Between Fair Competition and Market Openness: Assessing How the Foreign Subsidies Regulation Applies to Non-EU State-Owned Enterprises in Light of the Principle of Competitive Neutrality

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Abstract

This thesis explores the implications of the Foreign Subsidies Regulation (FSR) on non-EU state-owned enterprises (SOEs) and their cross-border acquisitions within the EU, focusing on the principle of competitive neutrality. The analysis is grounded in a doctrinal approach, examining the normative framework of competitive neutrality and evaluating the FSR's provisions in light of this principle.

The FSR, enacted in 2023, aims to prevent distortions in the internal market caused by foreign subsidies, employing mechanisms akin to those in the state aid, merger control and anti-subsidy regimes. The research identifies that while the FSR's objective is to foster fair competition, its current implementation may inadvertently disadvantage non-EU SOEs, complicating their investment activities due to extensive administrative requirements and overlapping regulatory frameworks.

To address these issues, the thesis proposes several amendments to the FSR, including refining key definitions, streamlining procedures, and integrating the FSR more effectively with existing EU merger control processes. These recommendations aim to enhance the clarity and fairness of the regulation, promoting a more balanced approach to competitive neutrality.

The findings contribute to the broader discourse on European competition and trade regulation and policy, offering insights into the complexities of regulating foreign subsidies in a globalized economy. By critically assessing the FSR's impact on non-EU SOEs, this thesis underscores the need for regulatory frameworks that not only protect domestic markets but also foster equitable treatment of international business entities.

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I. Introduction

The European Union ('**EU**') economy has always been open to foreign investments. According to the European Commission, as of 2016, non-EU investors owned or controlled around 3% of European companies (35% of all European assets).[1] The mere presence of those corporate ties is not concerning. However, they might be obtained as a result of the unfair advantage received by non-EU companies. For example, such an advantage might be received through subsidies granted by foreign governments.

a) Foreign subsidies

When EU Member State awards subsidies, they are subject to a stringent State aid regime. Thanks to the required transparency, the European Commission can identify distortive governmental aid and apply necessary remedies timely. However, not all countries have an equal level of state aid control. Therefore, there are concerns about the potential negative impact of foreign subsidies. Namely, there is a view that companies enjoying financial contributions from non-EU governments can get an unfair advantage compared to their non-subsidized competitors. According to the White Paper on Foreign Subsidies, 'subsidy may allow the subsidised acquirer to pay a higher price to acquire the asset than it would otherwise have paid, and can thus distort the valuation of EU assets'.[2] This issue is especially relevant when foreign subsidies occur in malfunctioning markets with high entry barriers and significant economies of scale.[3] In this case, subsidised undertakings have an immediate advantage in entering the market and establishing their dominant position there.

In trying to tackle this issue, the EU faced a particular regulatory gap regarding foreign subsidies. One found no mechanism addressing their negative impact on the internal market, especially concerning acquisitions and public procurements. Available international instruments, such as the General Agreement on Tariffs and Trade ('**GATT**') and the Agreement on Subsidies and Countervailing Measures (**'SCM Agreement'**), exclusively cover trade in

[1] Jorge Liboreiro, 'Brussels moves to control takeovers of EU companies by foreign governments' (*Euronews*, 5 May 2021)<https://www.euronews.com/my-europe/2021/05/05/brussels-moves-to-control-takeovers-of-eu-companies-by-foreign-governments#:~:text=Around%203%25%20of%20European%20companies,responsible%20for%2016%20million%20jobs.> accessed 13 April 2024.

[2] Commission White Paper on levelling the playing field as regards foreign subsidies, 17 June 2020, COM/2020/253 final (White Paper on Foreign Subsidies), p 7.

[3] European Commission Staff Working Document on Impact Assessment Accompanying the Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, 05 May 2021, SWD (2021) 99 final (Impact Assessment), p 8.

goods. EU anti-subsidies Regulation[4] has the same gap in its application. EU foreign direct investment screening covers only situations where the public order and national security are concerned. EU state aid rules do not deal with the financial contributions provided by the third states but only the ones of the EU Members. A foreign subsidy is also irrelevant for assessment under the EU competition and merger control rules.

As a result, in 2023, the EU implemented the Foreign Subsidies Regulation ('**FSR**') which is aimed to cover anti-competitive distortions of the internal market caused by foreign subsidies through acquisitions and public procurement.

b) State-owned enterprises

There is no legally binding definition of the state-owned enterprises ('**SOEs**'). The prevailing one proposed by the Organisation for Economic Co-operation and Development ('**OECD**') suggests that SOE includes 'any corporate entity recognised by national law as an enterprise, and in which the state exercises ownership'.[5] In the majority of cases, an enterprise in which the state is the ultimate beneficiary owner of the majority of shares or voting rights is qualified as an SOE.[6] However, a company might be defined as an SOE even if the state has a minority shareholding but by virtue of the so-called 'golden shares' can control or direct the management of such a company.[7]

SOEs exist in all countries but their importance varies from one market type to another. In liberal economies, such as the ones in most European countries, the USA and the UK, SOEs play a reduced role. Their markets are built on the principle of free competition where SOEs do not enjoy privileged treatment.[8] The latter is mostly active in the key markets, such as energy or transport,[9] and are often called to perform economically non-profitable activities for the sake of public interest.[10]

[4] Regulation (EU) 2016/1037 of the European Parliament and of the Council of 8 June 2016 on protection against subsidised imports from countries not members of the European Union, 30 June 2016, OJ L 176, p 55.
[5] OECD (2015), OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition, OECD Publishing, Paris, p 14.
[6] Ibid.
[7] Ibid.
[8] Pernazza F, The Role of State-Owned Enterprises in the Economic Transnational Relations. in Mauro MR and Pernazza F (eds), State and Enterprise (Springer, Cham 2023), p 173.
[9] Ibid, p 199.
[10] Case T-165/15 *Ryanair and Airport Marketing Services v Commission* [2018] ECLI:EU:T:2018:953 (*Ryanair*), para 144.

At the same time, in countries with state capitalism, SOEs have a crucial role in the economy. Their activities are expanding beyond the most strategic sectors,[11] and they usually enjoy numerous advantages in terms of preferential access to financing.[12] Often, the activities of such enterprises might be a part of broader governmental strategies, both domestically and internationally.[13]

SOEs have a significant role in transnational mergers and acquisitions. As an example, in 2021, among the more than 150,000 Chinese SOEs, 83 are included in the Fortune Global 500 list and constitute the majority of the SOEs included therein.[14] Only Chinese SOEs issue more than 100 cross-border mergers annually.[15] Moreover, non-EU SOEs also strengthened their position in the internal market in the past years. There were at least two significant cases of acquisition of companies operating in the EU by the Chinese SOEs. They include purchasing the Italian tyre manufacturer Pirelli in 2015[16] and German rail equipment producer Vossloh Locomotives in 2019.[17] Moreover, SOEs from Middle Eastern countries, like Saudi Arabia, the United Arab Emirates or Qatar, also increase their presence in global trade.[18]

Considering that SOEs often receive major subsidies from their governments, and their active latest presence on the EU market through mergers and acquisitions, it becomes evident that non-EU SOEs will be severely affected by new FSR tools. For the purpose of this thesis, 'non-EU SOEs' means enterprises whose ultimate beneficial owner is a state (government) that is not an EU member.

c) *Competitive neutrality*

The concept of 'competitive neutrality' implies that 'no entity operating in an economic market is subject to undue competitive advantages or disadvantages'.[19] While competitive neutrality is not a well-established legal principle, members of the OECD, including EU Member States, constantly commit to ensuring its presence in their regulatory policy. Competitive neutrality helps to maintain the allocative efficiency of the economy. When certain market participants

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[11] Pernazza (n 8), p 173.
[12] Pernazza (n 8) pp 173, 197.
[13] White Paper on Foreign Subsidies (n 2), p 7.
[14] Pernazza (n 8), p 196.
[15] Ibid.
[16] CNRC / Pirelli (Case M.7643) Commission Decision C(2015) 4608 final [2015].
[17] CRRC / Vossloh (B4-115/19) Bundeskartellamt [2020].
[18] Adel Alfalasi, 'The Gulf must harness the potential of new economic blocs' (*Arabian Gulf Business Insight*, 13 May 2024)<https://www.agbi.com/opinion/trade/2024/05/gulf-gcc-harness-potential-new-economic-blocs-trade/> accessed 28 June 2024.
[19] OECD (2012) Competitive neutrality: maintaining a level playing field between public and private business, 2012 Edition, OECD Publishing, Paris, p 17.

receive an undue disadvantage, the goods and services are not delivered to consumers by those who can do it the most efficiently.[20]

One of the factors that affect competitive neutrality is the form of ownership. The concept initially started to develop to tackle the preferential treatment of SOEs compared to privately owned ones. However, as follows from the definition of competitive neutrality, this scenario is not the only one covered. In general, the regulatory policy shall not cause an undue competitive disadvantage to any entity, regardless of the form of ownership or country of registration.

