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New instrument to protect the internal market becomes operational: the Foreign Subsidies Regulation and its Implementing Regulation

On 10 July 2023, the European Commission (“Commission”) published the much-awaited Regulation providing “detailed arrangements” for the implementation of Regulation (EU) 2022/2560 of the European Parliament and of the Council on foreign subsidies distorting the internal market (the “FSR”). With this Implementing Regulation, the new regime to assess foreign subsidies becomes operational.

Compared to the earlier draft put to consultation, the final version of the Implementing Regulation is a substantial improvement. However, the compliance effort remains very challenging.

1. The Foreign Subsidies Regulation: a quick recap of the essential elements

In March 2023, when describing the aim of the FSR, Executive Vice-President Vestager stated that it was “a net designed to catch the big fish”¹. However, it is fair to say that the net is very wide because the FSR requires companies setting up a record of transactions with public authorities, a new reporting duty altogether.

The difficulty is compounded by the very broad definition of the notion of “financial contribution”, potentially including also transactions in the ordinary course of business. Not to mention that the duty to keep such records applies retroactively – starting from foreign financial contributions granted in the three years prior to 12 July 2023.

The reporting obligation applies to EU and non-EU companies: the essential element is receiving financial contributions. Thus, an EU company operating outside the EU directly or through a subsidiary would be subject to the FSR.

Having a complete record of such financial contributions is essential for companies operating in the EU internal market seeking to (i) perform M&A transactions and/or (ii) to participate in EU tenders. This is because, from 12 July 2023

- a notification will be due in connection with M&A transactions involving the acquisition of a target with EUR 500M of EU turnover, when the acquiring party and the target have received EUR 50M of financial contributions from any third country in the previous 3 years.
- A notification will also be due for companies seeking to participate in public tenders, when the tender value is equal or above EUR 250 M, and the financial contributions per third country are equal to or above EUR 4M in the 3 previous years (including also key subcontractors’ financial contributions).

The notification will have to describe the financial contributions and essential elements to enable the Commission to make a first assessment as to whether (i) the financial contribution is a subsidy (which, essentially, is a synonym with the notion of State aid in the EU) and/or whether (ii) such subsidy is distortive. If the answer to both questions is “yes”, after 25 days the Commission will have to open an in-depth investigation, lasting approximately another 90 days.

¹ Speech, 6 March 2023, available at https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_23_1503.

Thus, even if their transaction is free from competition issues, operators may find themselves grappling with the Commission over distortive subsidies. And in more complex cases, one will have to think about competition issues and foreign subsidies issues together, including whether a single remedy may address both concerns.

For companies participating in tenders, it would be an absolute first to report about foreign subsidies. The reporting obligation includes also a duty to provide a declaration listing all foreign financial contributions received and confirming that the foreign financial contributions received are below the thresholds.

The new obligations have teeth: for M&A, filing is mandatory, there is a standstill obligation and fines for failure to notify may reach up to 10% of the aggregate turnover of the undertakings concerned. In the case of tenders, failure to notify also carries fines and possible rejection of the bid.

2. The Implementing Regulation

The consultation on the first draft of the Implementing Regulation closed with an uproar: regulatees from all quarters complained that the compliance burden was going to be “humongous”². The final version of the Implementing Regulation published today heeded some of those concerns.

- The notification threshold for reporting financial contributions has been raised from EUR 200,000 to EUR 1 million.
- There is a requirement for detailed reporting only on those contributions which are presumed to be distortive, i.e., (i) subsidies to ailing undertakings (in the absence of credible restructuring plan, (ii) unlimited guarantees, (iii) export financing measures not in line with the OECD arrangement on officially supported export credits, (iv) subsidies directly facilitating a concentration and (v) subsidies enabling an undertaking to submit an unduly advantageous tender.
- There is an exemption from reporting for financial contributions such as the supply of goods and services on market terms and in the ordinary course of business.
- There is also an exemption from reporting for deferrals of payment of taxes or of social security contributions, tax amnesties and tax holidays as well as normal depreciation and loss-carry forward rules of general application.

For contributions over the threshold and/or for distortive contributions, companies will have to detail the amounts, the rationale, the granting entity, any conditions attached, and what benefit it confers.

There are special rules for Private Equity (“PE”) funds. Whereas the rule is that financial contribution should be aggregated at the group level, for PE funds the financial contribution may be assessed at the level of the single fund when (i) the fund which controls the acquiring entity is subject to Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers or alternative third country pieces of legislation and (ii) the economic and commercial transactions between the fund which controls the acquiring entity and other investment funds (and the companies controlled by these funds) managed by the same investment company are non-existent or limited.

3. Next steps

For the Commission, the next few months will usher in a new era: starting from 12 July 2023, it will have the power to open ex officio investigations. And from 12 October 2023, the first notifications should start to arrive. But for regulatees the change is even greater. EU-based companies as well as non-EU companies will have to start thinking twice about the financial contributions they receive from foreign government because a

² For further information on the position of The Association of Inhouse Competition Lawyers on the Foreign Subsidies Regulation: <https://mlexmarketinsight.com/news/insight/eu-s-foreign-subsidy-regulation-risks-creating-humongous-burden-companies-warn>

“distortive” subsidy may become a spanner in a future transaction or tender.

At first glance, EU governments have been written out of the enforcement of the FSR, with the Commission being prosecutor and judge. However, if State aid enforcement is anything to go by for the FSR, their role may be as important as it is for EU State aid. After all, the effects of foreign investment are primarily felt in the destination country. And it should be up to the country receiving the investment to make its voice heard when it comes to balancing distortions and positive effects. After all, remaining open to foreign investment remains key for the EU.

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