INTERNATIONAL BAR ASSOCIATION

ANTITRUST COMMITTEE MERGER WORKING GROUP

RESPONSE TO REQUESTS FOR INPUT
TO THE EUROPEAN COMMISSION'S WHITE PAPER ON LEVELLING THE PLAYING FIELD AS REGARDS FOREIGN SUBSIDIES

23 September 2020

INTERNATIONAL BAR ASSOCIATION

ANTITRUST COMMITTEE MERGER WORKING GROUP

RESPONSE TO REQUEST FOR INPUT

I. INTRODUCTION

This submission is made to the European Commission's Directorate General for Competition ('**Commission**') on behalf of the Mergers Working Group ('**Working Group**') of the Antitrust Section of the International Bar Association ('**IBA**') in response to the *White Paper on levelling the playing field as regards foreign subsidies* ('**White Paper'**).[1] The comments contained in this submission focus solely on Module 2 of the White Paper, which addresses foreign-subsidized acquisitions of EU companies.

The IBA is the world's leading organization of international legal practitioners, bar associations and law societies. It takes an interest in the development of international law reform and seeks to help shape the future of the legal profession throughout the world. Bringing together practitioners and experts among the IBA's 80,000 individual lawyers from across the world and with a blend of jurisdictional backgrounds and professional experience spanning all continents, the IBA is in a unique position to provide an international and comparative analysis in the field of commercial law, including on competition law matters through its Antitrust Section.[2]

The Working Group hopes to contribute constructively to the Commission's consultation on its proposals. The Working Group's comments draw on the vast experience of the IBA's members in merger control law and practice within the EU and other jurisdictions across the globe.

II. GENERAL COMMENTS ON MODULE 2 PROPOSALS

The Working Group notes that the EU State aid system does not apply to non-EU subsidies, which could directly or indirectly be used to facilitate the acquisition of EU undertakings. On this basis, it is therefore possible to identify - technically - a form of regulatory "gap" (which could be addressed by Module 2 legislation).

Whether such a gap needs to be "addressed", however, is a separate question which the Working Group encourages the Commission to consider further.

The Working Group considers that, prior to proceeding with regulation, it would be useful for the Commission to develop a further Staff Working Paper with accompanying studies/impact assessments to assess why and how utilization of non-EU government capital in the context of acquisitions (either directly or indirectly) might be problematic. The underlying premise to (or the structural presumption contained in) the Module 2 proposal in the White Paper indeed

---

[1] Issued June 17, 2020. See, https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf. This submission does not necessarily reflect the views of the organisations with which individual members of the Working Group or officers of the Antitrust Section are engaged or employed.

[2] Further information on the IBA is available at http://www.ibanet.org and information about the Antitrust Section is available at https://www.ibanet.org/LPD/Antitrust-Section/Default.aspx.

appears to be that third country government investment in EU “targets” is *prima facie* "bad", without any developed economic analysis or evidence ("*foreign subsidies directly facilitating acquisitions would normally be considered to distort the internal market*").[3] No case studies or prior examples of distortive acquisitions are provided in the White Paper. Nor does it contain any economic analysis; reference is simply made to "*the allocation of capital*" and "*the possible benefits of the acquisition for example in terms of efficiency gains*".[4]

In particular, assessments of at least seven distinctive types of acquisition scenarios can be envisaged:

- **Type 1**: acquisitions of EU Targets by non-EU Sovereign Wealth Funds ('**SWFs**') and equivalent vehicles, made solely for the purposes of investment (i.e. passive financial investments);

- **Type 2**: acquisitions of EU Targets by non-EU State Owned Enterprises ('**SOEs**'), which do NOT have overlapping activities with the EU Target or activities in an area linked to or neighboring the activities of the EU Target (i.e. portfolio investments);

- **Type 3**: acquisition of EU Targets by EU or non-EU enterprises that have non-controlling minority non-EU government shareholders, which do NOT have overlapping activities with the EU Target or activities in an area linked to or neighboring the activities of the EU Target (i.e. portfolio investments);

- **Type 4**: acquisitions of EU Targets by listed or non-listed privately-held enterprises that may have received non-EU government financial contributions, which do NOT have overlapping activities with the EU Target or activities in an area linked to or neighboring the activities of the EU Target (i.e. portfolio investments);

