

Client Briefing

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Application of the Foreign Subsidies Regulation: The beginning of a level-playing-field or just more red tape?

With Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market (“Foreign Subsidy Regulation”), the EU introduced a new set of tools to scrutinize the influence on the EU market of subsidies granted by countries outside the EU (“Third Countries”). These rules introduce novel obligations for undertakings receiving financial contributions from Third Countries and give the Commission new competences to address distortive effects caused by foreign subsidies. The declared purpose is to create a level playing field and to close the perceived previous regulatory gap, in which subsidies from third countries could hardly be investigated. For undertakings, the introduction of the Foreign Subsidies Regulation often results in the considerable burden of establishing an internal reporting mechanism keeping track of any transaction falling under the broad definition of Third Country “financial contributions”.

I. EU Regulatory Framework on Foreign Subsidies

1. Foreign Subsidy Regulation and Implementing Regulation

The Foreign Subsidy Regulation (“FSR”) entered into force on 12 January 2023 and will be applied by the Commission as of 12 July 2023.

It aims at maintaining a level playing field on the EU market by addressing foreign subsidies. The underlying concern is that foreign subsidies may distort the EU’s internal market to the detriment of

fair competition, including by providing their recipients with an unfair advantage to acquire companies active in the EU. The FSR is supposed to close a regulatory gap, whereby subsidies granted by Third Countries currently go unchecked, while subsidies granted by EU-Member States are subject to close scrutiny under the EU’s state aid rules.

The FSR allows the Commission under certain circumstances to investigate “financial contributions” granted by Third Countries to companies active in the EU. If such financial contributions amount to “distortive subsidies”, the

Commission can impose measures to redress any distortive effects.

For instance, pursuant to Article 7(4) FSR, the Commission can oblige the beneficiary of distortive subsidies to offer access to or licenses under FRAND conditions infrastructure or assets; reduce capacity/market presence, refrain from certain investments; publish R&D results; divest assets; change its governance structure; dissolve a concentration; or repay the foreign subsidy.

In order for the Commission to be able to enforce the new rules, the FSR introduces a set of three new tools:

- An obligation to notify concentrations involving a financial contribution by a Third Country, where the acquired company, one of the merging parties or the joint venture generates an EU turnover of at least EUR 500 million and the transaction involves foreign financial contributions of more than EUR 50 million.
- An obligation to notify bids in public procurement procedures involving a financial contribution by a Third Country, where the estimated contract value is at least EUR 250 million and the bid involves foreign financial contributions of at least EUR 4 million per Third Country.
- A general investigation tool allowing the Commission to start *ex officio* investigations of alleged foreign subsidies distorting the EU market.

The Commission will be able to start *ex officio* investigations as of 12 July 2023. The new notification obligations concerning transactions involving EU companies and public procurement procedures, respectively, will apply as of 12 October 2023.

In light of the significant impact, which the new rules will have on transactions involving EU companies, the considerations below focus on the notification obligation for concentrations.

The FSR will be complemented with an Implementing Regulation 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 ("Implementing Regulation"), a draft of which was published in February 2023. The Implementing Regulation provides detailed procedural rules and, in its annex contains a standard form (comparable to the "Form CO" for EU merger control notifications) for notifications and describes the information to be submitted in an FSR notification in greater detail. It is currently expected that the final version of the Implementing Regulation will be published before 12 July 2023. This was most recently confirmed by the Commission in a Q&A published on 6 June 2023.

2. Key Terms and Concepts

In defining the notification requirement for transactions, the FSR relies on the term "concentration" as established in EU merger control and introduces the novel concept of "financial contributions" as one of the thresholds for the notification requirement.

a. Financial Contributions

Financial contributions can be granted by public or private entities. An entity's public character has to be determined with regard to elements such as its characteristics and the legal and economic environment prevailing in the Third Country in which the entity operates, including the government's role in the economy of that country. In addition, financial contributions can be granted through a private entity. This requires that the actions of the private entity can be "attributed" to the Third Country in question.

The term financial contribution is very broad. Pursuant to Article 3(2) FSR financial contributions include but are not limited to

- 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 rescheduling;
- the foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration; or
- the sale or purchase of goods or services.

Importantly, a business transaction can be considered a financial contribution even if it is made in line with normal market conditions. Whether a contribution is market-based is relevant only for the substantive assessment of a distortion of the internal market.

In the context of assessing whether a financial contribution distorts the internal market certain *de-minimis* rules apply. For example, where the total amount of a foreign subsidy to an undertaking does not exceed (i) EUR 4 million over any consecutive period of three years, or (ii) EUR 200,000 per Third Country over any consecutive period of three years, that foreign subsidy shall not be considered (likely) to distort the internal market (Article 4(2) and (3) FSR).

b. Thresholds

The concept of a “concentration” under the FSR is the same as in EU merger control and requires the change of control on a lasting basis. The definition of “undertaking” also follows EU merger control rules. As a result, the attribution of turnover – as well as the attribution of financial contributions – to groups of companies is in line with the calculation of turnover for EU merger control purposes. In both instances, all entities under the same strategic ownership/leadership are considered an “economic unit” and will be regarded together.

