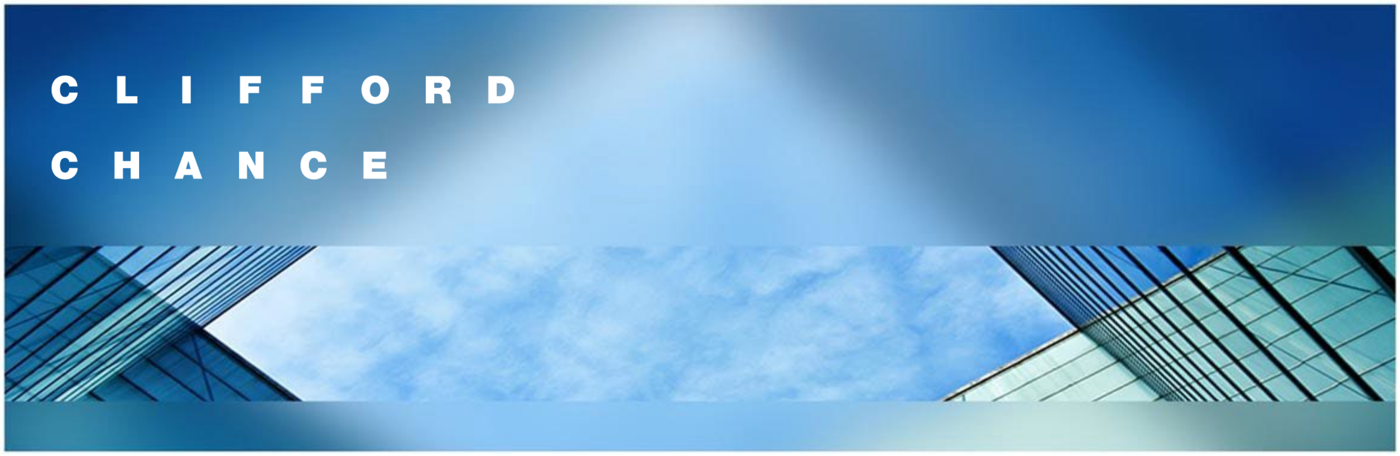

EU FOREIGN SUBSIDIES REGULATION: IMPLICATIONS FOR M&A IN THE EU

On 10 November, the European Parliament adopted a new EU Regulation on foreign subsidies which will enable the European Commission to take measures against subsidies from non-EU countries it rules to be market-distorting, including those that affect transactions involving EU-based targets.

Investors which are or which have relationships with non-EU public bodies and State-owned enterprises will have to assess whether they are caught by the new filing requirements for transactions involving EU targets and participation in public tenders, even if all those relationships are on commercial arm's length terms. This could result in a significant additional compliance burden.

Key issues

- New filing obligations will be created for M&A involving EU-based targets.
- The filing obligations will catch EU and non-EU investors that have dealings with foreign public bodies and State-owned enterprises, even if on arm's length, commercial terms.
- Assessing compliance with the filing thresholds is likely to be complex and burdensome.
- The Commission will be able to impose onerous remedies on recipients of distortive foreign subsidies affecting EU M&A transactions.

WHAT DOES THE REGULATION DO?

The EU has a stringent State aid regime to regulate subsidies granted by EU member states. However, many EU member states are concerned that the Commission has limited powers to act against companies that compete in the EU with the benefit of subsidies granted by third (i.e. non-EU) countries, in part because of gaps in the WTO rules on subsidies.

The Regulation addresses this concern by giving the Commission exclusive competence to assess whether a business has received foreign subsidies that are distorting the EU's internal market unfairly and, if so, to impose "redressive measures". For example, it will be able to require the subsidy recipient to divest certain assets, repay the foreign subsidy to the third country (with interest), reduce capacity or market presence, publish R&D results, or offer third parties access to its infrastructure or resources. The Regulation will also impose new procedural requirements in relation to M&A transactions and public procurements in the EU.

In the context of M&A, certain transactions will become subject to new mandatory filing and standstill obligations (akin to those under the EU Merger Regulation), so that the Commission is able to prohibit them or to require remedies / commitments before they close.

Filing obligations will apply if:

- the target (or one of its subsidiaries) is established in the EU (e.g. through a legal entity or branch) and generates an aggregate EU-wide turnover of at least EUR 500 million (for joint venture transactions, the JV must meet this threshold and for legal mergers it can be either of the merging parties); and
- the parties to the transaction received from third countries combined aggregate "financial contributions" of more than EUR 50 million in the preceding three financial years. The relevant parties are the target and each party acquiring a controlling or jointly-controlling interest in it.

