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The Anti-Subsidy Regulation: European Parliament and Council Clinch Last-Minute Deal

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On June 30, in the final hours of the French Presidency, the European Council and the European Parliament announced agreement on a regulation on distortive foreign subsidies (the Foreign Subsidy Regulation, or FSR). The FSR creates a unique new antitrust regime to combat distortions of competition in the European Union (EU) caused by subsidies multinationals receive outside the EU. It creates two new notification and approval regimes, for significant M&A transactions and bids in large-scale public procurement, and empowers the Commission to investigate other market situations and lower-value mergers and tenders. The regulation will be formally adopted after review by the Commission's lawyer-linguist teams, likely in the fourth quarter of 2022, and become effective 20 days after publication, in late 2022 or early 2023.

Agreement was extraordinarily rapid, considering the FSR's complexity: the Commission tabled its proposal in May 2021 and the Council and Parliament began negotiations based on their proposed amendments in May 2022. In its negotiating position, the Council sought changes to clarify application of the so-called "balancing test," which allows the Commission to overlook distortive effects of a foreign subsidy outweighed by positive effects; governance changes to give Member State greater visibility on enforcement; greater clarity and shorter timelines for the public procurement tool; and higher thresholds and shorter timelines. The Parliament's announced priorities were broadly similar, except that the Parliament wanted to widen notification obligations instead of narrowing them. Many of these issues were still on the table going into the final negotiating session, including thresholds, investigation procedures and the balancing test. For a detailed overview of the FSR and the state of play at the beginning of the trilogues, see here.

How does the final agreement stack up against the Commission's original proposal? The Parliament and Council agreed a number of changes that will be welcomed by the business community. But the Commission's original proposal is largely intact, and the final regulation will require multinationals who may be caught by notification obligations to adapt their existing reporting and compliance procedures. The non-exhaustive summary below reflects available information and discussions with Commission officials, but revisions may be required when the final text of the regulation becomes available.

Implementation

The Commission proposed that the FSR apply six months after effectiveness, but the final agreement provides for a staggered implementation timeline. While most of the regulation will apply after six months – i.e., mid-2023 — the M&A and public procurement notification obligations will apply three months later, and Member States will have six months to adapt their national legislation if needed to allow for inspections in their territory. The Commission will start work on an implementing regulation, including notification forms, and launch a public consultation around January 2023, to be able to formally adopt the implementing regulation six months after effectiveness. This will give notifying parties three months to familiarize themselves with the forms before the new notification obligations apply, but multinationals will likely need to have started collecting relevant information well before then. Other guidance, for instance on the definition of financial contributions, may follow later.

Financial Contributions, Foreign Subsidies and Distortions

The FSR's new notification obligations are based in part on the "financial contributions" received by the relevant parties. Financial contributions are defined much more broadly than "subsidy" or "State aid." The Parliament and Council tinkered with the definition of financial contribution (e.g., adding references to tax exemptions and special or exclusive rights granted without adequate remuneration) but made no major changes. In particular, the co-legislators ignored calls to introduce a *de minimis* threshold and to exclude categories of financial contribution that would be highly unlikely to qualify as subsidies to reduce the volume of information to be collected.

The co-legislators similarly made few changes to the criteria for determining whether a financial contribution qualifies as a foreign subsidy or whether a foreign subsidy is likely to be distortive. However, they did include a new recital indicating that a financial contribution granted exclusively to the non-economic activities of a public undertaking will not constitute a foreign subsidy unless it is used to cross-subsidize economic activities.

On the other hand, the co-legislators' agreement states that foreign subsidies that would qualify as *de minimis* aid for EU State aid purposes are by definition not distortive, while foreign subsidies making good damages from "natural disasters or exceptional occurrences" "may" be considered non-distortive. This addition acknowledges that multinationals all over the world have received significant support during the pandemic. However, beneficiaries of such assistance must still count it as financial contributions, and the Commission is not precluded from finding such assistance to be a distortive foreign subsidy. The final agreement also added a new category of foreign subsidy considered most likely to be distortive: export financing measures not in line with the OECD Arrangement on officially supported export credits.

