December 2022 on foreign subsidies distorting the internal market (OJ [2022] L 330/1).

[2] FSR notification obligations under Articles 21 and 29 commenced on Oct. 12, 2023, and started to apply as of July 12, 2023, when the Commission adopted its implementing regulation on foreign subsidies distorting the internal market: OJ [2023] L 177/1). https://www.friedfrank.com/news-and-insights/eu-s-unprecedented-foreign-subsidy-regime-comes-into-force-11222 and https://www.friedfrank.com/news-and-insights/ex-us-merger-control-top-five-trends-for-2024-11558.

[3] Commission Staff Working Document. https://competition-policy.ec.europa.eu/document/download/b4c8bb13-839b-4bfb-8863-78b188523d22_en?filename=20240726_SWD_clarifications_on_application_of_FSR.pdf.

[4] https://competition-policy.ec.europa.eu/document/download/22197012-2036-4b1e-8b02-0eb8b2d6e666_en?filename=kdar24001enn_competition_FSR_brief_1_2024_100-days-of-FSR-notification-obligation.pdf.

[5] Speeches by Executive Vice President Vestager: https://ec.europa.eu/commission/presscorner/detail/en/speech_24_3510) and https://ec.europa.eu/commission/presscorner/detail/en/speech_24_1927).

[6] https://www.houthoff.com/insights/news-update/a-year-in-review-levelling-the-field-with-the-eus-foreign-subsidies-regulation#:~:text=One%20year%20of%20FSR%20enforcement,also%20conducted%20one%20dawn%20raid.

[7] WindEurope Press Release (https://windeurope.org/newsroom/press-releases/eu-starts-investigation-into-chinese-wind-turbines-under-new-foreign-subsidies-regulation/). RENEWS, See https://renews.biz/94455/eu-extends-chinese-turbine-probe-to-germany/.

[8] https://efe.com/en/latest-news/2024-07-10/china-opens-investigation-into-eu-trade-barriers/.

[9] https://mlexmarketinsight.com/news/insight/foreign-subsidy-rules-don-t-discriminate-eu-regulator-says-in-response-to-chinese-probe).

[10] Order of 12 August 2024: Case T-284/24 R Nuctec Warsaw Company Limited and Nuctec Netherlands v Commission EU:T:2024:564 – https://curia.europa.eu/juris/document/document.jsf;jsessionid=9D02F5AA1D6DD2FE29D22752956D7E8F?text=&docid=289333&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=5331372.

[11] Guidance SWD (n 3), answer to Question 1 (p. 1 f.).