

FINAL APPROVAL OF THE FOREIGN SUBSIDIES REGULATION

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The European Union's Foreign Subsidies Regulation (FSR), published [on December 23, 2022](#), entered into force on January 12, 2023. The FSR will apply with most of its provisions six months after its entry into force—i.e., on July 12, 2023. The FSR will grant the European Commission (EC) new enforcement powers to address subsidies received by companies from third-country governments or public entities. In yet another game-changing move towards ex ante regulation by the EC, the FSR will require companies operating in the EU to report their M&A transactions as well as their participation in public procurement tenders if backed by foreign subsidies. The FSR will also allow the EC to investigate ex officio any economic activity carried out in the EU in such cases.

The objective of the FSR is to fill regulatory gaps identified by the EC in existing legislation that does not allow the EC to tackle distortions in the EU's internal market caused by foreign government subsidies. Under the current EU state aid rules, the EC can only challenge subsidies when these are from EU member state governments. EU public procurement rules or sectoral legislation at the EC's disposal have also proven to be insufficient to tackle unfair behavior of foreign state-backed companies active in the EU. Antitrust and merger rules do not specifically address the impact of foreign subsidies either, and trade defense instruments, World Trade Organization (WTO) rules, and Free Trade Agreement (FTAs) rules do not cover trade in services, investment, or other financial flows in relation to the establishment or operation of companies in the EU.

Morgan Lewis [previously covered](#) the EC's initial proposal in detail. The following provides a detailed overview of the adopted FSR, which introduces new red tape for all companies operating in the EU in case they benefit from support from third-country governments in the broadest sense.

WHAT IS AT ISSUE? THE FSR'S NOTION OF FOREIGN SUBSIDY

The notion of foreign subsidy draws from the notion of state aid known from EU state aid rules. Article 3 of the FSR provides that "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.**"

The definition of a **financial contribution** is very broad. It encompasses not only direct payments but also the transfer of funds or liabilities, capital injections, grants, loans and guarantees forgone, or not collected public revenue, the grant of special or exclusive rights without adequate remuneration or the provision or purchase of goods, services, or other assistance at favorable conditions (benchmarked against typical market or industry practice). Apart from financial contributions provided by third countries' central governments and public authorities on all levels, financial contributions provided by foreign public and private entities whose actions can be attributed to third countries are also covered by the FSR (Article 3(2), FSR).

Secondly, a financial contribution is regarded as conferring a **benefit** under the FSR where the undertaking could not have obtained such benefit under normal market conditions. In order to assess the existence of a benefit, the EC will use comparative benchmarks. Based on the nature of the benefit, such benchmarks could be the investment practice of private investors, financing rates obtainable on the market, a comparable tax treatment or the adequate remuneration for a given good or service. In case no directly comparable benchmarks are available, existing benchmarks can be adjusted or alternative benchmarks could be established based on generally accepted assessment methods (Recital 13, FSR).

Thirdly, the **selectivity** of the foreign subsidy has to be established, meaning that the benefit should be conferred on one or more undertakings or industries (Recital 14, FSR). It is important to note that all companies active in the EU, including EU companies established in the EU, may be recipients of benefits and thus subject to the EC's foreign subsidy reviews.

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The FSR grants the EC three novel tools to address suspected distortions caused by foreign subsidies: two prior authorization procedures for large-value mergers and bids in large-scale public procurement procedures and a third general ex-officio market investigation tool covering all market situations as well as certain lower value mergers and public procurement procedures.

PRIOR AUTHORIZATION PROCEDURE FOR M&A

Under the FSR, undertakings are obliged to submit an ex ante filing of their M&A transactions in case both of the following thresholds are met:

- The EU turnover of the company to be acquired or of at least one of the merging entities is equal or higher than **€500 million** (\$542 million).
- The foreign financial contribution is at least **€50 million** (\$54 million) in the **three years preceding** the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest (Article 20, FSR).

Any acquirer, merging party, or bidder will have to notify, ex-ante, any financial contribution received from a non-EU government in relation to concentrations meeting the thresholds.