- **Type 5**: acquisitions of EU Targets by non-EU SWFs or SOEs, which have overlapping activities with the EU Target or activities in an area linked to or neighboring the activities of the EU Target (i.e. trade investments);

- **Type 6**: acquisitions of EU Targets by EU or non-EU enterprises that have non-controlling minority non-EU government shareholders, which have overlapping activities with the EU Target or activities in an area linked to or neighboring the activities of the EU Target (i.e. trade investments);

- **Type 7**: acquisitions of EU Targets by listed or non-listed privately-held enterprises that may have received non-EU government financial contributions, which have overlapping activities with the EU Target or activities in an area linked to or neighboring the activities of the EU Target (i.e. trade investments).

Other scenarios are potentially conceivable.

[3] See, White Paper, Section 4.2.3.
[4] Ibid.

A fundamental distinction needs to be made between scenarios involving passive financial investments or portfolio investments, versus trade investments.

The Working Group notes that foreign government capital, particularly through significant and very sizeable Sovereign Wealth Funds ('**SWFs**'), can play an important role in capital markets around the world, including in the EU (e.g. from China, Hong Kong, Indonesia, Japan, Kuwait, Korea, Qatar, Saudi Arabia, Singapore, the UAE, etc).[5]

Significant investments have been made by such funds in various sectors of the EU economy in the past 10-15 years, such as in automotive, energy, steel, technology, etc. A significant number of EU companies have been able to secure new ownership and/or material capital injections from non-EU investors as a result, often where domestic investors have been reluctant or unable to invest (without there necessarily being a market failure justifying State aid).

Module 2 legislation may effectively render access by EU companies to the world's largest capital resources more challenging, if passive financial investments and portfolio investments are made less attractive.

The Commission should carefully consider the macroeconomic impact of Module 2 legislation on inward investment into the EU and the operation of European capital markets, particularly during the current period of economic instability (in the continued wake of the Global Financial Crisis, and more recently, the turbulence created by the COVID-19 crisis). Consideration should also be given as to how third country governments may respond to such initiatives (e.g. by adopting mirroring regulations - or more draconian rules - that make it harder for EU companies to invest, expand or carry on business outside of the EU). In addition, the increased regulatory burden on non-EU companies seeking to invest in the EU should be considered.

In light of these potentially significant negative consequences of regulating passive financial investments and portfolio investments into the EU, the Working Group considers that it would be important to have a full study of how non-EU government financial contributions can give rise to distortions in the internal market in the context of acquisitions (i.e. the mere injection of capital into the EU). In this regard, it should be recalled that the underlying aim of the EU State aid rules is to ensure that EU Member States do not distort the internal market to the benefit of their own nationals (i.e. attempting to ensure a level playing field). Non-EU States are not subject to these obligations, nor do they reap the benefits of the internal market or experience the effects of potential distortions arising within it. Consideration should be given to the distinction that exists between the incentives of an EU Member State intent on granting distortive State aid (to support failing national companies, of which there are numerous famous examples) and the incentives of a non-EU State to invest in the EU.

It is conceivable that inbound passive financial investments and portfolio investments are *less egregious* because they (i) do not involve any form of commercial overlap, in which the activities of the EU Target would be run in combination with the acquirer's existing activities; and (ii) imply that EU Target may likely continue to be managed and operated by existing management, with little involvement from the non-EU acquirer, such that the "*link*" between the perceived non-EU government financial contribution and the activities of the EU Target may be hard to establish.

[5] See, for example, https://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund.

For example, in passive financial investments and portfolio investments, any non-EU state financial contribution made to facilitate an acquisition (either directly or indirectly) is likely to end up ultimately in the hands of the selling shareholder of the EU Target (as part or whole consideration), rather than in the EU Target itself. In addition, passive financial investments and portfolio investments are less likely to involve material shareholder involvement in the operation of the EU Target. Typically, such investors act and operate in a manner that is consonant with private equity and capital funds (i.e. consistent with the market economy investor principle), where there is a clear goal of a return on investment.

