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Client Alert Commentary

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The Draft FSR Implementing Regulation Is Out — Now What?

Specific compliance considerations apply to M&A transactions and public tenders.

On 12 January 2023, the Foreign Subsidies Regulation (FSR) entered into force. The FSR empowers the European Commission (Commission) to control subsidies from non-EU States that distort competition on the EU internal market. On 6 February 2023, the Commission published its draft implementing regulation on key aspects of the FSR (Draft IR). The final implementing regulation is due to be adopted in Q2 2023.

The Draft IR provides practical guidance on the interpretation of key elements of the FSR, including the form, content, and procedures for notifying M&A transactions and public tenders falling within the scope of the regulation, as well as other procedural steps. Importantly, the Draft IR clarifies the information that companies are required to report in notifiable transactions. At the same time, the Draft IR imposes a significant administrative burden on companies falling with the scope of the FSR, in particular in M&A notifications, as all financial contributions still have to be monitored and recorded, regardless of size, to determine whether the reporting thresholds are met. For public procurement notifications, the Draft IR limits the reporting obligation to financial contributions most likely to be distortive – but once again, companies will be required to monitor and list all financial contributions for the purposes of assessing reportability.

Public comments on the Draft IR can be submitted to the Commission until 6 March 2023. After this date, the Commission will work to finalize the text and adopt the final version by Summer.

What Is the FSR?

A new investigative tool

The FSR is a new legislative tool that grants powers to the EU (i) to investigate subsidies from foreign States that distort the EU internal market and (ii) to remedy any possible distortions that they would create.

Impact on companies

The FSR imposes a notification obligation on companies that (i) have received "financial contributions" from foreign governments or State-owned companies; and (ii) are seeking to engage in M&A deals (acquisitions, mergers, joint ventures) or participate in public tenders in the EU, provided certain quantitative thresholds are met (see our Client Briefing from July 2022 for further guidance). The

Commission also has *ex officio* powers to investigate suspected distortive foreign subsidies on its own initiative, and can request *ad hoc* notifications for M&A transaction and public tenders that do not meet the relevant thresholds.

If the Commission identifies actual or potential distortions caused by a foreign subsidy during its investigation, notifying parties may need to offer remedies as a condition of clearance. If the remedy offer is deemed insufficient to redress concerns, the Commission may prohibit the transaction or public tender. Non-compliance (e.g., failure to notify, or implementation of an M&A deal or participation in a tender prior to clearance) may result in fines of up to 10% of a notifying party's corporate group's global turnover.

Timeline for compliance

The FSR will take effect on 12 July 2023. The notification obligation for M&A transactions and public tenders will however apply only from 12 October 2023, while the Commission's *ex officio* tool will be in force from 12 July 2023.

Draft Implementing Regulation

The Draft IR clarifies the procedural aspects of compliance with the FSR and is accompanied by draft notification forms plus guidance notes for M&A transactions (Annex 1) and public tenders (Annex 2). The Draft IR sets out procedural rules concerning notifications, Commission investigations, remedial commitments, the submission of observations, confidentiality, access to file, time limits, and the transmission of documents. The two annexes specify the category and granularity of information to be submitted for both types of notification, with M&A deals imposing a higher administrative burden than public tenders.

Key takeaways regarding the information that companies are required to submit when notifying an M&A deal or public tender (point 1), as well as other features of the Draft IR (point 2), are set out below.

1. **Content of notification forms**

   Information required to notify M&A transactions (Annex 1 contains the draft notification form)

   - Sections 1 to 4 of the notification form require information that is broadly akin to the information that must be provided in a notification under the EU Merger Regulation. This includes a description of the concentration, information on the parties to the concentration, a description of the ownership and control structure before and after the transaction, turnover data, the economic rationale of the transaction and sources of finance.