The Commission will be able to intervene in transactions below these thresholds on its own initiative.

Although the new rules are targeted at foreign investors in the EU, the new filing requirements will apply equally to both EU and non-EU investors in M&A transactions if the relevant thresholds are met. The Commission will also be able to intervene in any transaction that does not meet the thresholds if EU or non-EU parties have received market-distorting foreign subsidies.

IMPLICATIONS FOR TRANSACTIONS INVOLVING EU TARGETS

The Regulation is aimed at addressing distortive foreign subsidies, which arise only if they confer a selective advantage (e.g., transactions on terms that are more favourable than market rates). However, the new filing obligations are based in part on the much broader concept of "financial contributions", which need not have resulted in any selective benefit. This includes financial arrangements (such as capital injections, loans, loan guarantees, derivatives) but more broadly also transactions (even if on commercial, arm's length market terms) with any public or private entity whose actions can be attributed to a third country, e.g., sales or purchases of goods or services. Further, it includes the foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration.

Consequently, any EU or non-EU investor seeking to acquire a controlling interest in a business that is established in the EU and meets the relevant turnover threshold is likely to become subject to the filing obligations if it has significant relationships with non-EU public bodies and State-owned enterprises, even if it has received no market-distorting subsidies. Similarly, non-EU State-owned enterprises and sovereign wealth funds are likely to be caught if (as is likely) their financing meets the definition of a financial contribution.

M&A transactions can be subject to filings even if the purchaser has received no foreign financial contributions at all, provided the target has received foreign financial contributions in excess of the relevant threshold. This is an odd result, given that the filing regime was originally expressed as having the aim of preventing subsidised investors from being able to outbid others unfairly.

All acquirers of control in a target that meets the turnover threshold will need to be able to assess whether they meet the threshold for foreign financial contributions. This is likely to be an onerous and costly exercise. In particular, every transaction entered into over a three-year period by every entity in the purchaser's corporate group will have to be assessed to determine whether the counterparty meets the very broad definition of a “third country” (including non-EU public bodies and non-EU State-owned or controlled entities and even private entities whose "actions are attributable" to a non-EU government). For these purposes, the corporate group of an investor and the concept of control are defined in the same way as under the EU Merger Regulation. Consequently, a private equity investor will have to identify and aggregate all third-country financial contributions received by any portfolio company in which a fund that it manages has a controlling (or jointly-controlling) interest, as well as financial contributions that it has received itself (e.g., in the form of fees). It will likely also have to aggregate third-country contributions received by any fund that it manages, e.g., investments by sovereign wealth funds as limited partners. However, financial contributions received by passive limited partner investors would not typically need to be aggregated.

For every transaction with a third-country counterparty, the value of the "financial contribution" will need to be calculated, which is likely to be complex, particularly for financial arrangements and tax exemptions. Unless and until the Commission issues detailed guidance or implementing legislation that clarifies how to do this, there is a risk that investors may have to consider postponing or abandoning certain transactions because they are not in a position to assess the value of their foreign financial contributions, or to provide information about them in a filing form.

The Regulation is subject to approval by the EU Council, which is expected to occur in the coming weeks. The Regulation will then become applicable on the date falling six months and 20 days following its publication in the Official Journal of the EU, i.e., probably around mid-2023. However, the notification obligation described above will not apply to transactions that are agreed, or public takeover bids announced, before the date falling three months after the date of application of the Regulation (i.e., probably during Q3 2023), although the Commission's new intervention powers will apply to transactions agreed or public takeover bids announced on or after the date of application of the Regulation.

For a more detailed explanation of the new foreign subsidies regime, see this client briefing.

NEXT STEPS

Please do reach out to your usual Antitrust or Corporate Clifford Chance contacts to discuss what the implications of this Regulation are for your future M&A including how the information on "financial contributions" can be gathered.

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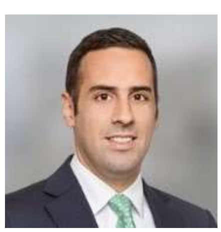

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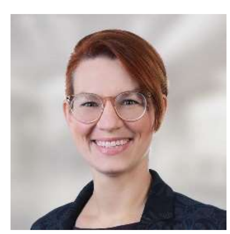

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