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How the EU's New Foreign Subsidies Regulation May Impact Cross-Border Acquisitions by U.S. Companies

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American companies and others outside the European Union (EU) pursuing large M&A transactions and public tenders in the EU's single market must now comply with a new regulation. Effective July 12, 2023, the Foreign Subsidies Regulation (FSR)[1] requires such companies—if they have received financial contributions from non-EU governments within the past three years—to notify and seek approval from the European Commission before consummating their transactions.

The FSR joins a global body of foreign direct investment and competition reviews—including CFIUS, the UK's National Security and Investment Act, and recently proposed amendments to the Hart-Scott-Rodino Act premerger notification rules—that require companies making acquisitions to disclose government subsidies and/or foreign ownership. While some of these reviews focus on particular industries, or on sensitive or classified or controlled technology or products, the FSR covers all economic sectors in the EU. The FSR is intended to ensure a level playing field for companies competing in the EU's single market, where other global review schemes are intended to restrict or block foreign ownership and/or access to sensitive or classified technology or products.

For businesses planning large cross-border acquisitions within the EU, this new regulation will add to their list of early gating and diligence items.

This legal update summarizes the new FSR for companies participating in M&A and public procurement activity in the EU and suggests practical steps to prepare for compliance with these exacting new requirements.

1. Foreign Financial Contributions

The rationale behind this new requirement to disclose certain financial contributions from foreign governments (FFCs) is that they can unfairly advantage recipients in the EU by, for example, enabling them to pay inflated prices to acquire companies and elbow out competitors.

The FSR broadly defines FFCs to include any direct or indirect contribution to a company engaging in an economic activity in the EU, including:

- the transfer of funds, such as capital injections, grants, loans, loan guarantees, fiscal incentives, the setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt-to-equity swaps, or rescheduling;
- the foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration; and
- the provision or purchase of goods or services, even on arm's-length terms.

Under this new regulation, the European Commission is empowered to review and potentially investigate FFCs and to restrict or outright prohibit those that distort competition.

2. FSR: How It Works

The FSR requires companies pursuing transactions subject to the filing obligation to disclose FFCs they have received in the previous three years. Specifically, the FSR requires filing for M&A deals involving: (i) an EUestablished party (i.e., having a subsidiary or permanent establishment in an EU member state) that has at least €500 million in EU turnover; and (ii) all transacting parties combined have been granted financial contributions of at least €50 million from non-EU states in the prior three years. Filing for public procurement is required for tenders involving (i) a contract value of at least €250 million, and (ii) a company that received at least €4 million from non-EU states in the prior three years.

Any proposed acquisition, merger, or public tender bid involving FFCs and triggering the FSR's value thresholds must be notified to the Commission effective October 12, 2023.

Within 25 working days after the parties formally file the FSR notification, the Commission will either clear the transaction or, if it believes the FFC constitutes a foreign subsidy[2] that distorts or has a negative impact[3] on the EU market, proceed to an in-depth investigation.

Certain foreign subsidies, called "Article 5 Financial Contributions," are presumed to be the most likely to distort the internal EU market, and include those that directly facilitate an M&A deal or enable a party to submit an unduly advantageous tender offer; however, even if a subsidy is deemed distortive, the Commission will weigh its negative effects against its positive effects in the internal market. For example, the Commission may find that the subsidized economic activity supports EU public policy objectives—such as environmental goals or R&D activity—and will take this assessment into account when deciding whether to impose measures to remedy the distortion.

The Commission generally has 90 working days from opening the in-depth investigation to clear the proposed transaction, either unconditionally or subject to redressive measures or commitments, or prohibit it outright.

Companies that fail to notify the Commission of relevant transactions or provide required information may face significant fines up to a maximum of 10 percent of the company's aggregate turnover in the preceding financial year.

3. Practical Steps You Can Take Now to Begin Preparing

Companies planning large M&A or procurement projects which include a business operating or selling in the EU can take practical steps now to prepare for possible FSR filings, including updating relevant due diligence and purchase agreement templates to provide for FSR analysis and filing obligations, as well as implementing a digital framework to facilitate monitoring and collecting data on foreign financial contributions received by EU companies in the prior three years, and factoring in additional deal time to allow for FSR filing preparation and Commission review.

ENDNOTES

[1] https://competition-policy.ec.europa.eu/foreign-subsidies-regulation/legislation_en.

[2] The Commission considers a foreign financial contribution to be a "foreign subsidy" if it is (i) provided by a non-EU state, (ii) directly or indirectly, (iii) confers a benefit on an undertaking engaging in an economic activity in the internal market, and (iv) is limited in law or in fact to one or more undertakings or industries. FSR, Article 3(1).

[3] A distortion exists where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market and where, in so doing, that foreign subsidy actually or potentially negatively affects competition in the internal market. FSR, Article 4(1).

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