In stark contrast to the rigorous rules governing State aid granted by EU Member States, foreign public financing granted to companies operating in the EU has largely gone unchecked to date. In an attempt to rectify this, on 5 May 2021, the European Commission ("Commission") adopted a proposal for a Regulation on foreign subsidies distorting the internal market ("Draft Regulation"), to address the existing regulatory loopholes. On 30 June 2022, the European Council issued a press release indicating that it had reached a provisional political agreement with the European Parliament on the Draft Regulation.

Provisions of the Draft Regulation
The Draft Regulation states that a foreign subsidy shall be deemed to exist where a non-EU country provides a financial contribution which confers a benefit to an undertaking engaging in an economic activity in the EU internal market, and which is limited to an individual undertaking or industry or to several undertakings or industries. "Financial contribution" is broadly defined for these purposes, ranging from the transfer of funds or liabilities – including loans, guarantees or set-offs – to the forgoing of revenues and the provision or purchase of goods and services. Foreign subsidies may be granted by foreign States, foreign public entities – including State-owned corporations – and any private entity acting on behalf of a foreign government. Where such subsidies improve the competitive position of the recipient and actually or potentially negatively affect competition in the internal market, they may amount to a distortion (determined on the basis of various indicators). The Draft Regulation details categories of foreign subsidies most likely to distort the internal market, being those: (i) granted to an ailing undertaking (in the absence of a restructuring plan which includes a significant contribution by the undertaking in question); (ii) in the form of unlimited guarantees for debts or liabilities of the undertaking; (iii) directly facilitating a concentration; and (iv) enabling undertakings to submit unduly advantageous tenders (on the basis of which they would be awarded the public contract).

The Commission will apply a balancing test to assess whether the positive effects of the subsidy outweigh the negative effects, and this will be taken into account when deciding whether to impose repressive measures or accept commitments to "... fully and effectively remedy the distortion caused by the foreign subsidy in the internal market", and remedies may be structural or behavioural in nature. Examples include offering fair and non-discriminatory access to infrastructure, reducing capacity or market presence, refraining from certain investments, divesting certain assets or unwinding a merger, or repaying the foreign subsidy received.

The Draft Regulation will introduce three tools:
- The first is a new mandatory, ex ante filing obligation with the Commission for concentrations where the EU turnover of the target company (or at least one of the merging entities) exceeds EUR 500

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1 Post-Brexit, this includes any type of funding from the UK Government or a UK Government owned entity granted to companies active in the EU.
2 These may include the amount and/or nature of the subsidy, the purpose and conditions attached to it, the situation of the relevant undertaking and the markets concerned, and the level of economic activity of the undertaking concerned on the internal market.
million, and the undertakings concerned received aggregate foreign subsidies exceeding EUR 50 million in the three calendar years prior to notification (there is no requirement that these subsidies are related to the transaction). As with the EU's merger control rules, full-function joint venture arrangements are also captured. Parties will be required to submit a mandatory notification to the Commission, following which closing must be suspended for a period of 25 business days. If the Commission opens an in-depth investigation during the first review period, closing must be suspended for a further 90 business days, subject to possible extensions (should the parties or the Commission require additional time, or if the parties offer commitments). Possible outcomes include unconditional clearance, clearance subject to commitments or, if no commitments are proposed in a transaction raising concerns, or they are inadequate, prohibition of the concentration. Fines of up to 10% of a company’s global turnover can be imposed for failure to notify, or for closing before the transaction has been cleared.

• Secondly, the Draft Regulation provides the Commission with the means of scrutinising bids involving a financial contribution from a foreign entity in public procurement procedures worth EUR 250 million or more. Any company wishing to submit a tender or request participation in such a procedure will be required to either notify the contracting authority of all foreign financial contributions received in the preceding three years or declare that no such contributions were received. Failure to do so will preclude that company from being awarded the contract. The Commission will have 60 days to complete a preliminary assessment, and a further 140 days to conclude an in-depth review, should this be considered necessary. It is worth noting that the Commission retains the right to request a notification at any time prior to the award of the contract and regardless of its value where it suspects foreign subsidies may have aided a company's bid. The Commission can accept commitments from the bidding party to remove the distortion on the market or, absent such commitments, prohibit the party from securing the contract.

