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The EU Anti-Subsidy Regulation – Implications for M&A

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The European Union (EU) is readying revolutionary new powers for the European Commission (the Commission) to combat distortions of competition resulting from subsidies from non-EU governments. The new regime, laid out in a proposed regulation (the Anti-Subsidy Regulation) published in May 2021, could be in effect as soon as mid-2023. The regulation includes new mandatory notification and approval requirements triggered by certain acquisitions, mergers and joint ventures that will apply alongside the existing EU and national merger control and foreign direct investment screening regimes.

The Anti-Subsidy Regulation addresses concerns that non-EU State-owned enterprises (SOEs) could use foreign subsidies to tilt the competitive playing field. According to the impact assessment accompanying the Anti-Subsidy Regulation, subsidized companies may overpay for acquisitions of EU businesses, crowding out potentially more efficient bidders and risking serious long-term harm to the functioning of the EU market. Case studies cited in the impact assessment focus on acquisitions by Chinese buyers. But the new notification requirements will likely impact mainly European and other western multinationals, who are most likely to participate in transactions triggering the regulation's thresholds.

Multinationals doing business in the EU or considering joint ventures with EU businesses will need to create new compliance systems to identify and quantify all governmental "financial contributions" they receive outside the EU over rolling three-year periods. They will also need to revise their transaction processes and documentation to take account of the new notification and approval requirements. Many groups will need to start this process well in advance of the regulation's effectiveness, depending on their activities.

Background

The Anti-Subsidy Regulation follows a June 2020 white paper on levelling the playing field as regards foreign subsidies (the White Paper). The White Paper was in turn inspired by criticism that the Commission's February 2019 prohibition of the proposed Siemens/Alstom merger failed to take account of competitive distortions caused by subsidies received by a Chinese competitor.

The regulation will create a unique hybrid of trade and antitrust tools, filling a hole in the EU's current toolkit. The Commission's trade defense rules offer no protection when non-EU subsidies distort investment decisions, market operations or pricing policies in beneficiaries' European

operations, facilitate the acquisition of EU companies, or distort bidding in European public procurement. Similarly, the Commission's powers to review and approve State aid do not apply to subsidies granted outside the EU.

The Anti-Subsidy Regulation will give the Commission new powers – modelled on the Commission's traditional powers to investigate cartels and other antitrust offences — to investigate and redress distortions of competition by companies benefiting from "financial contributions" that arguably increase their profitability and thereby affect their competitive behavior in the EU. Presumably, these ex officio investigations will prioritize non-EU SOEs.

The regulation will also impose a new requirement supplementing existing public procurement rules. Lead bidders will have to notify "financial contributions" received by themselves and their main suppliers and sub-contractors over the prior three years for all tenders valued at over €250 million (regardless of the amount of financial contributions received). The Commission's review may delay awards for up to 200 days.

Finally, the regulation will impose new ex ante notification obligations – modelled on the EU Merger Regulation (EUMR) — in relation to certain M&A transactions. The notification thresholds are based on a combination of revenue (or "turnover") and "financial contributions" received by members of the relevant groups from non-EU governments and entities "attributable" to non-EU governments. This blog focuses on this new ex ante mandatory notification regime for M&A transactions.

The Anti-Subsidy Regulation joins a crowded EU legislative docket, including the Data Governance Act, Digital Services Act, Digital Market Act, AI Regulation and (soon) Data Act. But the Anti-Subsidy Regulation has so far proved less controversial among EU stakeholders than some of these other measures and is expected to be approved by the end of 2022, in which case it would apply as from mid-2023.

Contributions, subsidies and distortions

The Anti-Subsidy Regulation distinguishes between three related concepts: "financial contributions," "foreign subsidies" and "distortions on the internal market." The Commission can only impose redressive measures or require commitments as a condition of approval where it finds that a "financial contribution" qualifies as a "foreign subsidy" that is likely to distort the EU internal market.

In the case of concentrations, multinationals' notification requirements are based on the financial contributions received by them and other transaction parties. "Financial contributions" are defined very broadly as "(i) the transfer of funds or liabilities, such as capital injections, grants, loans, loan guarantees, fiscal incentives, setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps or rescheduling; (ii) the foregoing of revenue that is otherwise due; or (iii) the provision of goods or services or the purchase of goods and services," whether provided by government authorities or public or private entities whose actions can be attributed to a non-EU country.

The Commission must assess "financial contributions" to determine whether they involve a "foreign subsidy." Similar to the EU State aid concept of "selectivity," a foreign subsidy is

deemed to exist where a financial contribution confers a benefit limited to an individual corporate group or industry or to several groups or industries. Once a financial contribution is determined to constitute a subsidy, the Commission must determine whether the subsidy risks distorting the EU internal market. The regulation includes a non-exhaustive list of subsidies most likely to be considered distortive: those granted to a group otherwise likely go out of business (unless there is a satisfactory restructuring plan), an unlimited guarantee of debts or liabilities, subsidies directly facilitating a concentration, and subsidies enabling an undertaking to submit an unduly advantageous tender.

Notably, the definition of "financial contributions" includes many forms of government interaction that involve no subsidy, such as government contracts awarded pursuant to competitive tenders. Financial contributions also include support that may involve a subsidy that would be authorized under EU State aid rules, such as incentives for R&D or support of under-developed regions, and therefore unlikely to be distortive.

