COMPETITION & ANTITRUST

EU Foreign Subsidies Regulation: Implications for M&A Transactions

November 6, 2023

COMPETITION & ANTITRUST

EU Foreign Subsidies Regulation: Implications for M&A Transactions

BY ANASTASIA DRITSA, KONSTANTINOS SIDIROPOULOS, AGIA STASINOPOULOU, MARINA MYZITHRA

The EU Foreign Subsidies Regulation ("**FSR**") was adopted in December 2022 introducing new tools aiming to prevent foreign subsidies from distorting the European Union's ("**EU**") internal market. It came into effect on 12 July 2023, while the notification obligations laid out therein have only recently kicked in, on 12 October 2023. In essence, the FSR (and its Implementing Regulation, which sets out the relevant procedural details of the regime, including the notification procedure, standard forms, and time limits) is the end result of the European Commission's ("**EC**") attempt to address distortions caused by foreign subsidies granted to companies operating in the EU, and thereby to ensure a level playing field for all companies active in the EU's internal market.

Particularly, while subsidies granted by Member States are subject to scrutiny under the EU State aid rules, financial support from non-EU countries went unchecked prior to the FSR. As such, **the FSR closes this perceived regulatory gap by introducing an extra layer of regulatory oversight for sizeable transactions**.

This **further expands the EC's jurisdictional authority to review M&A transactions** that it considers may harm competition (potentially even in the absence of compulsory filing requirements), thereby **creating a more challenging M&A environment**. In this regard, **deals may take longer to close, and parties contemplating M&A transactions should plan for longer and more complex processes**.

I. FSR in a nutshell

- **The FSR introduces an additional layer of deal conditionality for sizeable transactions,** on top of merger control and potential national foreign direct investment ("**FDI**") filing requirements.
- **The FSR applies to all companies (private or public), including state funds and state-owned enterprises ("SOEs"), that are engaging in an economic activity in the EU and have received any form of direct or indirect financial contribution from a non-EU country.**
- **The FSR establishes three distinct procedures:**
  - **a notification-based procedure for M&A deals**, relating to transactions where: (i) the acquired company, one of the merging parties, or the joint venture generates an EU turnover of at least €500 million; and (ii) the parties involved have received foreign financial contributions ("**FFCs**") of more than €50 million in the last three (3) years;
  - **a notification-based procedure for investigating public procurement bids**, applying to public procurement procedures where: (i) the estimated contract value is at least €250 million; and (ii) the bidder and its subcontractors have obtained a FFC

totaling a minimum of €4 million per third country in the three (3) years preceding the notification; and

- **an *ex officio* investigation tool**, allowing the initiation of a review in cases not covered by the FSR's notification-based procedures, mentioned above.

❖ **The EC is the sole enforcer of the FSR –** the Directorate-General for Competition ("**DG COMP**") is responsible for enforcing the FSR as regards M&A transactions and to start *ex officio* procedures to tackle distortions caused by foreign subsidies outside public procurement procedures; DG GROW is responsible for enforcing the FSR to financial contributions in public procurement procedures.

❖ The EC's powers are constrained by **a ten-year limitation period** from the date on which a foreign subsidy was initially granted.

❖ Parties should additionally be mindful that:

- **filings will be relatively short (unless distortive FFCs are involved) but collecting the relevant data may be burdensome;**
- **failure to seek *ex ante* approval for a notifiable M&A transaction or public tender can result in significant fines;** and
- **the EC has extensive redressive powers under the new FSR regime, incl. the unwinding of a transaction and prohibiting the award of a public contract**.

II. M&A transactions under the FSR's framework

New mandatory pre-closing notification requirement and beyond

The FSR creates an extra layer of regulatory oversight regarding the assessment of M&A transactions, thus imposing an additional burden on the parties to sizeable transactions. Specifically, **M&A transactions meeting the relevant notification thresholds are subject to mandatory and suspensory pre-closing filing requirements**.

