Kluwer Competition Law Blog

Who Watches the (FDI) Watchmen? The European Commission finds that Hungary infringed EU Law by Unduly Prohibiting a Transaction On FDI Grounds

Pablo Figueroa (Pérez-Llorca, Spain) and Rocío Acebal (Pérez-Llorca) · Tuesday, August 9th, 2022

Background

The recent proliferation of foreign direct investment regimes ("**FDI**") in Europe baffles practitioners and deal makers alike. Why is my acquisition of, say, a developer of grapes in Spain potentially subject to CFIUS-like rules? Can my carefully crafted leveraged buyout of a niche Polish producer of NFTs derail out of national security concerns because one NFT with Minnie Mouse (the cartoon character) was sold in Italy? In a welcome development, and after an arguably wishy-washy role in the inception of the EU FDI system,[1] the European Commission (the "**Commission**") appears to have finally brought some sanity.

In April 2021, the Hungarian government vetoed the sale of two subsidiaries of the AEGON Group ("**AEGON**") to Vienna Insurance Group AG Wiener Versicherung Gruppe ("**VIG**" and the "**Transaction**"). VIG and AEGON are insurance companies. Such veto was based on Hungarian emergency FDI Covid-19 legislation.

In addition to the Hungarian antitrust authorities, the transaction was also notified to the Commission. The Commission unconditionally authorised the merger on 12 August 2022[2]. This decision was without prejudice to the Commission's further assessment of the veto decision under Article 21(4) of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings ("**EUMR**"),[3] which confers on the Commission exclusive jurisdiction in relation to transactions with a so-called "Union dimension" (*i.e.*, exceeding the EUMR's turnover thresholds[4]).

Under Article 21 of the EU Merger Regulation, the Commission has sole jurisdiction to examine concentrations with a Union dimension. Consequently, Member States cannot apply their national laws to such concentrations but can only take appropriate measures to protect their legitimate interests, subject to them being compatible with EU law. The Commission decided to investigate whether Hungary's decision to veto VIG's acquisition of AEGON Group's Hungarian subsidiaries constituted a breach of Article 21 of the EU Merger Regulation and "*whether Hungary's veto aims at protecting a legitimate interest and whether it is compatible with EU law*"[5].

The measure was found to breach EU law and the European Commission ordered Hungary to withdraw its veto decision by 18 March 2022. Failure to comply could result in infringement

proceedings before the European Court of Justice.

Hungary withdrew the measure and, on 23 March 2022, it was announced that VIG had successfully acquired AEGON's subsidiaries in Hungary[6].

Legal Framework

As discussed, Article 21 EUMR establishes the sole jurisdiction of the European Commission to take decisions in the realm of concentrations with a Union dimension and expressly prevents Member States from applying its national legislation to these matters.

It does, however, allow Member States to "*take appropriate measures to protect legitimate interests*" not considered in the EUMR. If a Member State seeks to protect public interests other than "*public security, plurality of the media and prudential rules*", it must communicate such interest to the European Commission. The Commission will, in turn, assess its compatibility with European law before any measures may be taken.

The relevant part of the provision reads as follows:

"*[We do not reproduce nr 1, which is arguably irrelevant for the FDI debate.]*

2. *Subject to review by the Court of Justice, the Commission shall have sole jurisdiction to take the decisions provided for in this Regulation.*
3. *No Member State shall apply its national legislation on competition to any concentration that has a Community dimension.*

The first subparagraph shall be without prejudice to any Member State's power to carry out any enquiries necessary for the application of Articles 4(4), 9(2) or after referral, pursuant to Article 9(3), first subparagraph, indent (b), or Article 9(5), to take the measures strictly necessary for the application of Article 9(8).

4. *Notwithstanding paragraphs 2 and 3, Member States may take appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation and compatible with the general principles and other provisions of Community law.*

Public security, plurality of the media and prudential rules shall be regarded as legitimate interests within the meaning of the first subparagraph.

Any other public interest must be communicated to the Commission by the Member State concerned and shall be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures referred to above may be taken. The Commission shall inform the Member State concerned of its decision within 25 working days of that communication".

