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The EU Foreign Subsidies Regulation: What Antitrust Lawyers Should Know About the New Instrument

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The EU Foreign Subsidies Regulation ("FSR")[1] entered into force on January 12, 2023, and applies from July 12, 2023 onward. It introduces a new regulatory regime that allows the European Commission ("Commission") to investigate subsidies granted by non-EU countries to companies active in the European Union. For this purpose, companies will be, inter alia, required to notify certain M&A deals and may not implement such deals until they receive the Commission's clearance. If the Commission concludes that the deal involves foreign subsidies that distort the internal EU market, it may ultimately prohibit the transaction unless the parties propose commitments to remedy the identified distortions.

The new rules under the FSR will have significant consequences for companies active both inside and outside of the European Union and should form an important part of parties' planning of M&A deals. However, companies are, at this stage, exposed to significant legal uncertainty since important accompanying texts—such as the implementing regulation clarifying procedural aspects,[2] or guidelines on the substantive assessment of foreign subsidies—have either not yet been published by the Commission or are not yet available in final form.

The backdrop to the new FSR is the widespread perception that some foreign companies that are active in the European Union benefit from massive financial support from their governments. The typical example would be a Chinese company that buys European players with the help of Chinese state funding or which undercuts its European rivals by submitting subsidized bids in large-scale public tender proceedings.[3] It should be recalled in this context that EU Member States are not allowed to subsidize companies as they deem fit. Rather, to avoid a "subsidy race" and a distortion of competition resulting from state funding, EU Member States are generally prohibited from granting subsidies to individual companies or industries and may only do so within the strict boundaries of EU State Aid law.[4] Without control of subsidies granted by non-EU countries, the EU State Aid rules could thus put EU-based companies at a disadvantage vis-à-vis

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[1] European Parliament and Council Regulation No. 2022/2560, 2022 O.J. (L 330) 1, 45 (on foreign subsidies distorting the internal market) [hereinafter FSR].

[2] Draft Commission 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, including Annex 1 and 2, Ref. Ares (2023) 842946 (Feb. 6 2023), https://ec.europa.eu/commission/presscorner/detail/en/IP_23_591 [hereinafter Draft Commission Implementing Regulation].

[3] Even though the FSR does not explicitly mention China, it seems clear that China has been the primary trigger for the adoption of the new instrument. See Eur. Comm'n, *Commission Staff Working Document -Impact Assessment Accompanying the Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market*, SWD (2021) 99 final (May 5, 2021) [hereinafter Impact Assessment], which mentions China at least 176 times.

[4] Consolidated Version of the Treaty on the Functioning of the European Union art. 107 et seq, 2012 O.J. (C 326) 47 [hereinafter TFEU].

their foreign competitors. The FSR is intended to address this problem by closing the perceived "regulatory gap" in order to ensure a level playing field among all economic operators active in the internal market.[5]

The FSR constitutes a mix of traditional merger control, state aid law, and public procurement rules. It provides the Commission with three new tools to take action against distortive subsidies:

- First, a notification-based tool to investigate certain M&A transactions;[6]
- Second, another notification-based review procedure for bids in certain public procurement procedures;[7] and
- Third, an ex officio instrument which will allow the Commission to investigate all other market situations at its own initiative, including non-notifiable M&A transactions.[8]

For M&A transactions, the new filing requirement[9] is certainly the most relevant instrument. However, the ex officio instrument[10] also needs to be taken into account when drafting and negotiating M&A contracts.

In terms of timing, most of the new rules will apply beginning July 12, 2023.[11] The new filing requirements and standstill obligations will start applying only three months later, i.e., beginning October 12, 2023.[12] However, the FSR does not cover only subsidies that are granted after the law comes into effect. Rather, the Commission will be able to scrutinize foreign subsidies granted three to five years prior to the date of application of the FSR.[13]

A failure to notify or to respect the standstill obligation can be sanctioned with substantial financial penalties, with fines theoretically reaching up to 10% of the aggregate global revenues of the companies involved.

Overview of the new "merger control" regime

M&A transactions that qualify as "notifiable concentrations" (discussed *infra*) or that are subject to an ad hoc filing request of the Commission may not be closed before the Commission has concluded its foreign subsidies review.[14] A failure to notify or to respect the standstill obligation can be sanctioned with substantial financial penalties, with fines theoretically reaching up to 10% of the aggregate global revenues of the companies involved.[15]

Notifiable concentrations. The threshold-based notification obligation (and the corresponding standstill obligation) applies to M&A transactions that meet the following five cumulative criteria:

(1) Timing: The notification requirement applies starting from October 12, 2023 and covers all transactions signed on or after July 12, 2023 and not yet closed on October 12, 2023.[16]

(2) Type of transaction: Similar to the EU Merger Regulation ("EUMR"),[17] the new filing requirement only applies to transactions involving a change of control on a lasting basis and the

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[5] FSR, *supra* note 1, recitals 1-6.

