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I Background

On January 12, 2023, EU Regulation (EU) 2022/2560 on foreign subsidies distorting the internal market (FSR) entered into force. The FSR aims to counter distortions of competition that may arise when non-EU-countries ("Third Countries") subsidize companies operating in the EU. The FSR introduces additional, new notification and approval requirements for M&A transactions as well as public tender proceedings and provides the European Commission (EC) with authority to conduct *ex officio* examinations if it suspects foreign subsidies of distorting competition in the EU.

Following a six-month grace-period, the EC can examine M&A transactions with a signing date, as well as public procurement procedures with an initiation date, as of **July 12, 2023**.¹ However, the notification obligations for concentrations and public procurement transactions imposed by the FSR only will apply as of **October 12, 2023**.²

II Need for clearance by the European Commission

Transactions and public procurement procedures that are subject to the FSR may not close (*Vollzugsverbot*) until clearance by the EC has been obtained.

1. Thresholds for M&A Transactions

The FSR is applicable to "concentrations" if certain thresholds of turnover and financial contributions are exceeded. The definition of "concentration" is derived from the EU merger control regulation³ (as are various terms and concepts used throughout the FSR) and in general refers to (i) mergers, (ii) acquisitions or (iii) incorporations of joint venture companies.⁴

Pursuant to Art. 20 para. 3 FSR, the EC must be notified of a concentration if:

- (i) the EU-wide turnover of at least one of the merging undertakings, the acquired undertaking or the joint venture was **at least EUR 500 million** in the previous financial year; and

¹ Art. 53 para. 3 and 4 FSR.

² Art. 54 para. 4 FSR.

³ Regulation EC 139/2004.

⁴ Art. 20 para. 1 and 2 FSR.

- (ii) all undertakings concerned have cumulatively received financial contributions from Third Countries of **more than EUR 50 million** over the last three years.

In consequence, an obligation to notify the EC may exist even if the purchaser itself has not received any financial contributions from Third Countries, but the target company has. Accordingly, any purchaser will be well advised to include the FSR-compliance in the scope of its due diligence of the target. In addition, even if the thresholds mentioned above are not met, the EC can request ad hoc notification of proposed mergers, and the transaction will be treated in the same way as if it were subject to a notification obligation.

2. Thresholds for Public Procurement transactions

In addition, pursuant to Art. 28 para. 1 FSR, the EC must be notified of public procurement transactions if:

- (i) the estimated contract volume is **equal to or greater than EUR 250 million**; and
- (ii) the bidding company has received aggregate financial contributions **equal to or greater than EUR 4 million** per Third Country in the last three years.

The tender may not be awarded until clearance by the EC has been obtained.

3. Ex-officio review by the European Commission

Apart from the above notification requirements, the EC may examine foreign subsidies that it believes may distort competition *ex officio*.⁵ To obtain information, the EC may – amongst others – conduct interviews or dawn raids, inside and outside of the EU.⁶

As the EC also may examine concentrations which do not reach the thresholds mentioned above, EU member states may refer cases to the EC for examination, even if such cases are not subject to notification obligations under national law.

An *ex officio* examination also is possible in the case of mergers that already have been implemented.⁷ In such case, the EC may impose the same remedies on the respective undertakings as it could have done prior to the merger being implemented.

4. Examination Procedure in case of a Concentration

In the course of its examination of a concentration, the EC evaluates (i) whether a foreign subsidy exists (Art. 3 FSR) and (ii) whether such subsidy distorts the internal market (Art. 4 FSR). The EC's examination is structured as a two-phase-procedure consisting of a **preliminary review (Phase One, Art. 10 FSR)** and, if the EC has sufficient reason to believe that a foreign subsidy distorts the internal market, an **in-depth investigation (Phase Two, Art. 11 FSR)**. In Phase One, the EC must adopt a decision within **25 working days** after receipt of the complete notification, or initiate Phase Two.⁸ If Phase Two is initiated, the deadline

⁵ Art. 9 FSR.

⁶ Art. 14 and 15 FSR.

⁷ Recital (25), Art. 7 para. 4 lit. g); Art. 25 para. 6 FSR.

⁸ Art. 25 para. 2 FSR.

for adopting a decision is extended by an additional **90 working days**, with additional possibilities for prolongation by the EC.⁹

(1) Existence of a foreign subsidy

The definition of “foreign subsidies” is extraordinarily broad. A foreign subsidy “shall be deemed to exist where a Third Country provides, directly or indirectly, a financial contribution which confers a benefit on an undertaking engaging in an economic activity in the internal market and which is limited, in law or in fact, to one or more undertakings or industries”.¹⁰ Art. 3 para 2 FSR includes a non-exhaustive list of examples of “financial contributions” such as:

- (i) “the transfer of funds or liabilities, 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;
- (ii) the foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration; or
- (iii) the provision of goods or services or the purchase of goods or services.”

(2) Distortions in the internal market

According to Art. 4 para 1 FSR, “a distortion in the internal market shall be deemed to exist where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market and where, in doing so, that foreign subsidy actually or potentially negatively affects competition in the internal market”.