Where there is no overlapping business, it is also questionable how the "*efficiency gains*" from such an acquisition could be impacted simply because it involves one of the scenarios outlined in Types 1 to 4 above (i.e. there is no overlap from which efficiencies could be extracted).

It is also questionable as to whether the EU Targets can be naturally presumed to be inefficient market players (the economic preservation of which could be detrimental to the internal market). Naturally, it will be a fact-specific case-by-case rationale as to why any particular EU Target is an attractive investment target.

Further evidence is warranted prior to regulation

Without a coherent body of evidence that passive financial investments and portfolio investments lead to *verifiable, quantifiable and immediate competitive advantages* to the benefit of the EU Target, and resulting significant distortion to the internal market, such negative impacts cannot be presumed.

The Working Group therefore considers that there should not be a structural presumption that passive or portfolio investments are distortive merely because they may involve non-EU government financial contributions. Rather, scenarios in Types 1-4 should be presumed to be unproblematic. If the Commission were to proceed with Module 2 legislation, *the Working Group suggests that passive financial investments and portfolio investments not be subject to notification and review under any ex ante system. They could be considered as automatically exempt, or could be subject to investigation using ex officio powers for a limited period (e.g.one year) following completion of the transaction (during which time any distortive effects would be expected to be discernable).*

The Working Group recognizes that scenarios involving trade investments (Types 5 to 7) involve more complex considerations. Type 7 scenarios - involving a trade buyer in receipt of non-EU subsidies – have greater potential to have distortive effects than the other scenario Types. This is particularly the case where the EU Target is likely to be merged into, or amalgamated into, the acquirer's organization both from an economic and an operational perspective (i.e. a common group finance and accounting structure or where intra-group loans are anticipated).

A Type 7 scenario gives rise to the possibility that a non-EU government could (indirectly) subsidize an EU Target in the ordinary course of business (akin to a Member State propping up a national champion). The Working Group would consider that such a scenario may be akin to the more offensive type of EU State aid (e.g. operating aid), particularly if the EU Target is in "*difficulty*". Indeed, if the Commission were to proceed cautiously with Module 2 legislation, *the Working Group suggests that the only acquisitions that might be required to be notified* *under an ex-ante system could be those where the EU Target is in financial difficulty.*[6]

The Working Group believes that it would be useful for the Commission to undertake further analysis to determine whether there is a regulatory gap in relation to these or any other Types of subsidized trade investment acquisitions that has led to material detrimental impacts on the EU internal market. Unless *case studies showing significant and frequent distortions to the internal market can be provided, the basis for Module 2 intervention is unclear*.

The Working Group would therefore suggest a cautious approach before proceeding. Given the complexities, burdens and potential interference with capital markets that may arise from the Module 2 proposals, *the Working Group new EU legislation should only be adopted with a clearly identified and justified case for intervention*.

Light touch regulation or expansion of existing systems?

The Working Group considers that if regulation of foreign-subsidized acquisitions is introduced, it should be "light touch" in order to ease the burdens on companies (and avoid hindering M&A in the EU or rendering it less attractive).

The most efficient and least disruptive approach for Module 2 legislation would be *centralized (i.e. the Commission as the only supervising authority, offering a one-stop-shop), with a simple information notice procedure based on clear and precise criteria*. In particular, any system should provide certainty to non-EU investors, the EU targets, and the supervising authority on the scope of its application, procedure and timing.

The Working Group sets out below some general comments and some practical suggestions regarding the operation of Module 2 legislation should the Commission decide to proceed.

The White Paper provides that a "*new instrument on foreign subsidies would not affect the current rules on antitrust and mergers…those instruments will include a mechanism to address any overlap and ensure that procedures are efficient*".[7] However, no details are provided.

