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EU's Foreign Subsidies Regulation : Levelling the Playing Field

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An Introduction: EU's Foreign Subsidies Regulation

AN INTRODUCTION: EU'S FOREIGN SUBSIDIES REGULATION

The European Union (EU) has a history of proactively framing laws governing emerging issues. A notable example is the EU's General Data Protection Regulation (GDPR), which set a global standard for privacy protection by granting comprehensive rights to EU citizens over their personal data, regardless of where the data is stored or used. The EU has also taken a leading role in combating climate change and reducing greenhouse gas emissions through its Emissions Trading System.

The EU's Foreign Subsidies Regulation (FSR)¹ is a more recent example of the EU's proactive regulation of emerging issues. The FSR aims to ensure a level playing field for businesses irrespective of their geographical location in economic activities (for e.g., concentrations², public procurement, sale of goods and services, and setting up of factories among others) in the EU.

According to the EU, foreign subsidies can have distorting effects on the EU market³. At the same time, the EU state aid rules⁴ already in place are limited to regulating EU Member States' subsidies to the EU entities. Also, while the existing competition, public procurement, and trade defense rules are equipped to ensure fair conditions of competition for all the companies in the EU market, none of these regulations allow the EU to act when foreign subsidies take the form of subsidized investments, or when subsidized services and financial flows into the EU are concerned.⁵ In other words, none of these regulations have the ability to address foreign subsidies granted by a non-EU country, which could be used to finance economic activities in the EU such as investing, exporting services, participation in public procurement procedures, or acquisitions in the EU⁶. Even the EU trade remedy regulation concerning subsidized goods⁷ is limited to allowing a remedy for injury caused by the import of subsidized goods imported into the EU⁸.

¹ Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market, available at <https://eur-lex.europa.eu/eli/reg/2022/2560/oj> (last accessed July 9, 2023)

² According to Article 20 of the FSR, a concentration is deemed to arise where a change of control on a lasting basis has resulted from a merger or acquisition. Also, the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity is also a concentration.

³ Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on foreign subsidies distorting the internal market, available at https://competition-policy.ec.europa.eu/system/files/2021-06/foreign_subsidies_proposal_for_regulation.pdf (last accessed July 9, 2023)

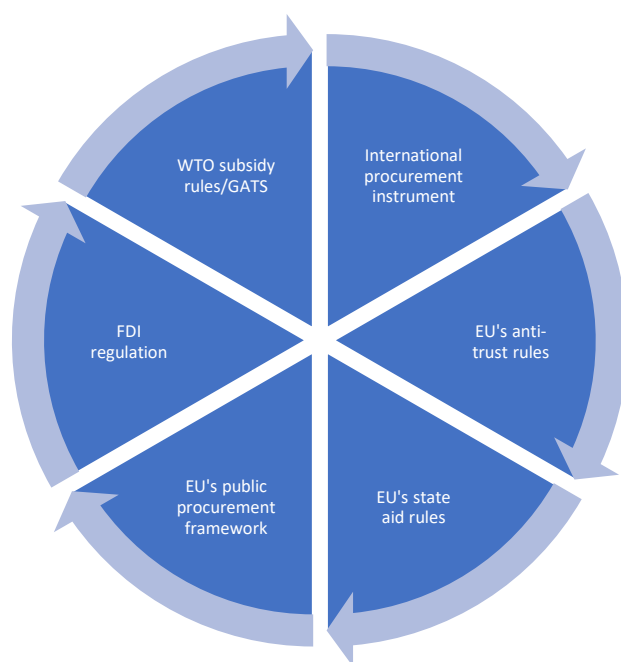
⁴ According to the EU, a company receiving any governmental support may cause distortions or gain a distortive advantage over its competitors in the EU market. Therefore, the EU generally prohibits state aid i.e., national public authorities providing advantage in any form on a selective basis to a company. The EU state aid rules have been brought in place to ensure that the prohibition is upheld and exemption applied appropriately across the EU. *EU's Competition Policy (State aid)*, available at https://competition-policy.ec.europa.eu/state-aid_en (last accessed July 9, 2023), and *EU's Competition Policy (State aid overview)*, available at https://competition-policy.ec.europa.eu/state-aid/state-aid-overview_en (last accessed July 9, 2023)

⁵ Paragraph 5 of the FSR

⁶ Paragraphs 2 to 4 of the FSR

⁷ The European Commission has clarified that the "[s]ubsidies falling within the scope of the WTO Agreement on Subsidies and Countervailing Measures cannot be redressed under Regulation (EU) 2022/2560. However, to the extent that those subsidies constitute foreign financial contributions within the meaning of Article 3(2) of Regulation (EU) 2022/2560, they nevertheless need to be taken into account for determining whether the notification threshold for concentrations set out in Article 20 of Regulation (EU) 2022/2560 is met.", *EC's Questions and Answers*, available at https://competition-policy.ec.europa.eu/foreign-subsidies-regulation/questions-and-answers_en (last accessed July 9, 2023)

⁸ Paragraph 5 of the FSR



Accordingly, the FSR has been enacted by the EU to address distortions in the EU market due to foreign subsidies by a non-EU country to an entity engaging in any economic activity in the EU market⁹. More particularly, it is intended to allow the European Commission (EC) to investigate foreign subsidies to entities operating in the EU, and to penalize, if necessary, the distortions caused by such entities in the EU as a result of foreign subsidies.

