ROPES & GRAY

MERGER CONTROL AND FDI OUTLOOK FOR 2023

JANUARY 2023

In This Issue

Merger Control and FDI Outlook for 2023 1

Greater number of merger control filings and more aggressive enforcement 2

Tougher reviews and greater skepticism of private equity ("PE") buyers 4

Increasing agency cooperation, but potential for divergent outcomes 8

Continued scrutiny of foreign direct investment 9

EU Foreign Subsidy Regime 12

OVER THE LAST 12 MONTHS, merger control and foreign direct investment has dominated the headlines. In 2022, we saw macro-economic conditions worsen as a result of political instability and the energy and cost of living crises, together with a continued reversal of the globalisation trend of the last decade. As we move into 2023, we can expect global merger control and foreign direct investment agencies to continue to embrace a bold and more interventionist stance to protect consumers and advance broader societal goals.

In this newsletter, we summarise the key issues that dealmakers need to be aware of in 2023. In particular, companies should note that antitrust agencies are taking jurisdiction over a broader range of transactions that would have historically escaped scrutiny and are aggressively enforcing violations. Not only is the number of filing obligations increasing, but the reviews themselves are becoming more challenging, with the agencies investigating novel theories of harm and being held to a lower standard of proof. A renewed skepticism of private equity ("PE") buyers is also being seen on both sides of the Atlantic.

With foreign policy becoming increasingly protectionist and a looming economic downturn, dealmakers can also expect foreign direct investment regulators to continue to carefully scrunitise transactions in sensitive sectors and to impose mitigation measures where there is any risk of national interests being impacted. In parallel, certain regulators have expanded their interpretation of national security risk—including to encompass risks that do not specifically arise from the transaction under review—thereby unilaterally expanding their mandates.

New regimes such as the EU foreign subsidy regime and other potential reforms such as outbound investment screening are set to further complicate M&A in 2023.

GREATER NUMBER OF MERGER CONTROL FILINGS AND MORE AGGRESSIVE ENFORCEMENT

In 2023, we expect antitrust agencies to claim jurisdiction over a broader range of transactions than ever before.

- In the EU, we understand that the European Commission (“**EC**”) has already considered more than 30 transactions for below threshold review, following its prohibition of Illumina’s reacquisition of Grail (which did not generate any EU revenue whatsoever). Companies in innovation-focused industries (such as life sciences and tech) and green sectors will need to scope the risk of cross-border review, even in the absence of a meaningful ex-US nexus.
- In the UK, the Competition and Markets Authority (“**CMA**”) will continue to take jurisdiction over more transactions post-Brexit, even those with limited UK nexus. The UK government is also considering new thresholds that would further expand the CMA’s reach.
- Regulators elsewhere have either introduced, or plan to introduce, transaction value-based thresholds to catch potentially anticompetitive deals that previously escaped scrutiny because the targets were too small (e.g., in Germany, Austria, South Korea). New rules are also under review in China, South Africa and Australia.

Companies involved in deals in sensitive or dynamic sectors in particular - irrespective of small/no target revenue - should expect increased scrutiny.

Authorities aggressively enforced antitrust violations in 2022, breaking multiple records. Some authorities (such as the General Authority for Competition in Saudi Arabia) blocked their first vertical merger and other authorities implemented their highest-ever sanctions and fines. For example, in 2022:

- China’s Competition Authority issued multiple gun-jumping fines. The Authority fined Alibaba, Tencent, and multiple other technology companies and PE groups for failing to report more than 60 transactions dating back to 2011. The agency issued the maximum fine currently available under the law for each unnotified deal - 5,000,000 yuan (US $743,000).
- The Brazilian Competition Authority imposed its highest possible gun-jumping fine of €11.6 million on Veolia for failing to notify stake-building in connection with its hostile takeover of rival Suez.
- The Portuguese Competition Authority levied its highest-ever gun-jumping sanction, fining Santa Casa da Misericórdia de Lisboa €2.5 million for failing to notify its acquisition of control over CVP - Sociedade de Gestão Hospitalar, S.A.
- In Argentina, the Secretary of Commerce fined Muzquin and Fiden a total of 20.7 million pesos ($115,484) in December 2022, for failing to notify three deals in a timely fashion. Two of the gun-jumping cases involved Muzquin’s acquisition of Laboratorios Poen and Megapharma. The third case involved Fiden’s acquisition of LS4 Radio Continental S.A. and Radio Estéreo S.A.
- The Guernsey Competition & Regulatory Authority fined a healthcare provider £1.5 million for imposing non-compete clauses on its consultants in the authority’s first-ever antitrust penalty since it split from the Channel Islands Competition and Regulatory Authorities in 2020.
- The Competition Regulatory Authority of Mozambique issued its first public infringement decisions in separate gun-jumping and price-fixing cases.