Pending the EC's review, the acquisition or merger in question cannot be completed and has, in other words, suspensory effect (Article 24, FSR).

PROCEDURE

Suspensory effect?	Phase I	Phase II ("in-depth investigation")	Possibility to extend?	Suspension of time-limits?
Yes, stand-still obligation applies.	25 working days from receipt of complete notification. <i>Note: This period of time begins on the working day following the receipt of the complete notification.</i>	90 working days from opening the in-depth investigation. <i>Note: This period of time begins on the working day following the adoption of the EC decision.</i>	1) Phase II is extended by 15 working days if commitments offered. 2) Phase II is extended at the request of the companies if the request is submitted within 15 working days after the opening of Phase II. 3) Phase II can be extended anytime by the EC with the agreement of the companies. In the case of (2) and (3), the total extension is a maximum of 20 working days.	Yes, if complete information is not provided by companies ("stop the clock").

DECISIONS

A decision may lead to a non-objection, imposition of commitments, or prohibition. The EC can adopt a no-objection decision if the preliminary assessment as set out in its decision to initiate an in-depth investigation is not confirmed or a distortion in the internal market is outweighed by positive effects.

Where the EC finds that a foreign subsidy distorts the internal market and the undertaking under investigation offers commitments which the EC deems appropriate and sufficient to fully and effectively remedy the distortion, it may decide to make those commitments binding on the undertaking. As a last resort, the EC may also prohibit a concentration (Article 25, FSR).

PRIOR AUTHORIZATION PROCEDURE FOR SUBMISSION OF PUBLIC PROCUREMENTS BIDS

The FSR establishes a mandatory ex ante filing obligation of participation in public tender procedures where the following thresholds are met:

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- The estimated value of the procurement is equal or higher than **€250 million**.
- The economic operator was granted financial contributions in the **three years preceding the notification** equal to or greater than **€4 million** per third country (Article 28(1), FSR). Only foreign subsidies granted in the three years preceding the notification may be assessed by the EC and the EC's assessment is limited to the public procurement in question.

Pending the EC's review, the investigated bidder cannot be awarded the contract—in other words the EC's review has suspensory effect.

PROCEDURE

Suspensory effect?	Phase I	Phase II ("in-depth investigation")	Possibility to extend?	Suspension of time-limits?	Two-stage procedure
Yes, but only for the award of the contract. <i>(All procedural steps are not suspended but the contract cannot be awarded.)</i>	20 working days from receipt of complete notification. <i>Note: The period of time begins on the working day following the receipt of the complete notification.</i>	110 working days from receipt of complete notification. <i>Note: The period of time begins on the working day following the receipt of the complete notification.</i>	1) Phase I can be extended by the EC once by 10 working days in duly justified cases. 2) Phase II can be extended by the EC in duly justified exceptional cases once by 20 working days .	No, but preliminary review closed without decision might be reopened by the EC in case of new information.	Phase I: 20 working days to examine the request to participate, then review is suspended until the final tender is submitted (submission of completed updated notification). Phase I resumes for an additional 20 working days . Phase II: 90 working days from the receipt of completed updated notification.

DECISIONS

As a result of its review, the EC can adopt a no-objection decision if the preliminary assessment as set out in its decision to initiate an in-depth investigation is not confirmed or a distortion in the internal market is outweighed by positive effects. Where the EC finds that a foreign subsidy distorting the internal market exists and the economic operator offers commitments that fully and effectively remedy the distortion, the EC can adopt a decision with commitments. Nevertheless, the EC may adopt a decision prohibiting the award of a contract where the economic operator concerned does not offer commitments or where the commitments offered are neither appropriate nor sufficient to remedy the distortion fully and effectively (Article 31, FSR).

EX-OFFICIO REVIEW

The FSR grants the EC broad powers to investigate financial contributions granted by non-EU administrations or on their behalf to enterprises operating in the EU. According to Article 9 of the FSR, the EC may on its own initiative examine information from any source regarding alleged foreign subsidies distorting the internal market. Such information can originate from member states, natural or legal persons, or associations. In other words, the EC may investigate all market situations where it suspects a foreign subsidy distorting the internal market may be involved: this includes greenfield investments, smaller concentrations and public procurement procedures below the thresholds set out for the authorization-based tools.