According to the EU's explanatory memorandum to the FSR, the EU's trade constitutes about 35% of its GDP¹⁰. The flow of goods, services, and investment into and from the EU contributes to the EU's growth and creates jobs¹¹. Additionally, there are over more than 1,00,000 companies owned by foreign entities within the EU¹². Evidently, there is a sufficient impetus for the EU to ensure that there is a level playing field through the implementation of the FSR in the EU's internal market to enable both EU and foreign entities to compete on merit. This is why businesses operating in the EU need to be aware of the EU's FSR and its requirements, as non-compliance can result in significant legal and commercial consequences.

In this primer, we will explore the key aspects of the EU's FSR, providing you with a comprehensive understanding of its scope, enforcement mechanisms, and implications for businesses operating within the EU. A high-level list of considerations for businesses to commence preparing for the FSR has also been provided.

⁹ Paragraph 6 of the FSR

¹⁰ *Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on foreign subsidies distorting the internal market*, available at https://competition-policy.ec.europa.eu/system/files/2021-06/foreign_subsidies_proposal_for_regulation.pdf (last accessed July 9, 2023)

¹¹ *Ibid*

¹² *Id*

An hourglass with red sand falling from the top bulb to the bottom bulb. The sand is in motion, creating a thin stream that tapers as it falls. The background is a soft, out-of-focus light gray.

When was the FSR introduced?

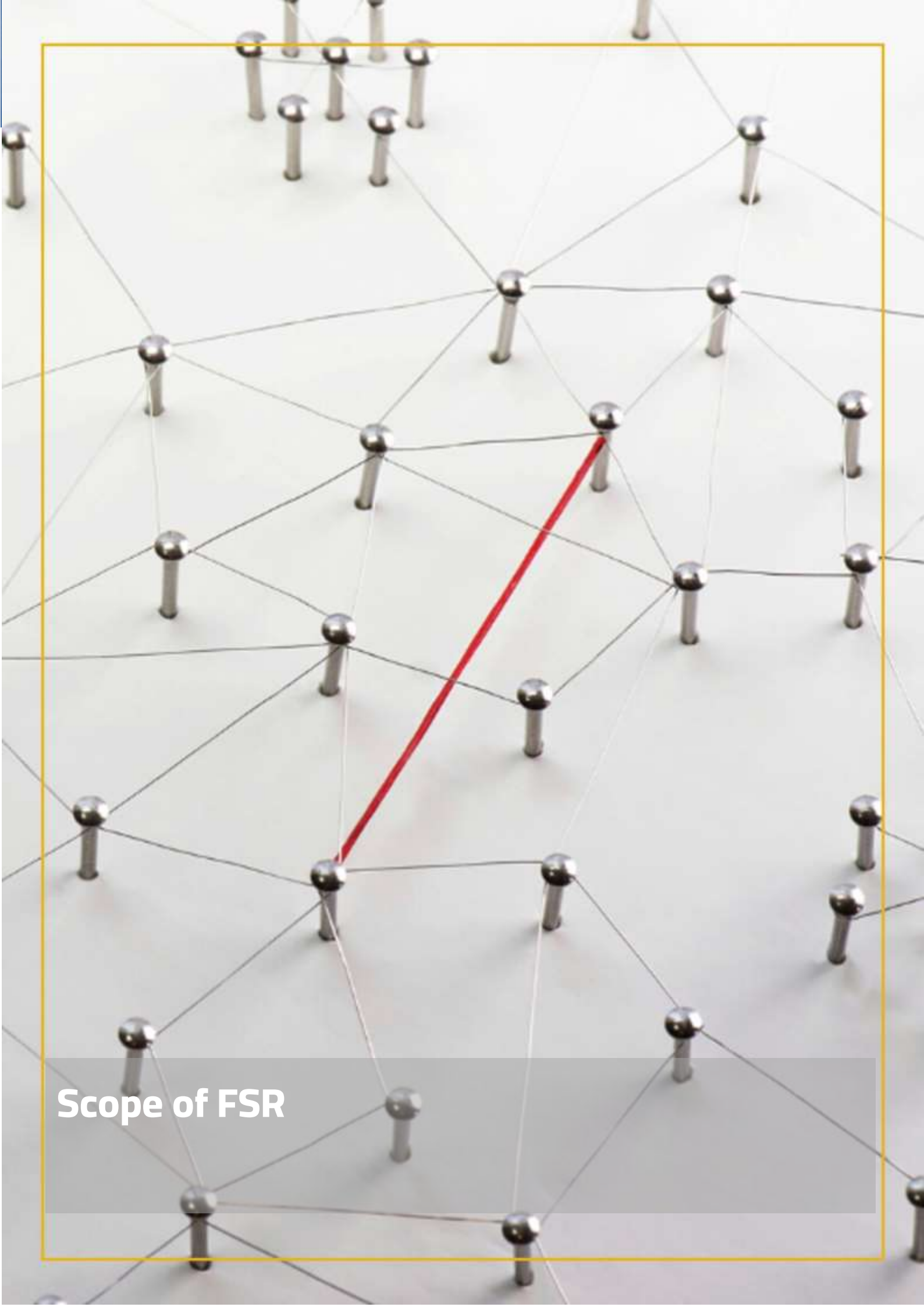
WHEN WAS THE FSR INTRODUCED?