The European Commission has recently decided to expand the scope of its antitrust whistleblower tool to include merger infringements and so going into 2023, we may see a small increase in the number of gun-jumping penalties in Europe.

TAKEAWAYS

Assess the risk of a transaction being reviewed even if thresholds are not met.

- Do not assume that transactions with little ex-US nexus will necessarily avoid ex-US scrutiny.

Remember, it is not the size of the target, but the size of the antitrust issue that is most important.

- Expect filings in transactions that have the potential to impact competition and where the revenues of the parties do not necessarily reflect their competitive potential.
- Be mindful of significant transaction multiples that are likely to attract scrutiny.

Minority interest acquisitions, certain joint ventures, collaboration agreements and IP licensing arrangements may trigger notifications under antitrust and/or foreign investment regimes globally.

- Do not assume that acquisitions short of sole or joint control will escape merger control and/or foreign investment review.

Having a global, well-planned approach to your clearance strategy is more important than ever.

- Coordination with foreign direct investment (and - in the future - EU foreign subsidy) reviews is becoming more important.

TOUGHER REVIEWS AND GREATER SKEPTICISM OF PRIVATE EQUITY ("PE") BUYERS

In 2022, while the European Commission cleared a greater proportion of simplified procedure cases than ever before, 22% of normal mergers required a remedy or resulted in a Phase II investigation and 2022 saw the highest number of abandoned deals. In the UK, the CMA found competition concerns in 58% of the mergers it reviewed (a significant increase from 31% in 2021 and 42% in 2020). Nine of the reviews were completed transactions and the CMA further called in two completed mergers (the acquisition of Arthur (Co-op) by Asda and *Vorenta / Eville & Jones*). Perhaps most interesting about the statistics is that the UK intervened (prohibited, required remedies, etc.) in a greater number of transactions than even the EU (25 to the EC's 18).

In 2023, we expect antitrust enforcers worldwide to undertake a more detailed review of transactions, particularly those involving innovation, data and digital markets.

- **NASCENT/POTENTIAL COMPETITION** is a key focus of the substantive analysis, particularly in the UK. The CMA's new merger assessment guidelines give it a high degree of flexibility and discretion regarding the assessment of likely and possible entrants, giving rise to less predictable outcomes. By way of example, in the *Facebook/Giphy* merger, Stuart McIntosh, chair of the independent inquiry group carrying out the phase 2 investigation, said "*the tie-up between Facebook and Giphy has already removed a potential challenger in the display advertising market. By requiring Facebook to sell Giphy, we are protecting millions of social media users and promoting competition and innovation in digital advertising*", notwithstanding that Giphy had no UK advertising business.
- **LOWER BURDEN OF PROOF:** Agencies may be held to lower burdens of proof. In 2022, the General Court upheld the EC's prohibition of the proposed joint venture between Thyssenkrupp and Tata Steel. It found that the EC had proved that there was a "*sufficient degree of probability*" of competition being harmed, marking a departure from the historical "*strong probability*" and "*sufficiently high degree of probability*" standards. While this decision is currently on appeal, we can expect the agencies to continue to press for lower burdens of proof particularly in dynamic markets where the likely outcome of future competition remains unclear.
- **NOVEL THEORIES OF HARM:** We expect agencies to consider increasingly novel theories of harm and topics outside of traditional antitrust analysis such as innovation, sustainability and effects on labour markets. For example, we see some antitrust authorities taking a novel approach to the counterfactual (what competition would look like absent the merger), including second-guessing the outcome of a seller's sales process and the assessment of possible purchasers.
- **SCOPE CREEP:** We can also expect reviews of PE deals in particular to involve issues like interlocking directorates and non-compete provisions. Indeed, on 5 January 2023, the FTC proposed a new rule that would ban non-compete clauses (and *de facto* non-competes) between employers and employees (with a limited exception for a 25% or more owner upon sale of a business). This new rule would equally apply to existing non-compete clauses which must be rescinded prior to the compliance date (subject to very limited exceptions). It remains to be seen whether the FTC chooses to make final such a sweeping rule, or whether it adjusts its scope in response to the public comments it receives. Expect significant legal and constitutional challenges to the FTC's authority to implement the rule immediately upon final issuance.
- **PREFERENCE FOR STRUCTURAL REMEDIES** continues in Europe, as well as in the US. For example, in *Illumina/Grail*, behavioural remedies were rejected on both sides of the Atlantic.
- **APPETITE TO LITIGATE:** The US agencies are likely to remain willing to litigate. The DOJ has articulated a high bar to accepting parties' proposed settlements. In 2022, the DOJ

