

„Turn it up a notch“ – Regulatory hurdles in M&A transactions are getting even tougher

The **Regulation (EU) 2022/2560 on foreign subsidies** distorting the internal market („**EU FSR**“) has been adopted by the European Parliament and Council and has been officially published in the Official Journal on 23 December 2022. The EU FSR aims to restore fair competition between all companies operating within the European Union by enabling the European Commission to take far-reaching measures against foreign subsidies distorting competition in the EU internal market.

When will the EU FSR start to apply?

- The EU FSR has entered into force on 12 January 2023.
- Most of its provisions will apply from **12 July 2023** (except for, in particular, Article 21 relating to the prior notification of concentrations, which will apply from 12 October 2023).

Who is affected by the EU FSR?

- The EU FSR aims to tackle all distortive foreign subsidies provided to companies engaging in “*economic activity*” within the EU.
- The EU FSR's definition of economic activity in particular includes **M&A transactions** (i.e. mergers, acquisitions of joint or sole control, creation of a full-function joint venture) within the EU.
- The EU FSR affects both EU and non-EU companies operating in the EU and having received direct or indirect “*foreign subsidies*” from a third country (i.e. the central government or any public authority, any foreign public entity, or any private entity whose actions can be attributed to a non-EU country).

Who will be the responsible authority?

- The EU FSR will be enforced exclusively by the **European Commission**, to which it grants far-reaching (investigation) tools.

What instruments and powers does the European Commission have under the EU FSR?

- Concentrations (i.e. mergers, acquisitions of joint or sole control, creation of a full-function joint venture) are subject to **mandatory ex ante filings** and **stand-still obligations** if the following thresholds are satisfied:
 - (i) at least one of the companies or company groups to a merger, (ii) the target company, or (iii) the joint venture is established in the EU and achieved an aggregate turnover in the preceding financial year in the EU of at least **EUR 500 million**, and
 - the parties to the transaction have received aggregate financial contributions of more than **EUR 50 million** from non-EU countries in the three years preceding the conclusion of the agreement, announcement of the bid or the acquisition.



- In addition to the above, the European Commission may also initiate investigations on its own (“**ex officio review**”) if it suspects that distortive foreign subsidies may be involved.
- Consequently, the European Commission may request **ad-hoc notifications** for smaller concentrations that do not satisfy the above thresholds.

What is the procedure and review period for investigations by the European Commission?

- Both the ex ante filing initiated by the parties as well as the ex officio review initiated by the European Commission are subject to a review process similar to the two-layered merger control procedure:
 - Within the initial **preliminary review phase** (similar to a “phase I” review period in merger control proceedings), lasting **25 business days**, the European Commission assesses whether there are sufficient indications that a foreign subsidy distorts the internal market.
 - If there are sufficient indications for a distortive foreign subsidy, the European Commission will initiate an **in-depth investigation** and assessment (similar to a “phase II” review period in merger control proceedings), which takes an additional **90 business days** (and which may be extended upon request or in case of commitment proposals).
- In case of an ex ante filing, the parties will however also have the possibility to **request pre-notification discussions**.

What financial contributions constitute a “foreign subsidy”?

- Foreign subsidies are situations “where a third country provides, directly or indirectly, a financial contribution which confers a benefit on an undertaking engaging in an economic activity in the internal market”.
- The EU FSR uses a **broad definition** of financial contributions including, inter alia, any transfer of funds or liabilities (e.g. capital injections, grants, loans, loan guarantees, fiscal incentives, the setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps or rescheduling) or any foregoing of revenue (e.g. tax exemptions or the granting of special or exclusive rights without adequate remuneration).

When is a foreign subsidy considered distortive?

- The EU FSR empowers the European Commission to determine the existence of a foreign subsidy that “distorts” the EU internal market.
- In essence, a foreign subsidy is distortive if it improves the competitive position of the recipient(s), thereby negatively affecting competition on the EU internal market, and this effect is not counterbalanced by any potential positive effects.
- However, the European Commission may further assess whether the negative effects of a distortive foreign subsidy can be outbalanced by its (broader) positive effects (so-called *balancing test*), e.g. in relation to relevant (EU) policy objectives.



What are the consequences and fines in case of distortive foreign subsidies or of non-compliance with the EU FSR obligations?

- The European Commission may impose a set of fines, periodic payments and redressive measures in case companies fail to comply with the EU FSR or fail to cooperate with the European Commission.
- In particular, the European Commission may impose fines of up to **10 % of the company's aggregate worldwide revenue** if the companies concerned, intentionally or negligently, jump the gun, i.e.
 - fail to notify a concentration prior to its implementation, or
 - implement a notified transaction prior to clearance.
- In addition, the European Commission may also **prohibit the implementation** of a subsidized concentration.
- The European Commission may furthermore impose **structural or non-structural redressive measures** in order to remedy any distortion (such as reducing capacity or market presence, the publication of R&D results, the divestment of assets, the requirement to dissolve the concentration concerned or the requirement to adapt the companies' governance structure).

What should companies do in practice?

- Aside from Merger Control and Foreign Direct Investment control, Foreign Subsidies Control adds to the ever increasing regulatory hurdles in M&A transactions. Companies should include regulatory review processes in any strategic M&A planning.
- Given the high risks of non-compliance and the potentially significant effect on the transaction timeline, companies need to get familiar with the new rules and obligations quickly.

- As the new rules will soon be fully applicable (ex officio reviews as of 12 July 2023 and mandatory filing obligations as of 12 October 2023), companies will need to expand their transaction checklists. It is becoming even more relevant to assess diligently who the (potential) buyer, transaction partner or target is, as even indirectly subsidized buyers can trigger filing requirements.
- Companies that are covered by the new regime should start preparing for the new challenges as it will be beneficial to have the data readily available at an early stage before commencing prospective M&A transactions. **Last updated: January 2023**

We will be happy to support you in all legal matters concerning the new EU FSR in addition to Foreign Direct Investment and Merger Control matters!



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