Foreign Subsidies Regulation – A New Tool for Merger Control

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In mid-2023, the Foreign Subsidies Regulation (FSR) entered into force: a new tool used by the European Commission (the Commission) to address distortions in the EU internal market caused by subsidies from non-EU Member States. One cornerstone of this new regulatory framework is the notification requirement, effective since 12 October 2023, for certain M&A transactions involving companies that have received financial support from third countries.

Given the broad definition of financial contributions and the potential for significant penalties - up to 10% of the aggregate turnover in the preceding financial year, or the annulment of deals for non-compliance - companies engaged in M&A transactions within the EU need to be aware of the new layer of regulatory scrutiny and its complex information requirements.

A new Regulatory Hurdle for M&A Transactions

While EU Member States were already subject to rigorous regulatory examination of state-granted subsidies prior to the new regulation, third countries that employ financial contributions as part of their industry policy, were not targeted by EU state-aid rules. Accordingly, they faced less scrutiny from European regulators.

To close this perceived regulatory gap and create a level playing field for all companies operating in the EU internal market, the FSR has introduced mandatory screening for transactions involving investors or target companies that have received financial contributions from non-EU Member States. Mergers, acquisitions, and the formation of joint ventures bringing about a lasting change of control must be notified to the Commission if:

- (1) the target (in case of an acquisition), one of the companies involved in the concentration (in case of a merger), or the newly formed JV (a) is established in the EU and (b) has generated an EU-wide turnover of at least EUR 500 million; and
- (2) all companies involved have received combined financial contributions from third countries of more than EUR 50 million during the last three years.

Notably, the Commission is also authorized to require notification for transactions falling below these thresholds if it suspects that financial contributions constituting foreign subsidies were granted in the three years prior to the merger.

What to Notify under the FSR

The concept of financial contributions, as defined in Art. 3(2) FSR, is exceptionally broad. It encompasses loans, guarantees, capital injections, certain tax benefits, fiscal incentives, debt forgiveness, and the supply or purchase of goods or services. Identifying the relevant financial contributions and determining whether the EUR 50 million threshold has been met – and therefore whether a filing is required – is a challenge for dealmakers.

After criticism from various stakeholders, the Commission issued an Implementing Regulation under which the obligations on notifying parties to disclose financial contributions have been clarified and eased. Notably, financial contributions not constituting foreign subsidies must only be disclosed if, in the last three years, the individual amount of the financial contribution exceeded EUR 1 million and, cumulatively, all financial contributions exceeded EUR 45 million per third country. Information on such financial contributions only has to be provided in an overview aggregated in a table format. The Commission may, however, request more detailed information.

Only for a limited subset of financial contributions, "most likely distortive" foreign subsidies pursuant to Art. 5(1) FSR, more detailed information must be provided. A financial contribution qualifies as a foreign subsidy if it confers a "benefit" that could not be obtained on market conditions. Certain foreign subsidies granted to ailing undertakings, unlimited guarantees, export financing measures, foreign subsidies directly facilitating a concentration or foreign subsidies enabling an undertaking to submit an unduly advantageous tender are considered "most likely distortive". For

these foreign subsidies the exact amount, purpose, potential conditions attached to the financial contribution and the main elements and characteristics, as well as supporting documents, must be provided.

For private equity investors, the FSR Implementing Regulation brought some simplifications with regard to the information to be provided on financial contributions: as long as a financial contribution does not qualify as a "most likely distortive" foreign subsidy, information (in the aggregated manner described above) only has to be provided for the acquiring fund. This simplification does, however, not apply to the assessment whether the notification threshold is met – this is still assessed across all funds managed by the private equity investor.

Impact on the Transaction Timeline and Agreements

Like EU merger control, the FSR regime has a suspensive effect – notifiable transactions must not be closed until clearance has been obtained (Art. 24(1) FSR). The FSR review broadly follows the EU merger control process: After having gone through a pre-notification phase, the formal review period in Phase I of up to 25 working days commences upon formal notification (Art. 25(2) FSR). If the Commission finds that a foreign subsidy exists and likely has distortive effects on the EU internal market, it can enter an in-depth investigation lasting 90 working days from formal notification, or 105 working days if remedies are offered (and which may be further extended up to 125 working days). The Commission may also suspend the time limit if the parties fail to submit complete responses to a request for information.

Whether the Commission initiates an in-depth investigation largely depends on whether there are "sufficient indications" that a foreign subsidy exists distorting the internal market (Art. 10(3) FSR). The Commission conducts a "balancing test" (Art. 6 FSR) where it weighs negative effects of a foreign subsidy against positive effects in the development of the relevant subsidised economic activity on the internal market. If the negative effects outweigh the positive ones, the Commission may, under Art. 7 FSR, impose redressive measures or accept commitments offered by the undertaking under investigation to remedy distortions in the EU internal market.

For M&A contract negotiations, it is important to bear in mind that a notification requirement under the FSR will need to be reflected as a pre-closing condition. Further, a long-stop date has to reflect the length of the review process. The allocation of risk in having to make commitments or the imposition of redressive measures by the Commission should be reflected in the transaction documents.

Navigating the Challenges: Setting up a FSR-Compliance Framework

Currently, there are doubts about whether the FSR strikes the right balance between creating a level playing field and imposing an added bureaucratic burden that will make M&A transactions within the EU more costly and time consuming. Gathering the required data for filing can be complicated and time-consuming and most companies do not

(yet) routinely collect the specific data needed for an FSR notification. Companies should therefore prepare themselves for this new complex regulatory layer of scrutiny – for example, by implementing effective information-gathering protocols and requiring target companies to disclose their foreign financial contributions as part of their standard due diligence.

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