More broadly, Article 63 of the Treaty on the Functioning of the European Union ("**TFEU**")[7] provides for free capital movements not only within the EU but also to third countries and any restriction needs to be suitable, necessary and proportionate to attaining legitimate public policy objectives. Such objectives are defined in the Treaty or in the case law of the Court of Justice as

overriding reasons in the general interest. Such objectives should not be purely economic.[8] Grounds of public policy, public security and public health can be relied on if there is a genuine and sufficiently serious threat to a fundamental interest of society.[9]

The decision

As of 5 August 2022, the decision's text is yet to be available. However, press releases issued to date[10] provide plenty of information in relation to the case.

The European Commission found that Hungary's measures infringed Article 21 EUMR in two ways:

First, in failing to communicate "*their intended veto to the transaction*" prior to implementing such veto. It is not entirely clear from the press release, but the Commission appears to be objecting on this point to the lack of prior communication of the Hungarian regime and not so much to the veto itself.

Second, in vetoing the transaction. Given the circumstances of the case, the veto itself was deemed to be contrary to European rules regarding freedom of establishment and, the Commission found, "*therefore, infringed Article 21 EUMR*". (We believe the "therefore" probably constitutes sloppy wording on behalf of the press department of the Commission: it goes without saying, a breach of free movement of capital does not necessarily constitute a breach of Article 21 EUMR).

Comments

First, the European Commission's approach to Article 21 EUMR should serve as a warning to Member States when taking decisions regarding mergers with a Union dimension. Member States must communicate any public interest to the European Commission before acting and wait for its decision. The only exceptions to this obligation are measures taken on the grounds of public security, plurality of the media and prudential rules. Even if based on these three grounds, the European Commission may review a measure taken to decide whether: (i) its aim genuinely falls within those grounds; and (ii) it is compliant with general EU law including free movement of capital and the general principle of EU law of proportionality.

Second, the significance of this decision is compounded by the EU's recent legislative climate, including but not only following the COVID-19 pandemic. Various Member States have enacted legislation broadening the scope for mandatory screening. Commentators rightly note that "*the regulatory environment regarding M&A transactions in Europe is becoming more and more complex: not only has the Commission changed its policy to now accept deals for merger review which do not meet the thresholds of the EUMR if referred to it by Member States […], but in a somewhat reverse development the majority of Member States now have far reaching FDI rules in place, while the Commission does not have central competence under FDI rules*".[11] The European Commission's intervention on mergers with a Union dimension may provide investors with an increased level of legal certainty. This would not guarantee a uniform solution but may provide welcome (if insufficient) protection for investors from at least some unjustified actions by

Member States.[12]

Third, in any event, the concept of "legitimate interests" is anything but straightforward. The concepts of "public security", "plurality of the media" and "prudential rules" are at the very least open-ended. Member States may have different criteria in considering whether their actions fall into these categories and may therefore in good faith fail to communicate measures prior to implementing them. Further guidance on the European Commission's interpretation of said concepts may be necessary, particularly if it intends to intensify its control over Member States' measures under Article 21 EUMR.[13] On 25 March 2020, the EC issued the *Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries and the protection of Europe's strategic assets*,[14] as part of the so-called "Coordinated economic response to the COVID-19 Outbreak". However, this text is mainly COVID-19 related and is arguably insufficient beyond this domain.

Fourth, the *Aegon* case is not the first time the Commission has objected to a Member State's lack of compliance with Article 21 EUMR. Precedent may be found in the *E.ON / Endesa* takeover[15] and in the Ruling of the CJEU in case *Portuguese Republic v. Commission*. The latter derives from a Decision the Commission adopted against the Portuguese Republic on 22 November 2000, whereby the Commission obliged the Portuguese Government to take the necessary measures to comply with Community law and withdraw two decisions ('*despachos*' of 5 July 2000 and 11 August 2000) the Government took to oppose a proposed concentration, which had a Community dimension, on the basis of national legislation on privatisation. The Portuguese government refused and so the notifying parties abandoned the merging plans. The Commission opened an investigation and found that none of the legitimate interests laid down in Article 21(4) -then, 21(3) ECMR 1989 – were applicable to the Portuguese decision. The matter was taken to the ECJ. The ECJ ruled on, among other pleas, whether the order to withdraw the Portuguese decision was proportional, which the ECJ found it to be.[16]

