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READY, SET, GO FOR THE EU FOREIGN SUBSIDIES REGIME: PROCEDURAL RULES CLARIFY SCOPE OF MANDATORY M&A FILINGS

The EU Foreign Subsidies Regulation brings in a new mandatory regulatory regime for certain M&A deals and public tenders and a general market investigation tool, each administered by the European Commission.

The EC has now adopted its final procedural rules, which include how parties should notify their M&A deals and public procurement bids. Although the final M&A notification form is more limited in scope than the draft version, those contemplating M&A deals will still need to undertake an extensive internal data collection exercise to be "FSR ready".

RECAP OF THE NEW MANDATORY M&A HURDLE

The purpose of the FSR is to enable the EC to investigate financial contributions granted by non-EU governments (so-called "foreign financial contributions") to companies active in the EU. If the EC finds that any of them constitute distortive subsidies (i.e. because they confer an unfair advantage on their recipients), it can impose measures to redress their distortive effects. This is designed to close the perceived regulatory gap between non-EU subsidies and subsidies granted by EU Member States, which are already scrutinised closely under the EU State aid rules.

The FSR applies from 12 July, at which point the EC can conduct own-initiative investigations. From 12 October, merging parties will need to notify and receive EC clearance prior to closing for M&A deals which meet the following thresholds:

i. The target (for acquisitions), at least one of the merging parties (for mergers), or the JV company (for the creation of a JV) is established in the EU (e.g. through a subsidiary or branch) and generated EU turnover of at least €500m in the previous financial year (**threshold 1**); AND

ii. The transaction parties together (in aggregate) have received combined FFCs of at least €50m in the three years prior to the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest (**threshold 2**).

For these purposes, FFCs are considered granted at the point at which the beneficiary obtains a legal entitlement to receive them (and not the date of disbursement). The EC's Q&A gives some examples of how to calculate the relevant date in practice.

Given the broad definitions used to identify relevant FFCs and the fact that threshold 2 is a combined threshold over three years, we expect that it will often be met depending on the nature of the parties. So in practice deals meeting threshold 1 are generally likely to be notifiable.

PRACTICAL IMPLICATIONS FOR DEAL EXECUTION AND TIMING

If deals signing on or after 12 July may not close until at least 12 October, parties should undertake an FSR assessment of the deal (entailing a potentially significant internal data collection exercise – see further below) to consider:

i. whether an FSR filing is required (in which case closing cannot happen until clearance is received); and

ii. whether there are any potentially distortive foreign subsidies at play and how this may impact deal feasibility. For these purposes, target due diligence processes should be expanded to include a review of potentially distortive foreign subsidies.

For relevant deals which trigger a filing:

- Parties should consider the impact on deal timing and reflect this in deal documents:
  - Since no formal filings can be made before 12 October, and parties cannot close their deal pending clearance, deals signing between 12 July and 12 October which would otherwise close in October or November may be subject to delays.
  - While there are significant similarities with the EU merger process (including the statutory review timelines being the same), the length of FSR review and especially pre-notification discussions in any given case is not yet tested, so the extent to which the two processes will be aligned in practice remains to be seen.
- To mitigate delays, parties should seek to engage in pre-notification discussions with the Commission as early as possible to be ready to notify on 12 October. If this happens, and assuming there are no issues requiring an in-depth review, the EC would have until 20 November (i.e. 25 working days) to issue a clearance decision.
- Parties should include an appropriate condition precedent in deal documents, and consider both the buyer's obligations to obtain FSR approval and the level of any cooperation required from the seller, depending on the substantive risk assessment.
- Buyers should also think about the inclusion of specific warranties to cover off the risk of distortive non-EU subsidies granted to the target and any required remedies, as well as gap covenants regarding the receipt of foreign subsidies pending closing. The EC can request notifications of deals falling below the thresholds if it suspects that foreign subsidies may have been granted to the parties in the three years prior to the deal.

LESS BURDENSOME FINAL M&A NOTIFICATION FORM

The final notification form (called the Form FS-CO) is narrower in scope than the EC's draft version. The draft was criticised for being disproportionately burdensome on merging parties (especially private equity sponsors – see below) by requiring granular information on almost all FFCs granted in the three years prior to the transaction (so 12 July 2020 at the earliest), the vast majority of which cannot be expected to be problematic.