The FSR entered into force on January 12, 2022, and will start applying from July 12, 2023. Also, certain *ex-ante* mandatory notification requirements are set to apply from October 12, 2023.

Additionally, on July 12, 2023, the EU published the rules implementing the FSR i.e., Implementing Regulation¹³ that sets forth the form, content, and procedural details of mandatory notifications, and other procedures relevant to conducting the investigations by the EC. Further, certain guidelines on the application of the criteria for determining distortion and balancing tests among others by the EC are expected to be published (as early as January 12, 2026).

¹³ COMMISSION IMPLEMENTING REGULATION (EU) 2023/1441 of 10 July 2023 on detailed arrangements for the conduct of proceedings by the Commission pursuant to Regulation (EU) 2022/2560 of the European Parliament and of the Council on foreign subsidies distorting the internal market, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2023.177.01.0001.01.ENG&toc=OJ%3AL%3A2023%3A177%3ATOC (last accessed July 12, 2023)



Scope of FSR

SCOPE OF THE FSR

Who would investigate foreign subsidies?

The EC has been conferred with the jurisdiction under the FSR to undertake an investigation of distorting foreign subsidies and apply redressive measures:

- Has the **concerned entity** engaging in economic activity in the EU been granted **foreign subsidies** by a **non-EU country**?
- Have such foreign subsidies distorted the competition in the EU internal market?
- Can the distortion resulting from these foreign subsidies be **counterbalanced by any positive effects**?

Key concepts¹⁴

Concerned entity:

- The FSR is applicable to entities irrespective of geographical location engaging in economic activities in the EU and receiving foreign subsidies from non-EU countries.

Foreign subsidies:

- Direct/indirect **financial contribution** by a **non-EU country** to the concerned entity;
- As a result of such financial contribution, there is a **benefit** conferred upon the entity receiving the financial contribution;
- The entity concerned engages in economic activities in the EU;
- Financial contribution and benefit are limited to specific entities/industries.

Financial contribution:

- Transfer of funds or liabilities such as capital injections, grants, loans, loan guarantees, fiscal incentives, setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps, or rescheduling;
- Foregoing of revenue such as tax exemptions or granting of special/exclusive rights without adequate remuneration;
- Provision of goods or services or the purchase of goods or services.

Non-EU country:

- Central government and public authorities at all other levels;
- Foreign public entity whose actions can be attributed to the non-EU country;
- Private entity whose actions can be attributed to the non-EU country, taking into account all relevant circumstances.

¹⁴ Paragraphs 14, and 18 to 21 and Articles 3 to 6 of the FSR

Benefit:

- Benefit is determined based on comparative benchmarks, such as financing rates obtainable on the market, a comparable tax treatment, or adequate remuneration for a given good or service.
- For e.g., a benefit exists if financing by a public authority does not comply with normal market conditions.
- Presumption of normal market conditions: If financing (for e.g., provision or purchase of goods or services) is carried out following a competitive, transparent, and non-discriminatory tender procedure.

Counterbalanced by any positive effects:

- An assessment of whether the distortion as a result of the foreign subsidies is counterbalanced by any positive effects has to be conducted.
- For instance, an assessment of positive effects entails an assessment of the relevant policy objectives of the EU such as a high level of environmental protection and social standards, and the promotion of research and development. Particularly, the EC is required to weigh the positive effects against the negative effects of a foreign subsidy in terms of distortion in the internal market.