The FSR uses a very broad definition of FFCs,[1] capturing almost any financial flow between an undertaking and a non-EU public authority or state-owned entity or private entity whose actions can be attributed to a non-EU foreign state. However, FFCs need to be **selective** to amount to a foreign subsidy, i.e. to confer a benefit to the recipient that could not have been obtained under normal market conditions and to be limited, *de jure* or *de facto*, to one or more companies or industries.

Apart from notifiable transactions under Article 20, the FSR awards **very broad discretion to the EC to request *ad hoc* notifications for M&A transactions below the FSR notification thresholds at any time before their implementation,** if it suspects the existence of distortive foreign subsidies. In the absence of specific guidance on the scope of this power, it remains to be seen how the EC will be exercising it in practice.

Substantive assessment

Like the review process under the EU Merger Regulation, the FSR provides for pre-notification discussions with the EC and a preliminary ("**Phase I**") review of 25 working days. In case of substantive concerns, the EC may initiate an in-

[1] Article 3 FSR provides for a non-exhaustive list of FFCs encompassing (i) the transfer of funds or liabilities, such as grants, loans, fiscal incentives, debt forgiveness, debt to equity swaps, etc.; (ii) the foregoing of revenue that is otherwise due, such as tax exemptions; and (iii) the provision of goods or services.

depth ("**Phase II**") investigation of a maximum duration of 90 working days, extendable by 15 working days if the companies offer remedies and further extendable by 20 working days in exceptional cases. If the EC fails to adopt a decision within this deadline, the parties to may proceed to implement the transaction.

A foreign subsidy is deemed to be distortive where it is liable to improve the competitive position of a company in a way that negatively affects competition in the EU internal market (Art. 4 FSR). This rather vague determination of distortion is accompanied by a set of **relevant indicators to be considered**, such as the amount and nature of the foreign subsidy, certain characteristics of the undertaking involved (e.g., size, markets and sectors concerned), the level and evolution of economic activity of the undertaking on the internal market, and the use of the foreign subsidy on the internal market. In the same vein, the EC provides a **rebuttable presumption of distortion** regarding aid to undertakings facing difficulties, unlimited guarantees, export financing measures not aligned with the OECD Arrangement, and subsidies directly facilitating a transaction. On the contrary, **foreign subsidies to an undertaking of up to €4 million over three years, are unlikely to distort the internal market**.

In case a distortive subsidy is found, the EC shall proceed to a **balancing test** between the negative effects of such subsidy and the positive effects on the development of the relevant subsidised economic activity on the internal market, while taking into account any other positive effects in line with the EC's broader policy goals (e.g., environmental protection, digital transformation, etc.).

EC's enforcement powers

An in-depth/Phase II investigation may result in:

- a no-objection decision, or
- a decision ordering redressive measures or accepting commitments, or
- a decision prohibiting the notified transaction.

Unlike the EU merger control regime, **commitments in the context of the FSR review procedure can only be offered in Phase II**.

In assessing potential **redressive measures and commitments**, the EC shall ensure their proportionality and suitability to remedy the distortion in question. In this regard, the FSR provides an illustrative list of **structural** (e.g., divestment of assets, unwinding of the acquisition, reduction of capacity or market presence, etc.) and **behavioural measures** (e.g., provision of licensing or access to infrastructure on FRAND terms, publication of R&D results, adaptation of the parties' governance structure, etc.) including the repayment of distortive foreign subsidies with interest.

III. Practical takeaways for companies

Being aware of the risks

Parties to contemplated M&A transactions should, in particular, be aware of the following risks:

- **notification requirements are combined with a standstill obligation**, i.e. a transaction may not close prior to an EC's approval, possibly subject to commitments;
- **failure to notify a notifiable M&A transaction may entail fines** of up to 10% of aggregate worldwide turnover of the parties concerned;
- **where companies supply incorrect, incomplete or misleading information, they may be subject to fines** of up to 1% of their worldwide turnover and periodic penalty payments of up to 5% of the average daily aggregate turnover for each working day of delay;

- **notification obligations are far-reaching and there is a large burden on notifying parties**;
- **FSR review period may affect transaction timelines** – the EC's time limits for reviewing a notification are similar to those under the EU merger regime, but review periods may not necessarily run concurrently, while further complications will arise insofar as any potential FDI notifications will be reviewed by the various EU national authorities;
- **the EC has extensive powers to adopt remedies**, including to require that a company reduce capacity or market presence, refrain from certain investments, make changes to its governance structure, or repay the allegedly harmful foreign subsidy to the third country with interest, which may undermine the rationale of a transaction; and
- beyond FSR notifiable transactions, **the EC's *ex officio* investigative powers are broad**, allowing it even to order the dissolution of an M&A transaction that has been implemented in breach of the FSR obligations.

