Organisation for Economic Co-operation and Development

DAF/COMP/WD(2022)104

Unclassified **English - Or. English**

10 November 2022

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

The Relationship between FDI Screening and Merger Control Reviews – Note by Hungary

30 November 2022

This document reproduces a written contribution from Hungary submitted for Item 13 of the 139th OECD Competition Committee meeting on 29-30 November 2022.

More documents related to this discussion can be found at
www.oecd.org/competition/the-relationship-between-fdi-screening-and-merger-control-reviews.htm

Mr Antonio CAPOBIANCO
[Email: Antonio.CAPOBIANCO@oecd.org]

JT03507262

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

Hungary

1. Background

1. The present paper aims to summarize the legal framework and the most important aspects of the relationship of the Hungarian FDI and merger control review procedures, while also presents Hungarian cases, where both regimes were applicable.

2. The paper furthermore presents alternative tools with different scopes for the screening of foreign direct investments (such as the extension of state aid law to third-country aids) as well as the means of interagency cooperation in the Hungarian administrative system.

2. Legal framework for foreign investment screening reviews in Hungary

3. Being an open market economy, Hungary has an extensive EU-harmonized legislation regarding both merger control and screening of foreign direct investment (hereinafter: "**FDI**".) As in many other jurisdictions, the main difference between merger control and FDI screening in Hungary is that the former focuses on the impact on economic competition while the latter is based on national security considerations.

4. The two main legislative acts currently in force which regulate FDI in Hungary are (i) Act LVII of 2018 on the control of foreign investments that violate the security interests of Hungary (hereinafter: "**Act on CFI**")[1], and (ii) Act LVIII of 2020 on transitional rules related to the end of the state of emergency and epidemiological preparedness (hereinafter: "**Emergency Act**")[2], which sets out rules for notification of transactions targeting „strategic" companies (Act on CFI and Emergency Act hereinafter referred together as: "**FDI Acts**"), whereas the basis of merger control is set out in the Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices (hereinafter: "**Competition Act**").

5. The Act on CFI established the "classic" foreign investment screening mechanism in Hungary in compliance with the Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments in the EU (hereinafter: "**EU Regulation on FDI**"). It renders acquisitions by foreign investors in companies operating in sensitive sectors subject to notification to – and approval of - the Minister responsible for the management of civilian national security services, (i.e. the Minister of Interior). The review aims at protecting *sensitive* industrial sectors from foreign investments based on national interest and national security considerations.

6. On 25 May 2020, during the coronavirus pandemic, the Government introduced a similar investment screening measure to protect Hungarian-based *"strategic"* companies for economic purposes, and later incorporated this provision in the Emergency Act after

[1] Supplemented by Government Decree 246/2018. (XII. 17.) on the Implementation of Act LVII of 2018 on Controlling Foreign Investments Violating Hungary's Security Interests (hereinafter: „CFI Decree")

[2] Supplemented by Government Decree 289/2020 (VI. 17.) defining the measures required for the economic protection of companies having atheir seats in Hungary (hereinafrer: „Emergency Decree")

the state of emergency in Hungary ended in order to ensure a clear and predictable regulatory transition. The relevant authority in charge of reviewing the transactions is the Minister of Technology and Industry, who either acknowledges or prohibits the transaction. During its assessment, the Minister examines a combination of economic factors as well as national interest and public order considerations.

7. The Competition Act applies to mergers that potentially restrict effective competition in Hungary. Mergers that fulfil the notification criteria under the Competition Act need to be reported to the Hungarian Competition Authority (hereinafter: "**GVH**"), an independent agency, which either unconditionally clears the merger, approves the merger subject to remedies, or prohibits the merger if no adequate remedies to the competition concerns have been proposed by the merging parties.

8. The above control mechanisms exist parallelly in Hungary, meaning that if a transaction/investment falls within the scope of both FDI Acts and the Competition Act as well, the foreign investor should submit three separate applications for the respective authorities' approval.

2.1. Connection with merger regime (Competition Act)

2.1.1. Personal scope

9. In the case of Hungarian regulations, the screening of foreign investments - in contrast to merger control - applies to a narrower circle of persons ("foreign investors" and "non-Hungarian based investors") targeting a (i) sensitive or strategic Hungarian-based company or (ii) the right to own, operate or use a sensitive or strategic infrastructure or asset in Hungary.