PROCEDURE

It should be noted that there is no set review term for ex officio investigations. In the frame of its *preliminary review*, the EC gathers all necessary information to assess, on a preliminary basis, whether the financial contribution constitutes a foreign subsidy and whether it distorts the internal market. To that end the EC can **request information** and conduct **inspections within and outside the EU**. As a result of its preliminary review, the EC can either arrive to the conclusion that there are insufficient indications to initiate an in-depth investigation and thus close the preliminary

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review or, if there are sufficient indications that an undertaking has been granted foreign subsidy that distorts the internal market, can adopt a decision to initiate an in-depth investigation (Article 10, FSR).

As part of its *in-depth investigation*, the EC can **request further information** and can conduct further **inspections within and outside the EU**.

INSPECTIONS

The EC's right to conduct inspections of undertakings encompasses the right to enter any premises, land and means of transport of the undertaking, examine books and other business records, ask any representative or member of staff of the undertaking or association of undertakings for explanations of facts or documents relating to the subject matter and purpose of the inspection and to record the answers, seal any business premises and books or records for the period of time of, and to the extent necessary for the inspection.

With respect to inspections outside the EU, i.e., in the territory of a third country, the EC can only conduct such inspections if the government of that third country has been officially notified and raises no objection to the inspection. The EC may also ask the undertaking or association of undertakings to give its consent to the inspection (Article 14 and 15, FSR).

INTERIM MEASURES

Moreover, the EC may order interim measures where there are sufficient indications that a financial contribution constitutes a foreign subsidy and distorts the internal market *and* there is a risk of a serious and irreparable damage to competition on the internal market. Interim measures include, among other things, the granting of access under fair, reasonable, and non-discriminatory conditions to infrastructure, an obligation to refrain from certain investments or a requirement of licensing on fair, reasonable and non-discriminatory terms of assets acquired or developed with the help of foreign subsidies. Nevertheless, no interim measures may be taken with regard to public procurement procedures (Article 12, FSR).

RETROACTIVE EFFECT

The FSR applies to foreign financial contributions granted in the three years prior to July 12, 2023, where such foreign financial contributions were granted to an undertaking notifying a concentration or notifying financial contributions in the context of a public procurement procedure under the FSR. This is extended to five years where such foreign subsidies still distort the internal market after July 12, 2023. Concentrations closed and public procurement contracts awarded, or procedures initiated prior to July 12, 2023, are excluded from the scope of the regulation (Article 53, FSR).

Moreover, under its ex officio investigation, the EC can investigate foreign subsidies for a period of 10 years, starting on the day on which a foreign subsidy is granted to an undertaking (Article 38 FSR).

WHAT IS A MARKET DISTORTION?

INDICATIONS OF A DISTORTION

Where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market and where, in doing so, it actually or potentially negatively affects competition on the internal market, a distortion shall be deemed to exist. Indicators may include:

- The amount of the subsidy
- The nature of the subsidy

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- The situation of the undertaking or the markets or sectors concerned (structural excess capacities, higher concentration, fast moving high-tech markets)
- The level of evolution of economic activity of the undertaking concerned on the internal market
- The purpose and conditions attached to the foreign subsidy as well as its use on the internal market

SAFE HARBOUR

A foreign subsidy is *unlikely to distort* the internal market if its total amount is **below €4 million** (\$4.3 million) over any consecutive period of three years.

A foreign subsidy with a total amount **not exceeding €200,000** (\$216,000) per third country over any consecutive period of three years *shall not be considered to distort* the internal market.¹

Moreover, a foreign subsidy *may be considered not to distort* the internal market to the extent that it is aimed at remedying the damage caused by **natural disasters or exceptional occurrences**.