Mitigating the risks

Given the new mandatory pre-closing notification requirement that the FSR has introduced, companies should be prepared for the possibility that they may need to submit a filing before the EC. It should, after all, not be neglected that, even if the FSR numerical thresholds for a pre-closing filing are not met, the EC still has the power to request a filing for a transaction if it considers that the parties may have received material foreign subsidies. As such, companies should maintain data on financial contributions and consider the effects on the drafting of transaction agreements and the respective timelines.

In particular, parties involved in transactions that may require an FSR filing should:

- **engage meaningfully in pre-notification discussions with the EC** to ensure swift FSR and merger reviews upon formal filing;
- **assess whether an FSR filing is required and conduct due diligence** focused on subsidies received to evaluate potential impact on the transaction itself and the timetable for its completion; and
- **include provisions relating to FSR clearance as condition precedents in the transaction's documentation**.

Beyond pending transactions, it is advisable for companies **to design and implement internal data gathering systems** to track FFCs from non-EU countries across group entities on an ongoing basis. This would enable companies to assess without delays whether an obligation to notify an envisaged M&A transaction exists but would also allow them to evaluate their FSR exposure to EC investigations, if the EC ever requests notification of a transaction below the thresholds or it launches an *ex officio* investigation. Considering that: (i) for any notifiable transaction, information on foreign subsidies is required from the past 3 calendar years and (ii) the EC can launch an *ex officio* investigation into any foreign subsidy granted in the past 10 years before the start of the investigation, without being able to look back further than 5 years prior to the application of the FSR, **records of any foreign subsidies received in the 5 years prior to 12 July 2023 should be maintained, and, going forward, the relevant data should be updated and retained for 10 years**.

IV. Final observations

The FSR does not prohibit foreign subsidies, nor does it introduce a pre-approval instrument for the granting of foreign subsidies; it empowers

instead the EC to review and remedy the potentially **distortive effects of foreign subsidies**.

It remains to be seen how this new framework will impact on M&A transactions in practice and, particularly, whether the expected longer review timelines and the increased uncertainties and expenses will affect businesses in pursuing strategic plans. Companies should also be aware that, although currently no FDI regime exists in Greece, there is an ongoing consultative process that is expected to result in the adoption of an FDI mechanism, thereby further perplexing the relevant regulatory landscape.

In any event, companies that may be subject to the FSR will have to exercise extra caution when navigating its notification procedures and ensure that competition law advisors are involved at an early stage of a transaction in order to identify filing requirements and assess related risks, even for transactions that do not meet the mandatory notification thresholds.

K | G
LAW FIRM

Contact Us

Anastasia Dritsa
PARTNER

a.dritsa@kglawfirm.gr

Follow Us

ATHENS OFFICE

28, Dimitriou Soutsou Str.,
115 21 Athens

T +30 210 817 1500
F +30 210 685 6657-8
E kg.law@kglawfirm.gr

THESSALONIKI OFFICE

31, Politechniou Str.,
551 34 Thessaloniki

T +30 2310 441 552
E kg.law@kglawfirm.gr

www.kglawfirm.gr

Disclaimer: This newsletter contains general information only and is not intended to provide specific legal, or other professional advice or services, nor is it suitable for such professional advice, and should not be used as a basis for any decision or action that may affect you or your business. Before making any decision or taking any action that may affect you or your business, you should consult a qualified professional advisor. We remain at your disposal should you require any further information or clarification in this regard.

©Kyriakides Georgopoulos, 2023