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

With the Foreign Subsidies 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. For undertakings, the introduction of the Foreign Subsidies Regulation results in the considerable burden of establishing an internal reporting mechanism keeping track of any transaction falling under the broad definition of "foreign financial contributions".

I. EU Regulatory Framework on Foreign Subsidies

Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market ("Foreign Subsidies Regulation" or "FSR") entered into force on 12 January 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. The FSR is supposed to close a regulatory gap, whereby subsidies granted by Third Countries absent the FSR 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 ("Foreign Financial Contributions" or "FFC") to companies active in the EU. If such FFC 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 novel tools:

- An **obligation to notify concentrations** involving a foreign financial contribution, 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 foreign 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.

Since 12 July 2023, the Commission has the power to start *ex officio* investigations. 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 the new rules will have on transactions involving EU companies, this client briefing focuses on the notification obligation for concentrations.

The FSR is complemented with the Commission **Implementing Regulation** (EU) 2023/1441 of 10 July 2023 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"). The Implementing Regulation provides detailed procedural rules, for example on time limits or questions of access to file and confidentiality. Its Annex 1 contains a standard form (comparable to the "Form CO" for EU merger control notifications) called "Form FS-CO" for notifications of concentrations and describes the information to be submitted in such a filing in more detail.

II. The FSR's 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 FFC as one of the thresholds for the notification requirement.

1. Foreign 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 assessment, whether a financial contribution was granted by such a "to be attributed" entity has to be made on a case-by-case basis.

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 not relevant for the calculation of the foreign financial contribution threshold. However, the Form FS-CO eases the burden of providing detailed information on foreign financial contributions stemming from the sale

or purchase of goods or certain services at market terms.

In addition, the question whether a business transaction is market-based plays a role in the substantive assessment of a distortion of the internal market. In this context, 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).

2. Tresholds

Pursuant to Article 20(3) FSR, concentrations need to be notified if (i) at least one of the merging undertakings, the acquired undertaking or the joint venture is established in the EU and generates an aggregate EU turnover of at least EUR 500 million; and (ii) the parties to the concentration received, over the last three years preceding the transaction, combined aggregate FFC of more than EUR 50 million.

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 owner-/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. Note, however, that 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 FFC to parties to a 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.

> Importantly, for the calculation of the EUR 50 million notification threshold, all foreign financial contributions received during the three-year-period need to be taken into account, notwithstanding the fact that the Form FS-CO does not require notifying parties to further elaborate on certain types of FFC.

3. Notifications and Review

Concentrations meeting these thresholds are "notifiable concentrations", which have to be notified to the Commission prior to their implementation. Responsible for reviewing these concentrations is **DG Competition**'s newly established Task Force Third-Country Subsidies. 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. Pre-notification contacts are not mandatory but strongly recommended.

Notifiable concentrations may not be implemented prior to clearance by the Commission (**standstill**). The review period for FSR filings is similar to EU merger control (25 work days for phase I and 90 working days for phase II). 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. Arguably, the Commission may also use the general investigation tool to call in non-notifiable concentrations post-implementation. In any case it is expected that the Commission's Third-Country Subsidies Task Force will at least initially focus its limited resources on the assessment of notified concentrations.

III. Compliance with FSR

1. Far-reaching Information Obligations

In principle, companies potentially being party to a "notifiable concentration" need to **monitor and keep record** of any FFC received worldwide during a three-year period on a rolling basis. This significant burden imposed by the FSR on market participants has been widely criticized and was at the centre of the discussion surrounding the FRS.

The final version of the Implementing Regulation, however, somewhat limits the reporting obligations regarding foreign financial contributions received during the relevant three-year period. While notifying parties will need to state whether or not the EUR 50 million **notification threshold** is met, not all foreign financial contributions relevant for the calculation of this threshold will need to be described in greater detail in the notification on Form FS-CO:

- Individual foreign financial contributions below **EUR 1 million** do not need to be specified.

- Detailed information is required only for foreign financial contributions ≥ EUR 1 million that are considered **critical by nature** pursuant to Article 5(1) FSR

- For foreign financial contributions ≥ EUR 1 million that do not fall under the categories of Article 5(1) FSR, an **overview** clustering individual contributions by type and by Third Country suffices. The Form FS-CO provides a template for such an overview.

- Certain types of FFC are **exempted** from further reporting obligations in the Form FS-CO:

  (i) FFC received by the **target**.

  (ii) **Deferrals of payment** of taxes or of social security contributions, tax amnesties and tax holidays as well as normal depreciation and loss-carry forward rules that are of general application, i.e. not specific to certain sectors, regions or (types of) companies.

  (iii) Application of tax reliefs for **avoidance of double taxation** in line with the provisions of bilateral or multilateral agreements for avoidance of double taxation, as well as unilateral tax reliefs for avoidance of double taxation applied under national tax legislation to the extent they follow the same logic and conditions as the provisions of bilateral or multilateral agreements.

  (iv) The **sale or purchase of goods** or services (except financial services) at m**arket terms** in the ordinary course of business.

  (v) Within **investment funds** structures, not necessarily all foreign financial contributions received by other funds of the same investment group need to be reported.

It is expected that the Commission will provide additional (informal) guidance concerning its interpretation of the FSR once it will have gained experience with the notification system in practice. The Commission also emphasises its discretion to waive specific reporting obligations on a case-by-case basis.

> Also, 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.

Finally, 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. While the FSR in principle applies without discrimination to all Third Countries, it is not expected that US companies and/or US financial contributions will be at the centre of the Commission's early enforcement of the FSR. Rather, a call for tender issued by the Commission on the eve of its general investigative tool entering into

force seeking external support for the implementation of the FSR and specifically requesting Chinese, Arabic and Russian language skills indicates that the Commission's current enforcement priorities rather focus on countries other than the US.

2. Considerations for Priorisation 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 (i) concerns financial contributions that are potentially problematic or (ii) is readily available or can be collected without undue burden. The approach should also reflect the level of detail that would be required in a notification should the company be involved in a potentially notifiable concentration after 12 October 2023. In any case, the data collection should aim at gaining a general understanding of the magnitude of financial contributions to be taken into account in order to assess the foreign financial contributions threshold for future transactions.

In a first step, the internal data collection should focus on FFC 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.

- FFC considered **critical by nature** under Article 5(1) FSR. These financial contributions will have to be described **in detail** in a potential FSR notification and comprise

  (i) FFC granted 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) FFC to finance or otherwise **directly facilitate** a M&A transaction.

- For FFC that are **not critical by nature** pursuant to Article 5(1) FSR, it is not necessary to include detailed information in the data collection process. The amount, origin and purpose of the FFC are the most important data points to collect upfront:

  (i) Financial contributions labelled/recorded as government grants, subsidies, etc. received from Third Countries.

  (ii) Tax exemptions labelled as such and granted by Third Countries.

  (iii) Government contracts with Third Countries at federal, state or municipality level.

  (iv) Financial contributions stemming from high risk countries (e.g., China, Russia, Saudi Arabia, Iran, Qatar).

Where it is not possible to collect precise data, at least **high-level descriptions** of the type of FFC together with its country of origin and an **estimate of its amount** should be collected.

In its application of the FSR on notifiable concentrations, the Commission will need to strike a balance between gathering all relevant information and keeping the process manageable both for notifying parties as well as for its own case teams. It is to be expected that over time best practices will emerge that eliminate at least some of the current uncertainties regarding the internal information process.

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