When are distortive foreign subsidies deemed to exist in the EU internal market?

A distortion is deemed to exist when a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market, and in doing so, the foreign subsidy actually or potentially affects the competition in the EU internal market. Various indicators under Article 4 of the FSR have been provided to determine distortion. The EC has also provided a few examples of when a foreign subsidy is *most likely to distort*¹⁵, *unlikely to distort*¹⁶ or *not distorting*¹⁷ the EU internal market, which are provided below:

Most likely to distort:

- A foreign subsidy granted to an ailing undertaking (without a restructuring plan that is capable of leading to the long-term viability of that undertaking and that plan includes a significant own contribution by the undertaking);
- Unlimited guarantees for the debts or liabilities of the undertaking;
- An export financing measure that is not in line with the OECD Arrangement on officially supported export credits;
- Enabling a company to submit an unduly advantageous tender;
- Facilitating a concentration (mergers and acquisitions).

Unlikely to distort:

- If the foreign subsidy does not exceed EUR 4 million in the past three years.

Not distorting the EU market:

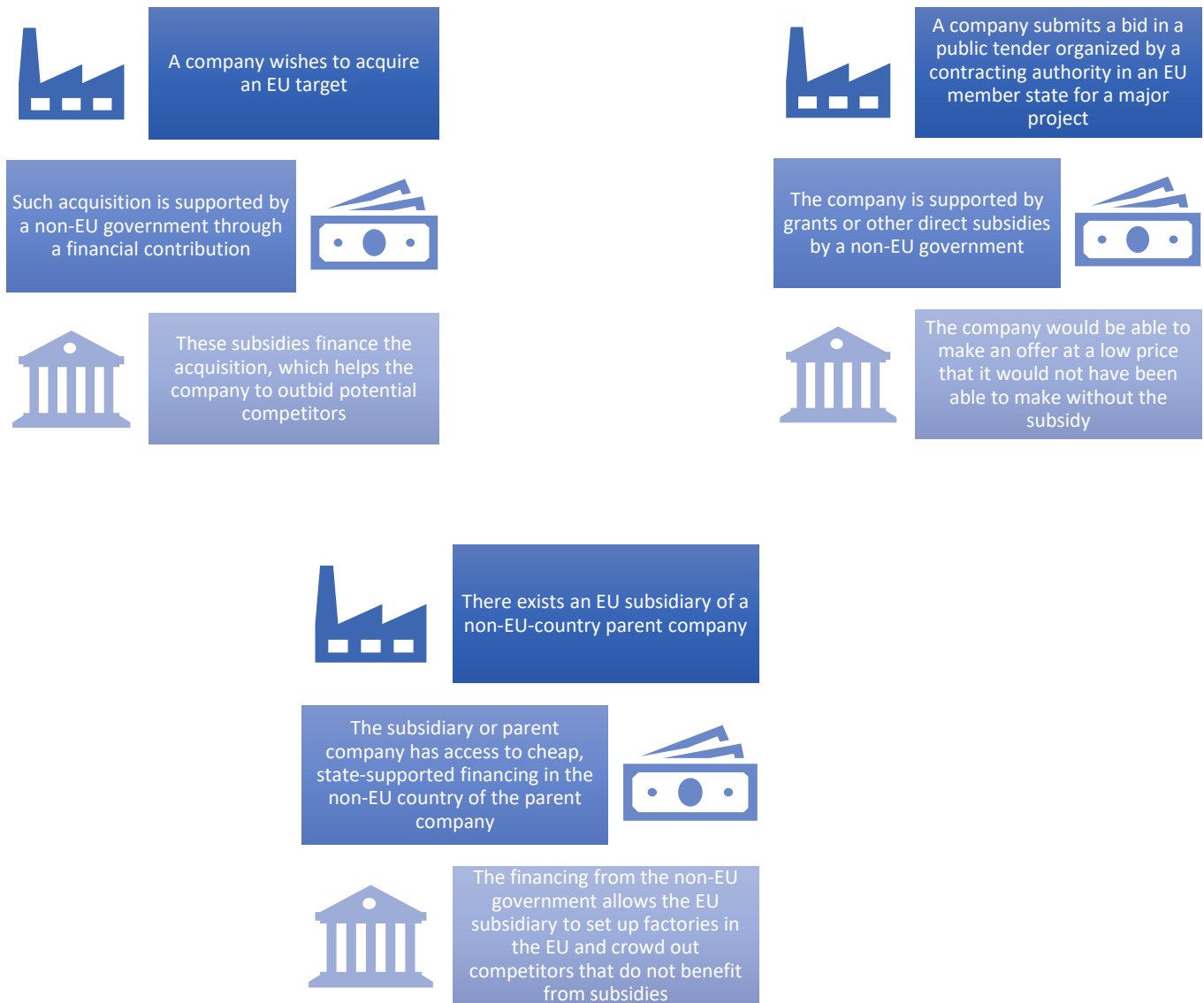
- Foreign subsidy is below EUR 200,000 per non-EU third country in the previous three years; or
- If the foreign subsidy is aimed at repairing damage caused by natural disasters or exceptional circumstances.

