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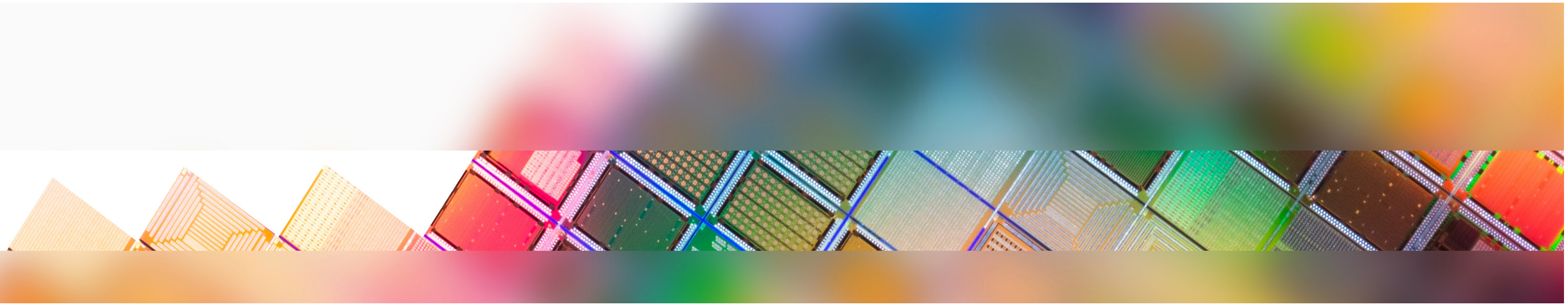

EU FOREIGN SUBSIDIES REGULATION – INCREASED RISK ON M&A TRANSACTIONS

Assessing the impact of the new regime for UK companies and others investing in the EU

The new Foreign Subsidies Regulation increases transaction risk for all companies doing deals with a significant European nexus. There are also new filing processes to contend with, and potentially longer deal timelines and increased transaction costs.

AT A GLANCE

1. From 12 October 2023, companies will need to notify certain M&A transactions and public procurement bids to the Commission and wait for clearance prior to closing the deal/being awarded the contract. The Commission can block deals or require structural and/or behavioural commitments where it considers there have been distortive foreign subsidies.
2. Deals that fall below the mandatory notification thresholds can also be proactively investigated if the Commission considers that they may involve distortive foreign subsidies.
3. The Commission can fine transaction parties up to 10% of aggregate worldwide turnover if its notification rules are not followed.
4. Acquirers will need to consider whether the new regime applies, on all M&A deals where the target's group generates significant turnover in the EU.
5. The regime will also affect public procurement processes.

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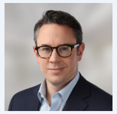

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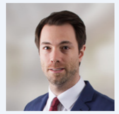

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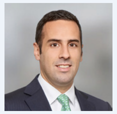

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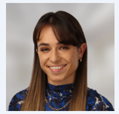

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The European Commission has long been hostile towards subsidies from foreign countries that may distort the EU's internal market. Whilst subsidies granted by EU member states are subject to the Commission's review and clearance under State aid rules, it argues that unchecked foreign subsidies distort the EU's investment landscape, giving recipients an unfair advantage when acquiring European businesses or obtaining public procurement contracts, for example.

To tackle this problem, the Commission has added the new Regulation to its legislative toolbox. The Regulation gives the Commission powers to investigate foreign subsidies and take action if it concludes they adversely affect the EU's internal market, including the power to block M&A transactions and public procurement bids.

Here are five takeaways:

1. M&A deals: increased execution risk and longer timelines

The Commission has the power to block deals or require structural and behavioural commitments where it considers distortive foreign subsidies have been given. Given the wide-ranging scope of the regime, and powers for the Commission to intervene, the risk profile of all deals with a significant European nexus will change, not only those deals where the buyer is clearly in receipt of foreign subsidies. Notably, the Commission can fine buyers up to 10% of aggregate worldwide turnover if the notification rules are not properly followed.

In the early days of the regime, because of the wide definition of 'financial contributions' dealmakers should operate on the basis that their transactions need to be notified, so long as the EU turnover test is met.