RED FLAGS

As per Article 5 of the FSR, the “**red flag**” behaviors likely to prompt an EC notification or investigation include:

- foreign subsidy granted to an ailing undertaking;
- unlimited state guarantees in terms of amount or duration;
- export financing measure that is not in line with the OECD Arrangement on officially supported export credits;
- a foreign subsidy directly facilitating a concentration; *and*
- foreign subsidy enabling an undertaking to submit an unduly advantageous tender, based on which the undertaking would be awarded the public contract, and which cannot be justified by other factors.

REBUTTAL

Undertakings under investigation have the opportunity to provide relevant information supporting that a foreign subsidy falling under one of the above categories does not distort the internal market in the specific circumstances of the case.

BALANCING TEST

The EC may balance the negative effects of the foreign subsidy in terms of distortion on the internal market with the positive effects on the development of the relevant subsidized economic activity. The EC can also take into consideration broader positive effects, e.g., in relation to the relevant EU policy objectives. Moreover, the EC must consider the balance between these negative and positive effects when deciding whether to impose redressive measures or to accept commitments. Finally, the EC must also take into consideration the nature and level of redressive measures and commitments.

ENFORCEMENT POWERS OF THE EC

NON-COOPERATION

¹ Reference is made to the de minimis threshold defined in Article 3(2) of Regulation (EU) No 1407/2013.

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Cooperation with the EC in case of a review is important. An undertaking under investigation is granted the possibility to provide relevant information as to whether a foreign subsidy does not distort the internal market in the specific circumstances of the case (Article 5(2), FSR). However, in case of non-cooperation of the undertaking, the EC can take a decision on the facts available based on which the result of the procedure may be less favorable than in case of cooperation.

Non-cooperation can arise where the undertaking under investigation provides incomplete, incorrect, or misleading information in response to a request for information, fails to provide the information requested within the time limit, refuses to submit to the EC's inspection within or outside the EU, or otherwise impedes the preliminary review or the in-depth investigation. Where an undertaking fails to provide necessary information to determine whether a financial contribution confers a benefit on it, the undertaking may be deemed to have received such benefit (Article 16, FSR).

FINES AND PERIODIC PENALTY PAYMENTS

Under the FSR, the EC may impose fines and periodic penalties for negligent or intentional procedural breaches (e.g., submission of incorrect or incomplete information). Such fines shall not exceed 1% of the aggregate turnover of the undertaking or association of undertakings concerned in the preceding financial year. With respect to periodic penalty payments, the imposed amount shall not exceed 5% of the average daily aggregate turnover of the undertaking or association of undertakings concerned in the preceding financial year for each working day of delay, calculated from the date established in the decision, until it submits complete and correct information as required by the EC, or until it submits to an inspection. A fine of up to 10% of the aggregate turnover may be imposed for failure to notify a concentration or financial contribution or if a concentration is implemented prior to authorization in breach of the suspensory effect of the notification tool.

REMEDIAL MEASURES: STRUCTURAL REMEDIES AND BEHAVIORAL COMMITMENTS

If the EC finds that financial contributions indeed constitute distortive subsidies, it can impose redressive measures, in the ex officio reviews only, to remedy the distortion caused in the internal market. The undertakings concerned may also offer commitments. These commitments may be accepted by the EC where they *fully and effectively remedy* the distortion in the internal market. The commitments are then made binding on the undertaking in *a decision with commitments* and the compliance with these commitments shall be monitored.

These measures may include:

- offering access under fair and non-discriminatory conditions to an infrastructure that was acquired or supported by the distortive foreign subsidies;
- reducing capacity or market presence (e.g., a temporary restriction on commercial activity);
- refraining from certain investments;
- licensing on fair, reasonable, and non-discriminatory (FRAND) terms of assets acquired or developed with the help of foreign subsidies;
- publication of results of research and development;
- divestment of certain assets;
- requiring the undertakings concerned to dissolve the concentration;
- repayment of the foreign subsidy, including an appropriate interest rate (if proposed as a commitment, the EC can only accept the repayment if it is transparent, verifiable and effective while also taking into account the risk of circumvention);
- adapting the governance structure of undertakings concerned.

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Moreover, the EC may impose reporting and transparency requirements. Importantly, any redressive measure must be proportionate and fully and effectively remedy the distortion caused by the foreign subsidy in the internal market.

