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BLOG

European Commission White Paper Proposes Additional Considerations of Foreign Subsidies in Merger Review

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On June 17, 2020, the European Commission (the Commission) published a White Paper proposing new mechanisms (including three modules) for the Commission and Member State authorities to tighten control of foreign subsidised companies' activities including in respect of acquisitions and bids for public contracts in the EU. While the proposal is open for public comments (before September 23, 2020) and broad discussions are expected before any concrete legislative moves, it's worth noting that the Commission is considering far-reaching changes including additional scrutiny of acquirers receiving foreign subsidies in merger review.

Below highlights several of the Commission's articulated concerns regarding competition involving foreign subsidies and proposed actions as underlined by the White Paper.

Commission concerns over foreign subsidies in relation to competition

The Commission opines that foreign subsidies create "distortive economic effects" in the EU market that are not sufficiently addressed by existing "EU and international instruments" including the EU competition rules.

For the purposes of the White Paper, it should be noted that a foreign subsidy is defined as a financial contribution by a government or any public body of a non-EU State, which confers a benefit to a recipient and which is limited, in law or in fact, to an individual undertaking or industry or to a group of undertakings or industries.

Drawing a comparison with state aid granted by EU Member States, the Commission notes that subsidies granted by non-EU authorities—where the beneficiaries are likely owned or ultimately controlled by a non-EU company or a foreign government—risk "undermining competitiveness and the level playing field in the EU market." However, unlike state aid granted by EU Member States, there is at present no jurisdiction over subsidies granted by non-EU authorities.

Generally, the Commission is concerned that foreign subsidies may result in less efficient operators growing and increasing market share at the expense of more efficient operators, the harmful effects of which may be exacerbated by the "lack of transparency and reciprocity in accessing third-country markets."

Specifically, in the context of acquisitions of EU targets, the Commission is concerned that subsidies might allow subsidised acquirers to pay artificially higher prices, distorting the valuation of EU assets and preventing non-subsidised bidders from "achieving efficiency gains or accessing key technologies," potentially leading to a loss of competitiveness and innovation potential of non-subsidised companies.

In respect of public procurement, the Commission noted that EU procurement markets are largely open to bidders from third countries but that subsidised companies might be placed on an unequal footing by virtue of potentially being able to make a more advantageous offer and that this could have a detrimental effect on the ability of non-subsidised competitors to compete both in respect of tenders awarded on the basis of the lowest price and those awarded to the bidder submitting the most economically advantageous tender.

Seeing a "regulatory gap," the Commission argues that the EU competition rules cannot exhaustively address the aforementioned competition concerns, mostly because:

- Existing (conduct and merger) rules do not specifically consider benefits from foreign subsidies and do not allow the Commission or Member States to act solely or mainly on this basis;
- EU State aid rules do not regulate financial support granted by non-EU authorities to companies in the EU, either directly or through their parent companies outside the EU.

The Commission's proposed new mechanisms involving merger review

The Commission proposes new mechanisms allowing the Commission and Member States to apply stricter analyses and take "redressive measures." In far-reaching terms, the Commission is consulting on a framework that consists of three "modules" which could either be applied alternatively on a stand-alone basis, or in combination:

- **Module 1 – a general instrument to capture foreign subsidies**—this would allow the Commission and Member State authorities to review (using a two-step system of preliminary review and in-depth investigation) whether there is a foreign subsidy that may distort the internal market, with the possibility to impose measures to redress distortions, these might include structural or behavioural measures and may include divestment requirements or prohibition of certain investments;
- **Module 2 – foreign subsidies facilitating the acquisition of EU targets**—this is intended specifically to ensure that foreign subsidies do not give an unfair advantage to their recipients when acquiring other undertakings. This would allow for an *ex ante* review of planned acquisitions by companies that have received financial contributions from a third country government. The Commission anticipates that there would be a compulsory notification mechanism and a two-step review phase with an associated standstill period. If an acquisition is facilitated by foreign subsidies and a distortion of the internal market is found as a result then following an in-depth investigation, there would be two possibilities: commitments offered and accepted by the notifying party to remedy the distortion or, as a last resort, prohibition of the acquisition;
- **Module 3 – foreign subsidies in public procurement**—this would ensure that foreign subsidies could be addressed in individual procurement processes through the introduction of a mandatory ground for exclusion from public procurement procedures for those economic operators that have received distortive foreign subsidies. Exclusion could apply to both the procurement procedure in question but also the subsequent procedures under certain conditions. The Commission envisages that economic operators participating in a public procurement process would have to notify the contracting authority when submitting their bid of financial contributions received within the past three years or any expected to be received during the execution of the contract. That notification would be transmitted by the contracting authority to the competent supervisory authority for investigation of the information and the existence of a foreign subsidy. If the result of an investigation is that the subsidy has distorted the public procurement procedure, this will lead to exclusion of the operator.

A possible increase of complexity in clearing EU deals

Responses to the Commission's White Paper will help the Commission to prepare for legislative proposals in the area of foreign subsidies. Whilst any changes as a result will take some to enact and come into force, companies should keep in mind that the proposals at present will involve an element of looking at past financial contributions received.

It is clear that the Commission is seeking to take an increasingly interventionist approach and is assessing whether its toolkit is sufficient to deal with issues of market distortion which fall outside the scope of existing rules relating to competition, state aid, public procurement, and trade defence. This is just one of a number of proposals that the Commission is considering to ensure that the competitiveness of markets is being preserved.

Companies that wish to express their views before the Commission finalises its proposal should consider submitting comments—either themselves or through counsel—during the public consultation period which ends on September 23, 2020.

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