EU Will Propose Merger Control Legislation for Foreign-Subsidized Companies' Acquisitions in 2021

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The European Commission's (EC) June 2020 white paper[1] proposing wide-ranging controls over foreign-subsidized companies' access to Europe's internal market has received fresh impetus. In a report issued earlier this month, the European Union's (EU) audit body faulted the EC for a hitherto balkanized approach to foreign state-backed acquisitions. Senior administration officials have committed to maximum legislative priority for the proposals.

- The white paper proposes subjecting foreign state-subsidized companies to market investigations, mandatory notifications of acquisitions and potential disqualifications from public procurement.
- The merger review proposals would represent a step change for mergers and acquisitions in Europe. The proposals suggest a much lower threshold for notification than antitrust controls, review of both control and minority stakes, an obligatory standstill period and presumptions of unlawful trade distortion *inter alia* if the subsidy facilitated the acquisition.
- After consultation closes in September 2020, the EC will start the legislative process in the first quarter of 2021. But it remains to be seen whether there will be sufficient support among national capitals, whose backing is also needed. EU member states may judge they are better placed to assess the benefits of foreign state investment.

Why the EU Is Acting on Foreign Subsidies

The area of foreign subsidies represents substantial unfinished business for Competition Commissioner Margrethe Vestager. In the aftermath of the EC's 2019 decision blocking Siemens' and Alstom's proposed creation of a European industrial champion in the railway sector, to counter China's CRRC, Commissioner Vestager promised to level the playing field for Europe by clamping down on foreign subsidies. Having returned in the new EC as competition and digital commissioner, Ms. Vestager and Single Market Commissioner Thierry Breton have proposed far reaching measures to protect the EU single market against the "harm that foreign subsidies can do."[2]

Under the EU state aid rules, the EC can sanction member states for distorting the market through unlawful subsidies, but the EU has no formal powers against foreign state subsidies. The World Trade Organization (WTO) has its own trade defense regime for unfairly subsidized exported products that has engendered long disputes between the EU and US on aircraft manufacturer aid. But the WTO process is lengthy and complicated, and does not cover market practices or acquisitions unrelated to exports. The EC proposals seek to address this alleged regulatory gap.

The Foreign Subsidy Merger Control Regime

"Foreign subsidy" is broadly defined. It includes any non-EU government or public body benefit conferred *de iure* or *de facto* on specific companies or industries. It applies to foreign subsidies granted to EU-based companies, subsidies granted to foreign companies but used by an EU affiliate, or subsidies used to facilitate an acquisition of an EU target or participate in an EU procurement contract. It covers export financing subsidies, debt forgiveness, subsidies to struggling companies, guarantees of debts or liabilities,

[1] White Paper on Levelling the Playing Field as Regards Foreign Subsidies, COM(2020) 253 final, 17 June 2020. For a detailed overview of the proposals, see our 24 June 2020 client alert, EU Proposes Controls on Mergers, Market Conduct and Public Contracts To Combat Foreign Subsidies.

[2] Commission Adopts White Paper on Foreign Subsidies in the Single Market, EC Press Release, 17 June 2020.

tax relief outside general measures and foreign subsidies directly facilitating an acquisition. As currently drafted, any preferential tax treatment or fiscal incentives such as tax credits by a non-EU government, whether or not supported by a ruling, could fall within the scope of the new regime. Subsidies under €200,000 over a period of three years are excluded.

In relation to acquisitions, foreign-subsidized acquirers would have to notify to the EC any contemplated acquisition of an EU target that meets the relevant filing thresholds (see below). This would be in addition to, rather than in place of, the merger control filings that may be required, though the two filings could be reviewed in parallel.

Based on the current proposals, the notification obligation would apply if the acquirer has received a foreign subsidy from a third-country government three years prior to the deal, or expects to do so within a year thereafter. In assessing the transaction, there would be no requirement that the foreign subsidy forms part of the consideration for the acquisition. Rather it would have to be shown that the acquisition: (i) was facilitated by the foreign subsidy either directly or indirectly by increasing the acquirer's financial strength; and (ii) would be likely to result in the distortion of the internal market. Foreign subsidies directly facilitating acquisitions would normally be considered distorting. The EC would consider the size of the subsidy, the position of the beneficiary, competition in the market(s) concerned and whether the beneficiary has privileged access to its domestic market.

The Notification Threshold and Procedure

The EC is proposing a significantly broader test for notifiable acquisitions than under EU merger control rules. This will encompass not just control, but an as-yet-undefined "material influence" threshold. Typically this would mean any substantial equity stake, perhaps with director appointments attached, that might influence major corporate decisions.

