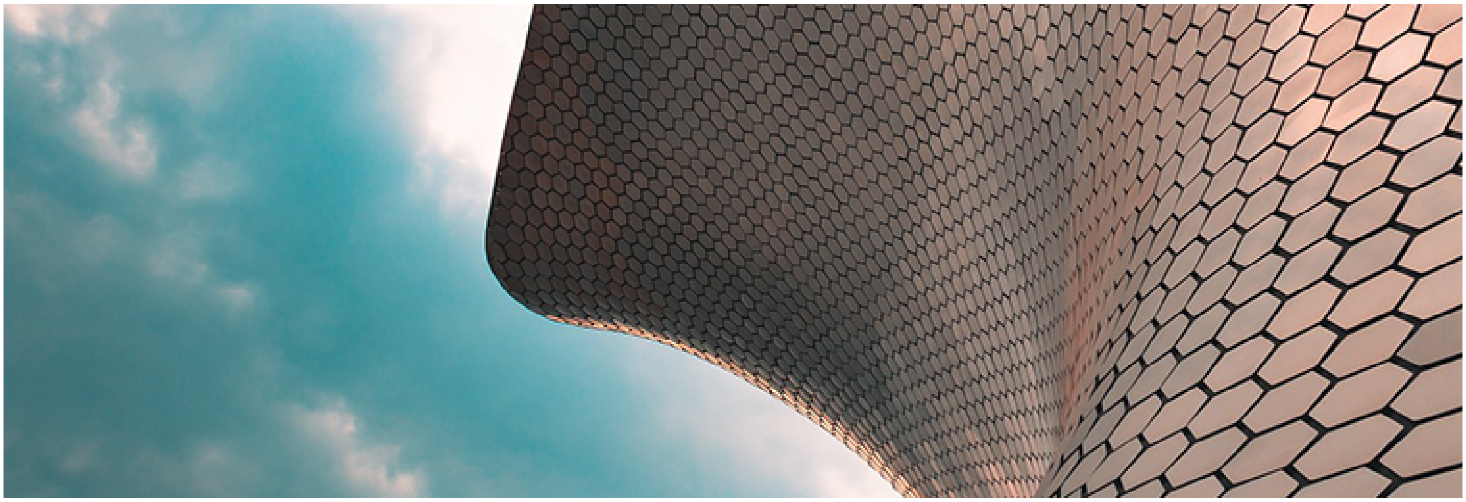

The European Commission proposes sweeping new controls on foreign subsidised companies

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Background

On 5th May 2021, the European Commission published a draft new legislative proposal seeking to impose broad controls on companies which have received support from foreign (non-EU) governments (the Subsidy Proposal).

With this draft regulation the EU is seeking greater control over foreign investments in Europe. This is designed to 'level the playing field' and close the regulatory gap arising as the EU has no power to review non-EU subsidies whereas subsidies granted by Member States are subject to close scrutiny. There is a growing concern from European businesses that they are struggling to compete against competitors backed by foreign governments in mergers and public procurement awards. European businesses believe competition is being distorted as rivals are being bought by firms with unparalleled access to credit and struggling to compete as foreign rivals can operate below market costs.

Against this background the European Commission published a white paper in July 2020 considering how the EU could address the perceived issues arising from foreign investments. The white paper identified three main problem areas; (a) general distortions in the internal market caused by foreign subsidies; (b) acquisitions of EU companies by foreign state backed companies; and (c) public procurement procedures not accounting for subsidies. The Subsidies Proposal is designed to remedy the issues identified in the white paper.

The Subsidies Proposal will have a substantial impact on foreign state backed entities both when operating in Europe and the management of new European acquisitions. While the proposal is likely to largely impact Chinese state-owned entities in the short term, it would also apply to any UK businesses that have received state support when investing and operating in Europe.

Mergers

Under the Subsidies Proposal acquisitions made by a state-backed entity meeting the thresholds set out below will have to be notified to the European Commission and will not be able to complete prior to approval. This will apply where the merger involves finance from a non-EU government where:

- the EU turnover of one of the merging parties is at least 500 million euros; and
- a party to the transaction received foreign financial contributions of at least 50 million euros in the three calendar years prior to notification.

Note that the proposed turnover threshold is very different from the various global and EU thresholds that apply under the EU Merger Regulation.

The European Commission would also have the power to call in any other transactions involving subsidised companies which fall below the thresholds set out above.

The procedure for review would be the same as under the existing EU merger control rules:

- the European Commission will have 25 working days in Phase I (following the submission of a complete notification) which can be extended by up to 90 working days;
- the European Commission could either accept commitments by the notifying party that effectively remedy the distortion to the internal market from the subsidy or block the acquisition;
- companies that fail to notify a deal could be fined up to 10 percent of their revenue; and
- providing incorrect information during a merger investigation can lead to a sanction of 1 percent.

Supervision of subsidised entities

The European Commission will have the power to initiate investigations into foreign subsidies which could distort the internal market. This power is very broad as the European Commission will have the power to investigate any foreign subsidy however foreign subsidies below 5 million euros are considered unlikely to be problematic. This will allow the European Commission to investigate a range of market situations, including transactions which fall below the thresholds.

The European Commission will investigate the existence of a foreign subsidy in a preliminary review and, if there is a possible concern, it can start an in-depth investigation assessing whether the subsidy is capable of distorting the internal market. This would look at the “amount and nature of the subsidy, the purpose and conditions attached to the foreign subsidy as well as its use in the internal market.”

The Subsidy Proposal notes that certain types of foreign subsidy will be considered likely to distort the internal market, such as:

- unlimited guarantees;
- aid that is essentially subsidising an acquisition of a European target; and
- where a company would collapse without aid from a foreign government.

As part of this investigation procedure the European Commission will be able to impose remedies including divestment of certain assets or the prohibition of certain market behaviour, such as offering access to infrastructure on fair and non-discriminatory terms.

Public procurement

Bidders in public procurement awards will need to notify the European Commission of financial contributions received from non-EU countries where the estimated value of the procurement is EUR 250 million. While the investigation is on-going the bidder cannot be awarded the contract.

If a company fails to notify the European Commission it may impose fines and review the transaction as if it had been notified.

What does this mean in practice?

Foreign business that have receive state support and trade in Europe will need to be prepared possibly to face new controls in Europe and the potential for disruptive remedies. Businesses will need to closely monitor the progress of the Subsidy Proposal and, if implemented, how the European Commission uses its new power of investigation in practice in order to ascertain their own potential risk of intervention.

It will also be advisable for merger parties, where one party is a non-European business which has received state support, to undertake greater risk assessment of whether the European Commission has or may seek jurisdiction to review the transaction. Unfortunately absolute certainty will not be possible given that the European Commission has reserved the power to call in transactions even where the thresholds are not met. Parties will need to ensure that transactional documents carefully address and allocate this risk.

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