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The EU Foreign Subsidies Regulation: A new set of wide-reaching powers for the European Commission

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Content

Scrutiny of Foreign Subsidies in Europe

The European Union's Foreign Subsidies Regulation (the FSR) entered into force on 12 January 2023 and creates a new regime aimed at combating distortions of competition on the EU internal market caused by foreign subsidies. It imposes mandatory notification and approval requirements for acquisitions of significant EU businesses and large EU public tenders, and gives the European Commission (EC) extensive powers to launch *ex officio* investigations. Since 12 October 2023, the notification obligations are fully applicable.

The EC adopted an Implementing Regulation (IR) on 10 July 2023 that clarifies the procedural steps and practicalities of the FSR system. The IR also has two annexes that contain standard forms detailing the information that companies need to provide in the context of concentrations (FS-CO) and public procurement (FS-PP).

Companies that are active in the EU (or plan to invest in the EU or participate in EU public tenders) and that have received "financial contributions" from non-EU countries need to put in place systems for gathering the information required for FSR purposes if this has not already been done. Some companies also need to consider how best to manage cost allocation, transfer pricing and governance issues, and prepare justifications relating to those foreign financial contributions (FFCs) most likely to distort competition in the EU.

What Counts as Foreign Financial Contributions under the FSR?

The FSR covers any form of direct or indirect contribution from non-EU governments or any public or private entity attributable to a third country. Such a contribution may be distortive where it confers a benefit not normally available on the market to a company in the EU, and that benefit is specific to one or more companies or industries as opposed to all companies or all companies active in a particular industry.

Financial contribution under the FSR is an extremely wide-reaching concept and can take a broad range of forms, including direct grants, interest-free or low-interest loans, tax incentives (e.g., exemptions/reductions), state-funded R&D, government contracts (regardless of size, whether they qualify as "subsidies" or whether they have any nexus to the EU), and grants of exclusive rights without adequate remuneration.

The EC's Investigative Tools

1. Mandatory Pre-Authorisation Tools

Companies engaging in (a) M&A activity or (b) a public procurement procedure in the EU triggering the thresholds in the FSR are required to submit a Form FS-CO or Form FS-PP respectively and await EC approval. Companies also need to notify M&A transactions for which the agreement was concluded on or after 12 July 2023 but which had not yet been implemented on 12 October 2023. Concentrations for which the agreement was concluded on or after 12 July 2023 but which were implemented before 12 October 2023 are not caught by the notification obligation.[1]

a) Filing Obligation for M&A Transactions

Transactions meeting the following (cumulative) thresholds need to be notified to the EC using the Form FS-CO:

i. Turnover threshold: The turnover of the target (in case of acquisitions), the JV (for creation of a JV), or one of the parties (for mergers) in the EU was at least €500 million in the last financial year; and

ii. Financial contribution threshold: The undertakings concerned (e.g., the acquirer and the target, the merging entities, or the JV and its parents) were granted[2], from non-EU governments or State-owned entities, "financial contributions" of more than €50 million in the three years prior to the conclusion of the agreement, the announcement of the public bid or the acquisition of a controlling interest.

The IR provides a *de minimis* threshold below which FFCs do not have to be disclosed in a Form FS-CO. An FFC has to be notified only if (i) the individual amount of the specific contribution equals or exceeds €1 million and (ii) it belongs to one of the categories of foreign subsidies most likely to be distortive (namely, rescue and restructuring subsidies, unlimited State guarantees, certain types of export financing or subsidies directly facilitating a concentration). FFCs that do not fall under these categories, only need to be described in an aggregated manner in a summary table, for which more limited information is required. Only those third countries where the estimated aggregate amount of all financial contributions granted in the three years prior to the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest is €45 million or more need to be included in the table.

The IR provides a list of FFCs that do not need to be described in the summary table (and which do not count towards the €45 million total). These exceptions include, for example, contributions below €1 million, contracts for goods and services concluded on market terms (except financial services), and certain general tax measures. Despite this effort at proportionality, which at least streamlines to some extent the quantity of information required for Form FS-CO, the burden on companies trying to comply with the notification requirements remains high. Companies must, for instance, still go through the potentially long and complex process of determining whether counterparties are attributable to third-country governments.

