How will the EU Foreign Subsidies Regulation affect international business?

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On 3 October 2023, Eddy de Smijter, Head of International Relations Unit, European Commission, DG Competition, Conor Quigley KC of Serle Court Chambers, and Nicola Mazzarotto, global head of economics at KPMG, joined A&O partners Kristina Nordlander and Dominic Long to discuss the impact of the EU Foreign Subsidies Regulation on global businesses. Here we summarise the main themes of their conversation.

What's the purpose of the regulation?

The EU Foreign Subsidies Regulation (FSR) is designed to identify and, where necessary, remedy the effects of subsidies given to businesses by non-EU countries that have the potential to distort competition within the EU's single market.

On one level the FSR can be seen as in effect extending the EU's restrictions on state aid (that apply only to EU Member States) by tackling state subsidies extended from beyond the bloc's borders that nonetheless have the potential to distort competition in the EU.

However, unlike (EU) state aid measures – which, if they give an advantage to a certain business or sector and are found to meet the various criteria of being distortive and selective, are presumed automatically illegal – foreign subsidies are not deemed per se problematic under the FSR. Instead, the EC must first establish that they have a distortive effect on competition and then seek to remedy their impact.

To assess distortion the FSR will look at a range of indicators, including the scale of the subsidy, the nature of the business (including its size, its economic activity within the single market and the sectors in which it operates), the purpose of the subsidy and any conditions attached to it.

How will the Foreign Subsidies Regulation be enforced?

The EC has three mechanisms it can now use to identify potentially distortive foreign subsidies – two notification tools through which it can probe large M&A deals and tenders in public procurement processes, and *ex officio* investigation powers that enable it to explore any situation where it suspects such ex-EU subsidies are present. The notification obligations came into force on 12 October this year, while the *ex officio* powers took effect in July.

The notification requirements apply only when certain thresholds are met. Under the transaction review regime, in summary deals have to be notified and approved prior to completion if: (i) one or more of the merging businesses (in the case of a merger), the target company (in the case of an acquisition), or the joint venture (in the case of a JV) are established in the EU and generate annual turnover of at least EUR500 million within the EU; and (ii) combined with all other parties to the transaction, have received aggregate financial contributions from non-EU countries of more than EUR50m over the previous three years.

Businesses that participate in public tenders in the EU will have to file a notification if: (i) the estimated value of the tender or framework agreement is at least EUR250m; (ii) the aggregate value of any "lot" (ie the segment of the tender/framework agreement being applied for) is at least EUR125m; and (iii) the relevant party (which in this context includes subsidiaries and holding companies, as well as subcontractors and suppliers in the context of the relevant tender) has received aggregate financial contributions of at least EUR4m from a non-EU country in the three years before notification.

More details on the application of the FSR to M&A deals and procurement tenders as well as the procedure and notification requirements can be found in our alerts here and here.

Wide definition of financial contribution

The concept of "financial contribution" under the FSR is extremely broad and includes the transfer of funds or liabilities (eg through capital injections, grants, loans, loan guarantees and debt-to-equity swaps) alongside non-ordinary-course tax benefits, fiscal incentives, debt forgiveness and even the purchase or sale of goods and/or services by or to non-EU public authorities.

Purchase of goods and/or services deemed particularly challenging

The inclusion of the purchase and sale of goods and/or services within the definition of foreign financial contributions was deemed by our panellists to be a particularly challenging aspect of the regulation, given that an FSR notification may be triggered in an acquisition where the target company transacts on arm's length terms with a non-EU public body, in circumstances where no other parties to the relevant M&A transaction receives any foreign financial contributions (much less foreign subsidies (distortive or otherwise)).

What does the EC expect in terms of filings?

The FSR merger filing form (a 'Form FS-CO') is structured to allow most non problematic foreign financial contributions to be notified in ranges (ie between EUR45m and EUR100m, EUR100m and EUR500m, EUR500m and EUR1,000m and > EUR1,000m) and includes a number of important and helpful exceptions to the requirement to disclose foreign financial contributions (including the provision/purchase of goods/services (except financial services) at market terms in the ordinary course of business). Contributions should also be aggregated by origin and type of contribution, rather than listed line by line.

However, so-called "red light" (or 'Article 5') subsidies – those deemed to be the most likely to distort

competition within the EU single market – must be itemised. When investigating the possibility of distortive foreign subsidies, the EC will conduct its own research alongside assessing the information provided in the notification form.

How long will the FSR process take?

The FSR transaction review process is separate from, but in many respects mirrors, that of the EU merger control regime. Parties are encouraged to engage in pre-notification discussions with the EC, after which a formal filing will start the clock on a 25 working day phase 1 review. Once this is complete, the EC will either provide clearance (expected in the majority of notifications) or launch an in-depth phase 2 investigation (lasting up to 90 working days, subject to extensions / suspensions). At the end of this process the EC can clear a deal or accept remedies offered by the parties, which could be structural (eg divestments), behavioural (eg repayment of distortive subsidies), or both. Ultimately, if it isn't possible to fully remedy a distortion, the EC can prohibit a deal.

Parties are gearing up to make filings

In the run-up to the regulation coming into effect, around 20 deals have so far been pre-notified to DG Comp, the unit in the EC that oversees the transaction notification regime. All of those transactions also required a parallel filing under the EU Merger Regulation (which is perhaps not surprising given the FSR notification threshold).

How are companies dealing with the FSR in practice?

Many businesses are already working out how to comply with the FSR, either because they are involved in a live deal or procurement process, or because they expect to be making FSR filings in the relatively near future. Here we are seeing central teams being assembled and requests for information going out to relevant areas of the business to begin gathering the information needed –for assessing whether the relevant FSR notification thresholds may be triggered, as well as front-loading the information gathering process required for the notification itself.

Where the required data is not reasonably available and/or is not necessary for the EC's investigation, the EC may be willing to grant a waiver (subject to consultation). However, the EC will not grant a waiver simply where it is difficult, time consuming or costly to gather the relevant information and will generally expect notifying parties to provide best estimates for any missing data. Providing incomplete, incorrect or misleading information (either intentionally or negligently) carries a penalty of up to 1% of global turnover. Missing a notification can give rise to fines of up to 10% of worldwide turnover.

Our panellists reported that the FSR is a key area of focus for both buyers and sellers involved in ongoing transactions with a material EU nexus. A key concern is how to allocate FSR risk, not least given many buyers are reluctant to agree to "hell or high water" provisions, thanks to the lack of precedent around what type of remedies the EC might look for in an FSR context.

Could the regulation lead to litigation?

Our panellists were asked whether the FSR was a possible source of litigation in the same way we have seen with EU state aid decisions. Challenges have come from member states required to recover state aid (or not put it into effect), the recipient or beneficiary of the state aid, and/or from competitors of the beneficiary.

In the context of the FSR, the universe of potential claimants may be somewhat different as the regulation doesn't produce a decision aimed at a state but rather the business receiving distortive foreign subsidies. It is possible that a third country could litigate to challenge an EC decision, but they would need to show that they're individually and directly affected by that decision. We might expect litigation from competitors, although they have limited procedural rights under the regulation (for example they have no rights to receive a copy of an FSR decision). However, whether this is sufficient to deny them legal challenge rights against the substance of a decision that they disagree with is likely to be tested through the courts.

To discuss the impact of the EU Foreign Subsidies Regulation on your business – or any other related matter – contact our market-leading antitrust or public procurement teams.

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