[6] *Id.* arts. 19 et seq.

[7] *Id.*, arts. 27 et seq.

[8] *Id.* arts. 9 et seq.

[9] *Id.* arts.19 et seq.

[10] *Id.* arts. 9 et seq.

[11] *Id.* art. 54(2).

[12] *Id.* art. 54(4).

[13] *Id.* art. 53(1).

[14] *Id.* art.24(1).

[15] *Id.* art. 26(3).

[16] *Id.* arts.53(3), 54(4).

[17] Council Regulation No. 139/2004, 2004 O.J. (L 24) 1, 22 (on the control of concentrations between undertakings).

creation of full-function joint ventures (so-called "concentrations").[18] Consequently, the new filing requirement covers true "mergers," direct or indirect acquisitions of sole or joint control in pre-existing undertakings, and the establishment of joint ventures ("JVs"), including "greenfield JVs", qualifying as "full function" (i.e. performing on a lasting basis all the functions of an autonomous economic entity). By contrast, the acquisition of non-controlling minority shareholdings or the creation of a non-full function JV is not subject to the notification requirement. The term concentration will be interpreted in the same way as under the EUMR.[19]

(3) Geographical scope of transaction: In order to qualify as a notifiable transaction, the acquired undertaking, the JV or—in case of a merger—one of the merging undertakings must be established in the European Union.[20] "Established in the European Union" includes any form of permanent business establishment in the European Union (for example the incorporation of a subsidiary). Hence, if none of the target group companies is established within the European Union, or if a JV is incorporated outside the European Union and has no subsidiary or other permanent business presence in the European Union, a transaction will not be captured by the new rules (even if the seller, purchaser, or, in case of a JV, the JV's parent companies, have a permanent presence in the European Union).

(4) EU turnover threshold: The acquired undertaking (including its subsidiaries), the JV (including its subsidiaries), or—in case of a true merger—at least one of the merging undertakings (including its subsidiaries) have generated an aggregate turnover in the European Union exceeding EUR 500 million in the last financial year.[21] Unlike under the EUMR, the turnover generated by the acquirer and, in case of a JV, the revenues generated by the JV's parent companies are not relevant in this context *(e contrario)*.[22]

(5) Third-country financial contribution threshold: The acquirer group and the acquired undertaking (including its direct and indirect subsidiaries)/the JV and its (controlling) parent companies/the merging undertakings have been granted combined (aggregate) third-country financial contributions ("TCFCs") exceeding EUR 50 million in the three financial years prior to the transaction.[23] Importantly, the concept of TCFCs is not limited to actual subsidies, but covers all kinds of business relationships with the "public sector" of non-EU countries in the broadest sense (discussed further *infra*).

Notably, there are no restrictions on or exceptions for specific economic sectors or for certain non-EU countries.[24] Hence, even transactions in which only EU-based companies are involved are covered if the filing thresholds are met.

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[18] FSR, *supra* note 1, art.20(1).

[19] *Id.* recital 9. For further guidance on the notion of "concentration", see Eur. Comm'n, Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004, 2004, O.J. (C 95) 1, 48 (on the control of concentrations between undertakings).

[20] *Id.* art. 20(3)(a).

[21] *Id.* art. 20(3)(a).

[22] *Id.* art. 20(3)(b).

[23] *Id.* art. 20(3)(b).

[24] The only potential exception is FSR, art. 44(9) which provides that the Commission is prevented from carrying out investigations or taking measures that would be contrary to the EU's obligations emanating from any relevant international agreement it has entered into. It remains to be seen to what extent this exemption will become practically relevant in the future.

[I]t can be expected that a significant number of transactions involving the acquisition of companies with permanent presence in the European Union will be caught by the new notification regime.

Given the relatively limited thresholds for the EU turnover of the target company group and for the aggregate TCFCs from non-EU countries across the globe, it can be expected that a significant number of transactions involving the acquisition of companies with permanent presence in the European Union will be caught by the new notification regime.

The (questionable) concept of "third-country financial contributions." While most of the five criteria set out above are relatively straightforward or at least familiar from the EUMR, the TCFC concept is not only new but also very broad. Both the term "financial contribution" and the imputability of the measure to a "third country" are defined in vague terms.[25] The concept essentially covers all financial relationships with the public sector of third countries.