¹⁵ Paragraphs 18 to 20 and Article 5 of the FSR

¹⁶ Article 4 (2) of the FSR

¹⁷ Article 4 (3) and (4) of the FSR

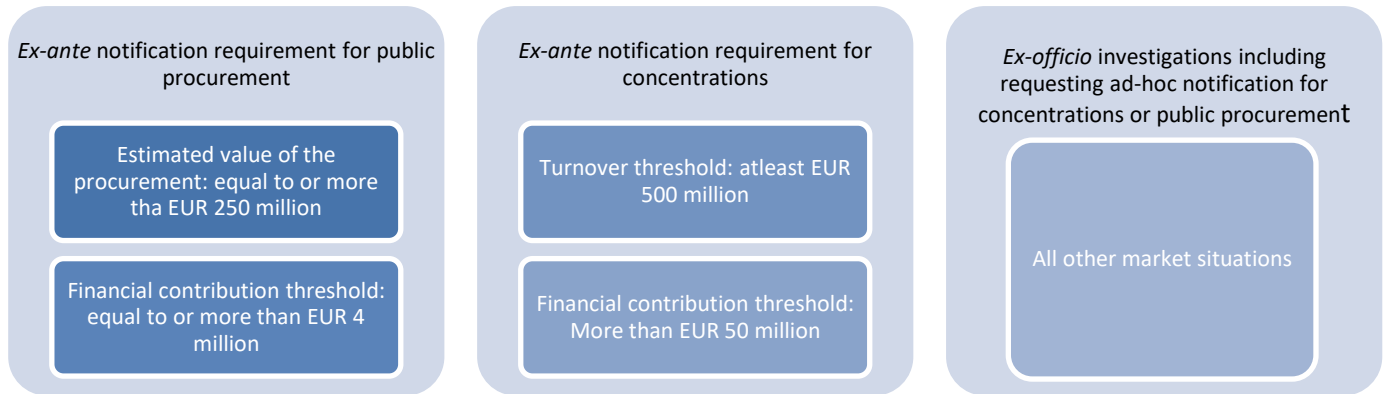
The EU has provided a few illustrations of distortive foreign subsidies¹⁸:



¹⁸ EU's guidance on the FSR, available at https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/europe-fit-digital-age/european-industrial-strategy/foreign-subsidies-regulation_en (last accessed July 9, 2023)

What procedure must the EC adopt to identify distorting foreign subsidies?

EC has been conferred with the power to conduct either an *ex-ante* or *ex-officio* investigation of the aforesaid criteria before applying redressive measures.



Entities engaging in concentrations (mergers & acquisitions and joint ventures) and public procurement are required to notify financial contributions received from non-EU countries in the last three years upon meeting certain thresholds (in terms of turnover and foreign financial contribution). Upon receiving such notifications, the EC may conduct an *ex-ante* investigation to ascertain if foreign subsidies distorting foreign subsidies exist or not.

In other market situations – including when the prescribed thresholds for concentrations and public procurement are not met – the EC has been conferred with powers to require the notification of foreign subsidies received on a case-to-case basis and/or conduct an *ex-officio* investigation¹⁹. Such *ex-officio* investigations can be concluded by the EC on its own initiative or upon receiving information from any source, including the EU Member States, a natural or legal person, or an association, regarding alleged foreign subsidies distorting the internal market²⁰.

For conducting *ex-ante* and *ex-officio* investigations, the FSR further prescribes a two-step process that includes a preliminary review²¹ and an in-depth investigation²². The object of the preliminary review is to ascertain if there are sufficient indications that an undertaking has been granted a foreign subsidy that distorts the internal market. If it is in the affirmative, an in-depth investigation will be conducted. On the other hand, if there are no such indications, the preliminary review must be closed.

In general, the EC has been conferred with powers to make decisions on the basis of facts available if the entity under investigation or the non-EU country that granted the foreign subsidy does not cooperate in the investigation²³.

