



Tackling foreign subsidies: new EU rules enter into force

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The EU Foreign Subsidies Regulation (FSR) empowers the European Commission (EC) to review and control subsidies granted by non-EU countries to companies active in the EU. The new rules, which start to apply from 12 July 2023, will have a significant impact on and create new obligations for parties that are participating in transactions and public tenders in the EU and have received foreign financial contributions.

The EC is aiming to close the regulatory gap whereby subsidies granted by EU Member States are subject to close scrutiny under EU state aid rules, while subsidies from non-EU countries are not subject to any control. The FSR will enable the EC to investigate foreign subsidies and to impose measures redressing their distortive effects to ensure “a level playing field” in the EU internal market.

Broad scope of application

The FSR has an extremely wide scope. It will apply to companies engaging in economic activity in the EU that receive foreign subsidies. It is irrelevant whether the recipient is a private or public entity (directly or indirectly controlled by the state) or whether it is established in or outside the EU.

Foreign subsidies are defined as: (i) financial contributions; (ii) granted directly or indirectly by a third (non-EU) country; which (iii) confer a benefit on the recipient (ie are not provided under normal market conditions); and which (iv) are selective (ie limited to one or more companies or industries). Each of these conditions must be met.

A “financial contribution” is defined very broadly and, in practice, may include any transfer or use of financial resources. It covers the transfer of funds or liabilities (eg capital injections, grants, loans, loan guarantees, fiscal

incentives, the setting-off of operating losses, compensation for financial burdens, debt forgiveness, debt to equity swaps or rescheduling) and foregoing of revenue otherwise due (eg tax exemptions, granting of special or exclusive rights without adequate remuneration). It also includes the provision or purchase of goods or services. Notably, the EC's transaction review tool detailed below imposes a notification obligation that is linked to financial contributions made by third countries rather than the more narrowly construed foreign subsidies concept.

"Third country" financial contributions include those provided by non-EU governments, public authorities and public entities, but notably also private entities if their actions can be attributed to the non-EU country.

Three tools for controlling foreign subsidies

The FSR equips the EC with three tools to tackle foreign subsidies in the EU:

- Transaction review tool: similar to the EU merger control regime, the EC will have the power to review deals if certain thresholds are met.
- Public tender review tool: the EC will be able to investigate bids in public procurement procedures if relevant thresholds are met.
- A general tool to investigate all other market situations: the EC can start a review on its own initiative, including into below-threshold transactions and public tenders.

Transaction review tool

Under the FSR, transactions (mergers, acquisitions or certain joint ventures) must be notified to the EC before their completion if the following thresholds are met:

Transaction notification thresholds (two cumulative limbs)

Limb 1 (Turnover threshold)

At least one of the merging parties, the target or the joint venture is established in the EU and generated an aggregate turnover in the EU **of at least EUR500 million** in the previous financial year.

Limb 2 (Foreign financial contribution)

The parties received combined aggregate financial contributions from non-EU countries **of more than EUR50m** in the last three years preceding the conclusion of the agreement, the announcement of the public bid or the acquisition.

Surprisingly, the thresholds are construed in such a way that a deal may need to be notified even if the acquirer has not received any non-EU financial contributions – it is enough that the target's foreign subsidies exceed the threshold.

Even where the thresholds are not met, the EC will be able to request the notification of a transaction where it suspects that the parties may have benefitted from foreign subsidies during the three years before the deal.

The FSR transaction review rules are separate from, but in many procedural aspects mirror, the well-established EU merger control regime. Parties will be able to engage in pre-notification contacts with the EC, which will be followed by a phase I review period of 25 working days. The EC will be able to open an in-depth phase II investigation, which will last 90 working days but can be extended and also suspended (eg if parties do not provide requested information). Time will tell whether, like the EU merger control regime, phase II reviews will remain uncommon and whether extensions and suspensions at phase II will be standard practice.

The FSR expressly allows parties to offer commitments during phase II. It is, however, not clear whether parties may offer commitments in phase I (as they can under the EU merger control rules).

The transaction cannot be implemented before the EC issues a no-objection decision or accepts commitments. While parties can apply to the EC for a derogation from this suspension requirement, we expect the EC to take a strict approach to any such requests, as it does under the EU merger control rules.

