



CLIENT BRIEFING

EU Regulation on Foreign Subsidies

The new EU tool to scrutinise the impact of financial contributions from non-EU countries on M&A, public procurement, and business activity in the EU.

1 July 2022

At a Glance

On 30 June 2022, the EU co-legislators (the European Parliament and the Council) agreed on a regulation to control foreign subsidies that distort the EU internal market (Foreign Subsidies Regulation or FSR).

The FSR, which is expected to enter into force by mid-2023, will have a major impact on M&A and public procurement in the EU and could affect the business activities in the EU of companies that have received subsidies from a non-EU country.

What Is the FSR?

The FSR is a new legislative tool that grants powers to the EU to investigate non-EU subsidies that distort the EU internal market and to remedy any possible distortion that they would create. The overall aim of the tool is to ensure a level playing field for competition between companies that receive subsidies from EU countries (already subject to EU State aid control) and companies subsidised by non-EU countries.

The tool combines elements of State aid, merger control, public procurement, and trade defence rules. Under the FSR, the European Commission (EC) can assess various forms of State funding (including direct grants, tax advantages, or subsidised loans) and their impact on M&A transactions, public procurement or, more generally, business activity in the EU.

Who Will Be Impacted?

The FSR will affect companies (i) engaging in M&A and joint ventures (JV) in the EU or looking to participate in EU public procurement procedures, that (ii) have received financial contributions from non-EU governments or non-EU State-owned companies.

The FSR does not target specific countries or sectors. It will particularly impact investments in the EU by State-owned companies, sovereign wealth funds, and state pension funds. More generally, it may also apply to any private companies investing in the EU that have received financial contributions from non-EU countries. Any company, either foreign or European, active in countries with ample state intervention in the economy, or in subsidised sectors, or benefitting from fiscal incentives can be subject to scrutiny.

The concept of a financial contribution is extremely broad as it catches any of the following:

- Any transfer of funds or liabilities: capital injections, grants, loans, loan guarantees, fiscal incentives, setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps, or rescheduling
- Foregone public revenues otherwise due (i.e., tax benefits, including statutory benefits, COVID-19 support schemes, or tax dispute settlements)
- The sale of goods or services to public entities; while further clarity is required to determine the exact scope of a financial contribution in this context, the total value of the sale of the goods or services likely would be taken into account

How Will Companies Be Impacted?

M&A

Under the FSR, the EC will conduct a suspensory review of M&A and JV transactions. Concentrations that meet the following two thresholds will have to be notified before implementation:

- **Turnover threshold:** The turnover of the target (in case of acquisitions), the JV (for a JV creation), or one of the merging parties (for mergers) in the EU is equal to or exceeds €500 million.
- **Financial contribution threshold:** The undertakings concerned (e.g., the acquirer and the target, the merging entities, or the JV and its parent companies) received from third countries a combined financial contribution of more than €50 million in the three calendar years before notification.

Regarding JVs in particular, the EC's original proposal was wider than that proposed in the FSR, but it has been amended to limit the notification obligation to JVs that are established in the EU and meet the two thresholds set out above. Similarly, only the acquisitions of targets established in the EU that meet the thresholds have to be notified.

The procedural rules governing the FSR review are similar to those of the merger control: Phase I of 25 working days (WD) and Phase II of 90 WD for in-depth review.

This additional regulatory layer will be added to existing merger control and foreign direct investment (FDI) scrutiny for M&As, which will increase complexity and may lead to delays in closing.

Public Procurement

Companies participating in relatively large public tenders in EU countries (i.e., if the estimated value of the public tender is €250 million or more) and the bids involve a foreign financial contribution of at least €4 million per third country must notify to the contracting authority all foreign financial contributions received in the three years preceding their participation in the tender.

If a public procurement procedure is divided into lots, notification is required if the aggregate value of the lots for which the company is bidding exceeds €125 million. Main subcontractors and suppliers will also be obliged to notify their participation in tenders.

Investigations in public procurement cases can take up to 160 WD. During the preliminary review (20 WD from the notification, which may be extended by 10 WD "in duly justified cases") and the in-depth investigation (which can last up to 110 WD, with a potential extension of 20 WD), the contract cannot be awarded.

Business Activity in the EU

The FSR also includes a general market investigation tool that the EC may use *ex officio* in a wide range of market situations. In addition to covering smaller M&A transactions and procurement procedures that fall below the notification thresholds, the EC investigatory powers extend to any situation in which it suspects that a distortive foreign subsidy may affect the operation of companies established or active in the EU.

Who Will Enforce the FSR?

The EC will be the sole enforcer of the FSR to ensure uniform application throughout the EU. EU Member States will be entitled to inform the EC about possible distortive subsidies that need to be investigated.

The FSR vests the EC with far-reaching investigative and decisional powers vis-à-vis companies active in the EU. In particular, the EC can:

- Request any necessary information, conduct inspections in the EU and outside, or impose interim measures during the investigation. *Ex officio* and *ex ante* investigations can review financial contributions received in the past five years and three years, respectively, capturing sums granted even before the FSR enters into force.
- Impose fines of up to 10% of a company's global turnover and periodic penalty payments up to 5% of its daily turnover for procedural infringements (e.g., failure to notify, gun-jumping, non-cooperation, provision of misleading information, or non-compliance with EC decisions/commitments).
- Impose far-reaching, redressive measures, such as repayments, behavioural remedies, divestments, or requirements for firms to adapt their governance structure. The EC can also order dissolution of a closed transaction, prohibit a pending transaction, reject public procurement bids if it finds a foreign subsidy to be distortive, or impose a temporary obligation to inform the EC of all concentrations and tenders in which the company takes part.

Before the FSR's entry into force, the EC is expected to adopt an Implementing Regulation providing more details on the FSR procedures. The EC will also publish guidance on the interpretation of several key elements of this novel regulatory tool. In terms of organization, three Directorates General of the EC (COMP, TRADE, GROW) and up to 145 new positions are likely to be involved in enforcing the FSR.

Preparing for the FSR

The Latham Brussels team has been following closely the development of the FSR since its inception, and are advising clients on the potential impact for businesses and how to prepare their business models for the application of the FSR.

The team's broad experience — particularly in merger control, FDI, State aid, and trade fields — positions us to provide advice, solutions, and insights to clients looking to prepare for the application of this new and complex legal instrument that can significantly impact their business models and investments. Once the FSR enters into force, the team will offer a "one-stop shop" regulatory M&A service to deal with all necessary approvals, including merger control, FDI, or FSR.

Contacts

If you have questions about this briefing, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Carles Esteva Mosso

carles.estevamosso@lw.com
+32.2.788.6266
Brussels

Elisabetta Righini

elisabetta.righini@lw.com
+32.2.788.6238
Brussels

Natália Solárová

natalia.solarova@lw.com
+32.2.788.6225
Brussels

Enrique Fayos de Arizón

enrique.fayos@lw.com
+32.2.788.6127
Brussels

Thomas Milleville

thomas.milleville@lw.com
+32.2.788.6149
Brussels

Piera Amato

piera.amato@lw.com
+32.2.788.6218
Brussels

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