Competitive neutrality is majorly unaddressed when it comes to cross-border mergers and acquisitions. FSR tools aim to 'replicate' the EU state aid regime concerning subsidies provided by the non-EU governments.[21] A state aid regime aims to 'prevent distortions of competition in the internal market due to selective advantages granted by national authorities and not to establish general competitive neutrality between SOEs and private companies'.[22]According to P. Baumann, while the EU state aid law ensures competitive neutrality within the EU,[23] the quasi-implementation of a similar regime through FSR aims to maintain competitive neutrality in cross-border transactions.[24]

While SOEs usually receive the advantage, this thesis aims to discuss the opposite. The main **research question** is to establish how the application of the FSR causes an undue disadvantage to the non-EU SOEs and their cross-border acquisitions in the EU in light of the principle of competitive neutrality. Additionally, this thesis intends to propose potential amendments to the FSR regime that can minimise the negative impact of the current version of this instrument.

Methodology

This thesis will use the doctrinal approach. The aim is to understand whether the FSR breaches the competitive neutrality putting the non-EU SOEs in an unfavourable position. As a first step, I briefly explain the purpose behind the FSR and the mechanisms this regime includes. Next, I am going to establish the normative framework of competitive neutrality and its position within

[20] Ibid, p 22.
[21] Kühling J, Weck T, Reinold P, Third-country state aid regulation: the European debate on foreign subsidies. in Asian Yearbook of International Economic Law (Springer, Cham 2021), p 8.
[22] OECD (n 19), p 83.
[23] Baumann P, The EU Foreign Subsidies Regulation: The Final Piece of the Regulatory Puzzle to Ensure Competitive Neutrality in Cross-Border M&A?. in Hillebrand Pohl, J, Warchol , J, Papadopoulos, T, Wiesenthal, J (eds), Weaponising Investments Springer Studies in Law & Geoeconomics vol 1(Springer, Cham 2023), p 204.
[24] Cunha Rodrigues N, Filling the regulatory gap to address foreign subsidies: the EC's search for a level playing field within the internal market. in Cunha Rodrigues N (ed) Extraterritoriality of EU economic law: the application of EU economic law outside the territory of the EU (Springer, Cham 2021), p 224.

the EU legal order. Then, I will continue to evaluate the FSR application to the non-EU SOEs in light of that principle.

Considering that FSR is in itself an intersection of various regimes, the analysis of such regimes must be conducted to interpret the instrument properly. The assessment covers the European Commission's practice in anti-subsidy investigations, the European Commission's practice concerning state aid, WTO practice on the SCM Agreement, OECD documents on competitive neutrality and SOE governance, as well as academic literature on the topic. To propose the amendments, I will rely on the best practices of various countries which have been used by them to tackle the negative influence of distortive foreign subsidies, as well as academic literature that offers theoretical solutions to similar problems.

Structure of the thesis

This thesis starts with Chapter II which presents the basic concepts and procedures implemented by the FSR. Chapter III aims to introduce the concept of competitive neutrality and its importance for the EU legal order. Chapter IV focuses on the definition of the 'foreign subsidy' and how it impacts the non-EU SOEs. Chapter V contains the assessment of the correlation between the EU State aid and FSR regimes and how the direct transfer of the State aid approach to the FSR makes it unfavourable for the non-EU SOEs. Chapter VI explains how the parallel application of the FSR and EUMR procedures might negatively influence the concentrations of the non-EU SOEs. Chapter VII provides suggestions on how to improve the FSR to ensure its 'competitive neutrality'. The thesis ends with a conclusion that summarises the most important findings of this research and gives insight into future possible research.

II. Foreign Subsidies Regulation in a nutshell

The Foreign Subsidies Regulation ('**FSR**') started to apply on 12th July 2023 and was complimented by the notification procedure that entered into force on 12th October 2023. Before proceeding to the analysis of its compatibility with the principle of competitive neutrality, it is necessary to understand the key concepts and proceedings implemented by FSR, as well as the purposes it is pursuing. Namely, this chapter will provide the definitions of 'foreign subsidy' and 'financial contribution' that constitute the backbone of the FSR and their correlation with each other. Furthermore, it will explain three main tools introduced by the FSR: M&A tool, Procurement tool and *Ex officio* tool.

A. Purpose behind the FSR

The FSR consolidated as a response to concerns about, particularly, Chinese subsidies that allowed local companies to enter the EU market.[25] In this regard, the European Commission claimed that '[f]air competition should be ensured within the single market and globally, both to protect consumers and to foster economic growth and competitiveness, in line with the long-term strategic interests of the Union'.[26] Since neither the EU trade remedies legislation nor the SCM Agreement could apply to them, FSR was implemented to tackle the existing regulatory gap. The FSR's core policy objective is to prevent distortions caused by foreign subsidies received by companies engaged actively in the EU's internal market.[27]

FSR is a unique blend of EU legal regimes. It combines features of such areas as EU merger control, EU state aid law, EU procurement law, EU trade remedies regulation, and SCM Agreement. FSR's hybrid nature is reflected in its legal basis: Articles 207 and 114 TFEU. On the one hand, FSR deals with foreign subsidies and their distortive effect on the EU market (including in situations of acquisition of EU targets by the subsidised company). Those issues are included in the definition of 'common commercial policy', which allows us to base the measure on Article 207(1) TFEU. On the other hand, while multiple Member States expressed the need to implement the instrument tackling the distortive foreign subsidies, introducing a uniform EU-wide action that applies across the entire internal market was found more efficient.[28] Hence, as Article 114 TFEU serves as the basis for the measures aiming to establish

[25] Andreas Reindl and Isabelle Van damme, The EU Foreign Subsidies Regulation (Concurrences 2024), p 1.
[26] European Council, European Council meeting (21 and 22 March 2019) – Conclusions (22 March 2019) 2 accessed 18 June 2024.
[27] Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market (FSR Regulation 2022/2560) [2022] OJ L330/1 (FSR), recital 6.
[28] Impact Assessment (n 3), p 36.

or improve the functioning of the internal market, this provision was selected as an additional legal basis for FSR.

B. Basic concepts and procedures

a) Definitions

Two concepts constitute building blocks of the FSR: 'foreign subsidy' and 'financial contribution'. Foreign subsidy consists of four cumulative elements. Namely, it is deemed to exist 'where a (i) third country provides, directly or indirectly, a (ii) financial contribution which (iii) confers a benefit on an undertaking engaging in an economic activity in the internal market and which (iv) is limited, *de jure* or *de facto*, to one or more undertakings or industries'.[29] This definition corresponds to the one provided by the SCM Agreement and EU state aid law.

Nevertheless, 'foreign subsidy' is not a starting element of the FSR. The referring point for its notification obligations is the concept of 'financial contribution'. Notwithstanding its importance, the FSR merely provides a list of illustrative examples and no clear definition for it. Article 3(2) FSR spells three types of circumstances that might be qualified as a '**financial contribution**': (i) transfer of funds or liabilities, (ii) foregoing of revenue that is otherwise due, and (iii) provision of goods or services or the purchase of goods or services.[30]

According to Article 3(3) FSR, a financial contribution is '**provided by a third country**' if it is granted by (i) the central government and public authorities at all other levels, (ii) a foreign public entity whose actions can be attributed to the third country or (iii) a private entity whose actions can be attributed to the third country.[31]

A financial contribution is considered to '**confer a benefit**' on an entity engaging in economic activity in the EU internal market when it 'could not have been obtained under normal market conditions'.[32] Recital 16 FSR clarifies that a financial contribution will not be a foreign subsidy if it is provided exclusively for non-economic activities.[33]

The criterion of subsidy's **specificity** is not relevant for the interpretation of 'financial contribution' as such but is crucial to determine whether the latter constitutes a 'foreign subsidy'.[34] Measures of general applicability that fall within the list of examples in Article 3(2)

[29] FSR (n 27), Art. 3(1)
[30] FSR (n 27), Art. 3(2)
[31] FSR (n 27), Art. 3(3)
[32] FSR (n 27), Recital 13
[33] FSR (n 27), Recital 16
[34] Reindl, Van Damme (n 25), p 53.

FSR count as a 'financial contribution' towards contribution thresholds (will be discussed in the section below) and must be reported unless specifically exempted from the reporting requirements.