In order to qualify as a "third-country" contribution, it is sufficient that the measure can be attributed directly or indirectly to a public authority of a non-EU country (e.g. central or federal governments, but also authorities at regional or local levels such as local municipalities).[26] In addition to public authorities, public entities (in particular stated-owned enterprises, e.g. public banks in non-EU countries) and potentially even private entities are covered, provided that their actions can be attributed to a non-EU state, taking into account all relevant circumstances.[27] It is likely that this criterion will be interpreted broadly, especially when it comes to state-owned enterprises. In this sense the application of this criterion may resemble the Commission's approach when assessing "imputability" of a measure to an EU Member State when applying EU State Aid law.[28]

The notion of "financial contribution" also includes a very wide set of measures. It encompasses not only "traditional" subsidies, but also (i) any transfer of funds or liabilities, (ii) the foregoing of revenue that is otherwise due, and even (iii) the mere provision or purchase of goods or services.[29] It is irrelevant whether the TCFC involves any subsidy element (i.e., whether a selective advantage is granted that is not in line with market terms) or whether it was actually granted in the context of the transaction.[30]

Accordingly, the concept of TCFC covers any kind of financial value stemming from public resources of non-EU countries in the broadest sense. In addition to public grants, it also includes measures such as state guarantees, tax benefits, the lease of land, the foregoing of revenues (e.g. tax waivers) and, ultimately, any kind of business involving the public sector in a third country. If, for example, a German or U.S. company purchases electricity from a municipal energy supplier in South Africa, the energy purchase will be considered as a TCFC even if it was fully remunerated by the company concerned. Similarly, the purchase price a Spanish company receives for the sale of products to a Japanese state-owned enterprise will constitute a TCFC even if the price paid by the

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[25] The (overly) broad scope of the TCFC-concept had been criticized already during the legislative process - unfortunately to no avail (*see, e.g.,* ESALA, Response of the EU State Aid Law Association to the Commission Consultation on the proposal for a regulation of the European Parliament and the Council on foreign subsidies distorting the internal market ("ESALA response"), at paras. 1.8 et seq, https://www.esala.eu/wp-content/uploads/2021/08/ESALA-submission-Foreign-Subsidies-Proposal-final-20210722.pdf; *see* also Christian von Köckritz & Harald Weiß, *"Merger control meets State aid law"—Der Vorschlag der Kommission für eine Verordnung über wettbewerbsverzerrende Subventionen aus Drittstaaten*, *in* Festgabe Für Rainer Bechtold Zum 80. Geburtstag, 2021, 165, 169 et seq. (Sozietät Gleiss Lutz ed., 2021); Ulrich Soltész, *"Game changer" für die M&A-Praxis: Die Verordnung über Drittstaatensubventionen*, 425, 426 (NZKart ed., 2022).

[26] FSR, *supra* note 1, art. 3(3).

[27] *Id.* arts. 3(3)(b) and (c).

[28] *See* Eur. Comm'n, Notice O.J. (C 262) 1, 50 (on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union [hereinafter Notice on Aid], section 3 (paras. 38 et seq.)

[29] FSR, *supra* note 1, art. 3(2).

[30] *E contrario* FSR, *supra* note 1, arts. 3(1) 5(1)(e). *See* also FSR, *supra* note 1, recitals 11 et seq.

Japanese purchaser was extremely low. Whether the product, service or consideration is provided on an arm's length basis, i.e. in line with market terms, does not matter in terms of assessment of the filing requirement and the calculation of the value of TCFCs. While the FSR does not specify how the value of individual TCFCs should be calculated, it is likely that the Commission will look at the full value of the financial benefit received from entities attributable to a foreign state, regardless of any consideration paid by the receiving company.

The impact of the EUR 50 million TCFC threshold will thus be very limited, in particular because the threshold is based on the aggregate amount, meaning that all TCFCs received by the parties' corporate groups worldwide over the last three years will have to be added together.[31] Consequently, not only the specific companies involved in the deal need to be taken into account, but the acquirer's entire corporate group, as well as the target and all its subsidiaries worldwide.[32] In case of a JV, the entire corporate groups of the JV's controlling parent companies will have to be taken into account as well. There are no exemptions or allowances for certain types of investors, such as private equity ("PE") investors. Consequently, PE firms may have to consider all financial contributions received by portfolio companies in which they directly or indirectly hold a shareholding conferring sole or joint control (as well as all subsidiaries solely or jointly controlled by such portfolio companies). Identifying and tracking such contributions can be expected to be burdensome. It remains to be seen whether the Commission will be able (and willing) to alleviate this burden in cases that are substantively unproblematic. Unfortunately, however, the scope for the Commission to make such allowances appears relatively limited given the impractical legal framework of the FSR.

No safe harbor for transactions below the filing thresholds. There are two important devices provided for under the FSR which effectively extend the reach of the filing regime to transactions which do not meet the filing thresholds set out in the FSR.

