THE EU FOREIGN SUBSIDIES REGULATION – A NEW CHAPTER FOR FOREIGN SUBSIDIES SCRUTINY IN THE EU

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THE EU FOREIGN SUBSIDIES REGULATION – A NEW CHAPTER FOR FOREIGN SUBSIDIES SCRUTINY IN THE EU

By James Killick, Irina Trichkovska & Jia Liu

The Foreign Subsidies Regulation, applicable as of July 12, 2023, gives the European Commission broad powers to tackle subsidies provided by non-EU countries that distort the EU's internal market. It also establishes a new system of foreign subsidies control, which introduces mandatory and suspensory FSR filing to the European Commission for M&A deals and public tenders in the EU above certain thresholds. This article provides an overview of the Foreign Subsidies Regulation and its Implementing Regulation adopted on July 10, 2023 and discusses the investigative powers of the European Commission, in particular regarding the FSR filing requirements for M&A deals and public tenders in the EU.

I. INTRODUCTION

On July 12, 2023, the EU Foreign Subsidies Regulation ("FSR") started to apply.[2] Shortly beforehand, on July 10, 2023, the European Commission (the "Commission") adopted the FSR Implementing Regulation ("FSR IR") and the accompanying FSR filing forms for M&A deals ("Form FS-CO") and public tenders in the EU ("Form FS-PP").[3]

The purpose of the FSR is to tackle distortions to the EU's internal market caused by subsidies that companies active in the EU receive from non-EU countries (i.e. foreign subsidies).

The FSR grants the Commission wide-ranging powers to investigate all types of direct and indirect foreign financial contributions ("FFCs") that companies active in the EU receive from non-EU countries and to assess if these FFCs qualify as distortive foreign subsidies allowing those companies to compete on advantageous terms in the EU, negatively impacting competition in the EU's internal market. In the event of a distortive subsidy finding, the Commission can impose various redressive measures, block M&A deals/public tender awards in the EU and even dissolve already concluded M&A deals.

The Commission considers that the FSR "closes a regulatory gap," as foreign subsidies have, so far, escaped its control. Traditional trade defense instruments have only tackled subsidized traded goods, not subsidized M&A deals, public tenders, services, or other market situations.

II. FSR ASSESSMENT BY THE COMMISSION

A. What Is an FFC, and What Is a Foreign Subsidy?

Under the FSR, the Commission has the power to assess if the FFCs granted to the company active in the EU constitute foreign subsidies that distort the EU's internal market.

Not all FFCs will be considered as foreign subsides. A foreign subsidy is established if an FFC is (i) granted by a non-EU country (or an entrusted entity by a non-EU country) (ii) it confers a "benefit" on the company engaging in economic activity in the EU (i.e. no private investor would have conferred the same benefit) and (iii) is "specific" to one or more company or industry in the non-EU country (i.e. limited in fact or in law).

The notion of FFC under the FSR is very broad, and includes, *inter alia*:

- **Any transfer of funds or liabilities by a non-EU country**, including but not limited to, a capital/equity injection; grant, loan, guarantee, setting of operating losses; compensation for financial burdens imposed by public authorities; debt forgiveness; debt to equity swaps or rescheduling; partial reimbursement of the cost of goods and services; direct investment in the capital of companies.

- **Any foregoing of revenue that is otherwise due by a non-EU country**, including but not limited to, any tax or social contribution exemptions/incentives or granting of special or exclusive rights without an adequate remuneration.

- **Any non-EU government contract for the sale or purchase of goods or services**, including contracts with entities entrusted by the non-EU country.

The measures described above must be attributed to a non-EU country in order to constitute an FFC. The notion of a non-EU country covers: (i) the central government and public authorities at all levels (e.g. central, local, regional, etc.) and (ii) a public/private entity whose actions can be attributed to the non-EU country.[4]

If a measure discussed above is granted by a foreign government/public authority, it will be considered an FFC. However, it will be more difficult for companies to ascertain if a measure granted by a public or private entity (such as, for example, contracts for the supply of goods with

2 Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market, available at https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32022R2560&from=EN.

3 Together "Forms FS-CO and FS-PP." 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, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2023.177.01.0001.01.ENG.

4 Article 3(2), FSR.

non-EU State-owned enterprises ("SOEs")) constitutes an FFC, as this will depend on whether the entity's actions can be attributed to a non-EU country.

