

Understanding the implications of the EU Foreign Subsidies Regulation on private capital

June 2024

Copyright © 2024 Media Scope Group OÜ

This article is licensed under the Creative Commons Attribution-ShareAlike 4.0 International (CC BY-SA 4.0) license. You are free to share and adapt the article, provided that you give appropriate credit to Media Scope Group OÜ and indicate any changes made. If you remix, transform, or build upon the material, you must distribute your contributions under the same license as the original.

For more information about the Creative Commons Attribution-ShareAlike 4.0 International license, please visit: <https://mediascope.group/legal/cc-intl-public-license/>

Please note that this license applies to the article text and does not extend to any images, graphics, or other materials that may be included in the article. Those elements may be subject to separate copyright restrictions and permissions.

For permissions or inquiries regarding the use of this article beyond the scope of the Creative Commons license, please contact Media Scope Group OÜ at info@mediascope.group.

Introduction

Since October 12, 2023, the European Union's Foreign Subsidies Regulation (FSR) has instituted a requirement for the reporting of specific large-scale transactions to the European Commission. The purpose of this mandate is to assess if the transaction encompasses a subsidy granted by a non-EU country, which could potentially disrupt the equilibrium of the EU's internal market.

This regulation, in conjunction with the notification prerequisites for potentially subsidized public procurement bids and comprehensive ex-officio investigative powers, is designed to foster a balanced ecosystem within the EU internal market. Furthermore, it endeavors to address the regulatory void for non-EU subsidies, which are not subject to the same rigorous regulations as subsidies conferred by EU Member States under EU State aid rules.

Despite the FSR regime being a relatively recent addition, it plays a crucial role in the regulatory framework for private capital transactions, supplementing merger control and foreign direct investment regulation. This article offers a concise overview of the salient points that the private capital community should be cognizant of to date, with an emphasis on its applicability to transactions.

Criteria for transactions requiring notification under the FSR

A transaction is required to be reported under the Foreign Subsidies Regulation (FSR) if it meets two cumulative conditions:

- The entity being acquired (or the joint venture, or at least one of the entities involved in a legal merger) is established in the EU and has an aggregate EU turnover exceeding €500 million.
- The total amount of “foreign financial contributions” received by the parties involved in the concentration exceeds €50 million over the past three years.

The European Commission also has the authority to demand notification of a transaction that falls below these thresholds if it suspects that the parties have received foreign subsidies in the past three years.

Once the notification obligation is triggered, a comprehensive set of information must be provided. The transaction cannot be completed until the specified investigation periods have elapsed – a minimum of 25 working days, which could extend to 115 working days or more if an in-depth investigation is initiated. Failure to comply with the notification requirement or breach of the standstill obligation could result in penalties amounting to up to 10% of the aggregate turnover of the relevant entities. If the European Commission ultimately concludes that the transaction involves a foreign subsidy that disrupts the EU internal market, it has the authority to prohibit (or reverse) the transaction if satisfactory remedies cannot be negotiated.

Key distinctions: “Foreign Subsidies” vs “Foreign Financial Contributions” (FFCs) in the context of the FSR

Two separate concepts play a crucial role in the application of the FSR:

- **Foreign Subsidy:** This refers to a financial contribution that originates from or is directed by foreign public authorities, which is selective and provides a benefit to an entity engaged in economic activity within the EU internal market.
- **Foreign Financial Contribution (FFC):** This is a broader concept that encompasses any transfer of financial resources from or directed by foreign public authorities. This includes transfers made on market terms that do not confer a benefit, or those that are universally available.

Under the Foreign Subsidies Regulation (FSR), the European Commission’s authority is limited to intervening against foreign subsidies that cause distortion to the EU internal market. However, it is important to note that the notification threshold for transactions is based on Foreign Financial Contributions (FFCs), not directly on foreign subsidies. Given this, it is anticipated that the €50 million FFCs notification threshold could be easily exceeded by a significant number of investment funds. This highlights the broad reach of the regulation and underscores the importance for entities to be aware of and comply with these requirements.

Emerging trends for private capital from the initial notified cases under the FSR

A [Policy Brief](#) released by the European Commission in February 2024 highlighted several intriguing trends from the initial notified cases. These are particularly relevant to private capital:

- An investment fund was the notifying party in approximately one-third of the 53 cases where the European Commission received a case team allocation request and participated in pre-notification discussions.
- While the majority of cases (33) were cross-border transactions between the EU and non-EU countries, the European Commission also scrutinized cross-border transactions within the EU (7), cross-border transactions outside the EU (7), and transactions within a single EU Member State (6).
- Out of the 53 cases where the European Commission participated in pre-notification discussions, only 14 were formally notified later. Among these, nine underwent a full assessment, and none led to the launch of an in-depth investigation.
- A significant number of cases under review were also concurrently assessed under the EU Merger Regulation and/or foreign direct investment screening in one or more EU Member States.

Essential takeaways for the private capital sector

- **Proactive due diligence:** It is recommended to undertake proactive due diligence to gather exhaustive information about any Foreign Financial Contributions (FFCs) provided by third countries as Limited Partner (LP) investments in funds. Some funds are opting for a strategy of updating their FFC data every six or twelve months, rather than at the moment of each investment necessitating an FSR notification.
- **Deal structure:** The deal's structure and the accurate categorization of a transaction as an acquisition, legal merger, or establishment of a joint venture could be crucial in determining whether the FSR notification thresholds are met and what type of FFCs need to be reported for each party.
- **Deal documentation:** The deal's documentation should encompass pertinent conditions precedent and warranties. Specific queries related to the potential application of the FSR regime should be integrated into due diligence questionnaires.
- **Notification requirements:** When both the turnover and FFC notification thresholds are fulfilled, careful consideration should be given to the information that needs to be included in the notification form concerning FFCs received by the transaction parties. Not all FFCs need to be reported:
 - Detailed data pertaining to all FFCs exceeding €1 million granted by third countries as LP investments in an acquiring fund should, in principle, be included, as these may fall within the category of subsidies most likely to be distortive.
 - This will involve explaining whether those investments have been made on market conditions and details of conditions attached to those investments.
 - The relevant undertaking will typically be constituted by the investment company and all the funds it manages, as well as all the portfolio companies controlled by those funds.
 - However, when reporting FFCs which fall outside the categories most likely to distort the internal market, there is a key exception for investment funds which allows parties to limit the information they provide to FFCs granted to the acquiring fund and the portfolio companies of that fund.
- **Publicity under the FSR:** Publicity under the FSR is limited compared to EU merger control, with no routine publication of notifications received and no formal clearance decision at the end of the preliminary review phase. However, if an in-depth investigation is initiated, a formal decision must be adopted, and a summary notice including the main elements of the decision must be published.
- The European Commission has not yet initiated an in-depth investigation into a concentration under the FSR, but it is evidently focused on the enforcement of the new regime: it has already opened three investigations into potentially distortive subsidies granted in the context of public procurement procedures and recently announced two ex officio (i.e., own initiative) investigations into suspected distortive foreign subsidies, one of which saw it use its dawn raid powers under the FSR for the first time.

About Media Scope Group

Media Scope Group is an Estonian multinational integrated communications firm delivering services in the fields of public relations, public affairs, advocacy, marketing, data analytics, artificial intelligence and consulting.

www.mediascope.group | info@mediascope.group

Scan the QR code to visit our website.