Public tender review tool

Entities that participate in public tenders in the EU will have to notify all foreign financial contributions to the contracting authority if the thresholds set out below are met. The authority will then pass on the information to the EC for review. Importantly, parties falling under the thresholds still need to declare their foreign financial contributions and confirm they are not notifiable.

Public tender notification thresholds (cumulative limbs)

Limb 1 (Contract value)

The estimated value of the public tender or framework agreement net of VAT is **at least EUR250m**.

Limb 1 (in cases where the tender is divided into lots)

The aggregate value of the lot(s) applied for is **at least EUR125m**.

Limb 2 (Foreign financial contribution)

The party (including its subsidiaries and holding companies) and its main subcontractors and suppliers involved in the same tender received aggregate financial contributions of **at least EUR4m** per non-EU country in the three years before the notification.

The EC may also request notification at any time before the awarding of the public contract, even if the thresholds are not met, if it suspects that the party may have benefitted from foreign subsidies in the three years before the submission of the tender or the request to participate in the public procurement procedure.

The EC will have 20 working days from notification (extendable only once by ten working days in duly justified cases) to complete its phase I review, and 110 working days (extendable only once by 20 working days in duly justified cases and after consultation with the contracting authority) for any in-depth phase II investigation.

During the EC's review, all procedural steps in the tender procedure may continue, except for the awarding of the contract. However, in certain cases, the contracting authority may award the contract to an entity who does not fulfil the notification criteria (confirmed in declaration) but submits the most economically advantageous bid.

Own-initiative investigations

The FSR enables the EC to investigate, on its own initiative, all (including below-threshold transactions and public tenders) foreign financial contributions that may distort the internal market. Own-initiative reviews of public procurements are limited to awarded contracts and, importantly, cannot result in the cancellation or termination of that contract.

The EC has the power to investigate foreign financial contributions up to ten years from the date they were granted (but up to five years before the date the FSR becomes applicable, where those foreign subsidies distort the internal market after that date).

The EC may initiate a review based on information from any source, including Member States. Like the procedure for the transaction and public tender review tools, there would be a preliminary phase I review and the EC may open an in-depth investigation. There are no deadlines to complete each stage of the review. However, the EC must endeavour to adopt a decision within 18 months of the opening of the in-depth investigation.

Assessing whether foreign subsidies distort the EU market

In its assessment of foreign subsidies, the EC will determine whether the subsidy has distortive effects in the internal market and if so, whether there are countervailing positive effects.

Distortive subsidies

A subsidy will be considered distortive if it could improve the competitive position of a business in the EU, and as a result it actually or potentially negatively affects competition in the EU.

The following categories of foreign subsidies will “most likely” distort the EU market:

- a subsidy to ailing businesses without a viable restructuring plan
- unlimited guarantees
- an export financing measure that is not in line with the OECD arrangement on officially supported export credits (this category has been added and was not in the draft FSR)
- a subsidy directly facilitating a transaction
- a subsidy enabling a business to submit an unduly advantageous tender, on the basis of which it would be awarded the public contract

Aside from this list, the FSR provides a non-exhaustive list of indicators that the EC may take into account in its assessment. These include the nature or amount of the foreign subsidy, the situation and size of the business, as well as relevant markets or sectors.

Safe harbours

Helpfully, the FSR provides the following safe harbours:

- foreign subsidies that did not exceed EUR200,000 per non-EU country in any three-year period are not considered distortive
- foreign subsidies that did not exceed EUR4m in any three-year period are considered unlikely to be distortive
- foreign subsidies that are aimed at repairing damage caused by natural disasters or exceptional occurrences may not be considered distortive

Balancing test

The EC may (particularly when deciding on redressive measures or commitments) balance any positive effects “on the development of the relevant subsidised economic activity” against the negative effects of distortive foreign subsidies. It may also take into account broader positive effects related to, eg EU policy objectives.

Unfortunately, the FSR does not provide further guidance on how the EC will apply the balancing test. The EC is obliged to publish guidelines on the test (as well as other issues) by 12 January 2026. Hopefully, the EC will give clarity well ahead of this date.