Instead, the final form requires detailed, individualised reporting only for those FFCs above €1m which are more likely to be distortive foreign subsidies under the FSR. These are limited to: subsidies granted to ailing companies, unlimited guarantees for a company's debts/liabilities, export financing which is not in line with the OECD Arrangement on officially supported export credits, or subsidies directly facilitating an acquisition. We expect these to be relatively rare in practice. If these were present, line-by-line information would need to be provided including: the type of FFC, the granting entity, the amount, the purpose and economic rationale for granting it, and any conditions attached to it.

Conversely, the form no longer requires this level of individualised information for all other (generally non-problematic) FFCs above €1m. Instead, it requires a significantly more limited overview, grouped by third country and by type in a prescribed table format. The table requires only:

- the type of FFC (such as direct grant, loan/financing instrument/repayable advances, tax advantage, guarantee, risk capital instrument, equity intervention, debt write-off, contributions provided for non-economic activities, or other);
- a brief description of the purpose of the FFC and the granting entity – which can seemingly be fairly high level (e.g. "*tax exemption for the production of product A and R&D activities*"; "*several loans with State-owned banks for purpose X*"); and
- the *estimated* total amount of FFCs per third country, expressed as a range ("EUR 45-100 million", "EUR >100-500 million", "EUR >500-1 000 million", "more than EUR 1 000 million").

Importantly, the table no longer requires any information on such FFCs granted to the target in an acquisition scenario; only those granted to the acquiring party/ies.

Furthermore, if the total amount of FFCs granted by the same third country to a notifying party in the three years before the transaction is below €45m, they will not need to be reported. So in most cases a pragmatic way to comply in practice may be to estimate whether this threshold has likely been met on a per third country basis, and to only investigate further when it has.

NO NEED TO REPORT CERTAIN FFCS AT ALL

Although all FFCs above €1m are relevant for determining whether the €50m notification threshold is met, three types are not reportable under the form, and do not count for the purposes of calculating the €45m threshold described above:

i. Supply/purchase of goods/services (except financial services) at market terms in the ordinary course of business;

ii. Certain tax arrangements unless they are limited e.g. to certain sectors, regions or types of companies; and

iii. Tax reliefs to avoid double taxation in line with bilateral or multilateral agreements (unilateral tax reliefs applied under national legislation will need to be reported).

We note here the slight lack of clarity between the reference to "tax advantages" as a type of FCC to be included in the table, and the relevant exemptions above – which may mean that in practice such arrangements will not need to be included.

The notifying parties can request waivers in writing during pre-notification, preferably within the draft form itself. Meanwhile, the EC may request additional information if it considers it necessary for its assessment / for the notification to be considered complete.

WELCOME PRAGMATISM FOR PRIVATE EQUITY FIRMS

In our consultation response, we expressed our concern about the particular burden of the draft rules on PE firms, with multiple funds and portfolio companies. Given how they generally operate in reality, with no room for "cross-subsidisation" between portfolio companies in different funds, we suggested that their M&A deals should benefit from a more streamlined notification procedure without needing to provide information on all funds.

In line with this approach, the final notification form limits disclosure of FFCs to the investment fund(s) directly acquiring the target (as opposed to all funds), as long as the other investment funds have a majority of different investors measured according to their entitlement to profit and it can be shown that:

i. the fund which controls the acquiring entity is subject to EU or equivalent legislation governing prudential, organisational and conduct rules; and

ii. the economic and commercial transactions (e.g. sale of assets, loans, credit lines, or guarantees) between the funds (and their controlled portfolio companies) are at most limited.

REQUISITE DISCLOSURE OF MATERIALS ON DUE DILIGENCE AND TRANSACTION VALUE

The final form limits the disclosure of supporting documents to those "*prepared by or for or received by any member of the board of management, the board of directors or the supervisory board*" (in line with the equivalent merger control notification form). Conversely, it now requires due diligence summaries, conclusions or reports prepared by external advisors (which we note could be legally privileged), as well as any documents where the value of the transaction is assessed or discussed.

PRACTICAL STEPS TO SECURE TIMELY APPROVALS

Preparation for the FSR – and the avoidance of delays to deal processes from 12 July – requires above all the swift collection of internal data on FFCs. These are unlikely to be collected already as part of existing reporting systems (including for merger control filings), and may not be easily accessible by deal teams.

We have been working closely with several clients, including PE firms, to establish practicable internal processes which efficiently and robustly collect and review requisite information on relevant FFCs, in addition to transaction-specific data ahead of any contemplated deal.

Now is the time for dealmakers to adjust any existing plans for internal data collection in line with the final procedural rules. Given the as yet untested nature of the FSR process, and the time lag before we can expect more EC guidance, forward planning will be vital to achieve approvals as quickly as possible, and to avoid the FSR becoming the long pole of M&A deals.

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:

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