Concerning the correlation between the two terms, the conclusion can be made that every 'foreign subsidy' is a 'financial contribution'. However, not every 'financial contribution' will be considered a 'foreign subsidy'.

Yet, there is an ongoing discussion about whether the concept of a 'financial contribution' under the FSR is very wide. Chapter IV will elaborate more on this issue as it largely contributes to the assessment of FSR's competitive neutrality towards the non-EU SOEs.

b) Proceedings

The FSR provides for three tools that will be enforced by the European Commission concerning foreign subsidies: (i) M&A tool, (ii) Procurement tool and (iii) *Ex officio* tool.

<u>1) M&A Tool</u>

Under the M&A Tool, companies shall notify their concentrations to the European Commission when two cumulative criteria are fulfilled.[35] First, the turnover of at least one of the parties to the concentration established in the EU in the last financial year shall be at a minimum of EUR 500 million. Second, the total amount of EUR 50 million of financial contributions shall be received in three years before concentration, depending on the type of concentration, by the acquirer, merging parties or the undertakings creating a joint venture and the joint venture.

The timeline starts after submitting a complete notification. The European Commission may initiate an in-depth investigation no later than 25 working days after the receipt of the complete notification.[36] If no such decision was made, the parties are free to proceed with the concentration. The in-depth investigation may not last more than 90 working days from the date the decision to initiate the in-depth investigation was issued.[37] Same as at the preceding stage, if no decision has been reached after 90 days, the concentration can be implemented.[38]

[35] FSR (n 27), Art. 20(3)
[36] FSR (n 27), Art. 25(2)
[37] FSR (n 27), Art. 25(4)
[38] FSR (n 27), Art. 25(4)

2) Procurement Tool

Under the Procurement Tool, a notifiable financial contribution shall also meet two criteria.[39] First, the procurement contract value shall be not less than EUR 250 million (at least EUR 125 million if the tender is divided into lots). Second, the bidding party (together with its affiliated companies and main subcontractors) shall have received at least EUR 4 million of financial contributions per third country throughout three years before the notification.

Concerning public procurements, the preliminary review by the European Commission shall last up to 20 working days (with a possible extension of 10 working days),[40] while the in-depth investigation should not last more than 110 working days from receipt of a complete notification, extendable by 20 working days in exceptional cases.[41]

3) Ex officio Tool

The last tool concerns all the other potentially distortive foreign subsidies that are covered by neither M&A nor Procurement Tools.[42] In this case, the European Commission has the mandate to conduct ex officio investigations and its powers in those cases are extensive. Namely, the European Commission can investigate support granted by third countries to entities up to 10 years before the start of the investigation (but not more than five years before the application of the FSR).[43]

As a result of M&A and Procurement Tools, the European Commission can make one of three decisions: (i) approve the transaction without objections, (ii) impose commitments or redressive measures, or (iii) prohibit the concentration or the award of a public contract.[44] Redressive measures and commitments can take either structural forms, such as undoing an acquisition, divesting assets, or reducing capacity or market presence,[45] or behavioural forms, like offering access to infrastructure under Fair, Reasonable, and Non-Discriminatory (FRAND) conditions, publicizing research, and development (R&D) outcomes, repaying foreign subsidies with interest, or adjusting governance structures.[46]

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[39] FSR (n 27), Art. 28(1), 28(2)
[40] FSR (n 27), Art. 30(2)
[41] FSR (n 27), Art. 30(5)
[42] FSR (n 27), Art. 9
[43] FSR (n 27), Art. 38(1)
[44] FSR (n 27), Art. 25(3), 31
[45] FSR (n 27), Art. 7(4)
[46] FSR (n 27), Art. 7(4)

The European Commission may also permit a transaction that it would otherwise ban under the FSR by weighing its negative and positive impacts,[47] a flexibility not available under EU merger control regulations. A positive impact could align with EU policy goals, such as environmental protection, digital advancement, job creation, or R&D promotion.[48]

If companies violate the standstill obligation by either completing a notifiable concentration or public procurement or failing to notify it, the European Commission has the authority to levy fines of up to 10% of their total turnover from the previous financial year.[49] Additionally, the European Commission can impose fines of up to 1% of the company's global turnover[50] and implement periodic penalty payments of up to 5% of the average daily turnover for each day of delay if companies provide inaccurate, incomplete, or deceptive information.[51]

[47] FSR (n 27), Art. 6
[48] FSR (n 27), Recital 21
[49] FSR (n 27), Art. 26(3), 33(3)
[50] FSR (n 27), Art. 26(2), 33(2)
[51] FSR (n 27), Art. 26(2), 33(2)

III. Competitive neutrality in the EU legal order

One will not often meet the term 'competitive neutrality' in the academic literature. However, it does not mean it has to be disregarded in competition enforcement. Before analysing FSR in the context of such a principle, it is necessary to briefly explain its relevance to the EU competition law.

A. Definition of 'competitive neutrality'

There is no single interpretation of 'competitive neutrality'. Several examples can be retrieved from the academic literature, governmental working documents, and publications of international organisations.

For instance, Määttä, Frank and Pääkkönen suggest that '[c]ompetitive neutrality implies that no market actors are discriminated against, favoured or entrusted with extra duties compared to others'.[52] Valkama adds that the presence of competitive neutrality ensures a 'market condition in which institutional factors neither favour nor discriminate against an incumbent or potential service producer'.[53] The Confederation of British Industry, an organization that represents the interests of business groups in the UK, in its joint study with Serco Institute on the UK public services market, summarized that competitive neutrality 'is the concept that competition should be fair between different classes of market participants so that there is a level playing field between public, private and voluntary providers of goods and services'.[54]

The latest definition provided by the OECD, in general terms, corresponds to the ones listed above. According to this Organisation, competitive neutrality is a principle that 'no entity operating in an economic market is subject to undue competitive advantages and disadvantages'[55] and a 'principle according to which all enterprises are provided a level playing field with respect to a state's (…) ownership, regulation, or activity in the market'.[56] This concept requires, among others, regulatory neutrality in competition (and other) law

[52] Kalle Määttä, Lauri Frank, & Jenni Pääkkönen, Kilpailun toimivuus teknisten tarkastusten ja ilmoitettujen laitosten tarjoamien palvelujen markkinoilla, Kauppa- ja teollisuusministeriön tutkimuksia ja raportteja 5/2001. Teknologiaosasto. Edita. Helsinki 2001,p 74.

[53] Pekka Valkama, Konkurrensneutralitet som utmaning för kvasimarknadsteorin, Nordisk Administrativt Tidsskrift 4 86 2005, p 243.

[54] CBI and the Serco Institute, A Fair Field and No Favours: Competitive Neutrality in UK Public Service Markets (2006), p 8.

[55] OECD (n 19), p 17.

[56] OECD (2021), Recommendation of the Council on Competitive Neutrality (OECD/LEGAL/0462), Paris.

enforcement against all market participants regardless of their ownership type,[57] as well as non-discriminatory conditions of competition for government procurement.[58]

As one can see, available definitions of competitive neutrality vary in their scope. Some avoid mentioning specific kinds of market actors covered by the principle, while others explicitly expand its application to both actual and potential participants of the market. Several interpretations limit the reach of competitive neutrality to competition between state-owned and private companies when many prefer to stick to more broad terms. For this thesis, I would summarise the definition of 'competitive neutrality' as a principle according to which all the entities active in the market are treated in a non-discriminatory manner during the competition law enforcement regardless of their ownership.

B. Purpose of competitive neutrality

Academic literature and work of international organisations present competitive neutrality as an essential element of the relationship between market participants and public authorities. However, an ordinary reader might be rightfully confused about the importance of this principle specifically in competition law enforcement without understanding its underlying purpose. One might say that Article 18 TEU established the principle of equality that applies across the Union law. Therefore, it would be unnecessary to create and enforce a whole separate concept if there is a general rule that already covers the issue.

Indeed, competitive neutrality means that all market participants shall be treated equally. Nevertheless, this thesis does not propose to define competitive neutrality as a new principle of EU law. Instead, the goal is to show that enforcement of this concept is indispensable for securing the fundamental principles of EU law.

To start with, ensuring competitive neutrality helps to achieve the main goal of EU competition law – protecting undistorted competition in the internal market. It aims to establish a state of competition in which the choice to purchase a certain product from one of the rival companies by a trading partner is not affected by outside factors but solely by its preferences. In simple words, its purpose is to protect undistorted competition.