10. The Act on CFI defines "foreign investor" as (i) a citizen of a "foreign" state (outside the European Union, the European Economic Area and the Swiss Confederation) or an entity registered in such a state; or (ii) a legal entity registered in a "non-foreign" state (in Hungary/the EU/the EEA/ the Swiss Confederation), if the person having a majority influence in the legal entity within the meaning of the Hungarian Civil Code Act (hereinafter referred to as the: "Civil Code Act") is a national of a "foreign" state, or a legal entity/other organization registered in such a State (hereinafter: "foreign investor").

11. This definition prevents circumvention of the legislation in such a way that a "foreign" person first acquires majority influence in a company already established in the EU that is not sensitive to the security interests of Hungary, and then tries to acquire ownership in a company operating in a sensitive sector.

12. Article 114 of Act XCIX of 2021 on transitional rules related to emergencies Affecting Hungary's Security Interests has widened the personal scope of the Act on CFI to nationals of another Member State of the EU/EEA or the Swiss Confederation and legal/other entities incorporated in such a State. (hereinafter: "non-Hungarian based investors"). This wider personal scope applies until 12 months after the end of the state of emergency in Hungary, thus, until 1st June 2023. The Emergency Act, on the other hand, originally applies this wider personal scope to certain acquisitions.

13. The GVH, on the other hand, has jurisdiction over companies that carry out economic activity and achieve turnover from that activity in Hungary, regardless of their place of establishment or nationality of their owners. As a general rule, the merging parties have to notify their transaction to the GVH in case they have a combined turnover exceeding 15 billion HUF and at least two of the merging parties' individual turnover exceeds 1 billion HUF.

14. Based on the above, in case a foreign/non-Hungarian based investor belonging to a group of companies that does not have a member that has achieved turnover in Hungary, wants to set up a new company/acquire shares in an existing company in Hungary; such transaction will not have to be reported to the Hungarian Competition Authority, but may have to be reported to the Minister in charge in case it concerns a sector covered by one of the FDI Acts - and fulfils the remaining threshold criteria.

15. On the other hand, in case a foreign/non-Hungarian based investor acquires ownership not directly in a company registered in Hungary, but in its' parent company established in another Member State, it may qualify as a notifiable merger under the Competition Act - as the group will carry out economic activity in Hungary -, but will not be the subject of FDI screening, as the FDI Acts apply only to transactions targeting companies established in Hungary. In such cases, however, the EU Regulation on FDI may be of particular importance, since Article 7 allows Hungary to raise its concerns with the Member State concerned in such cases.

2.1.2. Sectoral (material) scope

16. A common element of the FDI Acts is that they apply only to transactions in certain sectors which are deemed to be strategically important.

17. The Act on CFI covers activities relating to among others the (i) production of weapons, munitions and licensed military equipment, dual-use products, and secret service equipment; (ii) the operation of the payment system, (iii) the establishment, development, or operation of state and municipal electronic information systems; (iv) electricity, natural gas and water services, (v) electronic communications services as well as (vi) insurance and reinsurance activities.[3]

18. The Emergency Act covers activities within the energy, transport and communications sector as well as areas of strategic importance within the meaning of Article 4(1)(a) to (e) of the EU Regulation on FDI, excluding financial infrastructure. Based on this list alone, it seems that the Emergency Act captures less sectors and activities, however, Government Decree no. 289/2020. (VI. 17.) (hereinafter: "***Emergency Decree***") which supplements the scope of the Act provides for an extensive list of sectors and activities that are considered "strategic" and thus, are covered by the Emergency Act.

19. In contrast to the above, the Competition Act does not have any sector-specific element, meaning that all transactions which satisfy the turnover threshold and other criteria are notifiable and are evaluated on the same basis regardless of the sector that the companies are operating in.

2.1.3. Type of transactions covered

20. In sectors where the FDI Acts impose a notification requirement, a much more extensive scope of transactions is covered than those defined in the Competition Act - giving the Ministries a high level of scrutiny over these areas.

21. The FDI Acts make it clear that acquisitions are to be understood not only as transactions involving a classic transfer of ownership, but also as other transactions as defined in Hungarian company law which result in the foreign investor concerned acquiring a certain number of shares or certain influence on the decision-making of the company in question.

---

[3] insurance and reinsurance activities were added by Act XCIX of 2021., in effect since 1st December 2021

22. Thus, the Act on CFI also applies to the (i) formation of a company by the foreign investor alone, the (ii) changing of a companies' field of activity, and the (iii) establishment of branches, whereas the Emergency Act covers the (i) issuing of bonds by a strategic company and the (ii) establishment of a right of usufruct over a (business) share of a strategic company as well. In addition, both FDI Acts apply to the acquiring of a right to operate or use sensitive infrastructure or assets related to the covered activity.