Module 2 legislation will introduce significant additional regulatory burdens and complexities to M&A transactions in the EU. This is in addition to the current significant and complex regulatory burdens of merger control notification (whether to the Commission under the EU

[6] See, Communication from the Commission — Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52014XC0731(01). For the purposes of those guidelines, an undertaking is considered to be in difficulty when, without intervention by the State, it will almost certainly be condemned to going out of business in the short or medium term. Therefore, an undertaking is considered to be in difficulty if at least one of the following circumstances occurs: (a) in the case of a limited liability company, where more than half of its subscribed share capital has disappeared as a result of accumulated losses. This is the case when deduction of accumulated losses from reserves (and all other elements generally considered as part of the own funds of the company) leads to a negative cumulative amount that exceeds half of the subscribed share capital; (b) in the case of a company where at least some members have unlimited liability for the debt of the company, where more than half of its capital as shown in the company accounts has disappeared as a result of accumulated losses; (c) where the undertaking is subject to collective insolvency proceedings or fulfils the criteria under its domestic law for being placed in collective insolvency proceedings at the request of its creditors; and (d) in the case of an undertaking that is not an SME, where, for the past two years: i. the undertaking's book debt to equity ratio has been greater than 7,5 and ii. the undertaking's EBITDA interest coverage ratio has been below 1,0.

[7] See, White Paper, footnote 12.

Merger Regulation[8] and/or to Member States) and possible foreign investment review notifications arising under the EU FDI Regulation[9] and Member State foreign investment review regimes). Module 2 legislation would add a third, parallel notification system for non-EU undertakings seeking to execute an M&A transaction (and potentially place them at a disadvantage relative to EU undertakings who do not face such notification obligations).

The various procedures, information/document requirements and timelines of these systems should be harmonized as much as possible to minimize the burden and expense on parties.

There are potential alternatives to a standalone Module 2 regime.

Firstly, an alternative to Module 2 legislation could be to expand the current FDI Regulation rather than creating a third layer of regulation. This regime already deals with non-EU companies that are proposing to make acquisitions or investments in the EU. While it currently focuses on issues related to national security, the Working Group notes that the FDI Regulation explicitly considers whether an investor benefited from significant funding, including subsidies, by the government of a "*third*" country.

Secondly, another alternative could be to amend the EU Merger Regulation (cited above). The White Paper acknowledges that foreign subsidies could form part of the assessment under EU Merger Regulation. The Working Group appreciates that there may be broader considerations for the Commission in deciding whether to "*open up*" the EU Merger Regulation for amendments.

While the Form CO and the Short Form CO could be amended to include information requirements on non-EU subsidies, the Working Group acknowledges that reform of the EU Merger Regulation would be required to introduce executive powers to take decisions to ensure that foreign subsidies do not distort competition in the internal market in the context of acquisitions of EU targets (i.e. new powers would be required). There are potential advantages and disadvantages to injecting subsidization and related elements (e.g. the EU Interest Test) into an instrument and institutional design that is currently focused on competition law and economics.

Finally, the Commission could consider amending the existing State aid regime to remove the requirement that the "*State resources*" emanate from an EU Member State. In theory, this could allow the Commission to review and investigate all sources of government support regardless of which State is involved. However, it would be necessary to consider whether this would only apply to support that is directly or indirectly related to an acquisition. Also, it may not be possible to require non-EU States to notify the Commission, which would require alternative notification mechanisms. As this is a complex alternative, raising many questions and this response focuses on Module 2, the Working Group has not considered it further.

If Module 2 legislation is adopted…

If the Commission proceeds with Module 2 legislation, it would be important to try to minimize uncertainty in the interpretation and practical implementation. The current Module 2 proposal is complicated and not fully fleshed out, giving rise to substantial uncertainty and questions.

[8] Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings.
[9] Council Regulation (EU) 2019/452 of March 19, 2019, establishing a framework for the screening of foreign direct investments ("FDI") into the EU.

Ambiguities may lead to a significant volume of precautionary notifications (or informal approaches to the Commission) for transactions that are not intended to fall with the intended ambit of Module 2 legislation.

Further clarity and details of the limitations on the relevant concepts in the Module 2 proposal will be required by foreign investors, EU targets and the Commission or other supervising authority. *The Working Group recommends that a further public consultation, based on a Green Paper with detailed draft textual provisions and guidance notes, should be undertaken prior to the adoption of Module 2 legislation*.

Examples of some of the notable questions arising from the Module 2 proposal in the White Paper are set out below:

- How will broad concepts like financial contribution, direct and indirect subsidization, distortion of the internal market and the "*EU Interest*" be operationalized.