Competitive neutrality does not intend to make sure that all firms 'compete on equal footing'. It is clear that they might have different capacities in terms of experience, assets and skills that

[57] OECD (n 56), Recommendation 1(b), (c).
[58] OECD (n 56), Recommendation OECD 1(d).

form a set of competitive advantages and disadvantages of a particular company.[59] If one's rival offers fairly better alternatives, that company can anticipate losses as a result of regular competition[60] and it is a 'hallmark of a competitive market economy'.[61] Nevertheless, the uneven playing field caused by external factors, i.e., legal regulations, may have negative consequences for more efficient market participants both within one particular country and globally.[62]

The absence of competitive neutrality can impact both supply and demand for goods and services. For instance, problems with competitive neutrality can partially or completely obstruct the supplies from as-efficient or more efficient competitors. This, in turn, will lead to a simultaneous decrease in quality and innovations in the markets that depend on those supplies and an increase in production costs. In the situation of distorted competition, the long-term consequence is that market actors who do not enjoy the advantage will have no economic incentive to continue their economic activities. The final result of decreased competition will be lowered economic efficiency and consumer welfare.

In contrast, when competitive neutrality is enforced, the competition between the rivals in the market increases. As a result, trading partners have access to a wider choice of innovative products and can reduce their production costs. In the end, it will guarantee economic welfare and efficiency at various levels of the supply chain.

C. Competitive neutrality in the EU legal order

The previous subsection showed that the principle of competitive neutrality aims to ensure the 'competition on the merits' and establish a 'level playing field'. The same reason lies behind the competition law enforcement. It intends to protect fair competition in the internal market, in particular, through the EU state aid regime.

The focus of the latter is to guarantee that governmental assistance to businesses does not grant an unreasonable advantage. The General Court in *Ryanair v European Commission* confirmed that the principle of equality enshrined in the Treaty applies to the state aid regime, and

[59] Rhonda L Smith and others, 'Competitive Neutrality: OECD Recommendations and the Australian Experience' [2023] 19(2) Journal of competition law & economics, p 251.
[60] Pekka Valkamma and Martti Virtanen, 'Competitive Neutrality and Distortion of Competition: A Conceptual View' [2009] 32(3) World Competition, p 398.
[61] Rhonda L Smith and others (n 59), p 251.
[62] Rhonda L Smith and others (n 59), p 251.

differences in treatment during its enforcement will be accepted only when they comply with stringent criteria of necessity and proportionality.[63]

A state aid regime aims to 'prevent distortions of competition in the internal market (…)'.[64] The principle of competitive neutrality serves the same purpose. As the General Court pointed out, this goal cannot be achieved without implementing the non-discrimination principle. Competitive neutrality guarantees equality, especially among companies of various ownership types. Therefore, absent enforcement of competitive neutrality, the EU state aid regime cannot effectively achieve its aim. Hence, the principle of competitive neutrality is an integral part of the EU state aid regime that helps to guarantee the effective application of the principle of equality to the assistance provided to the companies by the Member States.

The same approach to competitive neutrality shall be transferred to the application of the FSR. The new FSR regime 'externally' replicates the EU state aid approach towards the governmental support granted outside of the EU.[65] Therefore, its further implementation shall be governed by the same principles as its 'internal brother', including principles of competitive neutrality and non-discrimination (equality). In its FSR Proposal, the European Commission affirmed its commitment to the principle of equality by saying that FSR will apply 'in an objective and non-discriminatory manner to all undertakings active in the EU irrespective of their ownership'.[66]

One might wonder whether a similar application of such principles is possible. EU state aid regime applies to Member States that are governed by the provisions of the Treaty, including the one on equal treatment. On the contrary, FSR applies to subsidies that were granted by third countries that might not have the same standards in their national laws. Moreover, international trade law instruments like GATT and the General Agreement on Trade in Services ('**GATS**') allow the EU to introduce restrictions on market entry.[67]

In this context, it is necessary to emphasize that non-discrimination is also a crucial part of the EU's international obligations, in particular, under international trade law. While GATT and GATS give its members the right to introduce trade barriers, they also require countries to respect the most-favoured-nation ('**MFN**')[68] and national treatment obligations.[69] Namely,

[63] Case T-379/20 *Ryanair v European Commission* ECLI:EU:T:2021:195 [2021], para 72.
[64] OECD (n 19), p 83.
[65] Kühling (n 21).
[66] Commission Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market 2021/0114 (COD) (Draft Regulation), p 57.
[67] See Articles I, III, XI GATT on trade in goods and Articles XVI, XVII in GATS.
[68] Article I GATT and Article XVI GATS.
[69] Article III GATT and Article XVII GATS.

when imposing trade limitations, the EU cannot provide unjustifiable advantages to goods and services from one country instead of others (MFN principle), as well as to its domestic products compared to the foreign ones (national treatment principle).

Indeed, there is a discussion on whether the FSR can infringe on the national treatment principle if its application leads to less favourable conditions for imported goods, services or service suppliers, compared to those originating in the EU.[70] However, this thesis does not plan to discuss compliance of the FSR with the WTO law directly.

Instead, this Chapter showed that ensuring competitive neutrality is an integral part of the effective functioning of the EU state aid regime. Due to the similarities in goals and procedures, implementation of the FSR shall be guided by the same set of rules. Therefore, enforcement of the FSR shall not put the non-EU SOEs in an unduly disadvantageous position. The following chapters will explore whether this statement is true.

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[70] François-Charles Laprévote and Wanjie Lin, 'Between State Aid, Trade and Antitrust: The Mixed Procedural Heritage of the Foreign Subsidies Regulation and the Overarching Principle of Non-Discrimination' [2022] Cleary Gottlieb Steen & Hamilton LLP<https://www.nomos-elibrary.de/10.5771/1435-439X-2022-3-443.pdf> accessed 17 June 2024.

IV. Definition of the 'foreign subsidy' vs. competitive neutrality

As was mentioned above, Article 3(1) FSR defines 'foreign subsidy' as a (i) financial contribution, (ii) directly or indirectly provided by a third country, (iii) which confers a benefit on the entity engaging in economic activity in the internal market and (iv) which is limited, in law or in fact, to one or more undertakings or industries.[71] This Chapter will shed light on how the application of all the elements of this interpretation (apart from the criteria of selectivity) put the non-EU SOEs in unfavourable conditions.

A. 'Financial contribution'

The concept of 'financial contribution' is the cornerstone of the notification procedures established by the FSR. The M&A Tool is based on self-assessment, i.e., companies shall fill out the application relying solely on their understanding of the legal text of FSR. This exercise already requires a lot of applicants' resources as such financial contributions might have been received in a large number of countries. Yet, the definition of 'financial contribution' provided by Article 3(2) FSR does not make their preparations any easier.

The list of examples includes three groups of practices that have the potential to be a 'financial contribution'. The first type is the transfer of funds or liabilities, such as capital injections, grants, loans, loan guarantees, debt forgiveness, etc.[72] The second one is the foregoing of revenue that is otherwise due, with prominent examples of tax exemptions or the granting of special or exclusive rights without adequate remuneration.[73] Lastly, financial contribution might be established in the case of the provision of goods or services or their purchase.[74]

The wording of the FSR includes the phrase 'such as' when providing examples of what is meant by one or another group of financial contributions. This clearly means that the list is non-exhaustive.

Let us make a comparison with other related EU legal regimes. In the EU state aid law, the Commission Notice on the notion of State aid provides a relatively detailed list of examples of forms of 'transfer of State resources' (the term in EU state aid law equal to 'financial contribution' in FSR).[75] Yet, even that list is not complete. According to Article 107(1) TFEU,

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[71] FSR (n 27), Art. 3(1).
[72] FSR (n 27), Art. 3(2)(1).
[73] FSR (n 27), Art. 3(2)(2).
[74] FSR (n 27), Art. 3(2)(3).
[75] Commission Notice on the notion of State aid as referred to in the Treaty on the Functioning of the European Union [2016] OJ C262/1, art 107(1) (Commission Notice on the notion of State aid), paras 51-53.

State aid may be granted 'in any form whatsoever'.[76] When it comes to countervailing measures under the EU anti-subsidies Regulation or SCM Agreement, the European Commission applies the concept of 'financial contribution' on a case-by-case basis, in light of a list of criteria developed in the decisional practice.[77] In both state aid and anti-subsidies regimes, the decision of the European Commission on a specific 'financial contribution' might be reviewed by the Court of Justice of the European Union and the latter might agree or disagree. Such Court's practice plays a pivotal role in shaping the list of examples of what can be identified as 'financial contribution'. However, this process takes several years to complete. Most probably, the same approach will be used in the application of the FSR. As no court practice or European Commission guidelines are available at the moment, non-EU SOEs will be trying to blindly navigate the field where the mistake might cost them up to 10% of their annual turnover.