23. In line with international practice, the legislator has also set the notification thresholds for investors under the FDI Acts much lower than the turnover thresholds defined in the Competition Act (see above). As such, the Act on CFI does not take into account the monetary value of the transactions, whereas the Emergency Act sets the general notification obligation for investments reaching or exceeding HUF 350 million in value.

24. As for the level of control, under the Act on CFI the notification obligation exists in case a foreign investor acquires (i) more than 25% of shares – 10% in the case of a public limited liability company – or (ii) a decisive influence under the meaning of the Civil Code, as well as if (iii) the combined shares of multiple foreign investors would exceed 25%. Under the Emergency Act, in general, the transaction needs to be reported if the (i) foreign/non-Hungarian based investor acquires majority influence under the meaning of the Civil Code, or (ii) the foreign investor acquires at least 10% of the shares in the strategic company.

25. Whereas the FDI Acts borrow the definitions from the Civil Code when defining what level of influence constitutes a notifiable transaction; the Competition Act uses its own definition in this matter. Direct or indirect control under the Competition Act means that the acquiring company has the power – by majority of shares, by contract, by the appointment of senior executives or an objective situation (a clear dominant position in the decision-making body for instance) - to assert major influence over the market behaviour of the other company.

26. Based on the above, the FDI Acts are stricter in the sense that it is enough if a foreign investor acquires less than 50% (25% and 10% respectively) of the shares of the Hungarian-based company, as this will automatically trigger the notification obligation, regardless of the foreign investors' influence on the behaviour of the company, and only in case a smaller number of shares are acquired by the foreign investor will make the authorities further consider their potential influence in the companies operation.

27. On the other hand, under the Competition Act only the acquisition of direct/indirect control (which may be based on majority voting rights, the appointment of senior executives, a contract, or the actual situation) is taken into account, whereas the acquisition of any less control, minority shareholding or any degree of influence (which does not amount to the level of "control") will not be subject to notification. De facto control exists when there is an objective situation such as the persistent ability of a prominent but minority shareholder in a fragmented shareholder situation to control, as this shareholder can permanently count on obtaining a majority at the general meeting (taking into account typical turnout, voting patterns etc.).

2.1.4. Substantive Assessment

28. Under the Act on CFI, the Minister of Interior examines whether the transaction violates the security interests of Hungary, and either acknowledges or prohibits the transaction - in the latter case a simplified justification must be given. The Act does not provide for a more detailed definition, meaning that the Minister of Interior has a wide discretion in establishing what constitutes a violation of national security interest.

29. Under the Emergency Act, after the formal requirements of a notification are met, the Minister of Technology and Industry examines whether (i) there is a prejudice or threat to the state interests, public security or public order of Hungary, in particular with regard to security of supply of basic societal needs (ii) the notifier is directly or indirectly controlled by a public authority of a State not belonging to the European Union (iii) the notifier has already been involved in an activity affecting security or public order in a Member State of the European Union, and whether (iv) there is a serious risk that the reporting person will engage in illegal or criminal activity.

30. Under both FDI Acts, the Ministers' decision may be challenged at court only on limited, mostly procedural, and interpretational grounds. The administrative court decides in a simplified lawsuit and has cassation power: if the court decides that the Ministers' procedure or decision was unlawful, it can set aside the decision and order the Minister to take a new procedure, but it cannot decide to change the decision.

31. During the GVH's competitive assessment of a merger, the GVH – similarly to the European Commission – adopts the SLC/SIEC test, and analyses whether a merger leads to a significant lessening of competition in the relevant market. Competitive constraints resulting from foreign competitors are duly considered, however, the background - including potential funding of the competitor companies by their own states, which might give them unfair advantage - is not being investigated by the GVH, those matters are usually referred to the relevant authorities.

32. Hence, the GVH only considers the transactions' impact on competition but not a wider "public interest" when conducting its investigations. There can be special situations where a "public interest" may be considered but this will not be assessed by the GVH, in these cases the Government has the authority to intervene. Article 24/A of the Competition Act states that „the Government may, in the public interest, in particular to preserve jobs and to assure the security of supply, declare a concentration of undertakings to be of strategic importance at the national level. Such concentrations shall not be subject to an obligation of notification to the Hungarian Competition Authority pursuant to Article 24."