- How will the proposed Module 2 legislation take account of and consider equivalent "*State aid*" regimes in non-EU states and any previous assessment/approval of such potential foreign subsidies?

- Which directorate in the Commission will have primary responsibility for review of transactions under Module 2 legislation?

- Will other services within the Commission also be involved in the review/decision-making process (e.g. DG TRADE, DG GROW)?

- Is there a risk of "*horse-trading*", as different Commission services barter for their respective political aims, putting transactions at increased risk of uncertainty of outcome?

- How will the analysis of foreign subsidies in a Module 2 review be coordinated with the analysis of subsidies in an FDI Regulation proceeding? Will the Commission have sufficient resources to effectively implement Module 2 legislation?

- What if any involvement will Member States have in the Module 2 regime, and how and when will this occur?

- Will the practical implication be that State investment vehicles from certain countries (e.g. Brazil, China, Hong Kong, Indonesia, Japan, Korea, Qatar, Russia, Saudi Arabia, Singapore, UAE, Ukraine, etc) are now required to notify every transaction they make in the EU?

- Will consideration be given to exempting non-EU subsidized companies' subsequent acquisitions if they have already filed and been approved for a prior acquisition (to avoid multiple filings for serial acquisitions by SWFs, investment funds and other companies that regularly engage in international M&A transactions)?

III. RESPONSES TO THE WHITE PAPER QUESTIONS

1. Do you consider that Module 2 appropriately addresses distortions of the internal market through foreign subsidies that facilitate the acquisition of undertakings established in the EU (EU targets)?

As currently drafted, the Module 2 proposal requires further development and clarification by the Commission. In particular, whilst the concept of a notification process is explained, the key substantive elements of the process are unclear. *The Working Group considers that further detailed and careful articulation of the substantive test and other elements will be required*.

For example, it is not clear how "*distortions*" arising from acquisitions made by non-EU third country funded companies will be properly identified, reviewed and assessed.

In this regard, the Commission wants to review the support measures on a case-by-case basis taking a "*collection of indicators related to the subsidies and the relevant market situation*" into account. These (many) aspects include:

- the relative size of the subsidies in question;
- the situation of the beneficiary and its size, as well as (unutilized) production capacity;
- the situation on the market concerned, as well as the existence of structural excess capacity and/or high degree of concentration;
- the market conduct in question, e.g. outbidding in acquisitions or distortive bidding in procurement procedures;
- the level of activity in the internal market of the beneficiary;
- the openness of the undertaking's domestic market for – the Commission argues – where a subsidy recipient faces only limited competition in that market, it could leverage its privileged position in other markets.

This starting point could benefit from more clarity. In addition, the White Paper suggests that the assessment will include a consideration of the EU's public policy objectives, such as "*creating jobs, achieving climate neutrality and protecting the environment, digital transformation, security, public order and public safety and resilience*". The White Paper further notes "*the balancing needs to be based on an appreciation of the various interests, including the need to protect consumers' interest*" and "*if on balance, the distortion on the internal market caused by the foreign subsidy is sufficiently mitigated by the positive impact of the supported economic activity or investment, the ongoing investigation would not need to be pursued further*".[10]

The substantive test for acquisitions proposed by the White Paper might create some legal uncertainty. In particular, the Commission suggests that "*the legal standard under which the competent supervisory authority would assess the acquisition would be the distortion of the internal market through the facilitation of an acquisition by foreign subsidies*". In this regard,

[10] See, White Paper, Section 4.1.4.

the regulator would not have to show a "*direct*" facilitation (i.e. a clear link between the subsidy and the acquisition), but a "*de facto*" facilitation (i.e. where foreign subsidies merely reinforce the financial strength of the acquirer) would be sufficient.[11] Given that the Commission intends to include all financial contribution during the last three years prior to notification and financial contributions granted until one year following closing, this is a very wide concept which would include a very broad range of measures.[12]

Thirty years' experience of EU Merger Regulation enforcement reveals how complex and difficult a pure competition assessment can be in certain cases. The Module 2 assessment would be materially more complex, involving not only price- and cost-related elements in the balancing exercise, but a complicated appreciation of non-quantifiable or even non-verifiable public interest elements (which are not exhaustively specified). This implies that any Phase II investigation of a potential distortive subsidized acquisition could be very lengthy and expensive for the notifying party(ies) as well as the EU target (involving external advisors such as lawyers, economists, environmental specialists, employment consultants, security consultants, public order and safety experts, and the large volume of material that they will inevitably produce to defend an acquisition).