did not enter into any formal settlements, preferring instead to litigate than accept remedies. While the FTC appears more willing to accept settlements, it has required significant divestitures and has insisted on onerous terms requiring acquirers to obtain "prior approval" from the agency before closing any future transaction affecting each relevant market for which a violation was alleged, and "prior notice" provisions for future acquisitions in some markets even though no enforcement actions were taken. The agencies collectively filed 10 complaints to block alleged anticompetitive transactions, based on both traditional and more novel theories of harm.

- **SKEPTICISM OF PE:** As the DOJ and FTC consider changes to their merger review guidelines, a spotlight on PE deals and other related investment vehicles could have major implications. In particular, a focus on the deal history of potential PE buyers would represent a departure from current practice and could create new hurdles for PE firms. In addition, in the UK, we understand that the CMA is canvassing views from interested stakeholders in connection with the effect of leverage on investments on consumers. The CMA's predecessors, the OFT and CC, had historically considered public interest issues in circumstances where capital gearing and interest cover ratios of the merged company would result in insufficient funds for capital expenditure (Swedish Match/Gillette (1991)), or result in the target company being put under pressure to give priority to short-term considerations in order to generate funds to reduce borrowings, or be forced to implement measures of rationalization leading to substantial job losses (Elders/Allied Lyons (1986)). Supermarket acquisitions (Morrisons) and (Asda) by financial sponsors renewed the debate, as both supermarkets have been accused of becoming less aggressive on pricing since being acquired by financial sponsors. The CMA has noted: "*Private equity is an important source of business finance, but these acquisitions can be highly leveraged, which can make the target companies more vulnerable to failure. At a macroeconomic level, rising corporate leverage can also amplify the effects of the business cycle and the impact of economic shocks. Separately, public policy questions have been raised about the possible impact of private equity investment on employment; and the treatment of private equity in the tax system.*" In practice, the CMA is not likely to take leverage into account in the context of a standalone acquisition, except where financial structure raises concerns regarding solvency. However, this may become more of an issue with a purchaser approval process in the context of divestiture, where the CMA may raise concerns regarding a PE firm's commitment to the relevant market and its incentive and industry know-how to vigorously compete. If PE is out of the picture, the consequence may be that we find an even greater number of prohibitions, if suitable corporate purchasers with the access to the right capital and historical investment track records cannot be found.
- **PRINCIPLES-BASED APPROACH IN THE EC:** The EC has signaled a renewed focus on a principles-based approach to EU competition policy, including fairness, maintaining competitive processes, consumer welfare, efficiency and innovation. This focus on the key principles underpinning EU competition law gives the EC extensive flexibility to adopt new rules and review existing laws and guidelines, and may allow it to pursue novel theories of harm when enforcing those rules.

On the plus side, we expect the EC will make significant changes to its simplified procedure in 2023, which will help to reduce the burden for businesses involved in qualifying deals. Currently, parties are required to notify to the EC transactions that do not affect competition in the EU under the same procedure as those transactions with limited effects on competition in the EU. The proposed revisions would allow certain transactions, such as joint ventures active outside the European Economic Area, to benefit from "super-simplified" treatment: no prenotification and reduced information requirements for the notification. Other proposals include expanding the scope of transactions eligible for simplified procedure and introducing multiple choice questions and tables in the short-form notification form.