One might say that the situation was the same when the EU state aid law started to apply and the European Commission could not provide clarity from the beginning either. However, there is a notable difference between the notification procedure under the FSR and the EU State aid regime. In the second scenario, the aid has to be notified to the European Commission not by the individual company but by the respective EU Member State.[78] The additional administrative burden on the company does not arise in this case. Moreover, while the aid might be reclaimed from the company, acquisitions that were subsidised through it may not be prevented, even if such concentrations have been facilitated by subsidies that distort the internal market.[79] In contrast, the non-EU SOEs carry all the administrative burden through self-assessment, which might still result in both payback of the subsidy back and withdrawal of the planned concentration.

B. 'Provided by a third country'

Article 3(2) FSR explains that the financial contribution is considered to be 'provided by a third country' when it is granted by (i) central government and public authorities of various levels, (ii) a foreign public entity whose actions can be attributed to the third country and (iii) private entity whose actions can be attributed to the third country.[80] The last two examples have a

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[76] Consolidated Version of the Treaty of the Functioning of the European Union [2016] OJ C202/1 (TFEU), Art. 107(1).
[77] Reindl, Van Damme (n 25), p 21.
[78] TFEU (n 76), Art. 108(3)
[79] Baumann (n 23), p 205.
[80] FSR (n 27), Art. 3(2).

particular impact on non-EU SOEs. Namely, it makes them both potential receivers and providers of foreign subsidies.

1) 'Public body'

The general principle of international law establishes that the public authority of a foreign country shall include any person or entity which has that status under the internal law of that State.[81] The assessment of whether the company is a public body in the context of the FSR is conducted on a case-by-case basis 'with due regard to elements such as the characteristics of the relevant entity and the legal and economic environment prevailing in the third country in which the entity operates including the government's role in the economy of that country'.[82]

In the state aid law, the Commission's Notice on the notion of State aid provides for possible indicators to determine whether a measure is imputable to a State. This might be a legal form of the entity at issue, the type of its activities on the market, the degree of supervision by the government, etc.[83] In its decision on *DRAMs (dynamic random access memories) (Korea)*, the European Commission elaborated that two elements indicate a 'public body'.[84] First, the governmental control over the activities of the entity shall go beyond mere ownership. Second, the entity shall pursue public policy objectives beyond the normal sphere of private companies.

The fact that an entity exists in the form of a private company does not automatically mean that it cannot be a public body.[85] At the same time, if the company is a wholly-owned subsidiary of a third country, it does not in itself mean that it is a public body.[86] On the other hand, if the entity does not have any governmental ownership in it or its shareholders are solely private companies, 'it will normally be difficult to establish that a company is a public body unless convincing evidence to the contrary exists'.[87]

The European Commission applied the same approach under the EU anti-subsidy Regulation. Based on this method and Article 2 of the mentioned Regulation, the European Commission

[81] Draft Articles on the Responsibility of States for Internationally Wrongful Acts 2001, Art. 4(2).
[82] FSR (n 27), Recital 12.
[83] Commission Notice on the notion of State aid (n 75), para 43.
[84] Council Regulation (EC) 1480/2003 of 11 August 2003 imposing a definitive countervailing duty and collecting definitively the provisional duty imposed on imports of certain electronic microcircuits known as DRAMs (dynamic random access memories) originating in the Republic of Korea [2003] OJ L212/1 (*DRAMs*), recital 13.
[85] Case C-482/99 *France v Commission of the European Communities (Stardust)* EU:C:2002:294 [2002], para 57.
[86] *DRAMs* (n 84), recital 11.
[87] *DRAMs* (n 84), recital 12.

concluded that the Chinese state-owned steel producers,[88] banks[89] and insurance companies[90] are indeed 'public bodies'.

The assessment under the Article 1.1(a)(1) SCM Agreement largely corresponds to the one of the European Commission. Namely, it must be established that the entity 'possesses, exercises, or is vested with government authority', and it performs functions ordinarily considered part of governmental functions in the legal order of the country under investigation.[91] With this criteria, the WTO Appellate Body confirmed the European Commission's finding that the Chinese state-owned banks are typically considered 'public bodies'.[92]

A prominent example of comprehensive analysis might be found in the *Coated Fine Paper (China)*. Therein, the European Commission established that Chinese state-owned banks granting loans to Chinese coated fine paper producers (some are also state-owned) were 'public bodies'.[93]This conclusion was based on the fact that such banks (i) more than 50% owned by the state, (ii) pursued governmental industrial policies and (iii) the state was determining the interest rates on loans to Chinese companies.

2) 'Private entities'

Actions of the private companies can be attributed to the third country when there is a 'link between the government and that conduct' in the form of 'entrustment or direction'.[94] This provision will rarely include non-EU SOEs directly. However, there is one interesting case that might have a serious impact on the scope of the FSR. In *Broad Spectrum Antibiotics (India)*, the European Commission found that preferential export credits granted by commercial banks constituted a financial contribution by the government because those banks were 'directed' by the Reserve Bank of India (an Indian SOE), which was found to be a 'public body'.[95] Applying

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[88] Council Implementing Regulation (EU) 215/2013 of 11 March 2013 imposing a countervailing duty on imports of certain organic coated steel products originating in the People's Republic of China [2013] OJ L73/16, recitals 45 – 73.

[89] Implementing Regulation (EU) 2018/1690 imposing a countervailing duty on imports of certain pneumatic tyres, new or retreaded, of rubber, of a kind used for buses or lorries and with a load index exceeding 121 originating in the People's Republic of China, [2018] OJ L283/1, recitals 168 – 208.

[90] Implementing Regulation (EU) 2019/72 of 17 January 2019 imposing a definitive countervailing duty on imports of electric bicycles originating in the People's Republic of China [2019] OJ L16/5, recitals 176 – 217.

[91] WTO Appellate Body Report, *US – Anti-Dumping and Countervailing Duties (China)* (2011), WT/DS379/AB/R, paras 290, 297 and 317.

[92] Ibid.

[93] Council Implementing Regulation (EU) 452/2011 of 6 May 2011 imposing a definitive anti-subsidy duty on imports of coated fine paper originating in the People's Republic of China [2011] OJ L128/18, recital 90.

[94] WTO Appellate Body Report, *US – Countervailing Measures (China) (Article 21.5 – China)* (2019), WT/DS437/AB/RW, para 5.103

[95] Council Regulation (EC) 713/2005 of 10 May 2005 imposing a definitive countervailing duty on imports of certain broad-spectrum antibiotics originating in India [2005] OJ L121/1, recital 113.

the same logic to, for example, Chinese state-owned banks which have the power to establish the interest rates on loans granted to Chinese companies, one can conclude that Chinese private banks 'directed' by them will be 'private entities whose actions can be attributed to the third country'.

3) Complications for non-EU SOEs

The examples and analysis above show that non-EU SOEs have a high chance to be 'public bodies' under FSR and be providers of 'financial contributions'. On the other hand, SOEs can also be receivers of the 'financial contribution' in cases when they, for instance, receive capital injections from the government that owns them, or when they receive a tax exemption. We also saw the example when the privately-owned company can become the provider of the 'financial contribution' by being directed by the SOEs. The main consequence of such an interpretation is that it becomes unnecessarily broad. Let us have a look at some hypothetical situations.

For instance, Company A plans to acquire Company B, which falls under turnover thresholds of the M&A Tool under the FSR. Company A has obtained a couple of loans from private banks in different countries. Normally, Company A would not consider that it has to notify such loans under the FSR as it does not seem to have any ties with the third country. However, as we saw from the examples of Indian state-owned banks directing commercial banks, Company A might be under the obligation to notify the loans under the FSR.

Another example might be retrieved from the situation of the Chinese steel products producers. Let us again imagine that Company A plans to acquire Company B, which falls under turnover thresholds of the M&A Tool under the FSR. Company A produces cars and for this, among many others, it needs to purchase coated steel products. If the main supplier of such goods is Chinese SOE and Company A purchased steel products for more than EUR 50 million in the last three years, Company A has to notify those supplies as a 'financial contribution' under the FSR. Even more, such an obligation might stay if the SOE representative provided training on technical skills related to those steel products.[96]

The fact that the definition becomes extremely broad when non-EU SOEs are engaged in economic activities is already problematic. However, it is exacerbated by the self-assessment type of notification under the FSR M&A Tool. In the absence of clear Commission guidance and the presence of case-by-case analysis, companies receive yet another administrative burden

[96] WTO Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)* (2006) Recourse to article 21.5 of the DSU by the European Union, WT/DS353/AB/R, paras 7.584–7.585.

to try to assess whether their contracts with foreign contractors are considered 'financial contribution' or not. The examples that were mentioned above show that the European Commission tends to expand the definition as much as possible. Therefore, it creates unnecessary and considerable uncertainty for future applicants.

