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Crack-down on Foreign Subsidies

The Commission's Proposed Regulatory Regime for Foreign Subsidies and what it Means for M&A Deals and Beyond

Markus Röhrig, Jan Bonhage and Lukas Ritzenhoff report on the latest developments from the European capital of competition law.

On 5 May 2021, the European Commission proposed legislation that would revolutionize the rules on foreign subsidies in the EU. What the Commission has in mind is nothing less than an entirely new regulatory notification regime akin to the EU Merger Regulation and the control of State Aid. Under the proposed regime, the Commission would have broad powers to investigate subsidies granted by non-EU governments to companies engaging in economic activity in the EU. In line with the Commission's 2020 White Paper on foreign subsidies, the proposed legislation would introduce an obligation for companies that have received foreign subsidies to notify M&A deals and bids submitted in public procurement procedures. In addition, the Commission would be empowered to investigate *ex officio* all other market situations on potentially distortive foreign subsidies.

The Commission would have the power to impose structural and behavioural remedies and, as a last resort, to block deals or bids. The Commission expects notification of approx. 30 concentrations, 13 to 36 bids in public procurements and 30-45 *ex officio* investigations per year (https://ec.europa.eu/competition/international/overview/scrutiny_board_opinion.pdf).

This edition of Brussels á Jour provides an overview of the Commission's proposal and offers some initial thoughts on the impact that the new regime might have on companies' M&A deals and beyond. In particular, the proposed power to investigate cases *ex officio* is likely to create substantial uncertainty in M&A deals and public procurement procedures that the companies' and their advisors will have to address, and they will need to think about what the mandatory notification regime means for their deal timetables.

Failure of Existing EU Antitrust, Merger Control and State Aid Law?

The Proposed Regulation addresses a perceived failure of public procurement and trade defence mechanisms under current EU antitrust, merger control and State aid law in relation to foreign subsidies.

Distortive effects have, for example, been criticized by European airlines facing low prices offered by largely subsidised airlines on Asian and Middle Eastern routes ((https://ec.europa.eu/competition/international/overview/foreign_subsidies_consultation_feedback_ACP.pdf). The Commission also identified several sectors, including steel, aluminium, aviation, oil and gas, and certain sensitive technologies, facing similar issues. The Commission proposed a complementing regulation to remedy such potential to distort the internal market.

New Notification Requirements and Substantive Test

The Commission must be notified if in a concentration at least one of the merging parties is established in the EU and generates an EU turnover of at least EUR 500m and the foreign financial contribution amounts to at least EUR 50m in the last three years prior to the notification. A standstill obligation applies during the review. The preliminary review of a concentration is confined to 25 working days, the in-depth investigation to additional 90 working days. These periods essentially mirror the respective timeline of EU merger reviews pursuant to the EUMR. Similar to the customary practices in EU merger control, the parties will likely have to account for an additional pre-notification period.

For bids in public procurement involving a financial contribution by a non-EU government, the proposed threshold is an estimated contract value of at least EUR 250m. The proposed preliminary review period is up to 60 working days, an in-depth investigation accounts for a total of up to 200 working days after notification.

The Commission also proposes to be competent to investigate all other market situations and concentrations as well public procurement procedures that do not meet these thresholds in case of alleged distortive foreign subsidies and may request an ad-hoc notification before implementation. The Proposed Regulation sets a – very low – *de minimis* threshold of EUR 5m, below which foreign subsidies are unlikely to distort the internal market.

The Commission will assess whether the financial contribution constitutes a foreign subsidy, as rather broadly defined in the Proposed Regulation, and whether it distorts the internal market. The Commission can consider positive effects of a foreign subsidy and balance these effects with any distortion (balancing/public interest test). Furthermore, it is competent to impose redressive measures or negotiate commitments of the parties to remedy the distortion. The potential remedies range from the repayment of the foreign subsidy, to the divestment of certain assets, the reduction of capacity or market presence, granting access to a certain infrastructure or the prohibition of a certain market behaviour.

The Proposed Regulation provides the Commission with far reaching investigative powers including, at least theoretically, inspections in and outside the EU. In practice, it will likely request written information from the parties as established in EU merger

control. The Commission may, if no such information is provided, base its decision on the established facts. Where it finds that a party, intentionally or negligently, failed to comply with obligations under the Proposed Regulation, the Commission may impose fines of up to 10% of the total turnover in the preceding financial year. In case a concentration is implemented in violation of the standstill obligation and it is found to distort the internal market, it may be dissolved.

Impact on M&A Transactions

The following – non-exhaustive – items would likely become relevant in the context of M&A deals:

- The parties will not be allowed to close notifiable deals until the Commission has completed its review. While this is a mechanism that companies are familiar with in a merger control context, the duration of the foreign subsidy review process will also have to be factored in when considering the long-stop date of the transaction. The transaction documents will need to include an additional closing condition and address issues such as the allocation of the "foreign subsidy risk" between the parties, the obligation to offer or accept potential remedies and how to their align the foreign subsidies with potentially parallel merger and/or foreign direct investment reviews.
- Non-notifiable transactions which carry the risk of distortive foreign subsidies may allow an *ex officio* investigation by the Commission – which may well be triggered by third party complaints. This may have significant impact on the timeline, depending on when the Commission would call the deal in. Informal guidance and comfort letters may help to mitigate this uncertainty.
- Companies and their M&A advisors structuring a sales process will need to reflect on the impact of potential acquirers requiring "foreign subsidies clearance" under the new regime. Bidders who are expected to trigger a filing requirement (or an *ex officio* review) may be at disadvantage and might have to consider how to handle the risk associated with the Commission's review.
- The foreign subsidies review comes on top of potentially applicable EU or national merger control proceedings and national FDI screenings.
- The new regime may impose a burden not only on non-EU companies receiving subsidies from foreign governments. EU-based corporations that at some point in the three years preceding an acquisition have received funding from an EU third-country exceeding EUR 50m may be caught by the filing requirement as well. Such funding may well have been attributed to financing a specific project in the EU third-country. If the company acquires an EU-based target with an EU-turnover exceeding EUR 500m it would nevertheless have to file despite the obvious lack of impact on competition in the internal market. If such cases cannot be excluded from the regime altogether, it might make sense to at least provide for a simplified procedure as in EU merger control to reduce the burden for the affected companies.

Outlook

The Proposed Regulation will be reviewed by the Member States and the European Parliament. Based on the support the topic has received from Member States so far, adoption of the Regulation essentially as proposed by the Commission would not be surprising.

Contact

Markus Röhrig
Partner
T +32 2 7885 525
markus.roehrig@hengeler.com

Jan D. Bonhage
Partner
T +49 30 20374 173
jan.bonhage@hengeler.com

Lukas Ritzenhoff
Senior Associate
T +32 2 7885 520
lukas.ritzenhoff@hengeler.com

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