The Form FS-CO contains an exemption for investment funds by which they are not required to disclose the FFCs received by their non-acquiring funds under certain conditions, alleviating the burden for private equity firms.

The FSR notification process and timetable are similar to the EU Merger Regulation process, with an initial 25 working day review period followed by an in-depth 90 working day review period (with a possible extension by 15 working days if commitments are offered) from the date of formal notification. Notifiable transactions must receive EC approval under the FSR before they can close, creating a standstill obligation. The EC's Q&A confirm that this obligation applies as well to notifiable transactions concluded on or after 12 July 2023 but not yet implemented on 12 October 2023.

As a result, companies contemplating M&A transactions must consider FSR compliance alongside merger control and foreign direct investment reviews. This means that FSR needs to become part of due diligence, and FSR clearances may need to be added to the list of regulatory conditions precedent, be considered in the context of deal timing and break fees and be built into representations & warranties as well as into disclosure schedules.

b) Filing Obligation for Public Tenders

Companies must notify the EC using the Form FS-PP if they engage in public tenders in the EU, and the following (cumulative) thresholds are met:

i. Contract value: The contract value is not less than €250 million, and in cases where the tender is divided into lots, the aggregate value of the lots applied for is not less than €125 million; and

ii. FFCs: The bidding party (including its subsidiaries and/or holding company and its main subcontractors (or suppliers)) was granted aggregated FFCs of not less than €4 million per third country in the three years prior to the notification. Bidding parties that received aggregate FFCs of less than €4 million per third country must submit a declaration setting out all FFCs received and confirm that they fall below the threshold.

The IR provides the following *de minimis* threshold below which FFCs do not have to be disclosed in a notification. Only those FFCs have to be notified that are equal to or exceed €1 million having been individually granted to the recipient by a third country in the three years prior to notification and that belong to the categories of foreign subsidies most likely to be distortive (namely, rescue and restructuring subsidies, unlimited State guarantees, certain types of export financing or those enabling an unduly advantageous tender to be offered). If the contribution does not fall under these categories, it only needs to be described in a summary table. Only those countries need to be included in the table where the estimated aggregate amount of all FFCs per country granted in the three years prior to the notification is €4 million or more. Further exceptions apply (mirroring those described above in relation to M&A transactions), meaning that certain contributions do not even have to be notified in the summary table (and do not count towards the €4 million total).

If companies need to make a declaration that they have received no notifiable FFCs, they still need to provide a summary description of the public procurement procedure, information about the notifying parties, and list all of the FFCs received. Those FFCs of a value below €1 million but above the value indicated in the EC's State aid *de minimis* regulation can be reported in an aggregate format. In addition, if the total amount per third country for the preceding three years is lower than the amount specified in the State aid *de minimis* regulation (currently at €200,000) they do not have to be included in the declaration at all.

In relation to public tenders, the EC's preliminary review will last 20 working days, extendable by ten working days, while the in-depth review should not last more than 110 working days from receipt of a complete notification, extendable by 20 working days in exceptional cases.

The FSR adds uncertainty and complexity to public procurement processes. Failing to report FFCs or benefiting from distortive subsidies could result in disqualification from a public tender.

c. Takeaways on Notification Obligations

Companies active in both M&A and public procurement face a challenge regarding compliance because of the different *de minimis* thresholds of €45 million and €4 million for those two activities.

Furthermore, while the exceptions of certain FFCs from the heaviest reporting obligations in both Form FS-CO and Form FS-PP (particularly regarding the provision of goods and services on market terms) mean that the amount of information to notify is significantly lower than envisaged by the draft IR issued in February 2023, it is still the case that all FFCs (even those that are exempted from disclosure) still count towards the €50 million and €4 million over three years FFC thresholds, which determines if an FSR filing for an M&A transaction or for a public tender is necessary in the first place.

2. General Tool for Investigating All Other Market Situations

The EC has the mandate to conduct *ex officio* investigations into all potentially distortive foreign subsidies and its *ex officio* powers are extensive. They permit the EC to investigate support granted by third countries to companies up to 10 years before the start of the investigation (but not more than five years prior to the application of the FSR).

