

BRACING FOR THE NEW EU FOREIGN SUBSIDIES REGIME: HOW SHOULD DEALMAKERS PREPARE FOR A NEW M&A HURDLE?

JANUARY 2023

The far-reaching **EU Foreign Subsidies Regulation** came into force on 12 January 2023. On 12 July 2023, this new regime will begin to apply. On 12 October 2023, the new notification obligations for M&A deals and public tenders will become effective.

The Regulation empowers the European Commission to remedy distortions caused by subsidies given by third-countries, *i.e.*, non-EU Member States (for example, China). Aid granted by EU Member States is already scrutinised closely under the EU State aid rules.

The Regulation is drafted broadly and much of the detail remains unclear whilst we await – hopefully – more clarity from the EC's implementing regulation, a draft of which is expected soon. There are several important preparatory steps that potential dealmakers should already consider ahead of that.

A NEW MANDATORY REGULATORY HURDLE FOR M&A DEALS

As well as a mandatory pre-closing regime for public tenders for foreign-subsidised entities, the Regulation gives the EC two important new tools relevant to M&A deals:

- From 12 October 2023, a mandatory pre-closing regime for certain M&A transactions similar to, but separate from and in addition to, the existing EU merger control system; and
- A "catch-all" tool to investigate any market situations on its own initiative if it suspects that distortive foreign subsidies may be involved, including smaller M&A deals which fall below the mandatory thresholds.

This means that certain deals involving businesses active in the EU will be subject to a new foreign subsidies filing requirement, alongside any parallel EU or Member State merger control and/or foreign investment control process. This should be factored into deal strategy and timing for any transactions signing on or after 12 July 2023 and where closing on or after 12 October 2023 is a possibility.

WHICH M&A DEALS WILL BE CAUGHT UNDER THE REGULATION?

Subject to some limited exemptions, transactions must be notified where both of the following two thresholds are met:

- i. The EU turnover of the target (for acquisitions), at least one of the merging parties (for mergers), or the JV company (for the creation of a JV) is at least €500 million in the previous financial year; and

- ii. The transaction parties together have received combined financial contributions from third countries of at least €50 million in the previous three years.

The definitions of both "financial contribution" and "third countries" are very broad:

- "Financial contributions" cover all sorts of financial arrangements, from public grants, loans, and loan guarantees to tax incentives, or even the provision or purchase of goods or services, regardless of whether these are conducted on an arms-length basis or confer a non-market advantage.
- Meanwhile, "third countries" include central governments, public authorities, and private entities whose actions can be attributed to a non-EU country. This could conceivably capture sovereign wealth and investment funds, and government-aligned pension providers. For private equity deals, it cannot be ruled out that investments by limited partners would be subject to scrutiny as regards links to third-country governments.

As with the EU merger control regime, the transaction parties are jointly responsible for making the filing, and can be fined up to 10% of their annual global turnover if they fail to do so.

WHAT LENGTH OF REVIEW CAN BE EXPECTED?

Like the EU merger control process, the regime is suspensory, meaning transactions must first be approved before closing.

Although the substantive assessment will be different, the timetable will – at least in theory – closely resemble that for EU merger control reviews, with an initial 25 working day review period, followed by either a clearance decision or a 90 working day in-depth investigation, extendable by 15 working days if commitments are offered. We hope that the EC would also seek to align the two pre-notification phases, so that the overall merger control and foreign subsidies timetables line up too. It would be useful if the implementing regulation clarifies this point.

In practice, the length of review will depend on whether the financial contributions constitute foreign subsidies. We expect only a minority of cases to involve foreign subsidies, with the vast majority being cleared at phase 1.

WHICH FOREIGN SUBSIDIES ARE LIKELY TO RECEIVE MOST SCRUTINY?

Narrower than the concept of “financial contribution”, a foreign subsidy is defined as any financial contribution provided directly or indirectly by a third country which confers a benefit limited to one or more undertakings or industries.

Once a deal is notified, the EC will assess whether a foreign subsidy exists and is likely to distort the internal market. This will depend on factors such as the amount and nature of the foreign subsidy, the size of the target and the markets it is active in. The EC will then balance the negative effect of the foreign subsidy on competition in the internal market against any positive effects it may have, for example by contributing to R&D. The EC will have the power to impose or accept commitments, and at the extreme, prohibit a proposed transaction.

Foreign subsidies considered most likely to be distortive include subsidies to an ailing company without a restructuring plan, unlimited guarantees, or subsidies which directly facilitate an acquisition. Potential dealmakers and bidders should also expect particular scrutiny of mergers involving sectors in which the EC has shown recent interest, such as tech, renewable energy inputs and infrastructure.

Conversely, foreign subsidies below €4 million over three years are presumed “unlikely” to be distortive while those below the EU State aid de minimis threshold of €200,000 over three years are considered non-distortive.

WHAT CAN POTENTIAL DEALMAKERS DO NOW TO PREPARE?

