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Levelling the playing field or just greater complexity – the implications of the EU Foreign Subsidies Regulation

The EU's State aid rules are premised on the notion that national governments should not pick winners or else artificially influence the EU's internal market through selective subsidies. However, the State aid rules have previously not applied to companies operating in the EU bloc which receive (or have received) any subsidies from foreign (i.e., non-EU) governments. The European Foreign Subsidies Regulation¹ ("**FSR**"), which came into force on 12 January 2023, has brought in a new set of rules which are intended to close this regulatory gap. Going forward, companies in receipt of so-called foreign financial contributions ("**FFCs**") will, in certain circumstances, be subject to scrutiny by the European Commission ("**Commission**").

The FSR had an implementation phase of six months, which afforded a transition period for stakeholders to prepare for the new regime. This period also saw a public consultation on the draft provisions regarding the implementation of the FSR.² A finalised Implementing Regulation ("**IR**") was adopted on 10 July 2023³ and the majority of the provisions of the FSR started to apply from 12 July 2023. The Commission has since been able to open investigations on its own initiative. The mandatory (and suspensory) notification obligations introduced by the FSR will apply from 12 October 2023.⁴

What is a foreign subsidy?

A foreign subsidy is a financial contribution provided directly or indirectly by a third (i.e., non-EU) country, which confers a benefit and which is limited to one or more undertakings or industries. "Financial

contribution" is broadly defined for these purposes, covering direct grants, the transfer of funds or liabilities, including interest free or low-interest loans, tax incentives (e.g., exemptions/reductions), guarantees or set-offs, as well as the forgoing of revenues or the grant of special or exclusive rights without receiving adequate remuneration in line with normal market conditions. The Commission has confirmed that exemptions granted by third countries from ordinary tax regimes will also amount to "foreign financial contributions" for the purposes of the FSR.

Post-Brexit, any type of funding from the UK Government or a UK Government owned entity granted to companies active in the EU will amount to a FFC. FAQs published by the Commission on 12 July 2023⁵ further clarify that financial contributions granted by EEA and/or EFTA countries (i.e., Iceland, Liechtenstein, Norway, and Switzerland) will also count in determining whether the notification thresholds are triggered.



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/legal-content/EN/TXT/PDF/?uri=CELEX:32022R2560&qid=1692641688721>

² This public consultation took place between 6 February 2023 and 6 March 2023. See https://ec.europa.eu/commission/presscorner/detail/en/IP_23_591

³ See https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3747

⁴ The Commission has clarified that notifiable concentrations signed on or after 12 July 2023 and completing after 12 October 2023 will need to be notified and suspended, pending the outcome of the Commission's review. Transactions which are signed on or after 12 July 2023 and complete before 12 October 2023 will not need to be notified.

⁵ See: [Questions and Answers \(europa.eu\)](https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3747)

What has the FSR introduced and what are the relevant thresholds?

The three tools introduced by the FSR consist of two new mandatory reporting requirements and an *ex officio* power of investigation for the Commission. Breaking this down:

1) Ex ante transaction notification requirement

As of 12 October 2023, any entities involved in transactions (e.g., M&A activity, creation of joint ventures) will need to seek mandatory clearance from the Commission where:

- a) the EU turnover of the target company (or at least one of the merging entities, or joint venture) exceeds EUR 500 million; and
- b) the parties (including their group companies) received aggregate foreign subsidies (i.e., from non-EU countries) exceeding EUR 50 million in the preceding three years before the transaction date.

For any transaction which meets these thresholds, the notification obligation is suspensory and parties cannot close unless, and until, the Commission gives its approval.

2) Ex ante filing obligation for public tenders

The FSR has introduced a mandatory notification obligation for parties involved in public procurement procedures worth EUR 250 million or more (or in cases where the tender is divided into lots and the aggregated value of the lots applied for is not less than EUR 125 million). In these cases, the FFC(s) involved (i.e., the FFC(s) which the relevant party has received) must be at least EUR 4 million per non-EU country in the preceding three years.

3) Ex officio power of investigation

The FSR has afforded the Commission the power to investigate (on its own initiative) any other market situations, as well as smaller concentrations and public procurement procedures, if it suspects that foreign subsidies could lead to a distortion in the EU internal market. The Commission has an applicable limitation period of ten years in which to exercise this investigative power in relation to particular FFCs, starting on the day on which the subsidy is granted.

Moreover, the Commission will have the power to investigate transactions and public tenders which fall below the thresholds above on an *ad hoc* basis. This acts as a safety net to ensure that FFCs, which are below the applicable thresholds but yet might still have a distortive effect, can still be caught and reviewed by the Commission.

Both of these *ex officio* powers have applied since 12 July 2023.

Commission's Review

Companies that trigger the thresholds will be required to submit formal notifications and await approval from the Commission before the relevant transaction can be completed or the public contract can be awarded. Breach of this standstill requirement in either case may result in fines of up to 10% of an undertaking's global annual turnover and, in the case of public tenders, even risk disqualification from the bidding process. Daily fines of up to 1% of an entity's global turnover can also be levied for the provision of incorrect, incomplete or misleading information.

The Commission will assess whether the relevant FFC(s) are likely to distort the internal market. It has highlighted the following categories of FFCs as being most likely to do so:

- (a) a foreign subsidy granted to an ailing undertaking, unless there is a viable restructuring plan (which includes a significant contribution by the undertaking itself);
- (b) an unlimited guarantee for the debts or liabilities of an undertaking;
- (c) an export financing measure that is not in line with the OECD Arrangement on Officially Supported Export Credits;⁶
- (d) a foreign subsidy directly facilitating a concentration; and
- (e) a foreign subsidy enabling an undertaking to submit an unduly advantageous tender on the basis of which it could be awarded the relevant contract.