This is because, the concept of a public/private entity whose actions can be attributed to a non-EU country is not defined in the FSR. The FSR only provides that, in order to determine if the measures of a public/private entity are attributable to a non-EU country, the Commission will take into account *"elements such as the characteristics of the entity and the legal and economic environment prevailing in the State in which the entity operates, including the government's role in the economy."*[5] The Commission has, however, recently clarified that, for an FFC to be attributable to a non-EU country, the public/private entities will have to be *"directed or entrusted by the third country to undertake a certain action."*[6]

This is overall a positive development for the SOEs as their activities would not automatically be caught under the FSR by virtue of its State-ownership. This is also in line with the test applied under WTO and State aid law, which states that State-ownership of companies is insufficient on its own, to establish attributability. A public/private entity must be vested with governmental authority or exercise a governmental function, for its actions to be attributable to a non-EU country.[7] That said, determining if an entity has been directed or entrusted by a non-EU country may be still difficult to determine, as this is not necessarily an information that is publicly available.

Once an FFC is attributed to a non-EU country, the Commission will analyze if the FFC confers a benefit on the company engaging in economic activity in the EU. The benefit of the FFCs will be determined based on comparative benchmarks, such as the investment practices of private investors, financing rates obtainable on the market, a comparable tax treatment, or the adequate remuneration for a given good or service. Using alternative benchmarks is also possible. If a company fails to provide the relevant information concerning the benefit, the Commission can apply *"facts available"*[8] and can deem that a benefit is conferred.

Finally, the Commission will assess if the FFC is specific (i.e. limited in law or in fact) to one or more undertakings or industries in the non-EU country. General measures that apply to all companies in the non-EU country will not be considered specific.

Only once all of the above criteria are met will the Commission be able to establish that an FFC constitutes a foreign subsidy.

B. Is the Foreign Subsidy Distortive on the EU's Internal Market?

In order to be distortive, a foreign subsidy will need to (i) improve the competitive position of the company in the EU and (ii) have actual or potential negative effects on the EU's internal market. In other words, the subsidy needs to have a sufficiently clear nexus to the EU to be considered distortive and in need of a remedy. A foreign subsidy to a company, unrelated to its competitive position in the EU, should not be considered distortive.

The level of distortion will be determined based on a number of indicators, which may include, *inter alia*, (i) the amount and nature of the foreign subsidy, (ii) the market position of the subsidized business, including its size and the markets or sectors concerned, (iii) the level of development of the subsidized economic activity in the EU's internal market, and (iv) the purpose and conditions attached to the foreign subsidy and its use in the EU.[9]

The FSR includes the following legal presumptions to establish distortion or lack thereof.

- ***Likely distortive subsidies.*** The following foreign subsidies are considered as *"likely distortive"* under the FSR: (i) supporting a failing business without a long-term plan for restructuring the subsidized business; (ii) unlimited guarantees; (iii) directly facilitating a concentration; (iv) an export financing measure that is not in line with the OECD Arrangement on officially supported

5 Article 3(2), FSR.

6 FAQ on the FSR, published by the Commission, Q8, available at https://competition-policy.ec.europa.eu/foreign-subsidies-regulation/questions-and-answers_en.

7 See e.g. Section 3 of the Commission Notice on the notion of State aid, available at https://eur-lex.europa.eu/legal-content/en/TXT/HTML/?uri=CELEX:52016XC0719(05)&from=EN. According to State aid case law, a measure is attributable to the State if public authorities were involved in the adoption of the measure (Case C-556/19, *Eco TLC*, §23; Cases C-434/19; C-435/19 *Poste Italiane*, §40). For example, measures taken under legislative or regulatory provisions, an administrative decision and a decision of a national court, could be attributable to the State. Similarly, the entrustment of public service obligations by the State, along with compensation for carrying out such services, is regarded as a measure attributable to the State.

8 Article 16, FSR.

9 Article 4, FSR

export credits;[10] and (v) enabling a company to submit an unduly advantageous tender.[11] For example, if a company (or one of its controlled affiliates) were to be given a subsidy to pursue an acquisition in the EU, it would be considered a likely distortive subsidy.

- ***Unlikely or non-distortive subsidies.*** If the total amount of foreign subsidies received is below €4 million over any consecutive period of three years, such subsidies are *"unlikely [to be] distortive."*[12]

C. FSR Balancing Test

Once the Commission establishes that a foreign subsidy is distortive, it will conduct a balancing test to assess if the distortive effects of the subsidy can be counterbalanced by the positive effects of the foreign subsidy on the development of the subsidized economic activity on the EU's internal market.[13] In this context, the Commission may consider if the foreign subsidy supports broader policy objectives, in particular, those of the EU. For example, if the subsidy itself or the subsidized entity is contributing to policies the Commission approves (e.g. energy transition digital agenda, etc.), the positive effects of that subsidy will likely be taken into consideration.