33. The above measure may be considered as an overlap between the two regimes as it creates a possibility to take into account "public interest" in the case of mergers otherwise notifiable under the Competition Act, although it does so more from an economic rather than from a national security point of view. These transactions are excluded from the GVH's investigation in case there is reasonable ground, due to the specificities of the given market, that the transaction would contribute towards the public goals defined above. The assessment of whether a particular investment is of particular public interest from the point of view of the national economy can be considered essentially an economic policy decision, which is primarily the political responsibility of the Government. The Government has in the past years revoked Article 24/A in cases involving companies in sectors of strategic importance primarily in energy, banking, telecommunication.

2.2. Connection with EU Regulation

34. In this section we will elaborate on how Hungary's regulation on FDI fits into the EU framework.

35. The underlying EU law (Regulation 2019/452, hereinafter: "***FDI Regulation***") inserted the European Commission (hereinafter: the "***Commission***") into a previously carefully guarded area of EU Member State authority – screening of foreign direct investment for threats to security and public order. The FDI Regulation set out minimum requirements for Member States' FDI screening mechanisms and a mechanism for coordinating Member States' FDI reviews. As in other areas, notably consumer protection,

the FDI Regulation expanded the EU's power by giving the Commission a new coordinating role rather than direct enforcement powers.

36. The Hungarian rules of FDI overwhelmingly comply with the EU FDI regulation, however, there is some level of uncertainty to the application of the supplementary (emergency) rules, introduced during the time of the pandemic.

37. During the pandemic, Member States increased the protection of their national markets and interests, which could lead to conflicts between Member States' and EU interests, as for example, in the VIG/Aegon case, which involved the acquisition of local businesses of Aegon by Vienna Insurance Group AG Wiener Versicherung (hereinafter: "***VIG***"). Since Hungary is an EU Member State, its rules on FDI control may come into conflict with the 139/2004 EU Merger Regulation (hereinafter: "***EUMR***") in case the Commission has jurisdiction to decide on a transaction which also has a Hungarian aspect.

38. In principle, under Article 21(2) of the EU Merger Regulation, the Commission has "*exclusive competence*" to review mergers with a European dimension. By way of exception, however, the same article provides that *"Notwithstanding paragraphs 2 and 3, Member States may take appropriate measures to ensure the protection of legitimate interests other than those taken into account by this Regulation and compatible with the general principles and other provisions of Community law"*

39. With respect to this notion of "*legitimate interests*", the Article referred specifies that *"public security, a plurality of the media and prudential rules shall be considered as legitimate interests within the meaning of the first paragraph"*. As this list is not exhaustive, the Member State concerned may take appropriate measures to protect any other public interest not listed in paragraph 4(2) of the same article, subject to compliance with the special procedure organized by paragraph 4(3) of that provision.

40. In substance, before the Member State concerned takes such protective measures, the following procedure must be followed: (i) first, the Member State concerned must communicate the public interest invoked to the Commission; and (ii) second, after examining its compatibility with the general principles of European Union law, the Commission must have qualify the particular public interest as a "*legitimate interest*" within the meaning of Article 21 of the EU Merger Regulation and notify its decision to the Member State concerned within 25 working days of the said communication.

41. One decision - with Hungarian relevance - that was a clear example of the clash between the two regimes (i.e. EU merger rules and national FDI laws) was the VIG/Aegon case, in which the Hungarian Minister of Interior applied a veto based on national FDI laws introduced by Hungary during the emergency (the veto applied was based on the transaction threatening Hungary's legitimate national security interests under the Act on CFI). The veto aimed to obstruct the acquisition of AEGON's Hungarian subsidiaries and was followed by an investigation from the Commission as well as a legal dispute between the parties, which resulted in the withdrawal of the veto applied.

42. The Commission concluded the Hungary's decision to veto would have breached Article 21 of EUMR (pursuant to the Commission has exclusive competence to examine concentrations with a Union dimension and requires Member States not to apply their national laws to these transactions). Furthermore, the Commission raised attention that Member States can only take appropriate measures to protect legitimate interests if (i) such measures are compatible with the general principles and other provisions of EU law and if (ii) the measures are genuinely aimed at protecting a legitimate interest. As a result of the investigation, Hungary withdrew its decision to veto.

43. In this case, it became clear that lawful application of the FDI rules can still be overruled by the European Commission, if the sole purpose of applying FDI rules is to distort the operation of other laws of the European Union. As such, the FDI rules must not be applied to hinder the operation of the Commission and the unobstructed exercise of law by the EU institutions must be compatible with the FDI rules of the Member States. In other words, the link between the European Merger control and the national controls on foreign direct investments must be applied with consideration to the primacy of European Union law over Member States' national (even FDI) laws.