   - Section 5 of the notification form provides for a limited reduction in the reporting obligation concerning financial contributions as compared to the wording of the FSR. Specifically, once the notification obligation is triggered (i.e., EU turnover of target, joint venture, or merging parties exceeds €500 million and aggregate financial contributions from third countries in the last three years exceed €50 million), the following exemptions to the reporting obligation apply:

     i. **Individual exemption:** Financial contributions below the *de minimis* threshold of €200,000 do not need to be notified.

     ii. **Aggregate exemption per third country:** The total amount of financial contributions per third country and per year must exceed €4 million before financial contributions

are reportable for that country. However, once this aggregate threshold has been met for a given third country, all financial contributions per third country and per year are reportable, subject to the *de minimis* threshold set out above.

- Although these exemptions reduce the number of financial contributions that must be reported, they do not limit the need to monitor and record *all* financial contributions which remain relevant for determining whether the notification and reporting thresholds are met.

- For each reportable financial contribution, the following information must be provided:

  - name of the receiving and granting entity;

  - third country to which the financial contribution is attributable;

  - type of financial contribution;

  - if the financial contribution results from a tender;

  - amount; and

  - date of granting.

- For financial contributions that are considered most likely to distort competition (i.e., aid to ailing firms, unlimited guarantees, export financing not in line with OECD rules, and foreign subsidies directly facilitating a concentration: Article 5(1) FSR), more detailed information must be provided (e.g., purpose and economic rationale for granting the contribution, whether the contribution confers a benefit, or whether any conditions are attached).

- Section 6 of the notification form requires detailed information on the merger process (e.g., on the bidding process, alternative candidates, bids, due diligence process, contact details of other bidders or interested parties). Notifying parties must also describe the business activities of parties to the transaction in the EU, including worldwide and EU turnover for each activity, and whether and how financial contributions related to the concentration are likely to improve the competitive position of each of the parties to the transaction. This reporting obligation may prove burdensome, as notifying parties are unlikely to have access to this type of often highly sensitive information, which will have to be obtained from the seller or target.

- Section 7 requires notifying parties to describe any possible positive effects of foreign subsidies received on the internal market, including in relation to relevant policy objectives.

- Section 8 requires supporting documents to be provided for financial contributions considered most likely to be distortive (e.g., aid to ailing firms, unlimited guarantees etc.), as well as any analyses, reports, or studies discussing the purpose and economic rationale for the subsidy.

Information required to notify public tenders (Annex 2 contains the draft notification form)

- The reporting obligations for notifiable public procurement procedures are more limited than for M&A transactions. Notifying parties (defined to include not only the main contractor or bidding consortium, but also the main subcontractors and suppliers) are required only to report financial contributions falling under one of the categories listed in Article 5(1) FSR, i.e.,

those considered most likely to distort competition (e.g., aid to ailing firms, unlimited guarantees, or subsidies enabling unduly advantageous offers) and subsidies relating to operating costs. It is not clear whether companies still need to monitor *all* financial contributions to determine whether the notification and reporting thresholds are met, or only those most likely to be distortive.

- Sections 1 and 2 require a summary description of the public procurement procedure and information about the notifying parties, respectively. The use of a European Single Procurement Document (ESPD) to participate in public tenders is encouraged, as doing so removes the requirement to complete Sections 1 and 2 of the notification form.

- Section 3 requires notifying parties to provide information on all financial contributions received in the past three years that fall into the categories listed in Article 5(1) FSR, with similar details required as in the M&A notification (e.g. the form of contribution, the granting entity, the purpose and economic rationale for the contribution, whether the contribution confers a benefit etc.). Financial contributions to support operating costs must also be reported. Specific additional information is required for each of the different forms of reportable subsidy.

- The reporting obligation arises only once the notifying party has received aggregate financial contributions equal to or exceeding €4 million per third country over the previous three years. As noted above, it is not clear whether this threshold applies to all financial contributions or only those most likely to be distortive (e.g., subsidies to support operating costs etc.).