III. FSR INSTRUMENTS OF THE COMMISSION

Under the FSR, the Commission has three main tools to control foreign subsidies that distort the EU's internal market:

A. Catch-All Market Situation Investigative Powers of the Commission

The FSR grants general powers to the Commission to investigate, on its own initiative (*ex officio*), all market situations that are suspected to benefit from distortive foreign subsidies (including, but not limited to, M&A deals and public tenders in the EU falling below the thresholds). The Commission can initiate such an investigation following information received from any source, including from Member States, complainants, business associations, or other interested parties.

The Commission can already use this tool as of July 12, 2023 and has thus far received a number of publicly reported FSR complaints.[14] It can also investigate subsidies granted five years prior to July 12, 2023, if such subsidies distort the EU's internal market after the start of the FSR's application.[15]

Examples of possible FSR investigations suggested by the Commission are greenfield investments and the provision of services conducted by the EU subsidiaries of a non-EU parent company that has access to beneficial non-EU State financing.[16] The Commission may consider that such financing allows EU subsidiaries of non-EU parent companies to set up factories in the EU, compete on unfair terms and crowd out competitors that do not benefit from such subsidies.[17]

The procedure under this instrument includes a preliminary review followed, if necessary, by an in-depth investigation; there is no legal deadline for the Commission to complete its investigations, although it must strive to complete them in 18 months.

10 OECD Arrangement on officially supported export credits, July 2023, available at https://one.oecd.org/document/TAD/PG(2023)7/en/pdf.

11 Article 5, FSR.

12 Article 4(2), FSR.

13 Article 6, FSR.

14 Belgian football club Virton has filed a complaint with the Commission, claiming that SK Lommel receives foreign subsidies from the Emirate of Abu Dhabi without economic rationality, see official statement, available at https://www.revirton.be/subventions-etrangeres-certains-clubs; Spain's top football division La Liga has filed a complaint with the Commission, claiming that the subsidies received by PSG from Qatar distort the EU's internal market, see official statement, available at https://www.laliga.com/en-GB/news/laliga-files-complaint-against-psg-with-european-commission.

15 Article 53(1), FSR.

16 FSR Q&A of the Commission: New Regulation to address foreign subsidies distorting the Single Market, 12 January 2023, available at https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_1984.

17 Commission's document concerning the FSR: Addressing distortions in the Single Market caused by foreign financial contributions, available at https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/europe-fit-digital-age/european-industrial-strategy/foreign-subsidies-regulation_en.

B. Mandatory FSR filing for M&A Deals

The FSR imposes a mandatory and suspensory FSR filing for M&A deals that meet the following criteria:

- **Type of M&A deal:** the transaction qualifies as a "concentration" under the EU Merger Regulation.[18]

- **EU-wide turnover threshold:** if the EU-wide turnover of the target (in case of acquisition), one of the merging parties (in case of merger) or the joint venture itself is at least €500 million in the previous financial year. Under this threshold, there is also a requirement that the above entities be established in the EU. However, establishment in the EU does not equal formal incorporation in the EU. Merging parties, targets or full-function joint ventures may thus be considered established in the EU even if they are not incorporated in the EU, but generate large EU turnover over certain period of time.

- **FFC threshold:** the combined FFCs of all the companies involved in the M&A deal (target included) exceeds €50 million in the three years prior to the signing of the M&A deal. This is a significant additional burden for companies, as they will need to collect and disclose their FFCs, even if they do not qualify as subsidies and have no link to the M&A deal. While all FFCs count towards the €50 million threshold, only certain FFCs will need to be disclosed in the FSR filing (see more details below in Section IV).

The FSR filing obligation for M&A deals starts to apply as of October, 12 2023 for deals signed after July 12, 2023 and that have not closed before October, 12 2023. Pre-notifications can already take place after July 12, 2023. Deals signed prior to July 12, 2023 do not need to be filed.

Akin to merger control, the FSR's preliminary review lasts for 25 working days. The in-depth review lasts for 90 working days, extendable by 15 working days if the companies offer remedies and further extendable by 20 working days in exceptional cases.

C. Mandatory FSR Filing for Public Tenders in the EU

The FSR imposes a mandatory and suspensory FSR filing for public tenders in the EU that meet the following criteria:

- **Type of contracts:** EU Member States' public contracts for works, supply of products or provision of services, as well as concessions, excluding contracts in the field of defense/security, urgency contracts without prior call, as well as contracts that can only be supplied by a particular economic operator.[19] The FSR filing requirement will be specified in the call for the tender.