Under the turnover threshold, the EU turnover of the target, one merging party or the joint venture (JV) must have been at least EUR 500 million during the last financial year. The acquirer or parents of a joint venture do not have to be taken into account for the calculation of the revenue threshold.

The financial contribution threshold is met if the combined aggregate financial contributions from Third Countries to parties to the concentration (including the acquirer and/or joint venture parents) exceeded EUR 50 million over the last three years preceding the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest. Relevant parties for the calculation of the financial contribution are

- (i) in the case of an acquisition, the acquirer or acquirers and the acquired undertaking;

- (ii) in the case of a merger, the merging undertakings;

- (iii) in the case of a joint venture, the undertakings creating a joint venture and the joint venture.

It is understood that the three-year period refers to a rolling three-year timeframe.

c. Notifiable Concentrations

Transactions meeting these thresholds are “notifiable concentrations”, which have to be notified to the Commission prior to their implementation. Similar to merger control filings, FSR notifications can be made prior to signing, i.e., at a point in time where the parties demonstrate to the Commission a good faith intention to go through with the planned transaction.

Notifiable Transactions may not be implemented prior to clearance by the Commission (standstill obligation). The timeline for the FSR review is largely modelled on the review periods of EU merger control. In practice and due to the large number of unsolved questions concerning the novel concepts introduced by the FSR, it is expected that the pre-notification contacts will be even more time consuming than during EU merger proceedings.

Finally, it should be borne in mind that the Commission, if it suspects that foreign subsidies have been granted to the parties, can request notification of any concentration at any time prior to its implementation pursuant to Article 21(5) FSR.

II. Compliance with FSR

1. Far-reaching Information Obligations

In principle, (groups of) companies potentially being a party to a “notifiable concentration” pursuant to the FSR need to monitor and keep record of any financial contributions received from Third Countries worldwide during a three-year period on a rolling basis. The (so far) unmitigated burden imposed by the FSR on market participants has been widely criticized and remains at the centre of the discussion surrounding the FRS.

It is expected that the Commission will provide additional (informal) guidance concerning its interpretation of the FSR including the concept of “financial contributions” and the relevant information required for the notification of a concentration once it will have gained experience with the notification system in practice.

Pursuant to Article 46 FSR, the Commission shall publish guidelines on different aspects, such as the criteria for the existence of a distortion in the internal market, not later than 12 January 2026.

In addition, it is generally understood that, at least initially, the Commission’s enforcement priority will be on cases potentially resulting in the most serious distortions on the EU market. Such cases will likely involve companies which regularly receive significant non-market-based financial contributions from their home countries. In addition, while the FSR in principle applies without discrimination to all Third Countries, it is expected that in particular financial contributions from China will be at the centre of the Commission’s early enforcement of the FSR.

2. Considerations for prioritization of Internal Data Collection

For companies not domiciled in “critical” countries it may be prudent to approach the internal data collection in a staggered process, which prioritizes information that is (i) readily available or can be collected without undue burden or (ii) concerns financial contributions that are potentially problematic. In any case, the exercise should serve to gain a general understanding of the magnitude of financial contributions to be taken into account and also to have a set of defined data available that could be used as a starting point for discussions with the Commission should the undertaking be involved in a potentially notifiable concentration after 12 October 2023.

In a first step, the internal data collection could focus on financial contributions received since July 2020 falling into one of the following buckets. Since the information needs to be available on a rolling basis for a three-year period preceding the transaction, it is important to record the date (month/year) the contribution was received.

Decisive is the moment the beneficiary obtains an entitlement to receive the financial contribution, an actual disbursement of the contribution is not required.

- Financial contributions labelled/recorded as government grants, subsidies, etc. received from Third Countries.
- Tax exemptions labelled as such and granted by Third Countries.
- Government contracts with Third Countries at federal, state or municipality level.
- If any, financial contributions considered critical by nature such as
 - (i) financial contributions granted by or on behalf of a Third Country to an ailing undertaking (i.e., an undertaking which will likely go out of business in the short to medium term in the absence of any subsidy), unless there is a restructuring plan that is capable of leading to the long-term viability of that undertaking and that plan includes a significant own contribution by the undertaking;
 - (ii) unlimited guarantees by or on behalf of a Third Country for debts/liabilities, namely guarantees without any limitation as to the amount or the duration of such guarantee;
 - (iii) export financing measures not in line with the OECD Arrangement on officially supported export credits entered into between Australia, Canada, the European Union, Japan, Korea, New Zealand, Norway, Switzerland, Turkey, the United Kingdom and the United States; or
 - (iv) financial contributions by or on behalf of a Third Country to finance or otherwise directly facilitate a M&A transaction.

Where it is not possible to collect precise data regarding the amount of financial contributions falling into one of the buckets described above, conservative estimates of the maximum amount of such contributions could be used.

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Dr. Oliver Schröder LL.M. (NYU)
Lawyer | Partner
M&A | Corporate Law | Foreign
Trade Law | ESG

T +49 69 9769601 149
E Oliver.Schroeder@sza.de



Dr. Stephanie Birmanns
Lawyer | Partner
Foreign Trade Law | Antitrust &
Competition Law

T +32 2 8935 121
E Stephanie.Birmanns@sza.de