TAKEAWAYS

Expect the unexpected and prepare transaction documents for the unexpected.

- Companies in innovation-driven segments should plan for longer and more complex regulatory processes with less predictable outcomes. For example, note that there has been a noticeable uptick in the number of "pull and refiles" before the European Commission which can give rise to unexpected delays.
- Undertake an antitrust feasibility study pre-signing to avoid unwanted surprises later on. This should include understanding the likely market reaction and whether there is a Plan B (e.g., divestitures) that still makes economic sense.
- Consider whether HOHW provisions provide enough protection in the event of litigation, or whether to look to other options, such as reverse antitrust termination fees, to allocate risk.
- Anticipate future regulatory requirements when designing alternative deal structures, such as option deals, licensing and collaboration agreements. Analyse at the outset whether competition concerns are likely to arise in the future if the project succeeds. Build in appropriate contractual mechanisms to address these points upfront.

Be ready to engage on complex theories of harm.

- Expect more thorough investigations into innovation strategy, pipeline, and investment, resulting in longer and more complex merger reviews. EU and UK authorities continue to scrutinize whether transactions may lead to a reduction in innovation across an entire market or field of innovation, including in areas where the parties may not yet be active.
- "Green killer acquisitions" (attempts to remove green innovators from the market) are starting to fall under the spotlight, such as in Norsk Hydro's Alumetal deal. Executive Vice-President Vestager recently stated that the EC has "*already had to step in several times, to protect innovative efforts to find less toxic pesticides, or to develop more energy-efficient turbines.*"

Educate deal teams on the importance of document creation.

- Companies need to be prepared to present robust evidence in response to complex concerns, including on multiple hypothetical markets.
- Develop a pro-competitive transaction rationale and explanation of deal valuation, including evidence of any synergies and customer benefits, which are clearly supported by internal transaction-related and ordinary-course documents.

Be prepared for significant levels of disclosure (including in connection with minority investments).

- In 2020, the EC initiated a study on the effects of common shareholdings by institutional investors and asset managers on European markets. While no major enforcement action has been taken since the report, the EC continues to monitor overlaps created by minority shareholdings. Indeed, the proposed new EU merger notification form would mandate disclosure of all material (including noncontrolling) shareholdings and directorships in competing companies or companies active in vertically related markets for each notifiable transaction.

Continued on pg.7

Continued from pg.6

TAKEAWAYS

Analyse your interlocking directorates position

- Undertake periodic reviews of board representations across portfolio to ensure compliance with Section 8.

Be mindful of gun-jumping risks.

- Longer timelines mean that deal teams may be more eager to monitor target activities and enforce interim operating covenants. Brief your team early on risks of gun-jumping and involve antitrust counsel early in deal planning. If a UK process is anticipated, it may be sensible to align interim operating covenants with Interim Enforcement Orders (IEO) to the extent likely in an anticipated merger.

Conduct targeted due diligence of existing commercial practices as a routine part of investment decisions.

- Following successful penalties that were imposed on PE in connection with the CMA's excessive pricing case, we understand that the CMA is seeking views from interested stakeholders on how it might reinforce its parental liability toolkit. Companies in innovative industries need to take particular care to ensure that business models and commercial strategies are compatible with competition, consumer, data privacy and IP/patent laws.

INCREASING AGENCY COOPERATION, BUT POTENTIAL FOR DIVERGENT OUTCOMES

Cooperation between authorities will be a strong feature of merger control in 2023. Merging parties should assume that information disclosed to one authority may be shared with other authorities around the world, and that theories of harm developed in one jurisdiction may inspire others. Establishing a consistent, global advocacy strategy from the outset is therefore imperative for merging parties.

Increasing cooperation will, however, not always lead to more consistent outcomes. For example, during the two-years since the UK left the EU, the European Commission and UK CMA have concluded reviews in 20 parallel cases and reached different conclusions in five of them. Most notable was the CMA's prohibition of the planned merger of Cargotec and Konecranes, two Finnish providers of container-handling equipment and services to port terminals and other industrial consumers worldwide, notwithstanding that the EC conditionally cleared the deal. The CMA regarded the "mix and match" remedy offer as too complicated to implement and enforce, whereas the EC was satisfied that it resolved all competition concerns.