¹⁹ Article 9 of the FSR

²⁰ Article 9 of the FSR

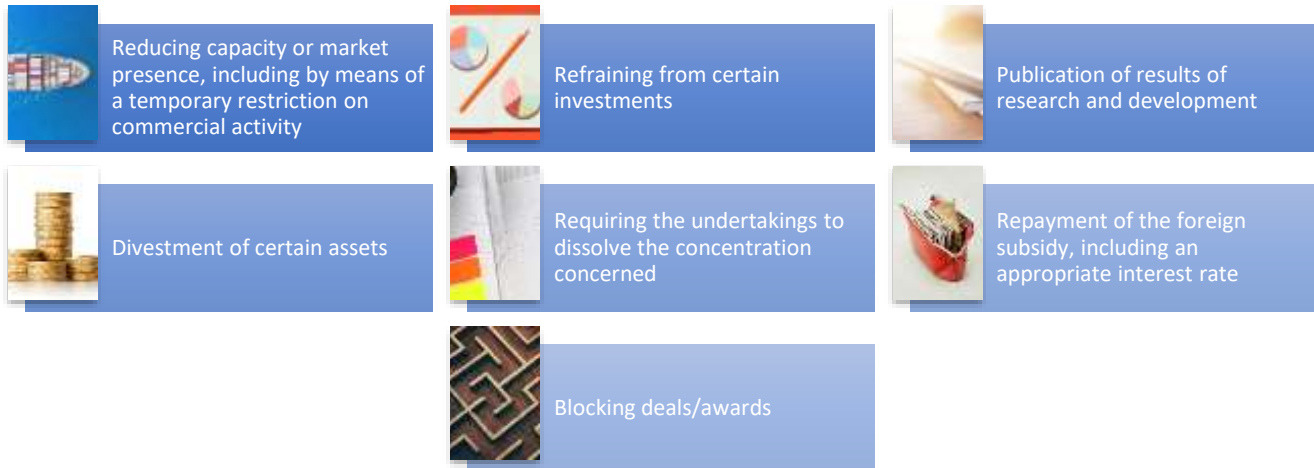
²¹ Articles 10 and 25 of the FSR

²² Articles 11 and 25 of the FSR

²³ Chapter 2 and Article 25 of the FSR

What redressive measures can the EC undertake upon finding distortive foreign subsidies?

Upon finding distorting foreign subsidies, the EC can impose redressive measures, which may differ on a case-to-case basis, particularly on the basis of the economic activity in question.



As an alternative, the EC also allows commitments from the entity in question (i.e., the entity which is responsible for causing distortions). Such commitments can be similar to the aforementioned redressive measures.

Additionally, certain interim measures²⁴, *inter alia*, including the following may be imposed:

- Refraining from certain investments;
- Offering access to subsidized infrastructure or licenses, etc to third parties²⁵.

Finally, the EC may impose fines or periodic penalty payments if:

- A party intentionally or negligently provides incomplete, incorrect, or misleading information, etc;²⁶
- The concerned entity doesn't comply with the decisions of the EC²⁷,

Are there any transition provisions provided under the FSR?

The FSR is not applicable to concentrations for which the agreement was concluded, the public bid was announced, or a controlling interest was acquired before July 12, 2023. It is also not applicable to public procurement contracts that have been awarded or procedures initiated before July 12, 2023. However, it applies to all the other situations below.

²⁴ No interim measures can be taken with regard to public procurement.