M&A Review

The new M&A review procedure in Chapter 3 of the FSR is modeled on the EU Merger Regulation (EUMR). Much of the text is familiar, including the definition of "concentrations" subject to notification and the review procedures and timelines. The Parliament and Council recognized the potential for administrative burdens and duplication between FSR and EUMR notifications, as well as notifications under national foreign direct investment (FDI) screening laws. The Parliament proposed adding a recital, which was included, envisaging pre-notification

consultations between transaction parties and the Commission. The text also envisages introduction of a simplified procedure, as under the EUMR. However, the Council's proposal to allow combined FSR and EUMR notifications was rejected.

The first limb of the new notification thresholds is based on turnover, as under the EUMR. To be caught, at least one of the merging parties, the target (in an acquisition of sole control) or a full-function joint venture involved in a transaction must generate aggregate EU turnover of at least EUR 500 million, the Commission's original proposal. However, the treatment of joint ventures represents a major improvement for business compared to the original proposal, which could have required notification of joint ventures with no EU connection.

The second limb of the notification thresholds is based on financial contributions. All parties involved in the concentration must have received combined aggregate financial contributions of more than EUR 50 million in the previous three calendar years, as originally proposed by the Commission. Calls to phase in the financial contribution threshold starting with one previous calendar year (so multinationals would not need to re-open their books on closed financial years) went unheeded.

A concentration not meeting the thresholds will be deemed notifiable if the Commission suspects that the parties received foreign subsidies in the prior three years and requests notification prior to implementation. Unlike Article 22 EUMR, which the Commission relies upon to get EUMR jurisdiction over sub-threshold transaction, its powers under the FSR do not depend on a Member State referral. However, the Parliament and Council inserted a requirement for the Commission to publish guidance on the application of this process and to update that guidance in light of enforcement experience. In a change proposed by the Council, multinationals investigated under the public procurement tool can also be required to inform the Commission of future sub-threshold concentrations, giving the Commission an opportunity to require a formal notification.

No changes were made to the FSR review processes, which as mentioned are modelled closely on the EUMR. The forthcoming implementing regulation will also likely track the Commission's EUMR implementing regulation, potentially with cross-references to other guidance such as the Commission's consolidated jurisdictional notice. The notification forms will, however, differ significantly from the EUMR's Form CO in view of the role of financial contributions and the different concerns underlying the FSR.

For a detailed discussion of the FSR's implications for parties and antitrust counsel in the M&A context, see here.

Public Procurement Review

The FSR's public procurement tool is set out in Chapter 4 and covers public tenders for supply, works, and services concessions covered by EU public procurement rules. Interestingly, contracts in the fields of defence and security and cases of extreme urgency are excluded from the notification obligation, but the co-legislators ignored calls to exclude such contracts from the financial contribution information to be collected and from the Commission's ex officio investigation powers.

The Parliament and Council made significant changes to the original text, including shortened

review timelines, but the core of the Commission proposal remains intact. The original proposal required notification of financial contributions where the estimated value of that public procurement was equal or greater than EUR 250 million. As with the M&A tool, the Parliament proposed lowering this threshold, while the Council proposed raising it. In the end, the co-legislators stuck with EUR 250 million but added provisions to address special circumstances such as specific procurement under the dynamic procurement system, framework contracts and tenders divided into lots. Multinationals previously investigated under this tool may be required to submit notifications in future tenders that do not meet the minimum thresholds.

The co-legislators added a new requirement that the bidder and its main sub-contractors and suppliers have received at least EUR 5 million in financial contributions over the prior three calendar years, far less than the EUR 50 million financial contribution threshold under the M&A tool. The addition of a minimum financial contribution threshold for public procurement notifications is welcome, but considering how broadly financial contributions are defined this addition will likely have little effect.

