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New EU Foreign Subsidies Regulation: Implications for Foreign Investments from Asia

The EU's Foreign Subsidies Regulation (the **FSR**) came into force on 12 January 2023. The new FSR regime is intended to address distortions in the EU internal market caused by foreign subsidies, and introduces a new mandatory and suspensory regime for M&A (including joint venture) transactions and public tenders above certain financial thresholds. The FSR will begin to apply on 12 July 2023 and the notification obligations will commence on 12 October 2023. Companies planning to invest in the EU or participate in EU public tenders, and which have received "financial contributions" from non-EU governments and government-related entities will need to consider how to navigate the new regime.

This briefing discusses the key features of the FSR regime primarily in the M&A context and identifies practical issues and steps for affected companies. It remains unclear how certain areas of the FSR will be interpreted and applied but, given the broad drafting of the regulation, we expect the new regime to impact many transactions involving investments into the EU by state-owned entities and sovereign wealth funds in Asia (and companies that do business with them).

KEY FEATURES OF THE FSR

Overview

The FSR gives the European Commission (the **EC**) the following new tools:

- two 'mandatory notification tools' which aim to level the playing field for larger M&A transactions and larger-scale public procurement bids; and
- a 'general market investigation tool' to enable the EC to investigate, and to request *ad hoc* notifications regarding, all other market situations including those falling below the mandatory notification thresholds.

These tools will allow the EC to investigate financial contributions granted by non-EU countries to companies engaging in an economic activity in the EU, to assess whether they amount to distortive foreign subsidies.

"Financial contribution" is defined broadly to cover a wide variety of arrangements that companies may have with governmental (and associated) entities.[1] Under the FSR regime, if a notification is required, the details of such contributions will need to be collated and notified to the EC.

"Foreign subsidy" comprises a financial contribution which: (i) is provided directly or indirectly by a third country; (ii) confers a benefit on an undertaking engaging in an economic activity in the EU; and (iii) is limited to one or more undertakings or industries.[2] The EC will then assess whether such subsidies have a distortive effect on the internal market.

Please see **Diagram 1**, at the end of the briefing, for a flowchart summarising the key points to consider when assessing whether a notification will be required under the FSR.

The EC has published a draft Implementing Regulation (IR) containing the proposed procedural requirements under the FSR, as well as the content of the notifications. The consultation period ended recently and the draft IR is being finalised for adoption by the end of Q2 2023.

Mandatory notification thresholds

Companies must notify an M&A transaction involving a lasting change of control (i.e. a "concentration", similar to the definition applied in the EU merger control context) where:

- at least one of the merging undertakings, the acquired undertaking or the joint venture is established in the EU and generates aggregate EU-wide turnover of at least €500 million; and

[1] Article 3(2), FSR.

[2] Article 3(1), FSR.

- (i) the acquirer(s) and acquired undertaking; (ii) the merging undertakings; or (iii) the JV partners and JV, received a combined foreign (i.e. non-EU) financial contribution of at least €50 million in the preceding three years.

Companies must notify a public procurement bid where:

- the estimated value of the public procurement agreement or framework agreement is at least €250 million; and
- the company (including its group companies, subcontractors and suppliers etc.) received aggregate foreign financial contributions of at least €4 million per non-EU country, in the preceding three years.

As noted above, "financial contribution" is very widely defined (broader than a "foreign subsidy") and assessed on a group-wide aggregated basis. It includes:

- transfer of funds or liabilities (e.g. capital injections, grants, loans, guarantees);
- foregoing of revenue otherwise due (e.g. zero-tax agreements or zero-interest loans); and
- provision or purchase of goods or services.

The financial contribution need not come from central government. It may also be provided by local government and public or private entities whose actions can be attributed to a non-EU country (taking into account factors such as the characteristics of the entity and the legal and economic environment prevailing in the relevant country (in the case of public entities) and all relevant circumstances (in the case of private entities)).

The EC has indicated that even contributions obtained on market terms would constitute a financial contribution. For example, loans granted to companies from state-owned or state-controlled banks, or private banks operating under state direction, may be a customary element of a business' operation. Where the terms of such loans are more advantageous than those obtainable under normal market conditions (e.g. low or zero-interest), the loans will clearly be classed as a financial contribution under the FSR. However, our current understanding is that even loans obtained in line with normal market conditions will be classified as financial contributions, thus potentially triggering a notification requirement.

Submission of information and review timetable

If the notification requirement is triggered, parties must submit a wide range of information to the EC regarding the foreign financial contributions received in the last three years (including the form of the contribution, the granting entity, the purpose and economic rationale for granting the contribution, whether any conditions were attached) and other relevant information to facilitate the EC's assessment of the potential distortive effects on the internal market.