Separately, the CMA referred *Suez / Veolia* for a Phase II review at the end of 2021, a week after the EC had conditionally cleared the deal at Phase I. Similarly, the EC opened Phase II investigations into *Kustomer / Facebook* and *eTraveli / Booking*, and required a divestment in *LeasPlan / ALD*, which were all cleared unconditionally by the CMA.

With the increasing number of parallel reviews by agencies with different legal frameworks and political priorities, divergent outcomes are likely to continue to be a trend.

TAKEAWAYS

Be ready for the increased practical coordination required in multiple parallel reviews.

- Proactively consider different privilege rules and ensure document production processes are run in an efficient and coordinated manner for multiple jurisdictions.

CONTINUED SCRUTINY OF FOREIGN DIRECT INVESTMENT

Foreign direct investment filings continue to proliferate with almost all EU Member States having adopted new national security screening mechanisms or amended existing ones, and with the Committee on Foreign Investment in the United States ("**CFIUS**") continuing to take a proactive approach to scrutinizing foreign investment in the United States.

The UK's National Security and Investment Act 2021 ("**NSIA**"), which came into force on 4 January last year, has taken centre stage, with the UK government already having blocked five mergers on national security grounds. US and European investors may feel comforted that each prohibition involved Chinese or Russian-backed investors, but the regime remains far-reaching and unpredictable. Indeed, the first prohibition decision related to a licence arrangement, and since it was not a corporate acquisition, the transaction was not subject to mandatory notification under the **NSIA** and was instead filed on a voluntary basis.

Two of the Investment Security Unit's ("**ISU**") five prohibitions also make use of the NSIA's retrospective call-in powers. The third prohibition was the first instance where the UK government reviewed a transaction that closed before the new regime even entered into force (Nexperia closed the acquisition in July 2021). However, it took the ISU until 25 May (over five months after the NSIA came into force) to call the transaction in for review and then until 16 November to reach a prohibition decision (far beyond the statutory review periods available to the ISU).

The ISU's latest prohibition concerned Russian-backed LetterOne's acquisition of Upp (formerly Fibre Me) in January 2021 as part of a £1 billion investment plan to build a regional broadband network reaching one million homes in Eastern England by 2025. On 19 December 2022, the government published an order requiring LetterOne to sell 100% of its shareholding in Upp "within a specified period" and requiring Upp to complete a security audit of its network prior to sale.

Per the most recent statistics published by CFIUS, which cover Calendar Year 2021, the number of CFIUS filings has continued to increase steadily year over year. In 2021, 272 notices (compared to 187 in 2020 and 231 in 2019) and 164 declarations (compared to 126 in 2020 and 94 in 2019) were submitted to the Committee, and these filings covered a broad range of industries and countries. In addition, the number of transactions that CFIUS independently scrutinized through its non-notified transaction review process also increased, with 135 independent outreaches in 2021 (compared to 117 in 2020 and 80 in 2019). Notably, the types of transactions that come under CFIUS scrutiny also has evolved, with CFIUS taking an increasingly broad view of what constitutes a threat to US national security and reviewing transactions that would, *inter alia*, expose US sensitive personal data to risk, reduce US technological leadership, or involve foreign parties with even indirect connections to countries of concern, like China and Russia.

CFIUS's increasingly robust approach to scrutinizing foreign investment was formalized—and implicitly ratified—by a September 2022 Executive Order, the first such Executive Order in CFIUS's nearly 50-year history. The Executive Order observes that companies outside of government contractors, semiconductor companies, and other traditionally high-risk industries may warrant enhanced CFIUS scrutiny, which is consistent with recent experience. The Executive Order directs CFIUS to consider five categories of risk in connection with transactions, including: (1) a transaction's effect on the resilience of critical US supply chains that may have national security implications; (2) a transaction's effect on US technological leadership in areas affecting US national security, including but not limited to microelectronics, artificial intelligence, biotechnology and biomanufacturing, quantum computing, advanced clean energy, and climate adaptation technologies; (3) industry investment trends that may have consequences for a given transaction's impact on national security; (4) cybersecurity risks that threaten to impair national security; and (5) risks to US persons' sensitive personal data.

