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EU Commission Seeks Broad New Powers to Control Foreign Subsidies

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On 5 May 2021, the EU Commission adopted a proposal for a far-reaching regulation to address distortions of competition in the EU internal market caused by subsidies provided by non-EU governments. The regulation aims at closing a perceived regulatory gap whereby subsidies granted by non-EU governments are generally not scrutinized while subsidies granted by EU Member States are subject to EU State aid control. The proposed rules provide for an entirely new obligation for companies to notify M&A deals and bids submitted in public procurement tenders where they have received foreign financial contributions, which would add complexity and risks for M&A transactions.

The draft regulation proposes three novel tools that would apply to all economic sectors and to a wide variety of situations:

1. A notification-based tool to investigate transactions where the turnover of the EU target exceeds €500 million and a financial contribution received from a non-EU government exceeds €50 million over the previous three years;
2. A notification-based tool to investigate bids in public tenders involving a financial contribution by a non-EU government where the estimated value of the procurement is €250 million or more; and
3. A tool to investigate *ex officio* all other market situations, smaller transactions (e.g., greenfield investments) and public procurement procedures, which the EU Commission can start on its own initiative.

Our *Alert* focuses on the notification-based tool for investigating potentially subsidized transactions.

Main Features of the Transaction-Related Tool

The transaction-related tool is largely modeled after the EU merger control regime and also includes elements of EU State aid concepts. Under the proposed regulation, the EU Commission would be solely competent to review transactions involving foreign financial contributions.

When is a transaction notifiable?

A transaction needs to be notified to the EU Commission if (i) it is a concentration, (ii) the EU target meets the relevant turnover thresholds, and (iii) it involves a foreign financial contribution received by the acquirer.

- Concentration: As is the case under EU merger rules, a concentration is defined as a change of control on a lasting basis resulting from a merger between two companies, the acquisition of control over another firm or the creation of a full-function joint venture (i.e., an economically autonomous entity). Control is defined as having the possibility to exercise decisive influence over another firm, i.e., this concept is also taken from EU merger rules.
- Turnover threshold: The target must be established in the EU and have generated turnover of at least €500 million in the last financial year prior to the notification. In case a full-function joint venture is established, either the turnover of the joint venture or that of one of its parents needs to exceed this threshold.
- Financial contribution: The proposed regulation defines this term broadly as comprising a transfer of funds or liabilities, e.g., capital injections, grants, loans or fiscal incentives. The financial contribution received by the undertakings concerned must be provided by a non-EU government authority, public entity or private entity that can be attributed to a third country. The financial contribution must exceed €50 million in the three calendar years prior to the notification. All financial contributions made to different companies belonging to the same group will be aggregated. Importantly, the recipient of a foreign financial contribution does not have to be a non-EU investor, but can also be an EU company.

What will the EU Commission investigate?

It will investigate (i) whether the foreign contribution is a foreign subsidy, (ii) whether it distorts competition in the EU, and (iii) whether negative effects of the foreign subsidy are outweighed by positive effects.

A foreign subsidy is defined as a financial contribution that confers a benefit on a company that is engaged in economic activity in the EU and is limited to the individual company or industry, or several companies or industries.

A distortion occurs if the foreign subsidy improves the competitive position of either the acquirer or target and where it actually or potentially affects competition in the EU. The EU Commission will determine whether there is a distortion of competition in the EU based on a set of indicators that include, e.g., the amount of the subsidy, the nature of the subsidy, the level of economic activity of the acquirer or target in the EU, and the purpose of and conditions attached to the foreign subsidy.

The proposed regulation provides examples of foreign subsidies that will most likely be distortive, such as:

- A foreign subsidy granted to an ailing undertaking that will likely go out of business in the short or medium term in the absence of any subsidy (unless there is a restructuring plan that is capable of leading to long-term viability);
- A foreign subsidy in the form of an unlimited guarantee for debts or liabilities of the undertaking; or
- A foreign subsidy directly facilitating a transaction.