For review of M&A or JV transactions, the review timetable will be similar to the merger control process (i.e. a Phase I of 25 working days and a Phase II of 90 working days for an in-depth review). In the Annexes to the draft IR, the EC encourages parties to engage in pre-notification discussions on the basis of a draft notification form, similar to the approach taken in EU merger filings, before the formal review timetable commences.

Distortive foreign subsidies

The EC will assess the extent to which financial contributions constitute distortive foreign subsidies requiring redress. As noted above, a foreign subsidy exists where a non-EU country provides, *directly or indirectly*, a financial contribution which confers a benefit on the undertaking, and which is limited to one or more undertakings or industries. It will be distortive if it is likely to improve the competitive position of an undertaking in the internal market and, in doing so, actually or potentially negatively affect competition.

The EC will assess the distortive effect of subsidies by reference to their amount and nature; the market position of the recipient company; the company's level of economic activity in the internal market; and the purpose and conditions attached to the subsidy.

The FSR sets out certain categories of financial contributions "most likely" to distort the internal market:

- subsidies granted to failing businesses which would otherwise have gone out of business;
- unlimited guarantees for a company's debts and liabilities;
- subsidies directly facilitating a concentration; and
- subsidies enabling a company to submit an unduly advantageous tender.

On the other hand, the FSR indicates that subsidies of less than €4 million over any consecutive period of three years, those aimed at making good natural disaster damage or granted in response to exceptional occurrences are unlikely to distort the internal market.

Where the EC finds that a distortive subsidy exists, it may impose remedies to redress the distortive effects. These could include behavioural commitments or the divestment of certain assets. If the distortive effects cannot be remedied, the EC can prohibit an acquisition or prevent the award of a public contract to a subsidised bidder.

Separately, even if the mandatory notification thresholds are not met, the FSR gives the EC *ad hoc* investigation powers on its own initiative, to request information from companies, conduct fact-finding inspections and launch market investigations regarding alleged foreign subsidies distorting the internal market. The EC's powers will extend to investigating subsidies granted up to five years before the FSR's entry into force and up to ten years after a subsidy has been granted.

IMPACT ON COMPANIES AND PRACTICAL STEPS TO TAKE

- Notifications are triggered by reference to "financial contributions" (a much broader concept than foreign subsidies) and it will be for the EC to assess whether the contributions amount to subsidies that have distorted the internal market. The regime will likely generate significant practical difficulties for notifying parties, who will be expected to conduct an extensive information-gathering process and submit potentially sensitive information.

- The required information goes beyond what is required under the EU merger control process. Companies planning to invest in the EU or bidding on EU public tenders which may reach the relevant thresholds should start considering whether they receive "financial contributions" that might meet the relevant thresholds and begin preparing for October 2023, when the mandatory notification regime goes live. Preparatory steps could include implementing processes to screen for in-scope governmental entities and to assess whether they provide any "financial contributions" on a group-wide basis.

- There is scope under the draft IR for parties to request an information waiver where the relevant information is not reasonably available and/or unnecessary for the EC's investigation. The extent to which waivers will be granted in practice remains to be seen. The EC has strongly encouraged parties to engage in pre-notification discussions to determine, and ideally reduce, the amount of information required. From a practical perspective, early engagement with the EC may, therefore, be advisable.

- Companies will need to consider the implications of the FSR on M&A deals involving EU targets with at least €500 million turnover, including whether their co-investors may be recipients or providers of a "financial contribution". Notified concentrations cannot be completed, and notified public procurement contracts cannot be awarded, until cleared by the EC. Penalties (of up to 10% of global turnover) may apply for breaching the standstill obligation or failing to notify. If the EC identifies a distortive effect that cannot be remedied, it may prohibit the concentration or award of public contracts to subsidised bidders.

- Market consultation feedback highlighted the complexity of the regime for entities such as investment funds that have received investments from sovereign wealth funds or SOEs on normal market terms and their portfolio companies—it remains to be seen whether the EC will (in finalising the draft IR) accommodate such structures.

CONCLUSION

The introduction of the FSR highlights the increasing complexity of the European regulatory and investment landscape, which companies will need to navigate carefully.

It remains to be seen how the FSR will operate in practice, particularly given the broad net it casts and the EC's own resourcing constraints. However, companies should start to prepare for the FSR's notification regime by assessing whether they receive financial contributions and the terms of such contributions, as this may be a complex exercise that can be conducted proactively, outside the context of a 'live' transaction.

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Diagram 1