FAR-REACHING REMEDIES AND MITIGATIONS

In 2022, 27% of reported cases in the EU were cleared with conditions, blocked or withdrawn. In the UK, 14 deals were cleared with conditions, blocked or ordered to be unwound. [In the United States, mitigation statistics have not yet been published for 2022. In recent years, the percentage of reviews resulting in CFIUS mitigation has been relatively consistent (11-14%); however, the scope of measures imposed in transactions subject to mitigation has steadily increased.]

FDI concerns can typically be mitigated by behavioral rather than structural remedies. Theories of harm are, however, often less clearly articulated (with most jurisdictions not publishing decisions at all), and FDI authorities have a different approach to negotiations than in the merger context. Understanding the process and engaging with government stakeholders is often key.

While US and European investors may escape outright prohibitions, they routinely find themselves subject to far-reaching commitments as a condition to clearance. And while commitments are intended to preserve the status quo (and protect national security), in practice, they can go further and include economic commitments.

Commitments might include maintaining domestic production capacity, protecting domestic R&D, protecting projected investment, ensuring compliance with existing contracts with public bodies and strategic companies, entering into commitments around security of supply for key products for governments, and/or permitting regulators to closely monitor compliance with mitigation commitments.

In the UK, previous national security interventions under the public interest regime have resulted in parties giving statutory commitments on board composition nationality requirements (including appointing government observers to the board - particularly in a defence/military context), information security commitments, continuity of supply, and site security requirements. Prospective purchasers have also offered economic commitments (e.g., to maintain the location of the target's headquarters, share listings and core operations, and to protect jobs) outside of the scope of the national security regime, particularly in relation to public deals.

In the United States, in October 2022, CFIUS published its first-ever CFIUS Enforcement and Penalty Guidelines, which set forth the process by which CFIUS will assess penalties for non-compliance with CFIUS regulations (including non-compliance with mitigation agreements and failure to submit mandatory pre-closing filings) and describe relevant aggravating and mitigating factors. Although CFIUS always has had the ability to impose monetary penalties for non-compliance with CFIUS directives (in addition to its authority to impose mitigation measures), the Committee has used its penalty authority only sparingly. The timing of publication of the Guidelines, on the heels the first-ever CFIUS Executive Order, may signal a pivot to a more aggressive enforcement posture going forward.

OUTBOUND INVESTMENT CONTROLS ON THE HORIZON

In addition to inbound screening, outbound investment screening seeks to control strategic investments abroad in countries like China and Russia as a means of addressing the risk that strategic and financial investors may facilitate the development in China or Russia of technologies that are sensitive and impact domestic national security.

In the United States, there are active discussions in Congress to establish a broad form of outbound investment screening—and recent reports suggest that the Biden administration is considering a targeted Executive Order in the first instance—but it remains to be seen whether a new regime will be implemented. In the meantime, the United States has taken related steps to limit Chinese and Russian companies' access to US resources, including new export control restrictions targeting China's semiconductor and advanced computing industries.

The EC has also announced that it will review its control mechanisms for outbound investments.

TAKEAWAYS

Include foreign investment filings as a primary factor in deal planning, including:

- understanding where filings will be necessary or advisable, whether the reviews may raise substantive risks and/or cause pinch-points in the deal timeline;
- staying informed of the possibility of new regimes coming into force post-signing and requiring notifications, and providing contractual protection for this;
- understanding how foreign investment regimes may affect the success rate and attractiveness of the deal; and
- considering the interaction between merger control and foreign investment filings and competing demands (e.g., information gathering).

Regimes are surprisingly broad/vague – Industries that are not generally sensitive from an economic or political view (such as standard industrial products and services) can be caught by FDI rules, particularly where the target is a supplier to the government or has access to government information or sensitive personal data.

Regimes cover non-controlling, passive minority shareholdings – Shareholdings of as low as 10% (or even less - for example in Japan) may be caught, as might investments by limited partners in fund structures. It is important to diligence all transactions for FDI, however small.