C. 'Confers a benefit'

After passing the stage of 'financial contribution', it is necessary to establish whether it 'confers the benefit' to the entity engaging in the economic activities in the EU. In general, a financial contribution should be considered to 'confer a benefit' on an entity if it could not have been obtained under normal market conditions.[97] In this case, a comparison shall be made with certain comparative benchmarks, such as the investment practice of private investors, financing rates obtainable on the market, a comparable tax treatment, or adequate remuneration for a given good or service.[98]

Usually in the anti-subsidies investigation, the point of comparison is the domestic market of the exporting country.[99] If there are no 'prevailing market conditions' in the country of provision of the goods or services which can be used as an appropriate benchmark, the European Commission will use other benchmarks. For instance, in an anti-subsidy investigation against the provision of certain steel products from Chinese SOEs, the Commission used a constructed benchmark based on the world market prices published in specialised steel journals.[100] In another case, the European Commission has used Taiwan's land prices as an external reference point in evaluating the value gained from financial contributions, such as offering land-use rights, within China.[101]

Under this analysis, the non-EU SOEs face an immediate disadvantage. As the SOEs prevail in countries with regulated economies, like China, their market conditions will probably not be considered as 'normal market conditions'. Practice of the European Commission in investigations where Chinese producers are involved shows that the Commission chose other benchmarks for comparison. The economy of countries with regulated economies is built in the way that subsidisation of SOEs is a normal market practice, which is not the same in the

[97] FSR (n 27), Recital 13.
[98] Council Implementing Regulation (EU) 215/2013 (n 88), recitals 81–82.
[99] Guidelines for the calculation of the amount of subsidy in countervailing duty investigations [1998] OJ C394/6.
[100] Council Implementing Regulation (EU) 215/2013 (n 88), recitals 81–82.
[101] Case T-444/11 *Gold East Paper (Jiangsu) Co Ltd and Gold Huasheng Paper (Suzhou Industrial Park) Co Ltd v Council of the European Union* EU:T:2014:773 [2014].

EU internal market. Therefore, there is a high probability that financial contributions received or granted by the non-EU SOEs will be considered to 'confer a benefit'.

This Chapter showed how the broad interpretation of the foreign subsidy, both in terms of the definition of 'financial contribution' and 'public body', has a negative impact on non-EU SOEs. Moreover, the application of the term 'confers benefit' to financial contributions from economies with different structures from the EU faces an immediate disadvantage due to the existing differences.

V. 'Transfer' of state aid regime into FSR

The regime under the FSR was supposed to mirror the one that applies to state aid within the EU but with regard to financial aid granted by third countries. For this purpose, the FSR implemented most of the instruments used under the EU state aid law. This Chapter aims to show that sometimes tools that are effective within the internal market might cause more harm than good when used under different circumstances. Four elements will be discussed in this context: (i) thresholds established by the FSR, (ii) availability of exemptions, (iii) balancing test and (iv) redressive measures under the FSR.

A. Thresholds

The M&A and Procurement tools set up specific thresholds below which there is no obligation to notify the financial contribution received from third countries (EUR 50 million for the M&A Tool[102] and EUR 4 million per country for the Procurement Tool[103]). Nevertheless, under the *Ex officio* Tool, the European Commission still has the power to open an investigation over the foreign subsidies that are below those numbers.[104]

Article 4(2) FSR includes the presumption that the foreign subsidy below EUR 4 million in the preceding three years is considered unlikely to distort the internal market.[105] This threshold is much more burdensome than the one established for the EU state aid. Namely, Regulation No 651/2014 (General Block Exemption Regulation) provides for the categories of aid compatible with the internal market under Articles 107 and 108 TFEU.[106] In particular, Article 4(1) of this Regulation demonstrates the notification thresholds for various types of state aid that are considered not to distort the internal markets.[107] All of the 36 thresholds are higher than the ones provided by the FSR.[108] Considering that the FSR aimed to tackle only the biggest and the most distortive foreign subsidies,[109] the established threshold seems to go contrary to the stated objective. This effect is exacerbated by the additional factors. The defined threshold of

[102] FSR (n 27), Art. 20(2).
[103] FSR (n 27), Art. 28(1).
[104] FSR (n 27), Art. 9(1).
[105] FSR (n 27), Art. 4(2).
[106] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (General Block Exemption Regulation).
[107] General Block Exemption Regulation (n 106), Art. 4(1).
[108] It should be noted that all the thresholds in the General Block Exemption Regulation are calculated per year, while under the FSR the timeframe is three years. Therefore, it is easier to reach the threshold of EUR 4 million in three years than EUR 2 million in one year.
[109] Lena Hornkohl, 'Protecting the Internal Market from Subsidisation with the EU State Aid Regime and the Foreign Subsidies Regulation: Two Sides of the Same Coin?' [2023] Journal of European Competition Law & Practice, p 16.

EUR 4 million under the FSR is not framed as a standstill exemption. The wording of Article 4(2) suggests that the European Commission can still open an investigation over the foreign subsidy when it is likely to distort the internal market even if its amount is lower than EUR 4 million.[110] On the other hand, if the aid from the Member State does not reach the threshold of the General Block Exemption Regulation, it is not distortive by definition, and the European Commission has no room for further examination.[111] This puts the non-EU SOEs in default unfavourable situation as they do not have a 'safe harbour' at all, unlike their EU competitors.

B. Exemption

The General Block Exemption Regulation was partially discussed in the previous subsection. According to it certain types of state aid that fall into the categories of Article 107(2) and 107(3) TFEU are exempted from the notification requirement. Apart from the ones that do not reach the thresholds in Article 4(1) of the Regulation, exemption refers to aid aimed at fulfilling the obligations under the EU Green Deal, measures with the objective of regulating energy prices etc.[112] According to the European Commission, 'more than 95% of the state aid measures are block-exempted and the Member States do not need to notify them to the Commission'.[113]

The same regime does not exist in the FSR. Article 4(4) FSR suggests that measures 'aimed at making good the damage caused by natural disasters or exceptional occurrences' may be considered not to distort the internal market.[114] Recital 21 FSR also elaborates that some positive effects, such as the promotion of R&D, the objective of a high level of environmental protection or social standards, might be considered in the balancing test during the in-depth investigation.[115] However, even though the foreign subsidy might not distort the internal market, the financial contribution still has to be notified under the M&A and Procurement Tools. Therefore, if the aid falls under the state aid exemption criteria, companies subsidised by EU Member States receive competitive advantages over the non-EU SOEs.[116] While in the cases covered by the General Block Exemption Regulation, EU state aid does not have to be notified, the non-EU SOEs receiving financial contributions from third countries are potentially subject to notification requirements and related burdensome review procedures.

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[110] Raymond Luja, 'The Foreign Subsidies Regulation: Countering State Aid Beyond the European Union' [2021] 20(2) European State Aid Law Quarterly, p 190.
[111] General Block Exemption Regulation (n 106), Art. 3(1).
[112] General Block Exemption Regulation (n 106), Art. 44(5) and 44a(1).
[113] Impact Assessment (n 3), p 65.
[114] FSR (n 27), Art. 4(4).
[115] FSR (n 27), Recital 21.
[116] Baumann (n 23), p 206.

C. Balancing test

Articles 5 and 6 FSR create the 'balancing test' to assess foreign subsidies. According to it, the financial contribution of the foreign state is only incompatible with the instrument when the negative effects of a foreign subsidy in terms of distortion on the internal market outweigh the positive effects on the development of the relevant subsidised economic activity on the internal market.[117] The European Commission introduced this analysis to align the regime with the EU State aid law.[118] Whilst being more nuanced and organised in the form of explicit exemptions, the compatibility test in EU state aid law also largely applies the balancing exercise of the positive impact of the provided aid against the negative effects.[119]

Considering that both FSR and EU state aid regimes have overlapping objectives and rationales, it would be logical to presume that the European Commission will attempt to apply the same set of standards in the balancing test under both instruments. However, when it comes to actual enforcement of the FSR, it becomes apparent that such an analogous application of the EU state aid law analysis will put non-EU SOEs in a disadvantageous position under the FSR.

First of all, as was already emphasised, the EU state aid law has a long-established list of guidelines on the compatibility of governmental support. Those standards often refer to specific numerical values of particular types of aids. Such values fit perfectly in the reality of the EU internal market and were carefully calculated and assessed for compatibility by the European Commission and the Court of Justice of the European Union. However, it makes little sense to assume they will be similarly suitable for the FSR regime that frequently applies to subsidies granted in countries with economies different from the EU one. Hence, the FSR test will remain ambiguous and lead to legal uncertainty for non-EU SOEs in the absence of separate guidelines.