A foreign subsidy is unlikely to distort the EU internal market if its total amount is below €5 million over a consecutive period of three fiscal years.

The proposal also includes a balancing test: The EU Commission will balance the negative effects of the foreign subsidy against positive effects on the development of the relevant economic activity (this could include, e.g., environmental or social policy objectives).

What is the proposed process?

Transactions cannot be implemented for a period of 25 working days following the notification. If the EU Commission initiates an in-depth investigation within the 25 working day period, the transaction cannot be implemented for another 90 working days (if the parties offer commitments, this period is extended by an additional 15 working days). Following the initiation of an in-depth investigation, the EU Commission can issue (i) a no objection decision, (ii) a decision with commitments or (iii) a decision that prohibits the transaction.

What type of remedies could be imposed?

Structural or behavioral remedies can be imposed by the EU Commission or offered by the parties during the in-depth investigation. The potential remedies include the repayment of the foreign subsidy, the divestment of certain assets, access remedies on fair and non-discriminatory terms or the prohibition of certain market behavior (e.g., refraining from making certain investments or reducing market presence).

What investigation powers will the EU Commission have?

The EU Commission's powers are similar to those in EU antitrust or merger control investigations. It can issue information requests, conduct inspections (within or outside of the EU) and impose significant fines for a failure to notify, non-cooperation or the provision of incorrect or misleading information, ranging from 1%-10% of the companies' global turnover (depending on the infringement).

How will M&A transactions be impacted?

- A foreign subsidies notification may be required in addition to potentially applicable EU or national merger control and national foreign investment filings, which means that an M&A deal may require three separate filings with three potentially different review periods.
- The parties will not be allowed to close notifiable deals under the foreign subsidies regime until the EU Commission has completed its review. The duration of the foreign subsidy review process will therefore need to be taken into account when determining the long-stop date of a transaction.
- Contractual provisions may need to be included in the transaction documents such as an additional closing condition for the foreign subsidies review and clauses regarding the allocation of the "foreign subsidy risk" between the parties as well as the obligation to offer or accept potential foreign subsidy-related remedies.
- Dealmakers structuring a sales process will need to take into account the impact of potential acquirers having to obtain foreign subsidies approval under the new regime.
- Non-notifiable transactions which carry the risk of distortive foreign subsidies may lead to an ex officio investigation by the EU Commission – which may well be triggered by third party complaints. This may have a significant impact on the

transaction timeline, depending on when the EU Commission calls in the transaction.

Outlook

The proposed regulation will now go through the ordinary legislative procedure (during which amendments are still possible). There will also be a two-month public consultation period during which the relevant stakeholders can comment on the draft. It is expected that the new foreign subsidies regime will enter into force next year. According to the draft regulation, the new foreign subsidies regime would mean a lot of additional work for the EU Commission as it would involve ~145 FTEs and an administrative expenditure of €90 million for 2021-27.

The draft regulation includes certain improvements compared to the White Paper that the EU Commission published last summer. In particular, it is helpful that the regulation relies on well-established concepts from EU merger rules and that the relevant thresholds are generally higher than those contemplated initially (e.g., for *de minimis* foreign subsidies). However, the substantive distortion test remains somewhat opaque and it is unclear how the balancing test will be handled in practice. The fact that transactions that otherwise do not have to be notified could still be called in by the Commission *ex officio* also increases deal uncertainty.

The proposal is the latest addition to the quickly evolving regulatory landscape in the EU and, if adopted by the EU legislature, will increase the regulatory risk and burden for companies operating or investing in the EU with support from non-EU countries. Only recently did the EU Commission decide to change its referral policy in the merger space, which effectively gives it the power to call in any transaction that could raise competition concerns (see our *Alert* here). In addition, as a result of the FDI Screening Mechanism that has been in effect since October 2020 (see our *Alert* here), a number of EU Member States have introduced new foreign investment regimes or expanded existing ones. A new foreign subsidies regime relating to transactions may have a dampening effect on investment into Europe, especially when seen in conjunction with these other M&A-related regulatory developments.

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