



New EU regulation on Foreign Subsidies to add on a Third regulatory approval Regime for M&A deals

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Introduction

The EU State Aid framework has for decades served to ensure a level playing field within the internal market when it comes to subsidies granted, directly or indirectly, to undertakings by EU Member States.

The EU State Aid framework applies only to subsidies granted by EU Member States and thus not to subsidies granted to undertakings engaged in an economic activity within the internal market to the extent that these subsidies are granted, directly or indirectly, by public authorities from a state outside the EU (“Third Country”).

With a view to bridging this regulatory gap, the European Commission (the “Commission”) on 5 May 2021 proposed a new regulation on foreign subsidies distorting the internal market (the “FSR”). On 30 June 2022, the Council and the European Parliament reached a provisional political agreement on the Commission’s proposal for the FSR. The FSR will enter into force once it is formally adopted by the Council and the Parliament and published in the Official Journal.

The Regulation will according to the Commission become directly applicable across the EU member states 6 months after coming into force.

The proposed regulation is far-reaching and will complement - and not replace - the existing EU State Aid framework, the EU merger control regulation and the EU regulation establishing a framework for the screening of foreign direct investments into the Union¹.

Under the proposed regime, the proposal is, that in-scope deals will need to be pre-cleared by the European Commission. Accordingly, the new regime will introduce a third regulatory approval in addition to merger review and foreign investment controls.

Accordingly, the FSR will have a particular impact on M&A transactions and the risks involved in such transactions.

While awaiting the formal adoption of the FSR and its final text, we will below reflect on the expected regulation based on the Commission’s proposal and the Council’s and the European Parliament’s provisional political agreement hereto.

While the implications on M&A transactions is the focus of this newsletter, it should not be overlooked that the FSR also applies to public procurement procedures and all other market situations where a distortion of the internal market caused by foreign subsidies may occur.

Main Principles of the FSR

A “*foreign subsidy*” under the FSR effectively corresponds to the definition of a “*State Aid*” under Article 107 (1) TFEU, which refers to the existence of “*state resources*”, “*economic advantage*”, “*selectivity*” and “*state imputability*”.

The form of the financial contribution is without relevance, as the decisive thing is *the effect* of the measure concerned in the same way as under the EU State Aid framework. Consequently, a “*foreign subsidy*” does not only cover positive grants, such as e.g., capital injections or transfer of funds. It also covers the foregoing of revenue, e.g. by way of

¹ Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.

granting tax exemptions or the provision of goods or services at a price below the market price.

Moreover, a “*foreign subsidy*” may be granted not only directly by the public authorities of the Third Country concerned but also by a *private entity* to the extent that its actions can be attributed to the (public authorities of the) Third Country.

Under the FSR, a distortion on the internal markets shall be deemed to exist where a “*foreign subsidy*” is liable to improve the competitive position of the undertaking concerned in the internal market and where it actually or potentially negatively affects competition on the internal market.

The establishment of a “*negative*” effect on competition requires a more complex *balancing test* equivalent to the one conducted by the Commission when assessing the *compatibility* of an aid measure with the internal market under the EU State Aid framework. It remains to be seen from the final text of the adopted FSR to which extent the Commission shall be obliged to take into account the positive effects of the “*foreign subsidy*” on other relevant Union law regulatory objectives, such as e.g., environmental protection, when conducting the balancing test on the “*foreign subsidy*” concerned.

Nonetheless, the FSR will seemingly apply a presumption rule according to which a “*foreign subsidy*” does not distort the internal market if it, on aggregate during a consecutive period of three (3) financial years, does not exceed EUR 5 million. No such similar presumption rule applies under the EU State Aid framework.

Moreover, the FSR will seemingly in addition apply a strict “*de minimis rule*” rule pursuant to which a “*foreign subsidy*” not exceeding EUR 200,000 per Third Country during a consecutive period of three (3) financial years shall *per se* be considered not to distort the internal market. This amount corresponds to the similar capped amount set out in the general EU State Aid *De Minimis* regulation².

On the opposite, the FSR also highlights certain categories of foreign subsidising which shall be considered *ex ante* most likely to distort the internal market. This covers inter alia the situation where the “*foreign subsidy*” directly facilitates an M&A transaction (“concentration”) covered by the FSR.

² Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid.

If the Commission finds that a “*foreign subsidy*” gives rise to a distortion on the internal market, it may decide to impose “*redressive measures*” or the undertaking concerned may offer “*commitments*” to remedy the distortion.

The redressive measures or commitments could inter alia consist in the Commission requiring the undertakings to dissolve the M&A transaction concerned (i.e., the acquisition, the merger or joint venture), repay the foreign subsidy with appropriate interests or requiring the recipient undertaking to reduce its EU activities, refrain from investments, divest assets or grant access to infrastructure.