However, these mergers were intra-European. Even though EU-protected free movement of capital also applies to non-EU investors, it applies differently from how it applies to EU investors. It would thus be interesting to see whether an investigation would have a similar outcome in cases involving non-EU investors and, in particular, whether and how the Commission would, regardless of any procedural Article 21 EUMR violation, invoke Article 63 and the EU fundamental freedoms.[17]

Fifth, and this is the main question mark deriving from the decision, one wonders as to whether a similar decision would have been adopted if (i) the infringing Member State were, say France or Germany, instead of Viktor Orban's Hungary and (ii) in relation to a less extreme set of facts. Indeed, the circumstances surrounding the Aegon case appear to have been quite outrageous. According to commentators, "*the Hungarian Government introduced an amendment to the "permanent" FDI screening regime which was published in the Official Journal Saturday evening, just the day before the signing of the transaction (scheduled for a Sunday morning). In the form of a Government Decree and as a special measure permitted under the state of emergency situation, the "foreign investor" definition was extended to cover EU and EFTA investors. Additionally, insurance activities were included in the catalogue of activities deemed sensitive to national security. Without this "last minute" legislative measure, the AEGON deal would have neither been caught by the "permanent" nor the "temporary" FDI screening regime […]*".[18]

In short, the AEGON decision will be a landmark case for development of the European system of

FDI. However, its practical implications remain to be seen. One would hope Member States will be more cautious in their FDI enforcement, at least vis-à-vis a merger with a Union dimension. However, if a Member State does breach Article 21 EUMR, action may take too long, and come at too high a cost for investors (both financially and in goodwill with the local FDI authorities and governments). Moreover, the Commission is a political institution, and it is uncertain that it will be as belligerent against the strongest EU Member States.[19] In this case, AEGON and VIG were able to successfully close their transaction in Hungary, but it was not without cost. In the face of delays, litigation and general inconvenience, companies may opt for other deal opportunities or settle for what they can obtain with the local FDI authorities.

As a result, the implications of this decision are perhaps to be found in litigation before the national courts. Article 63 TFEU has direct effect and can be relied on in litigation against the national authorities and Governments. The parties in Aegon did challenge the decision of the Hungarian Authorities before the local courts and the Metropolitan Court of Budapest requested a preliminary ruling from the ECJ[20]. The Budapest Court referred two key questions to the ECJ: (i) whether rules such as the Hungarian regulations applicable in this case may be laid out; and (ii), if the answer to the first question is affirmative, whether "*the mere fact that the Commission has conducted a merger control procedure, exercised its powers and authorised a concentration affecting the chain of ownership of a foreign indirect investor*" would "*preclude the exercise of the decision-making power under the applicable law of the Member State*". FDI practitioners and deal makers are thus encouraged to follow closely both the publication of the entire Aegon decision, the corresponding preliminary ruling of the ECJ and related national litigation.

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[1] See, *e.g.*, Figueroa, P., "Covid-19: la Comisión Europea y la tentación proteccionista"; Expansion, 2 April 2020; available at: https://www.expansion.com/opinion/2020/04/02/5e85d5ca468aebec678b45a0.html.

[2] Case M.10102 – *VIG / AEGON CEE* (available at: M_10102_8196601_401_3.pdf).

[3] Council Regulation (EC) No 139/2004 of 20 January 2004 *on the control of concentrations between undertakings (the EC Merger Regulation)*; OJ L 24, 29.1.2004, pp. 1–22.

[4] For a transaction to have such Union dimension, the combined aggregate worldwide turnover of the undertakings concerned must exceed €2.5bn and the aggregate EU-wide turnover of at least two of the undertakings concerned must exceed €100m (cf. Articles 1(2) and (3) EUMR).

[5] "Mergers: Commission opens investigation into possible breach of Article 21 of the EU Merger Regulation by Hungary in the VIG/AEGON transaction" (available at: https://ec.europa.eu/commission/presscorner/detail/en/mex_21_5664)

[6] "Aegon completes sale of Hungarian businesses and announces debt tender offer and share buyback" (available at: https://www.aegon.com/investors/press-releases/2022/aegon-completes-sale-of-hungarian-businesses-and-announces-debt-tender-offer-and-share-buyback/)

[7] *Consolidated version of the Treaty on the Functioning of the European Union*, OJ C 326,

26.10.2012, pp. 47–390

[8] Case C 563/17, *Associação Peço a Palavra*, ECLI:EU:C:2019:144, para. 70.