Given the complexity of the analysis, the challenges of quantification, and the degree of discretion and judgement inherent in the application of these concepts, any intervention decision is likely to end up being challenged before the European Courts.

These attributes of the Module 2 proposal indicate that this regime will require a significant resource commitment by the Commission to assess Phase I and especially Phase II cases. The level at which thresholds are set will have an important effect on the overall resource requirements, and the overall burdens imposed on private parties.

2. Do you agree with the procedural set-up for Module 2, i.e. ex-ante obligatory notification system, 2-step investigation procedure, the fact-finding tools of the competent authority, etc. (See section 4.2.5 of the White Paper)

The Working Group understands the envisaged procedure involves a two-step mandatory *ex-ante* notification system, namely: (a) notification based on thresholds/qualitative criteria resulting in a preliminary review ('**Phase I**'); and (b) an in-depth investigation if concerns are confirmed ('**Phase II**'). This appears to have some similarities with the EU Merger Regulation system and intuitively makes sense. However, the EU Merger Regulation Phase II review period in the EU is lengthy and burdensome. It would be desirable to have Phase II reviews under Module 2 legislation subject to shorter time limits if possible, to enable acquisitions (which create uncertainty for EU targets, employees, customers and other market participants, in addition to acquirers) to close quickly.

The Module 2 proposal appears to require parties to self-assess and submit a notification if the relevant acquirer has received a financial contribution from a third party country which satisfies certain quantitative and/or qualitative thresholds. A number of questions on the procedure are already identifiable, such as:

- Is it appropriate or even possible to request information and documents from certain

[11] See, White Paper, Section 4.2.3.
[12] See, White Paper, Section 4.2.2.1.

state-owned organizations / investment vehicles and their holding companies / shareholders?

- In large, complex groups of State-owned enterprises, how are injections of capital and other sources of shareholder support to be assessed across the group?

- Can all forms of contributions (especially indirect contributions) that subsidize an acquisition be reliably identified and valued?

- Will the Commission publish guidance on how to assess whether a transaction is notifiable under Module 2 legislation?

- In the absence of a notification, will it be possible in practice for the Commission to investigate potentially non-notified transactions under Module 2 legislation?

- Is the Commission capable of extending the market economy investor principle to economic environments outside of the EU into other financial capital markets (e.g. Islamic finance)?

Phase I

In Phase 1, the Working Group understands the Commission will consider if a "*foreign subsidy*" has been provided to the relevant acquirer. "*Foreign subsidy*" is defined quite broadly in Annex 1 of the White Paper:

> "*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*".[13]

Whilst this may align with some of the established notions of "*aid*" in the EU, this definition may raise complexities for non-EU entities. Particular difficulties may arise in respect of identifying and assessing "*foregone or not collected public revenue, such as preferential tax treatment or fiscal incentives such as tax credits*".

The Commission seems to favor a very broad definition of the term "*subsidy*" which is similar to the definition of "*State aid*". In general, as the Commission's practice under EU State aid control and the Anti-subsidy Regulation have shown, it will often be difficult to establish the existence of a subsidy. State support measures are (in many cases deliberately) very complex in order to conceal that they are subsidies, for example sophisticated capital injections, mezzanine and guarantee structures, as well as elaborate tax rules. The Commission Notice on the notion of State aid illustrates the complexity of this topic.[14] The Commission will have to look at grants, capital injections, low-interest credits, credit guarantees, debt relief, compensation for operating losses, export subsidies, compensation for regulatory burdens, non-imposition of public charges, preferential tax treatment or tax incentives and tax credits, the provision or acquisition of goods or services at preferential rates and much more.