Second, to align the two regimes, the European Commission deferred from the initial FSR Draft Regulation[120] and introduced the criterion that positive effects of the subsidised activity must take place primarily on the internal market.[121] Such an approach is reasonable in light of both FSR and EU state aid regimes goals – to ensure a level playing field within the EU market.

[117] FSR (n 27), Recital 21.
[118] Impact Assessment (n 3), p 48.
[119] Hornkohl (n 109), p 22.
[120] Draft Regulation (n 66), Art. 5.
[121] FSR (n 27), Art. 5(1).

Namely, when the foreign subsidy distorts the competition in the EU internal market, only the benefits occurring therein, not in the third countries, can outweigh such disadvantages.

Recital 16 FSR elaborates that 'other' positive effects, such as the ones related to the economic activities outside of the EU, should be considered in the 'balancing test'.[122] In this case, the problem for non-EU SOEs arises from the fact that while the law seemingly provides for equal opportunities, *de facto* it is almost impossible to prove the existence of sufficient positive effects. Loads of foreign subsidies are granted to implement public policies of third countries that mainly concern improvements in their domestic market. Yet, FSR leads to the situation when positive effects will only be accepted by the European Commission provided that they occur simultaneously outside and within the internal market. The only viable example of a satisfactory policy objective in this case is environmental protection.[123] Therefore, it becomes extremely hard, if not impossible, for non-EU SOEs to prove positive effects unless a subsidy is granted to them to tackle global warming. This puts them at a disadvantage and disregards their rights to defence.

D. Redressive measures

The general rule of the EU state aid law implies that if the aid is found to be distortive it must be repaid to the granting Member States.[124] The Court of Justice of the European Union confirmed that other types of redressive measures can exceptionally apply only if the repayment is not viable.[125]

The FSR approach is going in the opposite direction. The mainstream opinion of the European Commission is that 'it may be difficult in practice to establish that the foreign subsidy is actually and irreversibly paid back to the third country'.[126] Therefore, the priority will be given to other types of redressive measures. Namely, Article 7(4) FSR proposes such measures as refraining from certain investments, divestment of certain investments, adapting the governance structure or even unmerging the concentration.[127] According to the FSR, the repayment of the subsidy shall be used only 'where [an undertaking] can ascertain that the repayment is transparent, verifiable and effective while taking into account the risk of circumvention'.[128]

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[122] FSR (n 27), Recital 21.
[123] Ibid.
[124] White Paper on Foreign Subsidies (n 2), p 19.
[125] Case C-404/00 *Commission v Spain* ECLI:EU: C:2003:373 [2003], paras 45 ff.
[126] White Paper on Foreign Subsidies (n 2), p. 19
[127] FSR (n 27), Art. 7(4)
[128] FSR (n 27), Recital 24.

Such a regime puts the non-EU SOEs who receive subsidies from their respective third countries at risk of being treated differently than their EU counterparts.[129] It is obvious that Member States do not have trust in the transparency on behalf of non-EU SOEs. For instance, the German Monopolkommission suggested redressive payments to the Member States or the EU as the main redressive measure in such to tackle the doubts on effective repayment to the third countries.[130] Indeed, EU Member States are more trustworthy to each other as they function in the framework and adhere to the same high standard of protection against distortive state aid. However, the treatment of the non-EU SOEs under the FSR clearly imposes much more negative consequences on them rather than the EU state aid law concerning EU companies. This approach impairs the FSR's objective of restoring the level playing field in the internal market.[131]

[129] Crochet V, Gustafsson M, Lawful remedy or illegal response? Resolving the issue of foreign subsidization under WTO law. (World Trade Rev 20:3), p 362.
[130] Monopolkommission (2020) Chinese state capitalism: A challenge for the European market economy, Chapter IV of the Biennial Report XXIII of the Monopolies Commission, para 892.
[131] European Commission, Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, COM(2021), p 48.

VI. Parallel enforcement of the FSR and EU merger control

The M&A Tool provided by the FSR largely resembles the review process of EU merger control. Namely, it includes the *ex-ante* notification procedure for concentrations above established thresholds with the subsequent two-phase reviews. While there are debates on the elements of the procedure (for example, specific values of turnover and 'financial contributions' thresholds), this Chapter does not intend to assess the substance of the FSR M&A Tool. Instead, it will discuss the parallel application of the FSR M&A Tool and EU merger control.

The European Commission anticipated that the same transaction could fall within both notification procedures. However, it largely underestimated the actual percentage of overlaps. In particular, only in the first 100 days of FSR enforcement, out of 53 cases notified under FSR, 42 (almost 80%) were simultaneously subject to assessment under the EU Merger Control.[132]

Indeed, those instruments have major similarities in procedural aspects and underlying conceptual frameworks. At the same time, there are core differences in the subject of their analysis. Consequently, parallel assessment under FSR and EU Merger Control may have a significant (negative) impact on non-EU SOEs in terms of (i) timelines and (ii) outcomes of analysis.

A. Discrepancies of timelines under FSR and EU merger control

Presuming that certain transactions can fall within the scope of both FSR and EU merger control, the European Commission attempted to construct their notification procedures in an aligned manner. Both regimes anticipate an initial 25-working day evaluation for non-problematic arrangements with the possibility of a further 90-working day in-depth investigation for ones that present substantive concerns. While *de jure* those timeframes are the same, they are practically harder to synchronise than it appears. Notably, the non-EU SOEs under the FSR will be harmed more.

First, it is not foreseeable that filings under two instruments will be finished together. As was previously discussed, FSR includes numerous unclear concepts, such as 'financial contribution' and 'public body'. At the same time, this regime lacks formal guidelines from the European Commission and the Court of Justice of the European Union on those uncertainties. It seems

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[132] Luis Moscoso, Iveta Stoyanova, 'The Foreign Subsidies Regulation – 100 days since the start of the notification obligation for concentrations' (*European Commission*, February 2024) <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> accessed 5 July 2024

logical to predict that notifying parties will prefer to be on the safe side, which will require them to submit as much detailed information in the filing as possible. Usually, the main possessor of such data is the public body that provides subsidies to the non-EU SOE. However, unlike in the EU state aid regime, FSR imposes an obligation to notify support on the company receiving it instead of the governmental authority. Hence, to complete the M&A Tool filing, non-EU SOEs have to request the information from the authority, which will significantly delay preparations if they ever successfully receive a comprehensive reply to such inquiries. In contrast, the EU merger control requires the notifying companies to submit information related to the concentration that is already available or can reasonably be estimated by them.

Additionally, due to the varying lengths of pre-notification discussions, one European Commission case team might allow a notification to be filed well before the other. This is particularly likely when the transaction involves more substantively complex issues under one regulatory instrument compared to the other.

Even if the formal filings under the EU merger control and FSR happen simultaneously, nothing promises that their evaluation will proceed identically. Depending on the substantive concerns identified in each review process, one notification might require remedies for clearance while the other does not. The EU merger control allows measures to be offered in Phase 1, which can simply prolong the initial assessment phase.[133] In contrast, the FSR requires the European Commission to open an in-depth investigation to offer remedies.[134] Additionally, one case team might clear the transaction unconditionally at the preliminary review phase, while the other might open an in-depth investigation. Once an in-depth review is initiated under either mechanism, it is unlikely to conclude within the prescribed 90 working days.

The assessment standard under the FSR is like a 'far West' due to its recent implementation. In this case, I will be brave enough to conclude that the FSR case team will take longer to give a 'green light'. Therefore, notification under the FSR puts an additional burden and slows down the successful closing of the transactions in case of parallel assessment.

B. The subject of analysis under FSR and EU merger control

The M&A Tool under FSR and EU merger control intend to assess different aspects of the transaction. In the case of FSR, the Commission's analysis is merger-specific, and the theory of harm concentrates on the market for corporate control or on product markets in which the

[133] Reindl, Van Damme (n 25), p 99.
[134] Ibid.

company will be active post-transaction.[135] In simple words, the Commission will evaluate whether the financial contribution received by the company from the foreign government grants gives it an unduly advantage in completing the notifiable transactions. In contrast, in the EU Merger Control, the Commission mostly focuses on the question of whether the planned merger leads to the creation or reinforcement of a dominant position and potential abuse of market power.[136]

Under both regimes, the goal is to avert the distortion of competition. The Commission intends to prevent the impediment of the market structure and save the benefits of effective competition for the consumers, such as a wider selection of products and services, higher quality and lower prices.[137] However, they are achieving it through the analysis of two separate aspects that have little to no overlap with one another. The FSR focuses on whether the financing that makes the transaction possible gives an undue advantage, while the EU Merger Control evaluates if the transaction in its nature might be distortive.