First, the Commission can, at its own initiative, request the notification of concentrations that do not meet the filing thresholds as long as the relevant deal has not yet closed.[33] Such transactions will then be treated as notifiable transactions and will also be subject to a standstill obligation. The Commission can thus use this instrument in order to review certain transactions that do not meet the filing thresholds, but which likely involve foreign subsidies, and to prevent or stop the implementation of such deals pending the Commission's review.

Second, the Commission can use even wider general ex officio powers[34] in order to conduct an ad hoc investigation of any transaction that is not covered by the notification-based merger review–potentially even a long time after a transaction has been implemented.[35] The general ex officio instrument is supposed to serve as a catch-all instrument for distortions in the internal market linked with foreign subsidies. The Commission can thus apply this second tool to any kind of transaction, irrespective of whether it involves a concentration or not (including, for instance, the acquisition of non-controlling minority shareholdings or the creation of non-full function JVs), and even after closing has taken place. Hence, this second tool can be used in order to review potentially problematic transactions that do not qualify as "concentrations," or in cases where

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[31] FSR, *supra* note 1, art. 20(3)(b), 23.

[32] On the sell side, only the target and its direct and indirect sole or jointly controlled subsidiaries need to be taken into account, but not other parts of the seller's corporate group (*see,* FSR, *supra* note 1, arts. 23 and 22(2)).

[33] FSR, *supra* note 1, art. 20(5).

[34] *Id.* arts. 9 et seq.

[35] *See Id.* recitals 25, 36.

The FSR's aim to ensure that virtually no transaction escapes the Commission's radar obviously comes at a high price for transaction security.

the Commission only obtains knowledge of a potentially problematic "concentration" after its implementation.

It is still unclear how actively the Commission will make use of these ad hoc powers. It can, nonetheless, be assumed that other market participants, such as unsuccessful bidders, will attempt to use these tools as weapons for their own purposes, notably by filing complaints to the Commission and pushing the authority to intervene. The FSR's aim to ensure that virtually no transaction escapes the Commission's radar obviously comes at a high price for transaction security.

Substantive Test

Pursuant to Article 19 FSR, the Commission's investigation will assess whether a "foreign subsidy in a concentration distorts the internal market." This assessment "shall be limited to the concentration concerned," at least in the notification-based subsidy control proceedings (no similar limitation is foreseen for the general ex officio instrument).

It is not entirely clear how this will play out in practice. However it seems likely that the Commission will primarily assess whether a notifiable transaction was directly supported by foreign subsidies (leading to a "distortion of the acquisition process"),[36] or whether the transaction allows a heavily subsidized foreign undertaking to enter or expand its presence in the internal market. Such scenarios typically indicate that competition in the relevant markets in the EEA may be distorted due to subsidies granted to the activities of the undertakings involved in the transaction ("distortions resulting from the acquisition").

The Commission's assessment of foreign financial contributions will involve several steps.

Existence of a foreign subsidy. In a first step, the Commission will have to assess whether one or more of the TCFCs granted to the relevant undertakings involved in a concentration indeed qualify as "foreign subsidies" within the meaning of Article 3(1) FSR. According to this provision, foreign subsidies shall be deemed to exist where a financial contribution of a third country (i) confers a "benefit" to an undertaking engaging in an economic activity in the internal market; and (ii) is "selective," i.e., limited to one or more specific undertakings or industries.[37]

These notions are very similar to the well-established concepts of "advantage" and "selectivity" under EU State Aid law[38] and will in all likelihood be interpreted consistent with the case law and Commission's practice on these EU State Aid law concepts.[39] Broadly speaking, this means that a "foreign subsidy" will be deemed to exist if a specific undertaking or a specific industry obtains a financial contribution from foreign state resources (or resources attributable to a foreign state) at terms that the undertaking could not have obtained from private actors on the market and if this financial contribution is not made available to all other undertakings or industries in a similar situation. In addition to public grants, state guarantees or loss compensation payments, this may also cover a multitude of other measures such as tax reductions or tax incentives (including, potentially,

[36] FSR Article 5(1)(d) states that such "subsidies directly facilitating a concentration" are one category of the kinds of subsidies that are "most likely to distort the internal market."

[37] See also FSR, *supra* note 1, recitals 11 et seq.

[38] Notice on Aid, *supra* note 28, sections 4 (paras 66 et seq.) and 5 (paras 117 et seq.).

[39] FSR recital 9.

tax credits under the U.S. Inflation Reduction Act),[40] the transfer of staff, the lease of land, or the sale of a public shareholding. In addition, aid measures or subsidies can also be hidden in indirect measures, and—as far as publicly owned companies are concerned—even in intra-group measures (i.e., measures taken by one entity within a corporate group controlled by public authorities for the benefit of another entity of the same corporate group).