The EC is also able to request an *ad hoc* notification for transactions and public procurement procedures that do not meet the thresholds but in relation to which it suspects that the companies concerned were granted foreign subsidies in the three years prior to the concentration/tender submission.

The EC's Information Gathering Powers

To assist its investigations, the EC can gather information by issuing requests for information, interviewing natural or legal persons, and conducting dawn raids both in and outside the EU. Although there is no formal complaints process under the FSR, competitors may well make submissions to the EC concerning alleged FFCs received by other companies active in their field of operation.

Whether triggered by a third party submission or the EC's own monitoring, if a company were to receive a request for information, gathering the necessary information and financial data could be a significant task. In case of a refusal to supply information, the EC is able to take a decision based on facts available to it – which may be less favourable to the company than if it had provided the information.

The EC's Enforcement Powers

If companies breach the standstill obligation by concluding or failing to notify a notifiable concentration, the EC may impose a fine of up to 10% of their aggregate turnover in the preceding financial year. The EC also has powers to subject companies to fines of up to 1% of global turnover and periodic penalty payments of up to 5% of the average daily aggregate turnover for each working day of delay, where companies supply incorrect, incomplete or misleading information.

Following an in-depth investigation, the EC can adopt (i) a no objection decision; (ii) a commitments / redressive measure decision; or (iii) a decision prohibiting a concentration or the award of a public contract. Redressive measures and commitments can be structural (e.g., unwind an acquisition, divest assets or reduce capacity or market presence), or behavioural (e.g., offer access to or licence infrastructure on FRAND conditions, publicise R&D results, repay foreign subsidies with interest or adapt the governance structure).

The EC may allow a transaction it would otherwise prohibit under the FSR based on a balancing of negative and positive effects (an option that is not available under the EU merger control rules). A positive effect could relate to an EU policy objective (e.g., environmental protection, digital transformation, creating jobs, promotion of R&D).

Practical Considerations

If not in place already, companies now need to quickly design and implement systems for the collection of group-wide information relating to relevant contracts, grants of exclusive rights, tax incentives, etc. on a global basis. Given that information going back three calendar years is required, it is not advisable to wait until considering a notifiable transaction or tender.

Detailed data on FFCs is not only required to assess whether or not the obligation to notify transactions and public tenders is applicable. It will also be needed if the EC requests notification of a transaction or public tender below the thresholds or it launches an *ex officio* investigation (a step we would expect to be preceded by a burdensome request for information or a surprise inspection).

The design of any internal data gathering system should minimize the burden on company business, legal and compliance teams, including by leveraging existing contract management systems, grant tracking and other financial systems. One approach would be to develop a template with basic information that automatically pulls in relevant information already available in existing systems before sending the partially populated template to relevant business, financial and legal teams for completion. Template population could be achieved in many cases by developing queries for existing databases and populating a new database with the input from the various sources.

It may also be efficient to collect some information beyond the minimum needed to identify and quantify a potential financial contribution to reduce the risk of duplicate or significant follow-up requests later. For example, a contract identified as generating revenues likely to be a financial contribution would be unlikely to be considered a foreign subsidy if the contract was awarded pursuant to a competitive, transparent and non-discriminatory tender. Noting that that contract was awarded by competitive tender in the template would reduce subsequent data collection.

In addition to gathering the data described above, it may be advisable to determine whether FFCs received were given under market conditions, and to gather evidence to assist with demonstrating that they could not be distorting the internal market.

Final Thoughts

Because identifying and quantifying FFCs over a rolling three-year timeframe is time-consuming, the design and implementation of new systems should take place as soon as possible. Together with our legal-tech team we have developed a solution to streamline information collection in a manner that minimises the burden. We are also working with the EC regarding the information that is required to ensure compliance.

Footnotes

[1] European Commission, Foreign Subsidies Regulation Q&A

[2] According to the IR a foreign subsidy should be considered granted from the moment the beneficiary is entitled to receive the foreign subsidy. The actual disbursement of the foreign subsidy is not a necessary condition for it to fall within the scope of the FSR.

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