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EU Foreign Subsidies Regime – The Draft Implementing Regulation

Thomas Wilson (Kirkland & Ellis, Belgium) and Sally Evans, Athina Van Melkebeke (Kirkland & Ellis) · Thursday, February 16th, 2023

On 6 February 2023, the European Commission ("EC") published the draft Implementing Regulation and notification forms (together: the "IR") relating to the EU Foreign Subsidies Regulation ("FSR"). The EC has launched a four-week public consultation period that will allow stakeholders to comment; i.e., there may still be changes to the IR. However, it can in any event be expected that preparing the notification form and going through the process will be an involved exercise for parties.

When is the FSR triggered?

As a reminder, broadly speaking, FSR notifications will be required if:

i. the acquirer and / or the target have received combined aggregate foreign financial contributions of >EUR 50 m in the last three years;

ii. the target is established in the EU and generates revenues of >EUR 500 m in the EU; and

iii. the transaction relates to a change of control, a merger or the creation of a full-function joint venture.

The concept of "foreign financial contribution" under the FSR is **extremely broad** — we understand this was a deliberate policy choice. It includes the transfer of funds or liabilities, such as capital injections, grants, loans, loan guarantees, fiscal incentives (e.g., tax breaks) and the provision / purchase of goods or services. There does not have to be a selective benefit for the recipient of the foreign financial contribution. The provision or purchase of goods or services needs to be included as a financial contribution even if this occurs on an arm's length basis (including e.g., ordinary course customer / supplier agreements entered into with public bodies). Furthermore, all financial contributions received by controlled portfolio companies are relevant for the assessment. Financial contributions can be given directly or indirectly by all public and private entities that can be attributed to a non-EU government (e.g., the UK).

In its review, the EC will assess whether (i) the financial contributions are foreign subsidies within the meaning of the FSR, (ii) whether they actually / potentially distort the internal market and (iii) if distortive, whether the negative effect of the foreign subsidy can be outweighed by positive effects (including broader public policy objectives, e.g., environmental or social). Under the FSR

the EC can prohibit transactions or ask for far-reaching redressive measures or commitments by the parties (e.g., divestment of assets, access remedies or market presence reductions).

Process overview

The process set out in the IR is modelled on EU merger control. For example, the EC has similar powers to impose sanctions for failure to notify and for the provision of misleading information.

The FSR entails a statutory review timeline of 25 working days, and an additional 90 working days in case of an in-depth investigation. The 90-working-day period will automatically be extended by another 15 working days if commitments are offered. Both periods will run from the receipt of a complete notification and therefore allow for a pre-notification period to be added to the timeline, as for EU merger control proceedings (during pre-notification a draft notification will be discussed with the EC case team and questions addressed, including information requirements and possible waivers).

What information will need to be provided?

The notification form is largely modelled on the EU Form CO, but with some different information required.

Sources of finance for the transaction (Section 3)

The notification form includes a requirement to list all the sources of finance for the transaction, to identify the debt providers and guarantors, and all persons acquiring equity, as well as equity financing conditions. This wide requirement for funding sources goes significantly beyond information required in the context of EU merger control.

Foreign financial contribution (Section 5)

The key foreign financial contribution disclosures are covered in Section 5. T**he concept remains very broad, there is no list of information that will likely be benign / not relevant and the de minimis exemptions are very limited.** Going beyond the FSR, the IR considers a financial contribution to be granted as of the moment of **legal entitlement to receive a financial contribution** (not the moment it has actually been obtained).

Under Section 5, the parties must name the granting entity, the type / form of financial contribution (e.g., capital injection, tax exemption, whether the financial contribution was the result of a tender procedure), the amount of the financial contribution, the date of granting and the country to which the financial contribution can be attributed. The parties must also disclose whether any conditions are attached to the financial contributions and whether they could fall into any category under which the EC would likely assume a distortive foreign subsidy, e.g., a contribution to an ailing undertaking, export financing or contributions directly facilitating a transaction.

Only the following financial contributions do not have to be reported (Section 5.1):

i. individual contributions that are below EUR 200 k; and

ii. total contributions per third country and per year that are below EUR 4 m.

The parties can — prior to notifying — **ask for a waiver to provide certain information** if the parties give adequate reasons why (i) the information is not reasonably available and provide best estimates for the missing data or (ii) the information is not necessary for the examination of the case.

There is no express exclusion for contributions made by LP investors into PE funds. Such investments are arguably expected to count as relevant financial contributions to be taken into account towards the reportable thresholds in Section 5.1.

Information relating to the impact of the foreign financial contribution (Section 6)

The EC will require information about bidding processes as part of its assessment whether a bid by a subsidized bidder could lead to competitive distortions. This is a significant disclosure requirement and this type of information on alternative bidders would usually only be shared in the most difficult of Phase II antitrust reviews. **The information will have to be provided by the seller / target (even though the notification is made by the acquirer) and will be highly confidential / sensitive. Sellers may be reluctant to share some of this information with the EC. It is also unclear how the EC will interpret the data provided.**

The following information will need to be provided (Sections 6.1., 6.3):

– Detailed description about the bidding process;
– Indication of the number of candidates that were contacted;
– Indication of the number of candidates who expressed an interest;
– A description of the profile of bidders (e.g., industrial or PE); and
– Number of letters of intent and non-binding offers received and how many and which bidders withdrew when; and
– Contact details of all other undertakings who expressed an interest in the acquisition.

Section 6.2 requires a description of the due diligence carried out as well as all corresponding due diligence reports or equivalent documents prepared by external parties assessing the transaction from a strategic, legal, economic or tax perspective, including documents discussing the value of the transaction.

Section 6.6 requires a description as to whether and how the financial contribution is liable to improve (directly or indirectly) the acquirer / target's competitive position in the internal market (with reference to the nature, amount and use or purpose of the financial contribution as well as to how that use or purpose would have been financed absent the contribution).

Contact details of the target's five largest competitors in the EU as well as contact details of all competitors mentioned in merger control filings (either at EU or Member State level) must be provided (Sections 6.10/6.11).

Conclusions

The FSR will be relevant for companies investing in the EU going forward. It is possible that deals will have to be notified for merger control, FDI and now also under the FSR. Whilst only acquisitions of larger targets will be caught by the FSR thresholds, those that are look set to face far-reaching information requirements under the IR.

Given that information relating to foreign financial contributions may not be readily available, companies and sponsors who regularly engage in M&A of targets active in the EU may need to start collecting the relevant information now in order to be ready for October.

Particularly big “headaches” will be the information that will need to be provided relating to transactions’ financing arrangements and bidding processes. Acquirers and sellers will often be very reluctant to provide this type of information, even if it is on a confidential basis to an authority. In some instances, sellers may consider choosing another bidder whose bid will not trigger an FSR filing with the objective to avoid far-reaching information disclosures.

EC officials have said that the number of transactions notifiable under the FSR are anticipated to be in the “double-digit numbers”. This would mean significantly fewer FSR notifications than EU merger filings (which are ~350-400 p.a.). We see this as a potential indication that the EC is effectively willing to accept further limitations to the disclosure requirements through feedback provided in the consultation and will aim to apply the regime in a targeted manner, (hopefully) focusing on those cases with substantive issues (rather than creating a “red tape” regime that dis-incentivizes investment into the EU).

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