Nexus between foreign subsidy and the notified concentration. The wording of Article 19 FSR suggests that the notification-based concentration control proceedings only relate to "foreign subsidies "*in a concentration*," i.e., there must be some specific nexus between an identified subsidy and the notifiable transaction. Such a nexus will be easy to identify insofar as subsidies directly supporting an acquisition are concerned, but it is not yet clear how far the Commission will stretch this notion beyond such relatively clear-cut cases.

It seems likely that the Commission will take a broad approach and would deem any identifiable direct or indirect link between the foreign subsidy and the concentration as being sufficient for the purposes of establishing sufficient nexus. For example, the Commission might argue that a significant tax reduction granted to an acquirer in a third country had the effect of freeing up additional financial resources that could be used for a notifiable acquisition project. Hence, it is unlikely that the limitation of the assessment to foreign subsidies "in a concentration" will significantly limit the scope of the Commission's review.

Distortive effect. If a TCFC constitutes a foreign subsidy, the Commission will further assess whether this subsidy "distorts the internal market." Article 4(1) FSR specifies that a distortion in the internal market exists "*where a foreign subsidy is likely to improve the competitive position of the undertaking concerned in the internal market and, in doing so, actually or potentially negatively affects competition in the internal market.*"

Contrary to EU State Aid law, there is (of course) no general prohibition of foreign subsidies, and there is also no general presumption that foreign subsidies actually distort the internal market. Consequently, an actual or potential "distortion" has to be positively established by the Commission. Unlike under EU merger control, however, there is no "significance threshold" for the required effect on competition.

Article 4(1) contains a non-exhaustive list of indicators that the Commission should take into account in its assessment of a potential "distortive effect." This list includes indicators such as the amount and nature of the subsidy, the economic and competitive situation of the undertaking and the markets concerned, the purpose and conditions attached to the foreign subsidy as well as its use on the internal market. This list leaves the Commission a large margin of discretion and makes it difficult for companies to predict the outcome of the Commission's assessment in a specific case.[41]

The FSR specifies certain categories of foreign subsidies that will "most likely" be deemed to distort the internal market.[42] This category includes foreign subsidies granted to an ailing undertaking in the absence of a viable restructuring plan; unlimited guarantees for debts/liabilities of beneficiary undertakings; export financing measures that are not in line with the OECD Arrange-

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[40] See also the (elusive) answer given by the Commission's Executive Vice-President Vestager to a parliamentary question asking about the relationship between the FSR and the U.S. Inflation Reduction Act (*see* Eur. Parliament, Answer given by Executive Vice-President Vestager on behalf of the European Commission (March 23, 2023) (P-000441/2023(ASW)), https://www.europarl.europa.eu/doceo/document/P-9-2023-000441-ASW_EN.html).

[41] *See supra* note 25, para. 1.11 of the ESALA response.

[42] *Id.* art. 5.

ment on officially supported export credits;[43] and subsidies directly facilitating a concentration or the submission of an "unduly advantageous tender" that would enable the undertaking concerned to win a public contract.

On the other hand, the FSR also clarifies that certain types of foreign subsidy should benefit from more benevolent treatment.[44] A foreign subsidy will not be considered to distort the internal market if its total amount does not exceed a de minimis threshold defined in the Regulation on de minimis aid[45]– i.e. EUR 200,000—per third country, over any consecutive period of three financial years. In addition, a foreign subsidy is unlikely to distort the internal market if it does not amount to more than EUR 4 million over any consecutive period of three financial years.[46] Finally, a foreign subsidy may be considered not to distort the internal market if it is intended to remediate damage caused by natural disasters or exceptional occurrences. Unfortunately, however, only the de minimis threshold of EUR 200,000 constitutes a real safe harbor providing protection against a finding of a distortive effect in individual cases. The EUR 4 million threshold set out in Article 4(2) does not provide comparable comfort: for example, it is likely that even a foreign subsidy amounting to less than EUR 4 million could be considered to be distortive if the relevant subsidy falls within one of the subsidy categories considered to be "most distortive" pursuant to Article 5 FSR (e.g., a subsidy directly facilitating a concentration).

Further guidance on the Commission's assessment of "distortive effects" is not available at present but is expected to be published in the course of next year. However, the Commission emphasizes that EU State Aid law will serve as a benchmark for its assessment of foreign subsidies.[47] This suggests that a subsidy will not be considered to have a distortive effect if the subsidy in question could also have been granted by EU Member States under EU State Aid law. This certainly makes sense in light of the FSR's aim to avoid discrimination against non-EU companies. But it is difficult to see how this will work in practice, in particular as far as concentrations are concerned as the various Regulations and guidance documents setting out the conditions of permissible State aid measures are very detailed and difficult to comply with, and they typically do not contain provisions specifically addressing aid measures facilitating M&A-transactions.