On the other hand, the co-legislators broadened the public procurement tool by requiring bidders to submit financial contribution information where the value threshold is met but the works, supplies or services can be supplied only by a particular economic operator (so that a public tender is not required). Such information will not be considered a notification and will not trigger an investigation under Chapter 4, but it could lead to opening of an ex officio investigation under Chapter 2.

The final agreement includes new language fleshing out procedures for public procurement notifications, including a requirement for bidders to include an express statement as to whether a notification is required or a declaration that no notification is required, as well as steps to be followed where a notification is missing or the Commission finds it to be incomplete. The requirement for bidders to include information on financial contributions received by their main contractors and suppliers remains, and indeed the threshold for contractors and suppliers to be considered “main” has been reduced from 30% to 20% of the estimated contract value. On the other hand, responding to concerns about liability for potential errors, bidders will only be liable for the accuracy of their own financial contribution information.

The EU co-legislators also introduced language clarifying the consequences of a Commission investigation. Where a tender is accompanied by a notification, the tender cannot be awarded unless and until the Commission adopts a decision closing the investigation or fails to open an in-depth investigation within the preliminary review time limit. That time limit has been significantly reduced from the 60 days proposed by the Commission. Under newly clarified language, if a bidder submits a declaration that no notification is required, the contracting authority can award the contract without waiting for the end of the preliminary review period, unless the Commission has opened a review in the meantime.

Similarly, if the Commission opens an in-depth investigation, the contracting authority cannot award the contract until a positive decision is adopted or the in-depth review time limit has expired. That time limit has also been shortened from the 200 days proposed by the Commission. Contracting authorities will be required to reject tenders where the Commission adopts a decision prohibiting the tender or finding that the tender was irregular. If the contracting authority found that the tender in question was the most economically advantageous, the authority can award the tender to the next most economically advantageous tender.

Ex Officio Investigations

The agreed text leaves the Commission's powers to conduct *ex officio* investigations – which are set out in Chapter 2 and based on Regulation 1/2003 – essentially unchanged, although the co-legislators introduced a requirement for the Commission to inform Member State authorities and relevant contracting authorities when launching a preliminary investigation, in particular where Member States have informed the Commission of a relevant national FDI screening procedure. New recital language envisages creation of a cooperation mechanism for Member State authorities to submit information to the Commission on foreign subsidies and otherwise cooperate with Commission investigations. Such cooperation could be particularly relevant where FSR notifications and FDI screening procedures overlap.

The co-legislators did however agree tightening the criteria for imposition of interim measures (excluded in the case of public procurement investigations); specifying the Commission's power to conduct interviews of natural or legal persons who consent (subject to notifying authorities in the country where the interview takes place); introducing a proportionality requirement for the Commission's requests for information to third parties; and broadening the Commission's powers to impose fines and periodic penalty payments. The recitals also establish a target of 18 months for the Commission to close in-depth investigations.

Commitments and Redressive Measures

The co-legislators introduced language clarifying that commitments the Commission accepts to eliminate the distortive effects of foreign subsidies shall be proportionate. The list of potential commitments or redressive measures has been expanded by adding changes to undertakings' governance structures.

Balancing Test

The FSR includes an escape clause allowing the Commission to balance the negative effects of a foreign subsidy in terms of distortion on the internal market against positive effects on the development of the relevant economic activity. The ambiguity of the original text led to proposals to require the Commission to publish guidance. This proposal did not make it into the final agreement, but new recital language has been added on the application of the test and providing for Member States to submit their views to the Commission.

The original proposal allowed the Commission to balance negative effects in the EU against positive effects both within and outside the EU. The Parliament and Council both proposed limiting the consideration of positive effects to those in the EU, which would have greatly limited the test's significance because foreign subsidies will normally be designed to create positive effects in the granting country, not in the EU. The final text retains the focus on positive effects in the EU but also allows the Commission to consider other positive effects such as broader positive effects in relation to the relevant policy objectives.

International aspects

The co-legislators rejected a controversial Parliament proposal to introduce the notion of equivalency, which is familiar from the GDPR and other EU regulations. Although not fully fleshed out, the proposal could have created a basis for the Commission to exclude consideration of distortive effects of subsidies granted by jurisdictions with State aid review regimes comparable to the EU's.

