EU Foreign Subsidies Regulation Goes Live: Key Implications for M&A Transactions

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On 12 July 2023, the EU's Foreign Subsidies Regulation (FSR) entered into force. The FSR allows the European Commission (EC) to investigate and remedy subsidies received from non-EU countries that distort the EU internal market.[1]

The FSR introduces a new merger review regime, separate from and in addition to existing merger control and foreign direct investment (FDI) control regimes. It requires prior notification to and approval from the EC of transactions involving companies that have received financial support from non-EU governments. It also includes a new screening procedure for public tenders involving foreign-subsidized entities, and a broad investigation tool enabling the EC to investigate any commercial activity in the EU (deal-related or not) where foreign subsidies may have a distortive effect in the EU internal market.

The impact of the FSR will be significant, in particular for M&A transactions. Answers to common questions on the implications of the FSR for your next deal are set out below.

1. Which M&A transactions will need to be notified to the EC under the FSR?

A pre-closing filing is required if:

- The target (in case of an acquisition), one of the merging parties (in case of a merger) or a joint venture has turnover in the EU of at least €500 million and is established in the EU (*i.e.*, has a subsidiary or permanent establishment in an EU member state), and
- All parties combined have been granted at least €50 million in financial contributions from non-EU countries (foreign financial contributions or FFCs) in the three years prior to signing of the transaction agreement or the announcement of the public bid.

Like the EU Merger Regulation, the FSR merger review regime creates a bar to closing. Completing a transaction prior to FSR clearance may result in fines of up to 10% of global group turnover, similar to EU merger control.

Even if the thresholds above are not met, the EC will still have the power to request a filing for transactions where it believes the parties may have received material foreign subsidies, which would automatically introduce a bar on closing.

2. What are FFCs? Is there any difference between FFCs and foreign subsidies?

The FSR introduces a very broad notion of an FFC that would capture almost any financial flow between a company and any non-EU public body (or private body acting on behalf of a public body).

FCCs include:

- the transfer of funds or liabilities, such as capital injections, grants, loans, loan guarantees, fiscal incentives, the setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt-to-equity swaps or debt rescheduling;
- the foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration; but also

[1] Regulation (EU) 2022/2560 of the European Parliament and of the council of 14 December 2022 on foreign subsidies distorting the internal market.

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- the supply and purchase of goods and services, including ordinary-course arm's length transactions.

This extremely broad notion of FFCs only serves to determine if a filing is required. The EC's substantive assessment will focus on FCCs that are selective, *i.e.*, which confer a benefit on one or more specific companies or industries. The FSR calls this subset of FFCs "foreign subsidies" (see point 7 below).

3. When will the filing obligation apply?

If the financial thresholds are met, the filing obligation will apply to transactions signed on or after 12 July 2023 that have not closed before 12 October 2023. Formal notifications will not be accepted before 12 October.

4. How may an FSR filing obligation impact my deal timetable?

The FSR review process is similar to the one under the EU Merger Regulation, involving pre-notification and a Phase 1 review of 25 working days. In case of substantive concerns, the EC may open a Phase 2 review, which will last up to 90 working days (with possible extensions) and enables the parties to offer remedies. Unlike in merger control, however, the FSR does not allow Phase 1 conditional clearances; remedies can only be offered in Phase 2.

Although formal notifications will not be accepted until 12 October 2023, the EC invites parties to come forward with notifiable transactions for pre-notification discussions before then. Notifiable transactions unable to close before 12 October 2023 would then be prevented from closing pending the EC's formal review of the transaction.

5. What disclosures will be required in an FSR filing?

The EC issued its Implementing Regulation and template filing Form FS-CO on 10 July 2023.[2] Compared to the draft legislation, the EC has simplified some disclosure requirements to address feedback from companies and trade associations during the consultation process, but the final template still involves a significant burden for companies.

In addition to the typical requirements in merger control filings, the FSR filing form calls for various types of additional information (*e.g.*, detail on transaction financing and valuation, a detailed mapping of FFCs, detailed description of the bidding process and other bidders, if applicable) and supporting documents.

Information will be required on all FFCs valued at €1 million or more that have been granted to an individual transaction party in the three prior years, even if not linked to the transaction, including:

- detailed reporting for specifically defined types of contributions assumed most likely to distort the EU internal market (*e.g.*, aid to companies facing difficulties, unlimited guarantees, certain export financing, or aid directly facilitating a transaction) including supporting documentation; and
- an overview table of all other FFCs (however, FFCs granted by a specific non-EU country to a specific party of less than €45 million in total over the past three years require no disclosure).