Balancing test. If the Commission finds that a foreign subsidy distorts the internal market, it will further assess whether the distortive effects may be counterbalanced or outweighed by positive effects "on the development of the relevant subsidized economic activity on the internal market

[43] The text of this instrument can be downloaded at: http://www.oecd.org/tad/xcred/theexportcreditsarrangementtext.htm. The general aim of the OECD Arrangement is to provide a framework for the orderly use of officially supported export credits. In particular, the OECD Arrangement puts limitations on the financing terms and conditions (such as repayment terms, minimum premium rate, minimum interest rates) to be applied when providing officially supported export credits.

[44] FSR, *supra* note 1, arts. 4(2)-(4).

[45] Eur. Comm'n Regulation No. **1407/2013** O.J. (L352) 1, 8 (on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid).

[46] In contrast to the calculation of the TCFC-value for the assessment of the filing requirements, the values contained in FSR Articles 4(2) and (3) only relate to the "subsidy element," i.e., the financial benefit received by an undertaking without adequate consideration. By way of an example, assume a company purchases raw materials worth EUR 5 million from a state-controlled entity in China for a consideration of EUR 4.5 million. In that case, the TCFC would be valued at EUR 5 million (and this value would have to be taken into account for the purpose of assessing the filing requirement of a concentration), while the subsidy element would only be EUR 500,000 and thus remain below the EUR 4 million threshold (with the result that the subsidy would be considered as "unlikely" to distort the internal market).

[47] See, for example, FSR, *supra* note 1, recital 9.

It is likely that the Commission will want to use the balancing test and its power to request commitments in order to shape foreign subsidies and subsidized activities in a way that would ensure the equal treatment of recipients of foreign subsidies and recipients of State Aid granted by EU Member States.

while considering other positive effects of the foreign subsidy such as broader positive effects in relation to the relevant policy objectives, in particular those of the Union."[48]

Regrettably, the FSR does not contain any guidance as to how the balancing test will be applied in practice. The wording suggests that potential positive effects on the subsidized "economic activity" can only be taken into account to the extent that these effects actually materialize in the EU internal market, while other positive effects and contributions to the EU's policy objectives (such as combating climate change and promoting the green economy) are also relevant if they occur outside the EU. Nevertheless, the lack of any more precise criteria for the exercise of the balancing test leaves the Commission with almost unlimited discretion in identifying and weighing the potential negative and positive effects of a foreign subsidy.

It is likely that the Commission will want to use the balancing test and its power to request commitments in order to shape foreign subsidies and subsidized activities in a way that would ensure the equal treatment of recipients of foreign subsidies and recipients of State Aid granted by EU Member States. However, this is not guaranteed and there remains a significant risk that foreign subsidies and their recipients may be held to stricter standards than those applicable under EU State Aid law.[49]

Commitments and prohibition decisions

If the balancing test leads to a negative result, the Commission will prohibit the deal unless the parties offer commitments that fully and effectively remedy the identified distortion in the internal market.[50]

According to the list in Article 7(4) FSR, suitable commitments may consist, inter alia, of the following: (a) offering FRAND access to infrastructures acquired or supported by the foreign subsidies; (b) reducing capacity or market presence; (c) refraining from certain investments; (d) licensing on FRAND terms of assets acquired or developed with the help of foreign subsidies; (e) publishing the results of research and development efforts; (f) divesting certain assets; (g) dissolving the concentration; (h) repaying the foreign subsidy, including an appropriate interest rate, provided that the Commission can ascertain that the repayment is transparent, verifiable and effective while taking into account the risk of circumvention; and (i) adapting the undertaking's governance structure.

Commitments will have to be tailored to the issues identified in the case at hand, and they may have to be aligned with potential commitments in "ordinary" merger control proceedings that may have to be conducted in parallel. Based on the way in which the EU merger control regime has been enforced, it can be expected that the Commission will adopt a relatively strict stance on the suitability of proposed commitments to remedy any concerns that may have been identified.

Procedural aspects

Merger review process. The FSR procedure for notifiable transactions is closely modeled on merger control procedure under the EUMR.

Once the companies to a relevant transaction have formally notified, there will be a preliminary investigation ("Phase I") lasting up to 25 working days, potentially followed by an in-depth

[48] FSR, *supra* note 1, art. 6(1).

[49] In that sense, see also *supra* note 25, paras. 2.1 et seq. of the ESALA response.

[50] FSR, *supra* note 1, art. 25(3).

investigation ("Phase II"), lasting up to an additional 90 working days (with possible extensions upon request and in case of submission of a commitment proposals).[51] In addition, there will be an informal pre-notification stage prior to the submission of a formal notification, which–just as in EU merger control cases–may take several weeks or even months in complex cases.