- **Contract value:** The contract value is equal to or above €250 million, and in cases where the tender is divided into lots, the aggregate value of the lots applied for is equal to or above €125 million; and

- **FFC threshold:** the combined FFCs of the bidding party (including its subsidiaries and/or holdings) and its main subcontractors (or suppliers) exceeds €4 million in the three years prior to the FSR filing.[20] Bidding parties in large tenders in the EU that claim they are under the €4 million FFC threshold will still need to submit a declaration confirming that they are under the said threshold.

The FSR filing obligation for public tenders in the EU starts to apply as of October 12, 2023 for procedures initiated after July 12, 2023 and that have not been awarded before October 12, 2023.

The FSR's preliminary review lasts for 20 working days, extendable by 10 working days. The in-depth review should not last more than 110 working days from complete notification, extendable only once by a further 20 working days in exceptional cases.

18 Article 20, FSR; Article 3, EU Merger Regulation.

19 Article 28(3), (4) and (5), FSR.

20 A subcontractor or supplier shall be deemed to be "main" where their participation ensures key elements of the contract's performance, and in any case where the economic share of their contribution exceeds 20% of the value of the submitted tender; see Article 29(5), FSR.

IV. DISCLOSURE OBLIGATIONS FOR COMPANIES IN THE FSR FILING FORMS

Under Forms FS-CO and FS-PP, companies making an FSR filing must provide a description of the M&A deal/public tender in the EU, information about the parties, the financing of the M&A deal as well as information on the relevant FFCs received in the past three years.[21]

In relation to the FFCs, it is important to note that, all FFCs that companies receive in the three years prior to the signing of the M&A deal/FSR filing for the public tender in the EU count towards the €50/€4 million FFC threshold, which determines whether an FSR filing if required. That said, only the relevant FFCs will need to be disclosed in the FSR filing forms. Specifically:

A. Detailed Disclosure of the Likely Distortive FFCs

A detailed disclosure is required for all FFCs above €1 million that all the parties to the transaction (target included) have received three years prior to the signing of the M&A deal/FSR filing of the tender, if they fall under the "likely distortive" category of FFC, i.e. FFCs that (i) support a failing business; (ii) give unlimited guarantees; (iii) directly facilitates a concentration (only for M&A deals); (iv) is an export financing measure that is not in line with the OECD Arrangement on officially supported export credits;[22] or (v) enables a company to submit an unduly advantageous tender (only for public tenders in the EU).[23]

The detailed disclosure requires providing information on the relevant non-EU country/granting entity, the type of FFCs, amount, purpose, economic rationale, main characteristics, conditions attached to its grant and use, as well as an analysis of whether the FFCs constitute a foreign subsidy. Parties to the transaction are requested to provide all supporting documents relating to the likely distortive FFCs. In addition, the detailed disclosure requires the provision of board documents in relation to analyses, reports, studies, surveys, and any comparable documents discussing the purpose, use and economic rationale of the likely distortive FFCs.

B. General Disclosure of FFCs Exceeding €45/€4 Million Per Non-EU Country Over a 3-Year Period

Forms FS-CO and FS-PP require the notifying part(ies) (excluding the target) to further disclose their other FFCs that do not fall within the "likely distortive" category of FFCs, if these are (i) individually above €1 million, and (ii) in total, above €45/€4 million per non-EU country over a 3-year period for M&A deals/public tenders in the EU, respectively.

Importantly, the following FFCs do not require disclosure and do not count towards the €45/€4 million total:

- Government contracts for the supply/purchase of goods/services (except contracts for financial services) concluded on market terms (e.g. the supply/purchase carried out following a competitive, transparent, and non-discriminatory tender procedure);

- Deferrals of payment of taxes and/or social security contributions, tax holidays and tax amnesties, as well as normal depreciation and loss-carry forward rules that are of general application. If, however, these measures are limited, for example, to certain sectors, regions or (types of) companies, they will need to be disclosed;

- Application of tax relief for the avoidance of double taxation in line with the provisions of bilateral or multilateral agreements for the avoidance of double taxation, excluding, however, unilateral tax reliefs applied under national tax legislation, which will need to be disclosed;

- For M&A deals, Form FS-CO contains a special exemption for investment funds to provide an overview disclosure on a fund-by-fund basis. To benefit from the exemption, the investment fund should fulfill two cumulative criteria:

21 If the M&A deal occurs in the context of a structured bidding process, the notifying part(ies) must also provide a detailed description of the bidding process and provide a description of the profiles of the other bidders that they are aware of.