[9] See cases C-54/99, *Église de Scientologie*, ECLI:EU:C:2000:124, para. 17; C-503/99, *Commission v Belgium*, ECLI:EU:C:2002:328, para. 47; C-463/00, *Commission v Spain*, ECLI:EU:C:2003:272, para. 72.

[10] In particular, "Mergers: Commission opens investigation into possible breach of Article 21 of the EU Merger Regulation by Hungary in the VIG/AEGON transaction" (available at: https://ec.europa.eu/commission/presscorner/detail/en/mex_21_5664) and Mergers: Commission finds that Hungary's veto over the acquisition of AEGON's Hungarian subsidiaries by VIG breached Article 21 of the EU Merger Regulation (available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1258)

[11] Cf. Shoening, F., Kovach, A., Faust, S., Kirwitzke (S.) and Reckers, P., "Hungary lifts FDI veto after pressure from EU Commission – all's well that ends well?, 14 July 2022, available at: https://www.engage.hoganlovells.com/knowledgeservices/viewContent.action?key=Ec8teaJ9VapBY4tozCIHHsxgHJMKLFEppVpbbVX%2B3OXcP3PYxlq7sZUjdbSm5FIetvAtgf1eVU8%3D&nav=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQ0qFfoEM4UR4%3D&emailtofriendview=true&freeviewlink=true

[12] See Barth, C., and Sinziana, Ianc, "Transactional tug-of-war: tensions between Member States' competence over foreign investment screening and the EC's exclusive jurisdiction over EU mergers", available at: Transactional tug-of-war: tensions between Member States' competence over foreign investment screening and the EC's exclusive jurisdiction over EU mergers | ForeignInvestmentLinks | Blogs | Insights | Linklaters.

[13] As noted by Benica, J., Brice, N, Clerckx, S., de Muyter, L., and Vrheyden, A. G., "European Commission Blocks Hungary's Attempt to Veto Transaction Under FDI Rules", available here: EC Blocks Hungary's Veto Attempt Under FDI Rules | Jones Day.

[14] *Communication from the Commission, Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation)*, 2020/C 99 I/01, OJ C 99I , 26.3.2020, pp. 1–5.

[15] "Mergers: Commission decides that Spanish measures in proposed E.ON/Endesa takeover violate EC law". Available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_06_1853.

[16] Judgment of 22 June 2004 in case C-42/01 *Portuguese Republic v. Commission*, ECR 2004 I-06079.

[17] As noted by Yannouchos, G., Oikonomopoulou, E. and Barrantes, M. B., "Interplay of EU Merger Control and FDI Review: Implementation of National FDI Screening Regimes Have to Comply with EU law", available here: interplay_of_eumr_and_fdi.pdf (cliffordchance.com).

[18] Cf. Shoening, F., Kovach, A., Faust, S., Kirwitzke (S.) and Reckers, P., "Hungary lifts FDI veto after pressure from EU Commission – all's well that ends well?, 14 July 2022, available at: https://www.engage.hoganlovells.com/knowledgeservices/viewContent.action?key=Ec8teaJ9VapB

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[19] Antitrust practitioners (which probably constitute the majority of readers of this blog) might be surprised to hear that, outside the realm of Regulation 1/2003, the Commission enjoys unfettered discretion when it comes to rejected complaints.

[20] Case C-106/22 (*Xella Magyarország Épít?anyagipari Kft. v Innovációs és Technológiai Miniszter*). Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62022CN0106

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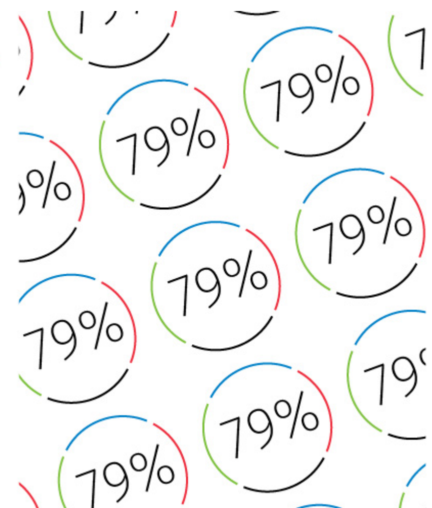

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