⁶ The OECD is a forum for maintaining, developing and monitoring the financial disciplines for export credits, which are contained within the Arrangement on Officially Supported Export Credits. These stipulate the most generous financial terms and conditions

that OECD Members may offer when providing officially supported export credits, promoting a level playing field to encourage competition among exporters.



Despite this list of illustrative examples, the Commission will conduct all its reviews on a case-by-case basis. In conducting its assessment, the Commission may balance negative distortive effects against positive effects "*on the development of the relevant subsidised economic activity on the internal market*", as well as other broader positive effects, such as those relating to the relevant policy objectives (in particular, those of the EU as a whole). However, guidance is awaited on the way in which this balancing test will be applied. Interestingly, at this stage it does not appear that the Commission will need to establish that the relevant FFC(s) *actually* distorts the EU's internal market – rather, the fact that the FFC(s) could have a distortive effect is sufficient.

[Following its review, the Commission can adopt: (i) a no objection decision; (ii) a decision requiring commitments and/or redressive measures; or (iii) a decision prohibiting a concentration or the award of a public contract. In terms of remedies, the Commission will agree to suitable commitments and/or redressive measures if it is satisfied that those offered by the relevant party fully and effectively remedy the distortion actually or potentially caused by the foreign subsidy in the internal market. Interestingly, unlike under the Commission's reviews under the EU Merger Regulation, remedies cannot be offered in Phase 1 but rather in Phase 2 only. Like mergers, however, suitable remedies can be both structural and/or behavioural in nature. The former will typically focus on divestments whereas the latter may include, for instance, offering products/services on fair, reasonable and non-discriminatory ("**FRAND**") terms and re-paying FFCs with applicable interest.

Timetable

The FSR notification process and timetable for M&A deals will involve an initial (Phase 1) 25 working day review period followed by an in-depth (Phase 2) 90 working day review period (with a possible extension of 15 working days if commitments are offered) from the date of formal notification if there are substantive concerns.

For public tenders, the Commission's preliminary Phase 1 review will last 20 working days, extendable by 10 working days, while the in-depth Phase 2 review should not last more than 110 working days from receipt of a complete notification, extendable by 20 working days in exceptional cases.

Procedure

Extensive information will need to be supplied as part of the FSR notification process, which has been set out – together with other procedural matters and the relevant notification forms – in the IR⁷, which was adopted on 10 July 2023. In brief, parties will need to provide the following:



- For concentrations:
 - Detailed information on all individual FFCs which are considered by the FSR as the most likely to distort the internal market (see above), of EUR 1 million or more, granted to the parties over the preceding 3 years; and
 - An overview of all other individual FFCs of EUR 1 million or more granted to the notifying party/ies over the preceding 3 years, only in relation to those countries that have granted at least EUR 45 million to the parties during the preceding 3 years (subject to certain exceptions).

⁷ 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.

Although the extent of information has been reduced from the broad requirements set out in the original draft, the disclosure obligations remain relatively onerous. Of limited assistance is a carve-out relating to acquisitions of control or creations of joint ventures by an investment fund or by a legal entity controlled by or via an investment fund. Such transactions do not need to include FFCs granted to other investment funds managed by the same investment company but with a majority of different investors measured according to their entitlement to profit (or granted to portfolio companies controlled by these other funds), provided certain conditions are met.



- For public procurement procedures, parties will need to report:
 - Detailed information on all individual FFCs which are considered by the FSR as the most likely to distort the internal market (see above), of EUR 1 million or more, granted to the parties over the preceding 3 years; and
 - An overview of all other individual FFCs of EUR 1 million or more granted to the notifying party/ies over the preceding 3 years, only in relation to those countries that have granted to each of the notifying party/ies at least EUR 4 million per country during the preceding 3 years.

Notifying parties are encouraged to engage in pre-notification discussions in advance, in principle as of September 2023, to facilitate the submission of notifications from 12 October 2023. During pre-notification they may discuss the information that needs to be included in the notification, and there is the possibility of requesting waivers from the requirement to submit certain information required by the form.

Comment

FSR compliance must now be considered alongside merger control and foreign direct investment reviews. FSR clearances must also be included in regulatory condition precedents where the thresholds are triggered (and taken into account for deal timing purposes).

Notably, the FSR thresholds incorporate longer time periods than, say, the EU's Merger Regulation which refers to immediately preceding financial years. Under the FSR, the thresholds refer to FFCs received in the three years preceding the conclusion of the agreement or the announcement of the public bid (as the case may be). Moreover, the Commission's *ex officio* investigation powers have an even longer "look back" period of five years prior to 12 July 2023, in the case of FFCs being investigated.

Given the extent of this information the Commission can demand, large group entities in particular, which will have numerous subsidiaries and/or interests in various portfolio companies such as private equity funds, are therefore advised to begin implementing a process of tracking and recording details of FFCs received by their group companies on a rolling basis sooner rather than later. This will be key in order to mitigate the burden of the new FSR regime and to ensure that these large entities are able to determine whether the notification thresholds may be triggered by any given deals and/or public contract awards they may contemplate in future. This is especially the case given that the FSR may be triggered by foreign subsidies received by any group company, and in view of the potential sanctions that may be imposed for failure to notify (e.g., fines of up to 10% of global turnover). Adequate preparation will be important ahead of the notification obligations starting to apply on 12 October 2023.



The Competition Team would be happy to assist with establishing and implementing a mechanism for recording FFCs, or with any other queries that may arise in connection with the new regime.

Contact us

Should you have any queries or wish to discuss any matter in this briefing, please do not hesitate to contact the Competition Team.



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