Regimes cover unusual transaction constructs such as internal reorganisations / fund-to-fund transfers, even where there is no change to the ultimate controller (Australia, Germany, UK). While the review of internal reorganisations can often be concluded more swiftly as they are typically unproblematic from a substantive perspective, this does not negate the need for a FDI filing.

FDI can also capture the acquisition of assets, e.g., in the UK, France and Italy. Assets may include contracts or IP rights connected to sensitive activities. Indeed, the UK's first prohibition decision (July 2022) under NSIA related to a licence agreement for certain vision-sensing technology between the University of Manchester and a Chinese company, Beijing Infinite Vision Technology Company Ltd.

Consider purchaser organizational structures – Some regimes (such as the UK) are acquirer-agnostic and can be tripped by UK purchasers. Direct or indirect involvement of any parties with strong connections to "hostile" states, regardless of their control rights, may complicate or delay foreign investment processes.

Consider warranties – Purchasers should gather extensive information on any activities that may be considered sensitive to anticipate risk and insist on warranties when relying heavily on target confirmations.

Understand geopolitical tensions and keep an eye on new developments – "National security" is broad and authorities' concerns may not be obviously security related.

Devise mitigation strategies early on (including remedies, "front foot" commitments, etc.) and ensure consistent messaging across all jurisdictions and channels (e.g., around investment rationale).

EU FOREIGN SUBSIDY REGIME

On 28 November 2022, the European Council formally adopted the new Foreign Subsidies Regulation (FSR). The FSR aims to tackle foreign subsidies which have the potential to distort the internal market.

The FSR introduces a new mandatory and suspensory notification obligation (that is independent of merger control and foreign direct investment) where a transaction results in a concentration and meets certain thresholds, which are described below. The regime will come into effect in mid-2023 and will have a considerable impact on M&A in the EU.

While much of the regime remains a mystery to advisors (and reportedly, the officials that plan to enforce it), deal-makers can expect clarity in the form of preliminary guidance that is expected early in 2023.

The EU has already inspired new foreign subsidy rules in the US and the UK. While they are both significantly more flexible than the EU regime, staying on top of the various different regulatory regimes adds yet more complexity to deal-making in 2023.

THE EU FOREIGN SUBSIDIES REGIME - WHAT DO YOU NEED TO KNOW?

The new FSR regime will apply to transactions where:

- There is an acquisition of sole or joint "control" (e.g., a JV);
  - **REMEMBER** "control" is not just defined as the acquisition of 50%+ of the equity or voting rights of a company, or control of the board. It can also include minority interest acquisitions where there is an acquisition of strategic veto rights (e.g., the approval of the annual budget, approval of the annual business plan, appointment / dismissal of senior management and / OR ordinary course investments);
- One of the merging entities, the acquired undertaking or the JV is:
  - Established in the EU (this is understood to include entities with an EU subsidiary); and
  - Generates an aggregate turnover of €500 million in the EU in the last full FY.
- The "undertakings concerned" received from third countries (government authorities and public entities) an aggregate financial contribution of €50 million over the last three calendar years.
  - This calculation includes financial contributions of the buyer(s) and the target business. This means that an acquirer with absolutely no links to foreign financial contributions must notify its deal to the EC if the *target h*as received the requisite level of foreign financial contributions (and vice versa).
  - The term "financial contribution" is deliberately wide and includes:
    - any transfer of funds or liabilities (capital injections, grants, interest free loans, loan guarantees, fiscal incentives, setting off of operating losses, COVID-related support, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps, or rescheduling);
    - the foregoing of revenue that is due (e.g., non-ordinary course tax benefits); and
    - the purchase of goods and/or services by public authorities of a third party (for example, government cleaning contracts, defense contractors, prison caterers, school stationary suppliers, and other innocuous purchases of goods or services).
  - The regime is agnostic with respect to the recipient of the foreign financial contributions and does not target specific industry sectors or countries. Under the regime,

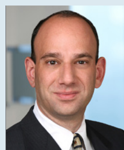
financial contributions received by a single portfolio company (for example, in connection with COVID-related relief) could trigger requirements for the entire PE firm on every transaction, even if that financial contribution has nothing to do with the acquisition and that portfolio company has nothing to do with the target.

