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New EU Foreign Subsidies Regulation starts to apply

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Today, the EU Foreign Subsidies Regulation comes into force. This gives the European Commission new, far-reaching powers to investigate whether companies receiving non-EU state financial support have an unfair competitive advantage over European businesses that do not enjoy comparable state backing. This market scrutiny power precedes mandatory notification regimes for M&A and public procurement that will apply from 12 October.

Today, the EU Foreign Subsidies Regulation (FSR) comes into force. The FSR gives the European Commission (the EC) new powers to examine whether companies benefiting from non-EU state financial support have an unfair competitive advantage over European businesses that do not enjoy comparable state backing, due to the limitations imposed by existing EU State Aid rules.

In summary, the FSR introduces three new mechanisms:

1. **General market scrutiny power (applies from today)**: the EC has discretion to investigate and request filings be submitted for any market situations where it suspects non-EU subsidies are distorting competition. There are no applicable financial thresholds; this provision gives the EC a far-reaching, 'call-in' power that may be exercised in relation to relatively low value transactions and public procurement processes. The EC may also investigate foreign subsidies granted up to 5 years before the FSR started to apply.
2. **M&A (applies from 12 October 2023)**: mandatory filing requirement for deals involving: (i) an EU-established party that has €500 million or more in EU turnover; and (ii) all transacting parties have received in the aggregate financial contributions of €50 million or more from non-EU states over the previous three years.
3. **Public procurement (applies from 12 October 2023)**: mandatory filing requirement for tenders involving: (i) a contract value of €250 million or more; and (ii) a company that received at least €4 million from non-EU states over the previous three years.

Set against the backdrop of the recent spread of foreign direct investment screening regimes across Europe, the FSR adds a further layer of complexity to the rapidly evolving regulatory landscape.

Practical considerations to keep in mind when assessing the FSR include:

- **What is a foreign subsidy?** The concept is imprecisely defined by the FSR as a "financial contribution provided directly or indirectly by a third country, which confers a benefit".
  - The "Financial contribution" concept is also broadly defined to include direct transfers of funds or liabilities (e.g., capital injections, grants, loans, loan guarantee, fiscal incentives, debt forgiveness, debt to equity swaps and rescheduling), foregoing of public revenue otherwise due (e.g., tax exemptions, ITC/PTC incentives, statutory benefits/reliefs), and the provision or purchase of goods/services (e.g., between a company and a public authority or private company whose actions are attributable to a non-EU government).

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  - For notifications of M&A deals and public tenders, financial contributions may be reportable if the individual amount of the contribution is at least €1 million.
  - The FSR also applies an expansive view of "third country", capturing central, regional or local governments and state-owned (or controlled) enterprises of non-EU member states.

- **Filing obligations and deal risk need to be assessed early in deal planning**: for many companies it will be challenging and time-consuming to develop internal systems to track and collect data in order to determine whether a transaction or public procurement process requires notification or is at risk of 'call-in' under the general market scrutiny tool.
- **Investigations will require extensive additional data gathering:** the EC will have the power to require production of extensive amounts of (sensitive) information during investigations, including market data, information on contractual arrangement with non-EU states and internal documents. The EC will also be able to carry out interviews and dawn raids (including dawn raids outside of the EU, provided it has approval from the relevant non-EU member state to do so).
- **Review timelines may be lengthy**: where a mandatory filing requirement arises, parties are required to suspend closing until the EC has cleared the transaction. Review timelines are likely to run for a minimum of 3-5 months, even in relatively straightforward cases. More complex reviews may run for significantly longer, potentially 12+ months, with deal timelines likely to be significantly disrupted.
- **The substantive assessment**: the EC will weigh "negative effects of a foreign subsidy in terms of distortion on the internal market with positive effects [in EU] on the development of the relevant economic activity". The EC has indicated that problematic financial contributions, which are deemed most likely to distort the internal market, are likely to include:
  - support granted to a business which would otherwise be likely to fail in the short to medium term in the absence of such support, unless there is a permissible restructuring plan in place;
  - unlimited guarantee for debts or liabilities;
  - export financing measures that are not in line with the OECD Arrangement on officially supported export credits;
  - a foreign subsidy directly facilitating a deal; and
  - a foreign subsidy enabling a company to submit an unduly advantageous tender.

- **Remedies may be imposed:** much like a merger control review, the EC can approve the deal, prohibit the transaction or approve it conditionally. The EC has indicated that remedies may include:
  - structural divestments (e.g., unwinding or divestment order);
  - reducing capacity or market presence;
  - licensing on fair, reasonable, and non-discriminatory terms;
  - publishing the results of R&D; and/or
  - other behavioral commitments (e.g., repaying foreign subsidies, changing the governance structure of the company, etc.).

- **Outcomes are uncertain**: at least during this initial phase of enforcement and whilst only limited guidance is available on how to apply key concepts and what foreign subsidies are of greatest concern, FSR outcomes will be unpredictable. FSR reviews are also at greater risk of political interference and changes in policy focus compared to traditional competition merger control. Transacting parties should also be wary of the risk of investigations being prompted by interventions by third-party complainants (including competitors).
- **Sanctions for non-compliance are severe:** non-compliance with the FSR may result in a one-off fine of up to 10% of a corporate group's global turnover. Where incorrect, incomplete or misleading information is provided, the EC may impose fines of up to 1% of the corporate group's global turnover or periodic fines of up to 5% of the corporate's group average daily global turnover.

What are the implications of the FSR? The FSR further complicates regulatory risk assessments for cross-border M&A that already have to take account of a recent uptick in intervention rates by antitrust regulators in major jurisdictions, notably in the US, UK and EU, as well as the recent rise of new foreign direct investment screening regimes in G20 countries.

What should companies be doing? Companies and deal teams should consider FSR filing obligations and 'call-in' risk at an early stage when conducting diligence and negotiating deal documents. Knowing and planning for these risks from

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the outset increases the chances that a review can be avoided or that its burdens can be minimized. To enable FSR risk assessments for contemplated M&A to be advanced promptly, companies should also establish mechanisms that allow for collection of relevant information as part of their annual corporate reporting.

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