The filing will not require disclosure of FFCs in the form of arm's length supply and purchase relationships (other than in relation to financial services) and generally applicable tax measures.

However, the Implementing Regulation is clear that all FFCs, whether disclosable in the filing or not, count towards the €50 million threshold to determine a filing requirement. Parties will therefore still need to identify all FFCs (at least up to a level of €50 million in the three years prior to the transaction) to determine if the transaction meets the thresholds for an FSR filing, even if not all individual FFCs need to be disclosed in the filing.

The Implementing Regulation recognizes that parties may seek to negotiate waivers for information that is not reasonably available and not necessary for the assessment of the case. An effective use by the EC of waivers will be crucial to keep FSR reviews manageable and proportionate.

6. How will this work in practice for private equity firms and other financial sponsors?

The FSR implies a particular burden on private equity firms and other financial sponsors, who will need to make a detailed assessment of FFCs both at the level of the fund and across portfolio companies.

In response to quite vocal industry push back, the EC has limited FFC disclosure requirements to just the acquiring fund (or funds) — including its investors and portfolio companies — under two conditions:

- the acquiring entity is subject to the EU Directive on Alternative Investment Fund Managers or equivalent legislation, and
- there are no or only limited economic or commercial transactions between the fund that controls the acquirer and other funds managed by the same investment firm (or their controlled portfolio companies), including sales of assets, ownership in companies, loans, credit lines or guarantees.

[2] Commission Implementing Regulation 2023/1441 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.

However, investment firms are still required to look across funds and portfolio companies to assess if any foreign subsidies have been granted that are assumed most likely to distort the EU internal market (*e.g.*, aid to companies facing difficulties, unlimited guarantees, certain export financing, aid directly facilitating a transaction). Such measures need to be disclosed irrespective of the acquiring fund(s). Also, the analysis of FFCs for the purpose of the €50 million notification threshold should still be done across all funds and portfolio companies. Here, too, waivers will play a key role to keep FSR filings manageable.

7. What is the substantive test under the FSR, and how may concerns be remedied?

The EC will assess whether foreign subsidies (*i.e.*, selective FFCs) distort the EU internal market. When reviewing M&A deals, this assessment is limited to the context of the transaction, although the FSR does not appear to require the EC to establish a direct causal link between the transaction and any market distortion.

Whether a foreign subsidy distorts the internal market (*i.e.*, improves the relative competitive position of the receiving company in the internal market) will be a case-by-case assessment, giving broad discretion to the EC. Contrary to merger control, the EC may also take into account any "positive effects" in line with the EC's broader policy goals (*e.g.*, EU Green Deal objectives, digital transformation, European strategic autonomy, etc.). EC guidance on the criteria for assessing distortions of the EU internal market and balancing such distortions against "positive effects" is not expected until at least next year.

The same level of discretion applies to remedies, which may go broader than typical divestiture or access-type behavioral commitments in merger control. For example, the EC may 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.

8. What should I do now?

Advance planning and data gathering are key to prevent delays as the notification regime enters into force on 12 October 2023.

- Companies with transactions in the works should assess as a matter of priority if an FSR filing is required, and plan for additional due diligence to evaluate potential impact on deal risk and timing.
- Deal documentation should reflect a potential FSR filing in the closing conditions, potentially including the risk of the EC requesting a filing even if the thresholds for notification are not met. Cooperation provisions should reflect the extensive disclosure requirements from all parties involved, and the long-stop date should factor in potentially lengthy reviews (including, if appropriate, the fact that remedies are only available in Phase 2). In addition, efforts covenants may need to reflect the diverse nature of potential remedies contemplated by the FSR going beyond the types of divestiture or behavioral commitments typically accepted in a merger control context.
- The EC encourages pre-notification discussions in transactions that may require a FSR filing. Parties involved in live transactions should seize this opportunity for early engagement to make progress in the coming weeks and months on draft filings, seek case-specific waivers to reduce the disclosure requirements, and maximize the chances of a swift review upon formal filing on or after 12 October.
- Beyond pending deals, it will be key for companies to establish internal processes to map FFCs on an ongoing basis in order to be able to hit the ground running when M&A opportunities present themselves. Tracking that FFC information will also allow companies to assess their FSR exposure to EC investigations outside any deal context.

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