The new regime mirrors the timetable and information-gathering powers under the existing EU Merger Regulation (EUMR), but the two clearance processes are distinct. It will not always be possible to synchronise the timelines, and some transactions will be notifiable under one regime but not the other. Unlike the EUMR process, the foreign subsidies regime does not provide any opportunity for early, upfront commitments to be offered to address the Commission's concerns. This will likely cause timeline extensions and additional cost in cases that raise potential subsidy concerns.

Transactions signed on or after 12 July 2023 that do not close by 12 October 2023 will be caught, so dealmakers should consider pre-notification discussions with the Commission to minimise any potential delays to closing.

2. M&A markets: State-owned enterprises and sovereign wealth funds in the crosshairs

The businesses that are most likely to be impacted by the new regime are State-owned enterprises and sovereign wealth funds, as their ownership and funding structures will likely trigger scrutiny, and there is a real risk that the Commission could seek commitments or block deals. As a result, these investors may shift their focus towards targets without a significant footprint in the EU, or start structuring investments in EU businesses in ways that are less likely to trigger the Regulation.

Whilst the filing threshold may be met on their M&A deals, it is unlikely that many UK companies will have received subsidies that give rise to concern, not least because the UK's own Subsidy Control Act regulates grants from the UK Government. COVID-related grants are not expected to cause a problem.

How the Commission deals with businesses benefiting from the US Inflation Reduction Act will be key, particularly given the EU's own permissive approach to subsidies for green objectives under its State aid regime.

3. Data-gathering: start now

When preparing any notification, gathering the information that is required will be challenging. Such information includes various types of foreign financial contributions that have been received by multiple transaction parties over a three-year period.

Acquisitive businesses should therefore identify appropriate processes to gather data on their financial contributions now, rather than in the middle of deal negotiations. We are advising clients on how to put in place proportionate internal systems and processes for collecting the relevant data.

Sellers who are commencing sales processes should consider conducting early-stage due diligence on interested bidders, as they would in relation to antitrust and FDI matters, to identify deal execution risk early. Bidders should be prepared for this scrutiny.

4. Navigating the new regime: wait and see

The Commission's approach to enforcement remains to be seen, but the breadth of its powers means that it could be highly interventionist. The Commission is not expected to issue any detailed guidance until 2025/26, in contrast to other similar clearance regimes such as the transaction screening mandated by the UK's National Security and Investment Act 2021. That regime has been challenging to navigate even with the detailed guidance available upon its implementation.

In the meantime, there are other strategies that transaction parties can use to mitigate risk; for example, by investing through non-controlling minority interests or allocating risk between transaction parties through the negotiation of hell-or-high water obligations.

5. Public procurement: not just M&A

In addition to its implications for M&A transactions, the Regulation will also require bidders participating in high-value EU public procurement processes (exceeding EUR 250 million) to report on their financial contributions from non-EU countries, with the risk of exclusion or fines for non-compliance.

Main contractors, suppliers and subcontractors that meet the filing thresholds will also need to notify, adding a similar layer of complexity and administrative burden to that created by the Regulation in the context of M&A transactions. As a result, bidders in public procurement processes may become more selective with whom they form consortia or supply chains and require additional due diligence ahead of selection.

IS MY TRANSACTION IN SCOPE?

Notification obligations apply if:

- the deal signs on or after 12 July 2023 and has not closed by 12 October 2023;
- the transaction involves the acquisition of control over the target (i.e., the ability to veto strategic commercial decisions, such as approval of the budget and business plan, or appointment of senior management), including joint control in the case of joint ventures;
- the target (including subsidiaries) is: (i) established in the EU; and (ii) generates an aggregate EU-wide turnover of at least EUR 500 million; and
- the acquirer(s) and target received combined aggregate **"financial contributions"** of more than EUR 50 million from **"third countries"** during the previous three financial years.

"**financial contributions**" are wide-ranging in scope and include the transfer of funds or liabilities, the forgoing of revenue that is otherwise due (such as tax exemptions) and the provision or purchase of goods or services, in each case (with the exception of the grant of special or exclusive rights) whether or not the transaction is on arm's-length terms.

"**third countries**" include non-EU governments and public authorities, public entities and any private entity whose actions can be attributed to a third country.

FIND OUT MORE

Clifford Chance has published briefings on the EU Foreign Subsidies Regulation, Implications for M&A in the EU and the Final Implementing Regulation and Filing Forms.

If you would like to watch a recording of our latest European Perspectives webinar: Foreign Subsidies Regulation: Implications for Businesses and How to Comply, please register here.

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