Much remains unclear pending the implementing rules, including exactly what information will be required from notifying parties as part of any mandatory or ad hoc filing. But as with existing merger control and foreign investment reviews, forward planning will be essential to manage the regulatory process and avoid roadblocks. There are several steps that potential dealmakers can take now to achieve this, including:

- **Collect information on financial contributions.** Establish an internal process to systematically and robustly collect and review information on financial contributions (what, when, who from?) on a group-wide basis for the last three financial years.

Acquiring a stake in a new company or portfolio company, while not triggering the notification thresholds, may still add to a company's or a PE fund's total financial contributions, and will therefore require monitoring. PE houses will also have to look at the investor level, for example when a state pension fund invests in a PE fund. The three-year time period will equally require further clarification from the EC.
- **Prepare for scrutiny.** Once relevant financial contributions have been identified as foreign subsidies, prepare potential arguments as to why they are not distortive of the internal market, or why their potential benefits would outweigh any distortions.
- **Adapt deal documents.** For relevant transactions, FSR clearance should be added to the list of conditions precedent. Consider whether warranties and disclosures are also needed, as well as additional due diligence. Parties should also consider the impact on deal timetables, including factoring in pre-notification discussions with the EC, in particular in the early days of the Regulation's implementation.
- **Take the opportunity for active engagement.** Once the EC presents its draft implementing regulation, stakeholders will have four weeks to provide feedback. Potential dealmakers should closely monitor the implementation process as it evolves, and consider giving feedback on the draft rules.

FOR MORE INFORMATION

Our Antitrust/Competition team is available to discuss any of these issues with you and answer any specific questions you may have. If you would like more information about the topics raised in this briefing, please speak to your regular contact at Weil or to any of the authors listed below:



NIKLAS MAYDELL

+32 28 8356 80
niklas.maydell@weil.com



JENINE HULSMANN

+ 44 20 7903 1767
jenine.hulsmann@weil.com



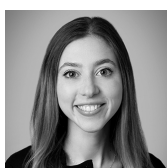
ROMAIN FERLA

+ 33 1 4421 9797
romain.ferla@weil.com



NICHOLAS BARNABO

+ 44 20 7903 1642
nicholas.barnabo@weil.com



JENNY PATROCLOU

+32 28 8356 86
jenny.patroclou@weil.com



BELLA SPRING

+ 44 20 7903 1753
bella.spring@weil.com

FURTHER MEMBERS OF THE EUROPEAN ANTITRUST/COMPETITION TEAM

Milica Antic, Associate
milica.antic@weil.com

Martin Ellie, Associate
martin.ellie@weil.com

Marija Momic, Associate
marija.momic@weil.com

Inês Sousa Mendes, Associate
ines.sousamendes@weil.com

Chris Chapman, Counsel
chris.chapman@weil.com

Robert Eyres, Associate
robert.eyres@weil.com

Marilena Nteve, Associate
marilena.nteve@weil.com

Chris Thomas, Associate
chris.thomas@weil.com

Gabriel Charki, Associate
gabriel.charki@weil.com

Steffen Florian Giolda, Associate
steffen.giolda@weil.com

Lucy Peckham, Associate
lucy.peckham@weil.com

Anna Zanazzo, Counsel
annagiulia.zanazzo@weil.com

Clémence Coppin, Associate
clemence.coppin@weil.com

Jayati Handa, Associate
jayati.handa@weil.com

Neil Rigby, Counsel
neil.rigby@weil.com

Jakob Dewispelaere, Associate
jakob.dewispelaere@weil.com

Patrick May, Associate
patrick.may@weil.com

Nafees Saeed, Counsel
nafees.saeed@weil.com

WEIL.COM

©2023 WEIL, GOTSHAL & MANGES (LONDON) LLP ("WEIL LONDON"), 110 FETTER LANE, LONDON, EC4A 1AY, +44 20 7903 1000, WWW.WEIL.COM. ALL RIGHTS RESERVED.

WEIL LONDON IS A LIMITED LIABILITY PARTNERSHIP OF SOLICITORS, REGISTERED FOREIGN LAWYERS AND EXEMPT EUROPEAN LAWYERS AUTHORISED AND REGULATED BY THE SOLICITORS REGULATION AUTHORITY ("SRA") WITH REGISTRATION NUMBER 623206. A LIST OF THE NAMES AND PROFESSIONAL QUALIFICATIONS OF THE PARTNERS IS AVAILABLE FOR INSPECTION AT THE ABOVE ADDRESS. WE USE THE WORD 'PARTNER' TO REFER TO A MEMBER OF WEIL LONDON OR AN EMPLOYEE OR CONSULTANT WITH EQUIVALENT STANDING AND QUALIFICATION.

THE INFORMATION IN THIS PUBLICATION DOES NOT CONSTITUTE THE LEGAL OR OTHER PROFESSIONAL ADVICE OF WEIL LONDON. THE VIEWS EXPRESSED IN THIS PUBLICATION REFLECT THOSE OF THE AUTHORS AND ARE NOT NECESSARILY THE VIEWS OF WEIL LONDON OR OF ITS CLIENTS.

#97864250

Weil