Art. 5 FSR provides certain categories of foreign subsidies which most likely distort the internal market:

- (i) “a foreign subsidy granted to an ailing undertaking, namely an undertaking which will likely go out of business in the short or medium term in the absence of any subsidy, unless there is a restructuring plan that is capable of leading to the long-term viability of that undertaking and that plan includes a significant own contribution by the undertaking;
- (ii) a foreign subsidy in the form of an unlimited guarantee for the debts or liabilities of the undertaking, namely without any limitation as to the amount or the duration of such guarantee;
- (iii) an export financing measure that is not in line with the OECD Arrangement on officially supported export credits;
- (iv) a foreign subsidy directly facilitating a concentration; and
- (v) a foreign subsidy enabling an undertaking to submit an unduly advantageous tender on the basis of which the undertaking could be awarded the relevant contract.”

A subsidy is not considered as “distorting” if it does not meet a certain *de minimis* amount of EUR 200,000 per Third Country over a period of three years.¹¹

Furthermore, a foreign subsidy is considered as “unlikely to distort” the internal market, if the subsidy’s total amount does not exceed EUR 4 million over any consecutive three year period.¹² Also, a foreign subsidy

⁹ Art. 25 para. 4 FSR.

¹⁰ Art. 3 para. 1 FSR.

¹¹ Art. 4 para. 2 FSR, Art. 3 para. 2 Regulation (EU) No 1407/2013.

¹² Art. 4 para. 2 FSR.

may be considered “not to distort” the internal market if it is aimed at making good the damage caused by natural disasters or exceptional occurrences.¹³

5. Examination Result and Balancing Test

As a result of the examination, the EC has to adopt a decision as follows: (1) raise no objection, (2) require redressive measures, or (3) prohibit the transaction altogether.

The EC may, on the basis of the information received, balance the negative effects of a foreign subsidy in terms of distortion in the internal market, against the positive effects on the development of the relevant subsidized economic activity on the internal market, while considering other positive effects of the foreign subsidy such as the broader positive effects in relation to the relevant policy objectives, in particular those of the EU.¹⁴ For example, tax incentives granted by Third Countries to support policies that also enjoy political support in the EU (e.g. reduction of CO2 emissions) may be permissible in this context. However, the FSR remains vague in this regard and leaves substantial room for interpretation, creating legal uncertainty.

If there are subsidies that distort competition and the exception described above does not apply, the EC can nevertheless approve a merger and prescribe commitments or redressive measures that it believes are suitable for eliminating the distortions caused by foreign subsidies. Potential remedies include, for example, the sale of certain assets, the repayment of the foreign subsidies including an appropriate interest payment, or the obligation to grant licenses on reasonable terms.¹⁵

6. Fines and periodic penalty payments

Fines or periodic penalty payments depend on the respective instrument, i.e. on whether the case concerns a concentration (Art. 26 FSR), public procurement (Art. 33 FSR) or an *ex officio* investigation (Art. 17 FSR).

However, the provisions on fines and periodic penalty payments are generally aligned and refer to the basic rule in Art. 17 FSR. In the case of concentrations, if incomplete, incorrect, or misleading information is provided, fines of up to 1% of the aggregate total annual worldwide turnover in the preceding financial year of the concerned undertakings are possible.¹⁶ If the notification is neglected or circumvented, the prohibition to close is disregarded, or a concentration is implemented despite a prohibition by the EC, the EC may impose fines on the concerned undertakings of up to 10% of the aggregate total annual worldwide turnover in the preceding financial year.¹⁷

III Upcoming Implementing Regulation for the FSR

On February 26, 2023, the EC published a draft FSR implementing regulation (IR) which clarifies certain procedural details of the FSR. The EC is currently revising the draft IR following a public consultation process.

¹³ Art. 4 para. 4 FSR.

¹⁴ Art. 6 para. 1 FSR.

¹⁵ See Art. 7 para. 4 FSR.

¹⁶ Art. 26 para. 2 FSR.

¹⁷ Art. 26 para. 3 FSR.

The final version of the IR shall be released in the second quarter of 2023, i.e. only shortly before the FSR becomes applicable on July 12, 2023.

The IR will include details on (i) notification procedures and content of the respective filings, (ii) rules for calculating deadlines and (iii) procedural rules regarding Phase One and Phase Two.¹⁸

IV Impact on M&A Transactions Worldwide

The FSR is expected to have a significant impact on M&A transactions inside and outside of the EU. Transactions which are signed, and public procurement procedures which are initiated, on or after July 12, 2023 and have a nexus with the EU market, will have to be examined and, if necessary, structured to comply with the FSR requirements.

As the EC may examine foreign subsidies from the past three to five years prior to the application of the FSR, companies should consider the FSR carefully when planning future M&A transactions or participation in public procurement transactions. In addition, when receiving financial contributions from Third Countries which may be deemed “foreign subsidies” under the FSR, companies should consider the potential impact of the FSR on future business development projects.

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¹⁸ For current status of the IR, please refer to the following website of the EC: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13602-Distortive-foreign-subsidies-procedural-rules-for-assessing-them_en.