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Exploring the First 100 Days of the Notification Obligation under the Foreign Subsidies Regulation

More Notifications, Limited Exceptions!

Markus Röhrig, Christoph Wilken and Christian Dankerl report on the latest developments from the European capital of competition law.

The first 100 days have passed since EU's newest regulatory regime to target foreign subsidies granted by non-EU countries in the context of transactions took effect on 12 October 2023. This seemed to be just the right moment for the Commission's Directorate-General for Competition (DG COMP) to share its experience and provide us with statistics of the first cases assessed under the Foreign Subsidies Regulation (FSR) in a Policy Brief issued on 1 February 2024.

Some stats

Firstly, the Policy Brief contains some statistics on the cases that the Commission dealt with under the new notification obligation:

- *Pre-Notification Procedures:* Until 20 January 2024, a total of 53 cases kicked off with pre-notification talks, leading to 14 formal notifications and 9 clearances following initial so-called "Phase I" investigations. So far, no concentration has been reviewed in-depth (so called "Phase II") or prohibited. A significant portion (42 out of 53) of these cases underwent simultaneous assessments under the EU Merger Regulation, with only five concentrations undergoing national merger control reviews. Roughly half of the FSR cases have also been subject to a foreign direct investment screening in one or several EU Member States. While these statistics are insightful, the Commission – unlike in EU merger control cases not falling under scope of a simplified procedure – does not publish a reasoned Phase I decision or even the fact that a transaction has been notified. So it remains unclear what specific criteria guided the Commission's past clearances under the FSR.

- *Surpassing Expectations:* The first numbers show that much more notified cases will occur than the 30 cases per year initially predicted by the Commission. To handle the caseload, the newly formed Directorate K within DG COMP, consisting of three units, has stepped into action, commencing its review of concentrations under the FSR since 1 March 2024.

Beyond the numbers – clarity!

Secondly, the Commission's Policy Brief provides much needed clarifications on recurring issues concerning FSR notifications. The key explanations are as follows:

- *Clarification of Notification and Reporting Requirement:* For both the notification and the reporting requirement, two concepts must be distinguished: "Foreign Subsidies" and "Foreign Financial Contributions" (FFCs).

  According to Art. 20 (3) FSR, concentrations require notification if:

  (1) The undertaking to be acquired, at least one of the merging undertakings, or the joint venture, is established in the EU and has aggregate EU turnover of €500 million or more; and

  (2) The aggregate amount of FFCs is more than €50 million over the past three years.

  While the FSR is only targeting foreign subsidies, both the notification and the reporting requirement are not triggered by foreign subsidies but FFCs. The latter is a much wider concept which covers any transfer of financial resources from a foreign public authority. It also includes FFCs received on market terms which do not confer any benefit. All FFCs received must be taken into account to determine whether the notification threshold is met. This also includes FFCs that are excluded from the reporting obligation for other reasons (see below).

- *Clear Distinction between Notification and Reporting Threshold:* Once notification is required, only those FFCs must be reported which (i) meet the threshold of EUR 45million per third country (according to Annex I, Section 9, point 3 of the Implementing Regulation) and are not excluded under points 6 or 7 of the Instructions set out in Annex I, Section 9 of the Implementing Regulation, or (ii) may qualify as a subsidy under Art. 5(1)(a) to (d) FSR or are granted directly to the notifying parties. This has led to situations in which a notification was required, yet none of the FFCs actually had to be reported to the Commission. In such instances, as clarified in the Commission's Policy Brief, parties are expected to provide an explanation as to why no reporting is necessary, and practice has shown that the case team may request further information on certain non-reportable FFCs.

- *Categorization of Foreign Financial Contributions:* Parties involved in the concentration are obliged to include in Section 5 Form FS-CO (the notification form for concentrations) detailed information about all FFCs that are "most likely to distort the internal market", according to Art. 5(1)(a) to (d) FSR, should they qualify as a subsidy. It is not necessary to determine whether these FFCs are indeed foreign subsidies at this stage.

However, parties can explain within the notification form why such FFCs do not meet the criteria for being considered foreign subsidies. During the pre-notification period, parties are encouraged to consult with the case team if there are uncertainties regarding the proper classification. The Commission explicitly encourages parties to err on the side of "over-reporting" FFCs, as this does not preclude the determination of whether they constitute a distortive foreign subsidy.

The Policy Brief also offers additional guidance on the types of FFCs that are "most likely to distort the internal market". The Commission stresses that in cases of a bail-out without an adequate restructuring plan, the assessment of whether an entity is "ailing" under Article 5(1)(a) FSR must be conducted on a legal entity basis, rather than (only) for the entire undertaking. This necessitates an undertaking to disclose if any of its legal entities meet the conditions to be considered "ailing" or has met the conditions within the previous three years, even if the overall group remains financially stable. For larger groups, this poses another very burdensome administrative exercise.

Regarding FFCs directly facilitating a concentration under Article 5(1)(d) FSR, parties must disclose all FFCs used to finance the acquisition or from which the transaction objectively benefits. It is irrelevant whether the granting third country subjectively intended to facilitate a specific transaction. Therefore, FFCs granted as limited partner investments in an acquiring investment fund should generally be reported, as their purpose typically involves providing resources for a specific acquisition. The notifying party is then required to furnish adequate information on whether these contributions were made at market conditions or not.

- *Narrowing Exceptions to the Reporting Requirement*: Point 6 and 7 of the Commission's Instructions to provide information on FFCs that do not qualify as "most likely distortive" (Table 1 to Form FS-CO) enlist exceptions from the reporting obligations. The Commission makes clear that these are exceptions to the general reporting rule and therefore must be interpreted narrowly. For example, the list of tax measures exempted under point 6 is exhaustive, and any other tax measure must be reported.

  Given that approximately one-third of all cases involve investment funds as notifying parties, the Commission found it crucial to clarify exceptions in point 7 that are specifically relevant to acquisitions by investment funds. While FFCs received by other funds within the investment company can be excluded under certain circumstances, parties will face a significant burden of proof to demonstrate that there is no likely cross-subsidization from other funds to the acquiring fund, or that mechanisms are in place to minimize this risk. This includes providing substantial evidence that (1) investors in the non-acquiring fund differ in terms of profit entitlement from those in the acquiring fund, (2) the acquiring funds adhere to Directive 2011/61/EU or equivalent third-country legislation to prevent cross-subsidization, and (3) economic and commercial transactions between acquiring and non-acquiring funds are either nonexistent or limited.

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The Commission continues to cast a wide net

Despite the unexpectedly high caseload, which might have indicated a need for stricter notification requirements, the Commission remains resolute in its determination to thoroughly examine all types of FFCs. Given the expansive nature of notification and reporting requirements, coupled with the limited exceptions, companies likely falling within the scope of the FSR are advised to conduct thorough and comprehensive reviews. Installing robust monitoring systems can help to ensure that companies are able to provide all necessary information accurately and completely within the extensive requirements under the Form FS-CO, or as directly requested by the Commission.

Until next time, don't forget that you can buy yourself flowers and follow us on LinkedIn for your favorite EU Competition Law topics!

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