Based on this definition, many if not most multinationals receive financial contributions, especially considering the support granted to businesses worldwide during the COVID-19 pandemic. But identifying and quantifying these contributions is likely to be a complex exercise, especially for groups operating in many jurisdictions and/or sectors.

Notification thresholds

The Anti-Subsidy Regulation's mandatory notification obligations, similar to the EUMR, apply to one group's, or "undertaking's," acquisition of sole control of another, the merger of two or more previously independent undertakings or parts of undertakings or the creation of a "full-function" joint venture (generally defined as a joint venture with its own personnel, assets and market presence, as opposed to a joint venture formed to provide goods or services to its parents).

In the case of an acquisition or merger, concentrations will be notifiable if the target (in the case of an acquisition) or at least one of the merging parties (in the case of a merger) is established in the EU and generates EU turnover of at least €500 million and the parties concerned received aggregate financial contributions in the three prior years of over €50 million. The €500 million EU revenue threshold is double the comparable EUMR threshold, but the €50 million financial contribution threshold seems very low, especially considering the broad definition, the rolling three-year period and the fact that the threshold is calculated on an aggregate group-wide basis.

The idea seems to be to catch potentially subsidized acquisitions of (or mergers with) large European businesses. Since the financial contribution threshold applies to all transaction parties together, however, the target could satisfy the turnover and financial contribution thresholds by itself. Thus, the thresholds for acquisitions could catch transactions even if the acquirer receives no non-EU financial contributions at all. Moreover, the €500 million thresholds has been criticized as too high, and the final figure seems likely to be significantly lower.

The Commission will also have the right to require notification of any transaction not meeting the thresholds if it suspects that the acquirers may have benefitted from foreign subsidies in the three years prior to the concentration, so long as it does so before the transaction's implementation. This flexibility may be inspired by the Commission's controversial decision to accept (and even encourage) Member State referrals of transactions below the EUMR thresholds, regardless of

whether the transaction in question meets Member State review thresholds.

Full-function joint ventures will be notifiable if the joint venture itself or one of its parent groups is established in the EU and generates aggregate EU turnover of at least €500 million and the joint venture and its parent groups received aggregate financial contributions in the three prior years over €50 million. As with acquisitions and mergers, since the financial contribution threshold applies to the joint venture and its parent groups together, a single party could satisfy the turnover and financial contribution thresholds.

Like the EUMR, the Anti-Subsidy Regulation will catch many joint ventures with little or no connection to the EU. Unless the joint venture thresholds are modified in the legislative process, virtually any full-function joint venture, regardless of its geographic scope, could trigger a notification if one parent is a multinational group with significant European revenues. Similarly, many joint acquisitions – a common practice of private equity groups and other financial investors, such as pension funds — will also trigger notification even where targets are not active in the EU.

Procedure

The Anti-Subsidy Regulation's notification process and timetable closely resemble the EUMR process, with an initial 25 working day review period followed by an in-depth 90 working day review period starting from the date of formal notification. Notified transactions cannot be closed while the review is pending.

Should the Commission find that the non-EU financial contributions received by the parties constitute "foreign subsidies" and that such subsidies distort the Single Market, it could either accept commitments by the notifying party that effectively remedy the distortion or prohibit the acquisition after its in-depth review (contrary to the EUMR, remedy offers in the preliminary review period are not allowed).

Commitments can include providing fair and non-discriminatory access to infrastructure; reducing capacity or market presence; refraining from making certain investments; licensing intellectual property rights on fair, reasonable and non-discriminatory terms; publishing R&D results; divesting assets; dissolving concentrations; and/or repaying the subsidies (with interest). Some of these measures could apparently reduce output and/or increase prices and thus run counter to generally accepted principles in merger remedies. On the other hand, the Commission could allow a transaction that would otherwise be prohibited based on a balancing of negative and positive effects (an option that is not available under the EUMR).

In contrast to the well-established criteria for evaluating the antitrust effects of concentrations in traditional merger review, the Commission will be ploughing new ground as it assesses the distortive effects of foreign subsidies in the M&A context. The Commission will no doubt draw on its experience assessing EU State aid, but analyzing potential distortions in the EU from dozens, or hundreds, of financial contributions in multiple sectors all over the world will present very different challenges compared to analyzing the effect of a single aid or aid scheme in the EU. Although the Anti-Subsidy Regulation includes some general guidance on foreign subsidies most likely to be considered distortive, much more detailed guidance will be needed.

Similarly, the Commission is presumably working on implementing measures elaborating on the

notification process and information required. Based on experience under the EUMR, it is likely that notifying parties will be expected to submit one or more draft notifications and answer questions from the case team before making the formal filing. These pre-notification discussions can and often do take as long or longer than the official review process.

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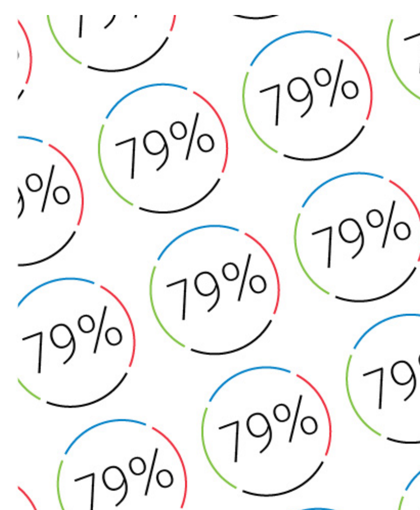

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