- Sections 4 and 5 permit notifying parties to provide, respectively: (i) a justification as to why the tender is not 'unduly advantageous' due to the financial contribution received by reference to various factors (e.g., the economics of the manufacturing process, technical solutions chosen, originality of the work, and compliance with environment, social, or labor laws etc.); and (ii) a description of any possible positive effects of the foreign subsidy on the internal market.

- Section 6 requires supporting documents similar to those required for M&A notifications.

2. Other notable features of the Draft IR

- **Waivers:** The Draft IR introduces the possibility for notifying parties to request waivers for certain information and documents required by the notification form during pre-notification discussions with the Commission. Waivers can be requested in relation to information (i) that is not reasonably available or (ii) that the Commission considers unnecessary for its assessment of the case. Pre-notification contacts will be key, as the Commission invites parties to discuss, *inter alia*, how best to limit the information required in the notification forms.

- **Investigative tools:** The Draft IR grants the Commission investigative powers similar to those available in EU merger control and antitrust investigations, such as the power to conduct interviews and carry out inspections. Notably, the Commission will have the power to conduct dawn raids outside the EU.

- **Confidentiality and access to file:** The Draft IR clarifies the rights of access to the file of notifying parties and third parties, subject to the limits imposed by confidentiality claims and

business secrets. While notifying parties are only entitled to receive a non-confidential version of documents referred to in the grounds of the Commission's decision, both legal counsel and economic and technical experts engaged by the company under investigation will receive access to all documents on the Commission's file without any confidentiality redactions.

- **Rules for calculating time limits:** The Draft IR provides rules applicable to time limits and suspensions in preliminary reviews and in-depth investigations.

- **Commitments:** The Draft IR sets out the procedure for companies to propose commitments to redress concerns about distortive subsidies identified by the Commission. Companies will be able to submit commitments during the 65 working days (for M&A transactions) and 50 working days (for public tenders) following the opening of an in-depth investigation.

Main Drawbacks

First, the Draft IR provides welcome clarity in a number of areas that may ease the compliance burden on companies required to make notifications under the FSR. In particular, the Draft IR (i) provides limited reductions in the reporting obligations for notifiable transactions, along with broader reductions for notifiable public tenders; and (ii) introduces a system of waivers for information that is difficult or impossible to obtain or is unnecessary for the Commission's assessment of the case. However, companies still face a significant administrative burden to comply with the FSR.

In particular, for M&A notifications, the Draft IR does not limit the categories of reportable financial contribution to those most likely to be distortive as listed in Article 5(1) FSR, other than exempting contributions falling below the individual and aggregate thresholds, which are low. While public tender notifications seem less burdensome, as they require only financial contributions that are most likely to be distortive to be reported, a public tender "declaration" (which the notifying party(ies) must submit when the €4 million reportability threshold is not met in any third country over the past three years) requires a list *all* financial contributions to be provided. As such, and in view of the broad notion of financial contribution included in the FSR, the collection of information required will remain an onerous exercise for companies. For instance, based on the current text, companies will have to monitor all purchases from or sales to a State-owned entity, which are potentially reportable under the FSR, even if the transaction was carried out on market terms. It would be welcomed that the Commission further amends the reporting requirements in the final implementing regulation to reduce this disproportionate compliance burden.

Second, the Draft IR also clarifies the rights of defense of companies under investigation, as well as the exercise of the right to be heard and the possibility to submit observations throughout the proceedings. However, the Draft IR's treatment of notifying parties' rights of defense presents some shortcomings:

- The right of access to the Commission's file by companies under investigation includes significant limitations. For instance, access to the file does not extend to internal documents of Member States or third countries, and does not cover correspondence among the Commission, Member State authorities, third countries, and contracting authorities. While similar provisions are also contained in the procedural rules for mergers under the EU Merger Regulation, such a restrictive approach will likely have a detrimental impact on companies' rights of defense in the context of the FSR, as documents that are likely to be highly relevant for the assessment of foreign subsidies will not be made available to the company under investigation.