Instead, the final agreement envisages a new power for the Commission to launch dialogues with individual non-EU countries where it identifies a pattern of repeat distortive subsidies. Such dialogues would aim to bring about changes in subsidy practices to end potential distortions in the EU. The procedure for such dialogues is not fleshed out, but the Commission would be required to keep the Parliament and Council informed.

Conclusion

The FSR is a rare new thing under the antitrust sun. While the procedures and timelines are familiar from existing EU antitrust tools, the concerns addressed are radically different. The Commission will need to develop new approaches to evidence, clarify theories of harm and develop new approaches to commitments and redressive measures.

Some changes from the original proposal will be welcomed by the business community, including excluding extra-EU joint ventures from the notification obligation and shorter timelines for public procurement reviews. But the co-legislators rejected other proposals, including introducing a *de minimis* exclusion for calculating financial contributions and phasing in financial contribution information requirements. Multinationals who may engage in transactions triggering notification will need to start identifying and quantifying their financial contribution information on a groupwide, global basis going back three years from the notification date – in practice, most likely 2021.

In the longer term, the FSR may spur changes in the way the Commission and Member State authorities work together. The European Competition Network has long provided a framework for communication among EU antitrust authorities, and a similar framework could be useful in the public procurement context. The FSR envisages linkages between FSR review and national FDI screening procedures, where the Commission already has a coordinating role under the EU FDI framework regulation. The FSR also envisages coordination between parallel FSR and EUMR reviews. New communication channels and closer coordination across diverse legal regimes may be an important by-product of the FSR.

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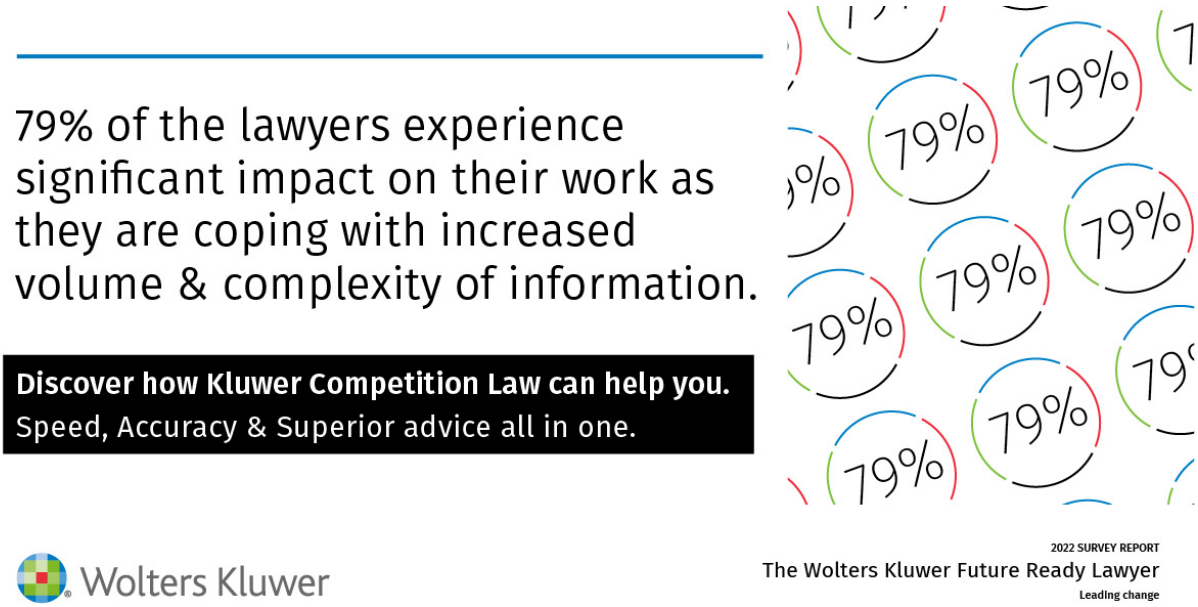

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