44. This decision of the Commission is a firm reminder of the principle of primacy of European Union law, according to which the rules of European Union law prevail over the national laws of the Member States[4], including national laws on the control of foreign direct investment.

2.3. Alternative tools of intervention

45. In addition to the FDI and merger rules, there are some alternative tools controlling foreign investments. Although the FDI Regulation was the first to create a general EU framework for reviewing private transactions since the EU Merger Regulation in 1989, it is unlikely to be the last.

46. Another new screening mechanism will likely be created under the EU's anti-subsidy regulation[5] proposed in May 2021. At the same time, a new approach to EUMR referrals adopted in March 2021 gave the Commission effectively unlimited jurisdiction to review M&A transactions whether or not they met the EUMR's "*Union dimension*" thresholds. The anti-subsidy regime will likely be enforced solely by the Commission, while the new EUMR referral policy abandons the EUMR's (formerly) fundamental one-stop-shop principle.

47. Under the proposed Regulation, the Commission will have the power to investigate financial contributions granted by public authorities of a non-EU country which benefit companies engaging in an economic activity in the EU and redress their distortive effects, as relevant.

48. In this context, the Regulation proposes the introduction of three tools, two notification-based and a general market investigation tool. More specifically: (i) a notification-based tool to investigate concentrations involving a financial contribution by a non-EU government, where the EU turnover of the company to be acquired (or of at least one of the merging parties) is €500 million or more and the foreign financial contribution is at least €50 million; (ii) a notification-based tool to investigate bids in public procurements involving a financial contribution by a non-EU government, where the estimated value of the procurement is €250 million or more; and (iii) a tool to investigate all other market situations and smaller concentrations and public procurement procedures, which the Commission can start on its own initiative (ex-officio) and may request ad-hoc notifications.

[4] ECJ, July 15, 1964, Case 6-64, Flaminio Costa / E.N.E.L

[5] Regulation (EU) 2021/0114 on distortive foreign subsidies (being currently in legislative phase)

3. Practical experiences

3.1. Mergers notifiable under both competition and FDI screening regime

49. As overlaps exist in the merger control and the FDI screening mechanisms, there can be cases where a merger will be notifiable under multiple regimes. The notifications may be made, and the respective procedures may carry on parallelly.

50. Obtaining other regulatory authorizations is not a prerequisite for the approval of mergers according to the GHV's practice, and as such, obtaining the acknowledgement of the respective Ministries in FDI-related cases is not a condition neither for filing the merger notification nor for receiving the GVH's certificate. However, the GVH usually does ask for the FDI-related notification to be made by the time it receives the merger notification and asks for a copy of the FDI-related notification to be attached to the merger filing form.

51. Closing the transaction is not possible under any of the regimes before the approval of the relevant authority, meaning that the foreign investor can't start the specific activity / exercise its shareholder rights until the transaction is cleared under all reviews, otherwise they will become subject to sanctions, including fines and injunctions.

52. To this date, the GVH has no knowledge of a transaction it investigated that was notifiable under the Act on CFI as well. On the other hand, it has knowledge of 11 transactions that were also notifiable under the Emergency Act involving companies in the IT-, energy and construction sector. The GVH has cleared 8 of these transactions unconditionally and 3 transactions are being investigated currently.

3.2. Interagency Cooperation

53. In practice, there is cooperation between the GVH and the respective authorities in case there is a possibility that a merger is notifiable under the Competition Act and one of the FDI Acts as well. In this year, the GVH has received three requests for information from the Ministry of Interior on whether the GVH has received a notification in respect of a transaction reported to the Ministry and, if so, what was the outcome of the investigation of the transaction. The GVH has investigated the matters and concluded in all three cases that the respective transactions were not notifiable under the Competition Act.

4. Conclusion

54. In this paper we have presented the relevant regulatory background of the Hungarian FDI regulation, as well as the compliance of the rules with EU laws. It was shown that the regulation is generally compatible with EU law, however, the rules introduced during emergency affected the scope of the FDI control in Hungary.

55. To conclude, Hungary has various measures to protect against potentially harmful foreign investments that threaten national security, the domestic economy and against mergers that may restrict effective competition and as such, reduce consumer welfare. The different review mechanisms intersect occasionally, as mergers may fall under the scope of more review mechanisms, however, the relevant authorities adopt a fundamentally different approach when assessing the transactions before them. The merger control of the GVH considers only effects on competition, while the Government has the authority to apply other public interest considerations.