While these timelines and procedural steps are almost identical to those of EU merger control proceedings, it must be stressed again that the FSR proceedings will be separate proceedings that are run independently from merger control proceedings (and most likely even by different case teams/units within the Commission). As a result, even if notifications under the FSR and the EUMR can be aligned and filed at the same time, there is a significant risk of diverging timelines for the completion of both proceedings.

The investigation measures that will be at the Commission's disposal[52] are also largely inspired by the powers available to the Commission under the EUMR. The Commission may send requests for information, conduct on-site inspections, "stop the clock" in case of a failure to respond to certain requests for information, etc. The FSR provides, however, for a significant lowering of the Commission's burden of proof in situations where the undertaking under investigation and/or the third country concerned fails to cooperate with the Commission, for example by failing to provide requested information. Article 16 FSR states that, in case of non-cooperation, the Commission can take decisions "on the basis of the facts available" and states that, in such a case, "the result of the procedure may be less favorable to the undertaking than if it had cooperated." It remains to be seen whether this threat will really incentivize foreign companies and governments to cooperate with the Commission.

Notification form. The Commission will have to adopt an implementing regulation setting out detailed procedural rules for the Commission's proceedings, including notification forms, by the time that the FSR becomes enforceable (July 2023 at the latest). A draft implementing regulation was published by the Commission on February 6, 2023 and was open for comment until March 6, 2023.[53] The text of the draft implementing regulation contains a version of the notification form that companies will have to complete and submit when filing a concentration.

Although there is some overlap with the notification forms under the EUMR as to the type of information required (such as deal rationale, information on the parties, etc.), a substantial amount of additional information needs to be provided in the FSR notification form.

First, Section 3 of the draft notification form requires the notifying parties (typically the acquirer) to disclose all sources of finance used for the funding of the transaction, including detailed information on debt and equity financing measures employed. This information should allow the Commission to detect the involvement of state-controlled entities in the funding of the transaction and allow for a first screening for unusually advantageous financing arrangements.

Second, and most significantly, the current draft notification form requires the notifying parties to disclose extensive information on TCFCs that they have received over the past three years. The draft notification form provides a detailed template to be filled in line by line for each financial contribution, listing the receiving entity, the granting authority, type of financial contribution, amount, date, conditions for the financing, etc. Given that the notion of TCFC is very broad and includes many types of measures that ultimately may not qualify as subsidies, this exercise will require

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[51] See *Id.* arts. 24(1), (4) and (5).

[52] *Id.* arts. 13 et seq.

[53] Draft Commission Implementing Regulation, including Annex 1 and 2, *supra* note 2.

companies to implement sophisticated internal tracking tools to monitor, collect, and compile all the relevant information on financial contributions, on a group-wide basis.

The draft form provides only for (very) limited exceptions: individual financial contributions do not have to be reflected in the notification form if they do not reach the de minimis threshold of EUR 200,000, or if the total amount of all financial contributions received by the undertakings concerned in a given third country and a given year remain below EUR 4 million. In addition, the notifying parties have the option to submit reasoned requests for a waiver of the requirement to provide certain information that "is not necessary for the examination of the notification" and/or that is not "reasonably available" to them.[54] While all of this may lessen the burden of providing information to the Commission to some extent, it does not significantly reduce the workload for the undertakings concerned, since even TCFCs below the values indicated above will still have to be tracked in order to establish whether the EUR 50 million TCFC threshold is met and a filing is required.

Another example of new information necessary under the current draft form is that, in case the "concentration occurs in the context of a structured bidding process," the parties have to provide, inter alia, details on how many other candidates were contacted, which candidates expressed an interest or submitted an offer, the profile of each candidate, which bidders withdrew at what stage of the process, whether an advisor assisted the notifying party, copies of all due diligence reports, the contact details of all other candidates, etc. Requesting such information from the notifying party (i.e. the successful bidder) does not seem to make much sense, given that such information will typically not be available to the bidder (but only to the seller who may be reluctant or even barred by confidentiality obligations from disclosing such information to the successful bidder). This information would thus be an obvious candidate for a waiver request unless the transaction documentation ensures that the seller can provide this information to the notifying party on an outside counsel only-basis for the purpose of preparing the notification.

These examples show that notifications under the FSR will place an enormous burden on notifying parties. It is therefore not surprising that the feedback from stakeholders on the draft implementing regulation was extremely negative across the board, stating inter alia that the new rules put an "extraordinarily burdensome workload both on affected companies as well as on the Commission" and that "the uncertainties surrounding the concept of financial contributions are simply unacceptable."[55]

In light of this adverse feedback, there is still some hope that the Commission may substantially revise the draft implementing regulation and the notification forms. It has been reported that there are concrete plans within the Commission to no longer request companies to provide, in the merger filing form, information on TCFCs (i) stemming from transactions regarding the provision of goods or services or the purchase of goods or services at market terms, (ii) resulting from non-selective tax advantages, or (iii) not exceeding certain thresholds, which would be significantly higher than the thresholds currently foreseen in the draft notification forms.[56] Such amendments would alleviate the administrative burden on companies and would constitute an important step in the direction of a more focused application of the FSR. However, for full clarity, companies will have to wait for the final version of the implementing regulation.