- Co-investment from sovereign wealth funds in connection with acquisitions are included. However, the extent to which passive LP interests from sovereign wealth and public pension funds are included remains unclear.
- Crucially, for the notification obligation to arise, there is no requirement for the "financial contribution" to confer any "benefit" or advantage to the recipient (akin to a "foreign subsidy"). The question of whether the foreign contribution results in a distortive "foreign subsidy" is assessed only after the notification has been made.
- If the European Commission identifies any concerns, it can require commitments or even prohibit a deal.
- If the timing falls in line with the current EU merger control regime, we can expect that even straightforward notifications may take a minimum of 3-4 months overall.
- As with merger control filings, a failure to notify can result in fines of up to 10% of aggregate global turnover of the acquirer. Other financial penalties also apply.
- The European Commission plans to dedicate 145 full-time employees to this new initiative (the size of several units within a major Directorate General) which reinforces the likely scale of the new regime.

TAKEAWAYS

- **Compile a record of "financial contributions" received from non-EU states (or state-owned enterprises, such as sovereign wealth funds) over the last three financial years**. Start working with your accountants and tax advisers to identify non-EU government financial contributions for all of your portfolio companies for the last three years to determine whether the €50 million threshold is satisfied.
- **Ascertain whether these identified financial contributions were received on market terms** – If thresholds are met, this will not relieve buyers of the notification obligation, but it is important to avoid financial contributions being qualified as foreign subsidies, which the regulation targets and which may lead to the EC requiring remedies or prohibiting a transaction. When mapping the received financial contributions, you should assess their impact on investments and economic activities in the EU and pre-empt any finding of distortion.
- **Adopt internal procedures to take account of FSR rules especially in mergers and acquisitions and public tender processes.** Put in place a tracking system and a reporting obligation for each portfolio company each time they receive a non-EU government financial contribution and determine whether it could be regarded as a distortive foreign subsidy.
- **Sell-side considerations** – On the sell-side, you should be aware that this new regime will add complexity to the execution of exits and sellers should diligence potential buyers to assess to what extent these new filing requirements affect the attractiveness of their bids.

GLOBAL ANTITRUST CONTACTS



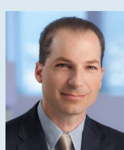
Mark Popofsky
Washington, D.C.
mark.popofsky@ropesgray.com
+1 202 508 4624

Jane Willis
Boston/New York
jane.willis@ropesgray.com
+1 617 951 7603

Ruchit Patel
London
ruchit.patel@ropesgray.com
+44 20 3201 1702

Chong Park
Washington, D.C.
chong.park@ropesgray.com
+1 202 508 4631

Mike McFalls
Washington, D.C.
michael.mcfalls@ropesgray.com
+1 202 508 4684



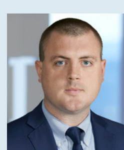
Jonathan Klarfeld
Washington, D.C.
jonathan.klarfeld@ropesgray.com
+1 202 508 4764

Samer Musallam
Washington, D.C.
samer.musallam@ropesgray.com
+1 202 508 4850

Annie Herdman
London
annie.herdman@ropesgray.com
+44 20 3201 1680

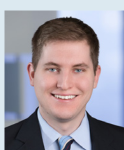
CFIUS CONTACTS

Ama Adams
Washington, D.C.
ama.adams@ropesgray.com
+1 202 508 4655



Brendan Hanifin
Chicago
brendan.hanifin@ropesgray.com
+1 312 845 1311

Emerson Siegle
Washington, D.C.
emerson.siegle@ropesgray.com
+1 202 508 4744



Kurt Fowler
Chicago
kurt.fowler@ropesgray.com
+1 312 845 1108

ROPES & GRAY

ropesgray.com

BOSTON | CHICAGO | DUBLIN | HONG KONG | LONDON
LOS ANGELES | NEW YORK | SAN FRANCISCO | SEOUL
SHANGHAI | SILICON VALLEY | TOKYO | WASHINGTON, D.C.

© 2023 Ropes & Gray LLP. All rights reserved. Prior results do not guarantee a similar outcome. Communicating with Ropes & Gray LLP or a Ropes & Gray lawyer does not create a client-lawyer relationship. 23_0139_0130