In addition to the obligations detailed above, the EC may require the undertakings concerned to inform the EC, where proportionate and necessary and only for a limited time, of the undertakings' participation in concentrations or public procurement procedures (Article 8, FSR).

ANALYSIS

The FSR reflects the continuing policy shift toward increased ex ante intervention in the EU, which we have seen most recently in the digital space. In 2022, the Digital Markets Act² and the Digital Services Act³ came into force. Both regulations provide ex ante tools for the EC to be able to tackle the issues arising from the practices of certain Big Tech companies operating in the EU, thereby demonstrating the EC's increasing will to prevent rather than to remedy. The FSR is another piece of the enforcement puzzle and seeks to create a level playing field between those operators subject to EU state aid rules and those who are not.

In order to do so, the EC has sought inspiration from its existing arsenal of regulations while seeking to cast the net much wider. In essence, the FSR introduces a parallel merger control review process and a mechanism to screen public procurement bid as well as control smaller subsidies ex post. On top of that, it creates very broad powers to investigate virtually all business dealings on suspicion of foreign subsidies. The result is a lot of red tape and uncertainty for companies operating in the EU.

IDENTIFYING THE SUBSIDY

One of the big contentious issues is identifying which financial contributions companies need to bring into the equation. Large firms could have millions of items to comb through. Purchases and sales to public entities could cover a vast array of items, starting with day-to-day transactions like social security payments or postal services or utility bills. Reporting of a great number of public contracts or relations will also inevitably raise confidentiality issues. There will certainly be a way to discuss with the EC the type of financial contributions in prenotification contacts, but it may be too late for companies that will want to carry out the required internal diligence before such late point in time where the transaction timeline is generally already running.

UNCERTAINTY FOR BUSINESS

Even where deals were or are not reportable under the FSR, the EC will still have the possibility to investigate them after closing. This will lead to significant practical uncertainties and means that internal due diligence needs to be taken very seriously. Companies may want to do some internal soul searching over the last three years and determine whether any support received could qualify as a subsidy subject to scrutiny. This exercise will then have to be a continuous exercise going forward.

MORE RED TAPE FOR BUSINESSES

For M&A deals and public procurement, companies will face additional notification requirements. Transaction documents will require substantive modifications, such as the addition of the relevant

² Regulation (EU) 2022/1925 of the European Parliament and of the Council of September 14, 2022 on contestable and fair markets in the digital sector and amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act). Also see our recent [report on the Digital Markets Act](#).

³ Regulation (EU) 2022/2065 of the European Parliament and of the Council of October 19, 2022 on a Single Market For Digital Services and amending Directive 2000/31/EC (Digital Services Act).

condition precedents, and deal teams will have to estimate timelines taking into account any potential FSR procedure.

THE OVERALL TRADE CONTEXT

EU companies operating internationally or globally or part of such groups will have to navigate carefully through various jurisdictions. Ecological transition, access to critical raw materials, digital sovereignty, and prevention of inflation are all factors which drive governments around the world to hand out financial incentives to support their national industries, and international and European companies may or may not be beneficiaries—the current discussion about the US Inflation Reduction Act is a prime example. Such incentives may fall squarely within the scope of the FSR and will therefore to be carefully assessed by businesses operating or willing to operate in the EU.

NEXT STEPS

The FSR will apply as of July 12, 2023. As for the prior notification of concentrations and the prior notification or declaration of foreign financial contributions in the context of public procurement procedures, these obligations will apply as of October 12, 2023.

In the meantime, the EC will publish guidelines regarding several provisions of the FSR, including the application of the balancing test, the existence of a distortion of the internal market and the EC's power to request prior notification of concentrations or public procurements (Article 46, FSR). Moreover, the EC is also empowered to accept implementing acts concerning, among other things, the form, content, and procedural details of notifications of concentrations and public procurement procedures (Article 47, FSR). At least the notification forms are expected to be available early in the year. In the interest of businesses operating in the EU, such guidance and implementing legislation will hopefully be published as soon as possible, for companies to prepare for and assess their new obligations.

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