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[54] Draft Commission Implementing Regulation, *supra* note 2, section E of Annex 1.

[55] The feedback has been published on the website of the Commission, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13602-Distortive-foreign-subsidies-procedural-rules-for-assessing-them_en.

[56] Tono Gil and Lewis Croft and Nicholas Hirst, *Companies face looser 'contribution' threshold under the foreign-subsidies regulation, new draft implementing rules show*, MLex (24 May 2023).

Another ray of hope in the medium term is that, according to statements by Commission officials at various public events, the Commission aims to introduce a simplified procedure for unproblematic cases.[57] Unfortunately, however, this "light" version of the notification process will in all likelihood not be available from the beginning of the application of the FSR, but only once the authority has reviewed a sufficient number of FSR cases and gained a certain level of practical experience in this area.

Conclusion and Future Outlook

There is no question that the FSR will lead to significantly more red tape for a significant number of companies doing business or willing to invest in the EU.

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At this stage, almost all elements of the substantive assessment to be carried out by the Commission under the FSR remain largely unclear and require further clarification. The Commission has committed to provide initial guidance regarding the concept of a distortion on the internal market and the application of the balancing test at the latest 12 months after the date of application, i.e. by mid-2024. Until any such guidance is issued and enters into force to bind the Commission in the exercise of its discretion, companies active in the European Union and benefitting from foreign subsidies (or companies acquiring EU-based recipients of such subsidies) will be exposed to significant legal uncertainty when investing in the European Union.

The notification procedure for planned acquisitions will be costly and time-consuming. The new system is to run in parallel to merger control regimes at EU and national level as well as national trade and investment control rules . The standstill obligations, the risk of diverging timelines, as well as all other potential risks and uncertainties–including the possibility of ex officio investigations in cases in which the notification thresholds are not met, potentially even after closing–will all have to be addressed in M&A deal documentation.

The FSR therefore goes far beyond the U.S. Merger Filing Fee Modernization Act of 2022 which introduced a foreign subsidy disclosure requirement to the existing HSR filing notification process. The U.S. disclosure requirement only covers subsidies which the parties received from "foreign entities of concern," namely entities owned or controlled by "covered nations" such as China and Russia.[58] By contrast, the FSR introduces an entirely new mandatory filing regime that comes on top of the existing merger and foreign investment filing requirements. The notification and review procedures under the FSR and the relevant merger control and foreign investment laws are independent from each other, with the result that companies may have to prepare and file parallel notifications and cope with parallel proceedings under different legal instruments with different timelines and standstill obligations. In particular, each regime has different public policy objectives and consequently different substantive standards of assessment. In addition, the FSR is not limited to subsidies from a specified list of countries, but applies to all subsidies received from any non-EU country.

The overall impact of the FSR will largely depend on the Commission's enforcement approach. It is an open secret that the tool was mainly introduced to address potential distortive effects resulting from heavily subsidized Chinese companies active in Europe. In addition, it seems that the Commission itself is trying to restrain the new regulatory behemoth: according to recent statements by Commission Vice President and Competition Commissioner Margrethe Vestager, the

[57] See also FSR, *supra* note 1, recital 75 and art. 47(1)(a).

[58] *See* H.R.3843 - Merger Filing Fee Modernization Act of 2022, 117th Congress (2021-2022), https://www.congress.gov/bill/117th-congress/house-bill/3843/text.

Commission intends "to focus on major distortions [and the FSR] is a net that is designed to catch the big fish … .And one way to achieve this, of course, is to focus on large transactions."[59]

Ultimately, however, the practical relevance of the FSR in the longer term will largely depend on the reaction of non-EU countries. The FSR explicitly stipulates that international agreements concluded by the European Union take precedent over the new regulation.[60] The far-reaching and ambiguous content of the FSR may thus work as a "bargaining chip" and might be perceived as a strategic attempt by the European Union to incentivize third countries to negotiate and conclude bilateral or multilateral trade agreements with the European Union, containing clear rules for a fair and predictable foreign investment regime. It is still unclear whether this strategy has any chance of success. At the moment, and unless significant changes are made to the implementing rules, it seems more likely that this strategy might backfire and the FSR may simply curb investment by global players into the European Union. ●

59 Tono Gil and Natalie McNelis, *EU's foreign-subsidies control will be 'fair' in light of state aid tweaks*, MLex (March 6, 2023).

60 FSR, *supra* note 1, art. 44 (9).