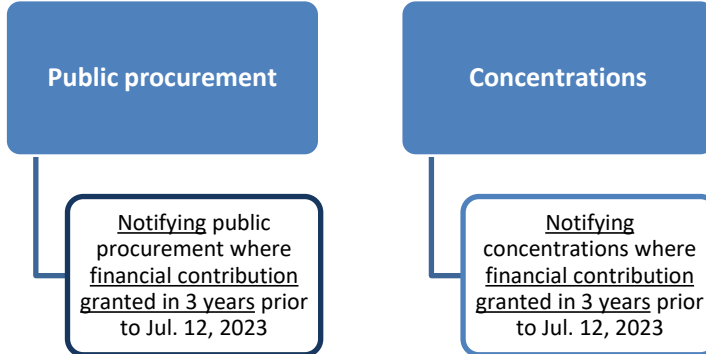
²⁵ Article 12 of the FSR

²⁶ Article 17 of the FSR

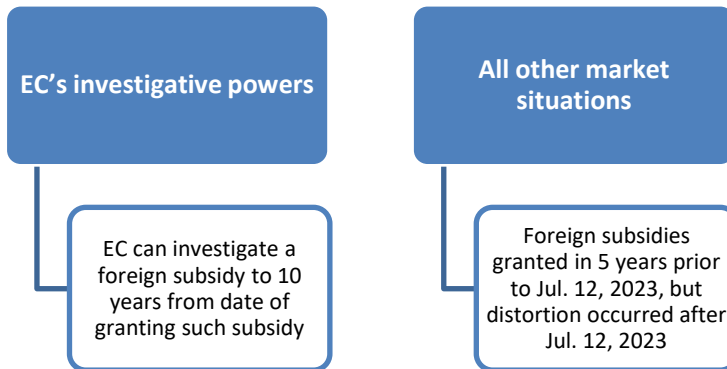
²⁷ Article 17 of the FSR

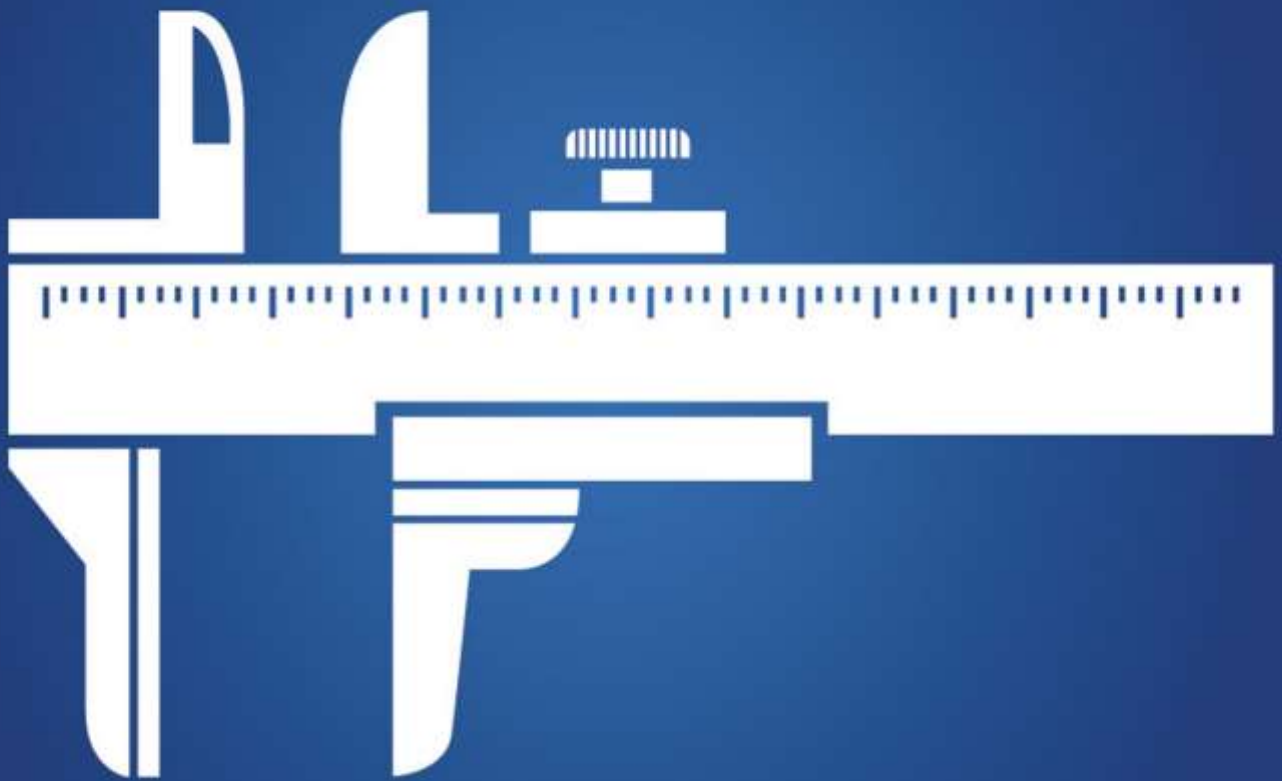
Transitional provisions

Applicability of FSR to public procurement and concentrations not yet concluded



Applicability of FSR to all other market situations





Which areas/sectors in India are likely to be impacted?

WHICH AREAS/SECTORS IN INDIA ARE LIKELY TO BE IMPACTED?

FSR's *ex-ante* and *ex-officio* investigations apply equally to all sectors and do not target any specific country. However, market investigations into specific sectors, types of economic activity, or foreign subsidy instruments are also envisaged.

That said, in 2022, India exported over USD 73.6 billion worth of goods to EU countries. The top product categories include Mineral Fuel and Petroleum Products, Electrical Machinery and Equipment, Organic Chemicals, Machinery and Mechanical Appliances, and Iron and Steel. These 5 categories comprise about 49% of the total export basket. These are some of the sectors that may likely be impacted by the FSR.

Top 10 Commodity Exports from India to the EU



Source: TradeStat, DGCI&S for the year 2021-22

Also, given that India is also actively involved in exporting services, investing, and participating in public procurement in the EU, FSR may be seen impacting these areas as well.