M&A Transactions – Notification of Concentrations

The FSR sets out an obligation for companies to notify those M&A transactions (“concentrations”), which constitute “*notifiable concentrations*”.

This applies first and foremost to transactions where the acquired company, one of the merging parties or the joint venture generates an EU wide turnover of at least EUR 500 million and the undertakings involved in the transaction were granted an aggregate financial contribution of at least EUR 50 million from Third Countries in the three (3) calendar years prior to notification.

Under the FSR, the notion of “*concentrations*” generally covers M&A transactions in the form of either i) mergers, ii) the acquisition of the direct or indirect control, whether by the purchase of shares, securities, or assets, and iii) the creation of a joint venture performing the functions of an autonomous economic entity on a lasting basis³.

However, the Commission is also empowered to require prior (*ad hoc*) notification of any of the above-said M&A transactions falling below these thresholds at any time before its implementation if the Commission suspects that “*foreign subsidies*” have been granted to the undertakings concerned in the three (3) years prior to the “*concentration*”. This transaction shall then also be considered a “*notifiable concentration*” for the purposes of the FSR.

In case of notified M&A transactions covered by the FSR, the Commission shall end the formal investigation procedure by adopting either

³ The FSR applies a positive list of certain confined situations, in which a “*concentration*” is not deemed to occur, such as where control is acquired by an administrator or estate according to the laws of the Member State concerned relating to liquidation, winding up and insolvency proceedings.

- i) a decision prohibiting the M&A transaction concerned (the “*concentration*”) if the Commission finds the existence of a foreign subsidy distorting the internal market,
- ii) a “*decision with commitments*”, if the Commission finds the existence of a foreign subsidy distorting the internal market while the undertaking investigated has offered commitments to remedy this which the Commission considers acceptable or
- iii) a “*no objection decision*” if the Commission finds the non-existence of a foreign subsidy or that a distortion of the internal market would be outweighed by the positive effects of the foreign subsidy.

The FSR imposes a stand-still obligation on the companies involved in the transaction as a “*notifiable concentration*” cannot lawfully be completed until cleared by the Commission.

Any transaction carried out in breach of the notification obligation shall only be valid, if at all, after the final decision taken by the Commission after the conclusion of an in-depth investigation procedure under the FSR.

Failure to comply with the notification obligation could also imply that the Commission may impose fines on the responsible companies involved in the transaction, which may reach up to 10 % of their aggregated world-wide turnover.

In case of the transaction having not been notified and already implemented, the Commission may adopt a decision where it finds the existence of foreign subsidies in that transaction distorting the internal market, requiring the undertakings concerned to dissolve the “*concentration*”. That could be by way of e.g., a disposal of all the shares or assets acquired.

Our Comments

The FSR constitutes a third regulatory hurdle for M&A transactions in case of any of the parties having benefitted from third country “financial contributions”. In case of such financial contributions, a transaction could potentially be subject to a FSR notification in addition to merger review and foreign investment controls.

Because of this new regime, it will be necessary to further consider and screen potential buyers of M&A targets. Buyers falling under the new regime will face a regulatory disadvantage and imply an additional deal-uncertainty compared to rival buyers due to the third regulatory approval being required. Advanced planning in such situations will be crucial.

From an M&A perspective, there can be little doubt that the FSR must be taken very seriously by all parties to M&A transactions involving undertakings engaging in an economic activity within the EU.

The FSR will have implications not only for the structuring of the deal but also a consequent risk, or possibility, of strategic complaints to the Commission and subsequent litigation.

From a due diligence perspective, undertakings intending to be involved in M&A transactions related to the EU *on the acquisition side* should already now start conducting a thorough analysis of to which extent they have or will be granted a “*foreign subsidy*”. If so, these undertakings should also assess how this will likely impact the distortion of competition assessment under the FSR to the extent that they decide to participate on the buy-side in an M&A transaction related to the EU after the date of application of the FSR.

Moreover, after the date of application of the FSR, all undertakings involved in M&A transactions related to the EU *on the acquisition side* would be well-advised to include, as part of their due diligence investigation of the target company/companies, a thorough analysis of whether the target has received any foreign subsidies during the relevant period of time and whether the contemplated transaction would trigger any mandatory or – likely – *ad hoc* notification obligation.

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We have extensive experience representing clients not only in the most complex, transnational M&A transactions but also in connection with the most complex State Aid, EU competition law and EU trade defence proceedings before the Commission, as well as subsequent litigation before the Union courts and national courts, for which reason we will be happy to assist you with any query or question regarding the application of the FSR.

We will follow up with further information once the FSR has been formally adopted.

If you have any questions or require further information regarding any of the above, please do not hesitate to contact us:



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