The size of notifiable transaction is also not yet decided. But the proposal suggests the thresholds will be far lower than the current EU merger control thresholds. It could be a size-of-target test (for example, revenue over €100 million) or value-of-transaction test. The latter may be more appropriate where the target has a valuable, but as yet uncommercialized, technology or business concept.

In terms of procedure, there would be a mandatory standstill period while the acquisition is considered. Either there would be no finding of distortion, and the acquisition cleared, or an in-depth inquiry ordered. The inquiry would examine whether there is sufficient evidence tending to show that the acquiring company could have benefitted from foreign subsidies facilitating the acquisition. The EU could prohibit the acquisition or order remedies as the price of approval.

The Impetus To Act

Public statements by senior EC officials show strong institutional support to move forward with this legislation. EC President Ursula von der Leyen's Letter of Intent to the European Parliament and Council, published alongside her State of the Union 2020 speech of 16 September, singles out foreign subsidy legislation as one of the major initiatives in the upcoming year.[3] And the EC's Deputy Director-General for State Aid Carles Esteva Mosso stated that the proposals have "maximum priority" for the EC. He reported that there had been substantial support in response to the consultation and the EC would move forward with a legislative proposal as quickly as possible, saying that 2020 is "almost materially impossible, but 2021 — certainly." This was echoed by Dutch and German officials highlighting the limitations of the EU's current trade defense tools.[4]

A report issued by the EU's audit body, European Court of Auditors (ECA), has added support.[5] It stated that EU actions taken in response to China's increasing investments in the EU are not properly coordinated, financed or monitored. It identified that Chinese state-owned enterprises have backed over half of China's investments in the EU. While under EU rules, such subsidies would, if granted by a member state, be treated as state aid, the EU does not currently have the tools to take similar action against foreign subsidies. The ECA refers to the white paper proposals as a way to avoid potential distortions and achieve a level playing field.

The proposals also come at a sensitive time for EU/UK trade negotiations. Once outside the bloc in January 2021, the UK will become a third country potentially subject to the new foreign state subsidy rules. The UK has resisted the EU's desire to include state subsidy "level playing field" obligations in any future trading agreement.[6] A foreign subsidy regime may be seen by the EU as an alternative means of securing a level playing field as the UK exits.

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[3] Letter of Intent to President David Maria Sassoli and to Chancellor Angela Merkel, State of the Union 2020, 16 September 2020.

[4] Ensuring a Level Playing Field Between European Companies and State Owned or Subsidised Enterprises From Third Countries, European Competition Day 2020, 7-8 September 2020.

[5] The EU's Response to China's State-Driven Investment Strategy, Review No 03/2020, European Court of Auditors, 10 September 2020.

[6] Government Sets Out Plans for New Approach to Subsidy Control, Department for Business, Energy & Industrial Strategy Press Release, 9 September 2020 (The UK intends to apply the minimalist WTO rules on subsidies as of 1 January 2021).

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The EU sees these types of unilateral measures as helping the EU negotiate multilateral state aid controls with international counterparts. Deputy Director-General Esteva Mosso stated that "the multilateral road continues to be there, but we need to be realistic. If this is not advancing, we need to have our own instruments."

Legislative Outlook and Implications

The EC's proposals clearly have strong institutional support within the EU and some member states. That said, whether there will be political appetite for these measures once the EC turns them into a concrete legislative proposal remains to be seen. The EU legislative track would typically be 18 months for something of this complexity. And it is uncertain that the legislation would secure the necessary qualified majority vote among EU governments, who may consider themselves better placed than the EC to determine the benefits of inward investment into their economies, whether subsidized or not. Foreign states may also respond negatively through trade or legal pressure to the proposals, and question the proposals' compatibility with existing multilateral anti-subsidy regimes. The measures also currently contain many placeholders for crucial legal questions, not least the threshold at which EU intervention becomes appropriate.

Nonetheless, even a partial implementation is expected to have material implications for foreign companies operating or investing in the EU. For M&A practitioners the proposals represent a further political overlay in relation to transactions. Sellers would need to give close consideration to a non-EU acquirer's ownership, source of funds, home-state backing or market-access privileges and whether the transaction may be perceived as part of a foreign state-backed acquisition strategy in Europe. Sellers would also have to consider the additional potential risks presented by state-supported acquirers and the possibility that European domestic complainants might use regulatory pressure to challenge acquisitions. Companies would also need to be wary of a deal becoming a political, or geopolitical, football. The low thresholds for intervention — potentially biting on minority stakes and targets with a minimal revenue nexus to the EU — create additional legal uncertainties.

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