Export of Services from India to the EU

Year	EU imports of services from India (in billion EUR)
2020	17.693
2021	20.673

Source: EuroStat

Indian Foreign Direct Investment in the EU

Particulars	2020	2021
FDI into the EU from the Rest of the World (EUR Million)	13,542,230.2	14,051,438.0
FDI into the EU from India (EUR Million)	5,183.2	6,163.5
% of Indian FDI in total FDI	0.04%	0.04%

Source: EuroStat

Public Procurement

Particulars	Number of Tenders
Total tenders awarded in the EU in 2018-22	5,099,612
Tenders where India is a contracting or sub-contracting party	136 (0.0027%)

Source: Tenders Electronic Daily (TED) (csv subset) – Contract Award Notices 2018-2022



What should businesses do to comply with the FSR?

WHAT SHOULD BUSINESSES DO TO COMPLY WITH THE FSR?

As per the information available in the public domain, atleast one complaint under the FSR has been made before the EC²⁸. As the FSR will start applying from July 12, 2023, the EC may be seen investigating such complaints.

Given the above developments, and until greater clarity on the application of the FSR is provided on a case-to-case basis, Indian entities engaging in economic activities in the EU (especially with a legal presence within the EU) must consider assessing whether their operations are in any manner susceptible to the FSR and the redressive measures thereto. A starting point for such an assessment would entail answering *inter alia* the following questions.

Is the company currently engaging or anticipate entering into a concentration within the EU?

Was a public procurement contract awarded to the company or procedures initiated for public procurement recently in the EU?

Does the company anticipate bidding for a public procurement in the EU?

Does the company have a parent company or a subsidiary or a related party in the EU? Does the company anticipate financing or providing any goods or services to its parent company or subsidiary or its related party in the EU?

Does the company export to a manufacturer in the EU?

Does the company anticipate providing goods or services to a company within the EU?

Does the company anticipate investing in a company in the EU?

Has the company been granted in the last five (5) years or is expected to be granted assistance (financial or otherwise) from the Indian government or entity owned or controlled by the Indian government?

²⁸ A complaint requesting the EC to investigate foreign subsidies distorting the professional football club in the EU, and particularly, Belgium has been made. Foreign subsidies to certain clubs, available at <https://www.revirton.be/subventions-etrangeres-certains-clubs> (last accessed July 9, 2023)

We hope the primer has been a useful read.

Economic Laws Practice (**ELP**) has been at the forefront of international trade and customs as well as policy in India since the firm's inception. Our market-leading practice in International Trade and Customs has charted a course of exponential growth, integrating an extensive team of specialist resources geared toward advising clients on international trade rules governing their business, developing and executing strategies to improve market access, and minimizing risk arising from international trade developments.

ELP has been assisting companies understand compliance requirements in multiple jurisdictions. ELP can help companies also navigate the FSR, particularly from the stage of undertaking due diligence on the applicability of the FSR to the economic activity in question to the stage of opposing any investigation by the EC.

For further details on the FSR, please reach out to us at insights@elp-in.com or reach our authors:

Sanjay Notani, Partner – Email – SanjayNotani@elp-in.com

Ambarish Sathianathan, Partner – Email – AmbarishSathianathan@elp-in.com

Parthasarathi Jha, Partner – Email – ParthJha@elp-in.com

Harika Bakaraju, Principal Associate – Email – HarikaBakaraju@elp-in.com

Divyashree Suri, Senior Associate – Email – DivyashreeSuri@elp-in.com



**ECONOMIC
LAWS
PRACTICE**
ADVOCATES & SOLICITORS

MUMBAI

9th Floor, Mafatlal Centre
Vidhan Bhavan Marg Nariman Point
Mumbai 400 021
T: +91 22 6636 7000

NEW DELHI

801 A, 8th Floor, Konnectus Tower, Bhavbhuti Marg
Opp. Ajmeri Gate Railway Station, Nr. Minto Bridge
New Delhi 110 001
T: +91 11 4152 8400

AHMEDABAD

C-507/508, 5th Floor, Titanium Square
Thaltej Cross Roads, SG Highway,
Ahmedabad – 380054
T: +91 79460 04854

PUNE

202, 2nd Floor, Vascon Eco Tower
Baner Pashan Road
Pune 411 045
T: +91 20 4912 7400

BENGALURU

6th Floor, Rockline Centre
54, Richmond Road
Bengaluru 560 025
T: +91 80 4168 5530/1

CHENNAI

No 18, BBC Homes, Flat-7 Block A
South Boag Road
Chennai 600 017
T: +91 44 4210 4863

GIFT CITY

Unit No. 605, Signature, 6th Floor
Block 13B, Zone - I
GIFT SEZ, Gandhinagar 382355
E: elplaw@elp-in.com



elplaw.in



insights@elp-in.com



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