- In addition, the exercise of the right to be heard also presents limitations, notably, that observations must be submitted in writing. Unlike the situation in antitrust or merger control proceedings, the Draft IR does not provide for the possibility of requesting an oral hearing.

One innovation is the introduction of a system of access to the Commission's file through "confidentiality rings", following similar provisions in the draft Implementing Regulation for the Digital Markets Act. The system requires the Commission to grant access to all documents in its file, without confidentiality redactions, to "*a limited number of specified legal and economic advisors and technical experts engaged by the company under investigation*". This access right allows the notifying parties' advisors to see the full set of evidence supporting the Commission's decision and, as such, may lead to some efficiency gains compared to the traditional system that provides the companies under investigation with access to file as well, but subject to more extensive discussions about confidentiality redactions. Under this new system, however, the right of access to the Commission's file by the companies under investigation has significant limitations. Notably, if the company requests access to documents in the file, the Commission is obliged only to provide a non-confidential version of documents mentioned in the grounds of the Commission's decision. For all other documents on its file, the Commission is required only to provide a list of the relevant documents in question, with some justified exceptions.

Preparing for the FSR

The notification obligations in the FSR apply from 12 October 2023. From Q4 2023, acquirers planning potentially notifiable M&A deals and potential bidders in large-scale public tenders in the EU will need to assess whether mandatory notification thresholds are met and, if so, be ready to file. The three-year lookback period for financial contributions means that companies need to start collecting information on historical financial contributions (i.e., from 12 October 2020) and should already put in place a group-wide system for tracking and recording future financial contribution as they are received.

More generally, the broad notion of "financial contribution", involving a wide range of transactions not limited to monetary transfers — such as sales to public entities even at market terms, tax exemptions, or financial assistance received in foreign countries (e.g., COVID-19 relief measures) — means that companies will need to prepare well in advance for the reporting obligation that will commence in October 2023. Financial contributions granted through private entities will also be caught if the actions of the entity are attributable to a non-EU country — a determination that will often require a case-by-case assessment.

Preparing for FSR compliance

Companies should start taking concrete steps to prepare for FSR compliance, as it can be burdensome to collect and compile all the information required. Key preparatory steps include:

- Conducting an **analysis** to identify all financial contributions and establish systematic, group-wide procedures to process this information in a streamlined, rapid manner. This analysis should:
  - determine which contracts or sales are "attributable" to non-EU governments: this exercise will require, among other things, customer-specific information and input from different business units and regional or country managers across the group; and
  - identify grants, tax exemptions, or other incentives and quantify the financial contributions involved: this exercise will require input from the companies' tax and accounting teams.
- Establishing appropriate procedures to identify M&A transactions or large public tenders that presumptively meet FSR thresholds.

Compliance steps for M&A transactions and public procurement procedures

Specific compliance considerations apply to M&A transactions and to public tenders:

- For notifiable **M&A deals**, potential acquirers will need to collect information on financial contributions not only for themselves but also for the target, merging party, or joint venture, as well as for the acquirer's parent entities and portfolio companies. Relevant considerations include:
  - Due diligence of the target will need to include a review of potentially distortive non-EU subsidies, alongside the target's compliance with EU State aid rules.
  - Transaction processes, timelines, and documentation (e.g., conditions precedent, effort obligations and cooperation clauses, long stop date, representations and warranties) will also need to be reviewed to take into account the impact of the FSR.
- For notifiable **public tenders**, the main contractor will need to provide information not only on itself but also its main sub-contractors and suppliers. Failure of the main contractor to supply this information will result in exclusion from the tender or may lead to heavy fines.

Public Consultation

Publication of the Draft IR on 6 February 2023 launched a four-week public consultation on the text. Feedback on the Draft IR can be submitted to the Commission here until 6 March 2023.

The Latham Brussels team has closely followed the development of the FSR since its inception, while advising clients on practical solutions for compliance, and will continue to monitor and report on developments.

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