22 OECD Arrangement on officially supported export credits, July 2023, available at https://one.oecd.org/document/TAD/PG(2023)7/en/pdf.

23 Article 5(1) (a)-(e) of the FSR.

- The fund controlling the acquiring entity is subject to the Directive on Alternative Investment Fund Managers/an equivalent legislation; and

- The economic and commercial transactions (such as sale of assets, including ownership in companies, loans, credit lines or guarantees) between the fund controlling the acquiring entity and other investment funds (and the companies controlled by these funds) managed by the investment company are either not present or limited.

The general disclosure of the FFCs has to be provided in the format requested by the Commission (Table 1 of the adopted Form FS-CO and Form FS-PP), which requires companies to provide details on the relevant third country/granting entity, the type of FFC, a brief description of the FFC's purpose. While not part of Table 1, the companies will also need to collect the FFC's amount and the approximate date of grant, as otherwise it will be difficult to comply with the notification form requirement to quantify the notifiable FFCs for the past three years.

C. FSR Procedure

The Commission's review procedure will follow a two-tier structure: a preliminary review to check if there are sufficient indications that a company has been granted a foreign subsidy that distorts the EU's internal market, followed by an in-depth investigation should that prove to be the case. The Commission can then adopt a no objection, a redressive measure, or a decision prohibiting a merger or the award of the contract. Companies may be requested to offer far-reaching commitments if they want their transactions approved or in order to close the *ex officio* investigation of the Commission.

V. ANALYSIS

The FSR is a novel piece of legislation in terms of its scope. While anti-subsidy cases are well known in the trade world, they are limited to imports of goods from the country executing the subsidizing. With increased interconnectedness globally, and the increase in trade in services, the effectiveness of such trade defense cases has become more limited. The FSR is an attempt to fill the gap – with FSR filings for large M&A deals and public tenders in the EU, in addition to the broad power to investigate any other market situation that causes distortions to the EU's internal market.

It will be interesting to see how the latter power is applied. As it is so broad, it could cover all sectors and a wide range of subsidized economic activity. However, investigating foreign subsidies is complicated – we often see this in the trade and State aid world, where EU anti-subsidy and State aid findings typically run to many dozens of pages. The Commission will need to prioritize the industries and subsidies on which it will focus. The trade defense experience suggests that the impact of subsidies control is typically seen too late – i.e. when the EU industry is already suffering injury. It may also be that there are fewer ex officio cases in the initial period while the FSR filing system for M&A deals and public tenders gets up and running. But, for sure, the time will come when the EU decides to use its shiny new tool.

The mandatory FSR filings are expected to have a fundamental impact on companies doing large M&A deals and public tenders in the EU. That said, companies are used to merger control when doing deals, and the FSR fits into the trend of ever-increasing numbers of filings for deals globally (both FDI and merger control). By contrast, there has never been a system of external approval of a bidder in a public tender, so this is a fundamental change. In addition, the process of notifying the public contracting authority running the tender, which then passes the file to the Commission (DG Grow), is more complicated than in M&A deals, where there is a direct notification to the Commission (DG Competition). The relatively low FFCs threshold for public tenders, €4 million in the three years prior to the FSR filing, is likely to catch most, if not all, bidders for the type of major public tenders subject to an FSR filing.

For M&A deals, the potential impact of the FSR, although likely narrower, is still significant. Narrow in the sense that, for most companies, the FSR will mean an additional notification for major EU deals – but where there is no real risk of the deal being blocked. In essence, it would mean an additional relatively simple and short filing. On the other hand, companies or investment funds receiving funding from non-EU States that intend to acquire major companies established in the EU will need to disclose strategic information. It is likely that the FSR will have a material impact on this relatively narrow category of acquirers, but it is yet to be seen if the risk of the deal being investigated (and possibly blocked) under the FSR will disincentivize such entities from generating M&A deals in the EU.

Finally, given the broad definition of FFCs under the FSR, collecting the data for an FSR notification will not be a simple task. All companies collect revenue data in the normal course of business for their financial reporting, so it is relatively easy to generate turnover data by country to see if a deal meets merger control thresholds. Very few companies systematically collect data on their contracts with States or subsidies they have received – especially not if the subsidies are granted at local or State level rather than at central level. The challenge that companies face to establish systems for the collection of the FSR-relevant data collection is significant and quite burdensome.

As Zhou Enlai famously said about the impact of the French Revolution, it's too early to say. We will need to wait and see how the FSR develops in the coming years.

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