Accordingly, there is a realistic scenario of a negative outcome in one review and a positive in another one. However, the consequences for non-EU SOEs will be significantly different depending on in which procedure they got a 'red light'. If the prohibition was issued in the EU merger control review, chances are the concentration could be restructured and made compliant in the future. On the contrary, if otherwise non-problematic under EU merger control concentration of the non-EU SOE is stopped in the FSR proceeding, it remains unclear what such an enterprise can do. One might suggest that such an SOE can be privatised in order to continue its entrance into the internal market. However, taking into account a very broad definition of a 'financial contribution' under the FSR, corporate reorganisation does not guarantee that the European Commission will not find a presence of a distortive foreign subsidy even if received by a newly privatised company. Therefore, the non-EU SOEs can be stopped from expanding their business into the EU simply because of the form of their ownership.

[135] Reindl, Van Damme (n 25), p 107.
[136] European commission, 'Mergers' (*Competition Policy*,) <https://competition-policy.ec.europa.eu/mergers_en> accessed 5 July 2024
[137] Ibid.

VI. Proposal for changes

Analysis conducted in the previous Chapters comprehensively showed that the application of the FSR towards non-EU SOEs can be hardly defined as 'competitively neutral'. The main concerns can be summarised as follows:

1. The definition of 'financial contribution', the starting point of FSR notification obligations, is unclear, which puts an additional administrative burden on non-EU SOEs;
2. The approach to the concept of a contribution 'provided by a third country' makes non-EU SOEs both providers and receivers of foreign subsidies. Consequently, the scope of notifiable transactions becomes unnecessarily wide;
3. A typical finding of whether subsidy 'confers benefit' includes deferral from the 'normal' EU market economy. Countries where non-EU SOEs receive subsidies often have regulated economies, which almost certainly leads to the conclusion that such subsidies 'confer benefit';
4. Under the FSR, thresholds for subsidies to be considered 'unlikely distortive' are higher compared to the EU state aid ones;
5. FSR does not provide for policy objectives that completely exempt financial contribution from the obligation to notify it, unlike the EU state aid law does;
6. Positive effects of foreign subsidies outside of the EU (in countries where they are granted) are unlikely to outweigh potential negative externalities for competition if they are not producing simultaneous benefits in the EU internal market;
7. Redressive measures under FSR are much stricter than simple repayment of contribution under the EU state aid law;
8. In the case of parallel assessment under the FSR and EU merger control, it is practically almost impossible to align *de jure* equal timelines due to the higher administrative burden non-EU SOEs are carrying under the FSR;
9. Parallel assessment of FSR and EU merger control can lead to contradictory outcomes, which can block non-distortive transactions because of the ownership type of the acquirer.

Certain amendments can be made to minimise the mentioned negative effects of the current version of FSR. They include (i) additional guidance from the European Commission, (ii) amendments to the FSR procedure, as well as (iii) inclusion of the FSR M&A Tool into the EU merger control framework.

A. Guidelines from the European Commission

A good portion of the FSR issues discussed in this thesis come from unclear and wide terms. Everyone can agree that it is impossible to make sure that every single legal term has an exhaustive list of included examples. However, when it comes to FSR, the absence of any guidance on what core concepts, like 'financial contribution', mean causes too many doubts for non-EU SOEs. They are left with two choices – continue attempts to expand their business in the EU or abstain from it. In the first case, non-EU SOEs are 'walking on a minefield', where they have to submit notifications based on their understanding and hope that the European Commission will agree. In the second situation, both the EU market and non-EU SOEs will lose the benefits that trade globalisation brings.

A really easy solution to avoid this is for the European Commission to issue official guidelines on the application of the most controversial aspects of the FSR. One might say that it is impossible to be done without at least a couple of years of practical implementation. I disagree with this kind of statement. FSR is not a completely new instrument – it is a combination of already existing regimes. To relieve the unnecessary administrative burden from the non-EU SOEs, the European Commission can at least issue provisional guidelines where it clearly states which kinds of sources (decisions, judgements, regulations, etc.) will help companies to make a self-assessment that will be successfully accepted during the FSR review.

B. Amendments to FSR assessment

The European Commission expressed its intention to align the FSR and EU state aid regimes and make them 'sisters' in different dimensions. Namely, EU state aid shall protect the internal market from distortions from governmental support of Member States, while the FSR – from distortive foreign subsidies. However, when creating the FSR regime, the Commission took away all the flexibilities that exist in EU state aid law. Therefore, while companies receiving aid from EU Member States can enjoy exemption on numerous occasions, non-EU SOEs have a stand-still notification obligation expecting that the result of the balancing test will be in their favour.

To tackle this issue, the European Commission can make certain amendments to the current FSR procedure. Unfortunately, it is not viable that the Commission will agree to equalize the numerical values of thresholds under both regimes as the ones of EU state aid were carefully calibrated to the conditions of the internal market. However, it is possible to include the exemptions from notification based on the policy objective of the foreign subsidy, if it is the same as the one exempted under the EU state aid law. Additionally, the Commission can give more weight to the positive effects of foreign aid outside of the EU.

As a consequence, non-EU SOEs will be relieved of at least some administrative burden and can enjoy a 'safe harbour' close to the one guaranteed under the EU state aid law. At the same time, if the European Commission has doubts concerning certain exempted foreign subsidies, it can still apply the *Ex officio* Tool to check their compatibility.

C. 'Marriage' of FSR M&A Tool and EU merger control

EU merger control and FSR M&A Tool usually go hand-in-hand as many transactions fall within reach of both simultaneously. Chapter V explored how such a parallel assessment in many cases is almost impossible to be finished at the same time and, sometimes, with the same substantive outcome. Hence, I believe, it might be more efficient to merge the FSR M&A Tool with the merger control process.

After the latest update, the EU merger control application form (Form CO) contains a part where the notifying company has to specify whether it has received a foreign subsidy and whether it expects to make the FSR notification.[138] To avoid contradicting outcomes, the European Commission can make the FSR M&A Tool a 'second step' in merger control analysis. In particular, if the concentration distorts competition based on merger control rules, it will not be implemented anyway. Hence, there is no need to spend the other (FSR) team resources. Instead, the FSR team may be involved only in cases cleared by the merger control team to 'double-check' whether there is no distortion of competition because of foreign subsidies. Similarly, the European Commission can still use the *Ex officio* Tool in case of any doubts.

I must admit that while this suggestion can save the resources of the Commission and improve time controversies between two regimes, it has two major flaws. First, it does not resolve the situation when the FSR team blocks transactions that are otherwise unproblematic under

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[138] Commission Implementing Regulation (EU) 2023/914 of 20 April 2023 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings and repealing Commission Regulation (EC) No 802/2004, Annex 1.

merger control. Second, it is quite unrealistic to be implemented by the Commission because it will mean the abolition of the already introduced mechanism. This might take many more resources than could be saved. Taking this into account, it seems that the most probable changes that can be accepted by the European Commission are official guidelines and amendments to the assessment process.

VII. Conclusion

Foreign investments subsidized by the governments of third countries have been an essential part of the EU market economy for a long time. To prevent the distortion of competition in the internal market that can be caused by them, the EU introduced FSR, a unique blend of different legal regimes aimed at tackling problematic foreign subsidies. While the policy objective behind this instrument is entirely legitimate, its enforcement leaves doubts concerning its 'competitive neutrality' towards the non-EU SOEs.

The analysis in this thesis has demonstrated that the FSR imposes significant administrative and procedural burdens on non-EU SOEs, which could potentially deter their investment activities within the EU. The broad and sometimes overlapping definitions and requirements of the FSR, such as those concerning 'financial contributions' and 'foreign subsidies,' further complicate compliance for non-EU entities. The standard for assessment under the FSR 'balancing test' leaves almost no room for non-EU SOEs to justify receiving subsidies through outweighing benefits or being exempted, unlike their rivals who acquire state aid from the EU Member States. These complexities are exacerbated when considering the parallel application of the FSR with other regulatory frameworks like EU merger control, leading to inefficiencies and possible contradictory outcomes.

To mitigate these issues, several recommendations have been proposed. They include additional guidance from the European Commission, making changes to the evaluation standards, or including analysis of foreign subsidies into other regimes, such as EU merger control.

In summary, while the FSR aims to protect the integrity of the EU internal market, its current application needs recalibration to balance regulatory oversight with the promotion of fair competition and investment. Future research could explore the long-term impacts of the FSR on the investment patterns of non-EU SOEs and assess the effectiveness of the proposed amendments in achieving true competitive neutrality.

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