EC’s broad enforcement powers

The EC will be the sole authority enforcing the FSR, with comprehensive enforcement powers. According to **the FSR impact assessment**, the EC foresees engaging around 145 employees.

Decision-making powers

If the EC concludes that an assessed foreign subsidy does not raise concerns, it will close its investigation with a no-objection decision.

If the EC finds that a foreign subsidy has distortive effects, it may impose redressive measures or accept commitments offered by the parties to remedy the distortion.

These can take the form of structural remedies (eg divestment of assets, reducing capacity or market presence, a ban on certain investments) and/or behavioural remedies (eg offering access under fair, reasonable, and non-discriminatory conditions to infrastructure, including research facilities, production capabilities or essential facilities, repayment of the foreign subsidy, and publication of results of research and development).

If it is not possible to fully and effectively remedy the distortion, the EC can prohibit (or unwind) a transaction or the awarding of a contract in a public tender.

In advance of a final decision being taken, the EC can also impose interim measures (although not in relation to public procurement procedures).

Investigative powers

The EC will have extensive investigative powers similar to those granted to it under EU antitrust and merger control rules. In particular, the EC can request information, interview and carry out dawn raids. The FSR allows the EC to conduct dawn raids in non-EU countries, provided the relevant government is notified and has no objection. It will be interesting to see how much use the EC makes of this power in practice.

Harsh sanctions for non-compliance

Companies face fines of up to 10% of their global turnover for failing to notify a transaction or public tender, implementing a transaction before approval or failing to comply with commitments, interim measures or redressive measures. Periodic penalty payments may also be imposed.

The EC can impose fines of up to 1% for the provision of incorrect, incomplete or misleading information in a notification or response to an EC information request, or for failing to provide information within set time limits.

Practical implications

The EC's impact assessment notes that it anticipates around 30 cases a year under the transaction review tool and 36 under the public tender tool. These are not huge numbers and, given the broad scope of the FSR and potential penalties for failing to notify, it is possible that notification numbers will be much higher, at least while the regime is in its infancy. Companies should therefore make sure they are prepared for the additional layer of execution risk, not to mention administrative burden, of the new notification regimes.

In particular, investors will need to effectively track and aggregate financial contributions that they or any of their group companies have received in the three years prior to notification. This will include all provision of goods/services to and purchases of goods/services from a non-EU country. This exercise could prove particularly burdensome for private equity firms and funds, which will need to monitor relevant information across all of their portfolio companies.

It is important to bear in mind that, under the FSR, the calculations of financial contributions are not based on financial years, meaning that companies will need to have systems in place to collect information on contributions on an ongoing rolling basis. Properly calculating the amount of certain financial contributions (such as tax exemptions or certain transfers of funds) and aggregating them is also likely to be challenging.

As well as tracking the amount of foreign subsidies received, investors will have to consider the potential substantive effects (both positive and negative) that these subsidies may have, given the risk that the EC could investigate any potentially distortive financial contributions even where thresholds are not met.

Where notifications are required, parties should consider providing for any FSR review in transaction documentation, and ensuring that the deal timetable accounts for the preparation of notifications (as yet we have no detail on what information will be required) and the EC's investigation period (including any potential extensions/suspensions). Developing a filing strategy which encompasses FSR notification/review as well as merger control and other regulatory (eg foreign investment control) processes will be crucial to managing timing. Where it is possible that the EC will raise concerns over foreign subsidies, parties should think upfront about possible commitments they would be prepared to offer to address them.

What's next?

The FSR entered into force on 12 January 2023, although most of its provisions will apply from 12 July 2023. Importantly, the notification obligation for parties participating in transactions and public tenders start to apply later – from 12 October 2023. The EC will have no jurisdiction to review transactions signed, public bids announced or public procurement contracts awarded/procedures initiated before the FSR starts applying.

Given that the EC proceeded with the legislative initiative very quickly and that it plans to commit a large team to the FSR, we should expect active enforcement.

However, as outlined above, there remains a great deal of uncertainty around the application of the regime. The EC's implementing regulation (on which it will consult) and promised guidelines will hopefully shed some light on these issues.

We will keep you updated of further developments.

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