• The Commission’s final tool under the Draft Regulation is perhaps the most significant. Alongside the mandatory notification regimes for concentrations and public procurement contracts, the Commission will also have the power to investigate (on its own initiative) any other market situations, as well as smaller concentrations and public procurement procedures, if it suspects that foreign subsidies could lead to a distortion in the EU internal market. Investigations will comprise a preliminary review followed by an in-depth investigation, and the Commission will have various tools that can be used in the context of procedures, including interim measures and requests for information. With reviews able to be initiated on the basis of any source of information of which the Commission is made aware, it is likely that Member States and competitors will have an active role in bringing specific cases to the Commission's attention.

The Commission will be able to investigate foreign subsidies granted in the ten years prior to the entry into force of the Draft Regulation, where such foreign subsidies distort the internal market after its entry into force.

Review by the Council and European Parliament
On 4 May 2022, the European Council confirmed its position on the Draft Regulation, which included: (i) suggesting that the merger control and public procurement notification thresholds should be raised to EUR 600 million and EUR 300 million respectively; (ii) shortening the deadlines for investigations; (iii) recommending the publication of guidance on the balancing test to be conducted and in relation to public procurement procedures; and (iv) shortening to five years the period during which the Commission can retrospectively investigate subsidies granted before the regulation enters into force.4

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3 Such as greenfield investments.

4 Regulating distortive foreign subsidies in the internal market: Council adopts position - Consilium (europa.eu)
Conversely, within the European Parliament, MEPs agreed that the merger and public procurement thresholds should be lower than those proposed in the Draft Regulation, so potentially extending the scope of the new rules to a larger number of transactions. However, they agreed that the Commission’s investigative deadlines should be reduced, and that guidance should be published on how to assess foreign subsidies and balance their market-distorting effects against their potential wider benefits.

Against the background of these mandates, the European Council and European Parliament have been negotiating to agree on the final version of the Draft Regulation. The provisional agreement reached on 30 June 2022 indicates that the co-legislators have decided to maintain the notification thresholds proposed by the Commission for mergers and public procurement procedures (i.e. EUR 500 million and EUR 250 million, respectively), and that undertakings may be fined for failure to notify (and the Commission will be able to examine the transaction as if it had been notified). The European Council and European Parliament have, however, reduced the Commission’s ability to investigate subsidies granted prior to the entry into force of the regulation, from ten to five years.

It is confirmed that the Commission will be exclusively competent to enforce the regulation, though Member States will be kept regularly informed and will be involved in decisions (through the advisory procedure).

Going forward, the provisional agreement reached will be subject to approval by the European Council and the European Parliament. The Draft Regulation will enter into force on the 20th day following publication in the Official Journal of the European Union and, once adopted, will be directly applicable across the EU.

Final Thoughts
The new regulation will undoubtedly place additional burdens on all parties involved in transactions triggering the relevant notification thresholds. However, these are likely to be particularly challenging for private equity investors, given the range of sectors in which their portfolio companies may operate and the various sources of financial assistance that these could receive. Although the Draft Regulation contains an exemption to the obligation to notify for “credit institutions or other financial institutions or insurance companies, the normal activities of which include transactions and dealing in securities for their own account or for the account of others”, this requires that the institution does not exercise voting rights in the company, so unlikely to be of benefit in the private equity context. It also remains to be seen to what extent the Commission will make use of its new wide-ranging powers to initiate ex officio investigations, what transactions may be prioritised and how these are likely to be brought to its attention. In the meantime, there may be a period of considerable uncertainty for any undertaking in receipt of any kind of foreign subsidy, that engages in a transaction within the EU.

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5 New trade defence tool to protect EU firms from distortive foreign subsidies | News | European Parliament (europa.eu)
6 Foreign subsidies distorting the internal market: provisional political agreement between the Council and the European Parliament - Consilium (europa.eu)