In particular, ascertaining the presence of preferential treatment when it comes to capital

[13] See, White Paper, Annex I.
[14] See, OJ 2016 C 262/1.

injections requires a great deal of economic expertise and data.[15] The fact that the financial flows between the relevant state governments and companies (some of which are not even legally separate) are not very transparent does not make the practical application of this system very easy for the Commission.

Moreover, there are numerous foreign State aid rules of a general nature (e.g. tax relief) which benefit a large number of groups (including EU undertakings in some cases) and are not aimed at providing preferential treatment to a certain subsidiary in the EU. The question arises whether they should likewise be covered. The recent *Apple* judgment has demonstrated the difficulties of establishing the existence of State aid in case of tax measures by EU Member States.[16] Such a task will be even more difficult if the measures are taken by a third country.

The Working Group suggests that a more precise list of concrete financial contributions would be prudent, and importantly, limited to actual financial assistance that can be clearly identified and quantified (e.g. capital, loans, forgiveness of debt, etc).

The White Paper states that a short information notice will be required.[17] *The Working Group encourages the Commission to provide (in the further public consultation) a draft notification form for comment.* Ideally, the notification form should be as light as possible (e.g. even lighter than the Short Form CO for the Super-Simplified Procedure). Document disclosure requirements should be avoided, particularly as they may require the translation of large volumes of pages that may not be of any significant utility for an assessment (e.g. annual reports and accounts in Mandarin or Arabic, etc).

The purpose of a two-phase process is to allow quick identification of non-problematic transactions that need not be subjected to the delay and burden of a detailed investigation. Noting that a transaction may trigger a Module 2 filing but not an EU Merger Regulation (or indeed any national) filing, *the Working Group considers that the time period for a Phase I review should be quite short (e.g. 15 working days).*

To facilitate the early identification of non-problematic transactions, the Working Group suggests that the filing form should also allow acquirer to provide details as to why (a) any financial contribution is not a "*subsidy*"; (b) any subsidy is unrelated to or does not facilitate the acquisition; (c) there is no distortion of the internal market; and/or (d) why the acquisition is in the EU Interest overall.

Phase II

The Working Group notes that the White Paper states that the Commission will "*open an in-depth investigation, if it had sufficient evidence tending to show that the acquiring company could have benefitted from foreign subsidies facilitating the acquisition*".[18] Greater clarity is required to properly define the appropriate legal test for initiating Phase II proceedings.

The Working Group considers that this is not an appropriate test for initiating Phase II. *Rather, the Commission should be under an obligation to demonstrate that it has "serious doubts that*

---

[15] Under the so-called "*market economy investor principle test*", see *Westdeutsche Landesbank Girozentrale and Land Nordrhein-Westfalen v Commission* (Cases T-228/99 and T-233/99), ECLI:EU:T:2003:57, paragraph 251.
[16] See, *Ireland and Apple v Commission* (Cases T-778/16 and T-892/16), ECLI:EU:T:2020:338.
[17] See, White Paper, Section 4.2.5.
[18] Ibid.

the acquisition results in a significant distortion to an effective internal market, taking into account the EU Interest".

Any Module 2 legislation should make it clear that, in order to interfere with a transaction in the capital markets on the basis of foreign subsidization, the burden of proof lies with the Commission to demonstrate that the acquisition is not in the EU Interest. Therefore, in order to open a Phase II investigation the Commission should have serious doubts (reasonably held based on a convincing and compelling body of evidence meeting the requisite standard of proof) that the acquisition in not in the EU Interest.

In the Working Group's view, simply having a suspicion that the acquirer has benefitted from subsidies after review of an initial notification form should not be sufficient. In addition, any structural presumption that such acquisitions are "*bad*" (*ab initio*) should be avoided. Module 2 legislation must proceed on the assumption that such acquisitions are neither good nor bad, and that it is for the Commission to discharge the relevant burden before intervening (respecting appropriate due process and the rights of defence).

In terms of sanctions, the Module 2 proposal follows the well-established but strict approach followed by DGCOMP over the past decades. In this regard, the Commission has evidently drawn inspiration from the existing powers in antitrust, merger and State aid control. Acquisitions can be prohibited or divestment of certain assets can be ordered. Further options include reductions of capacity, investments and market presence by means of divestments. There are sanctions for non-compliance with such orders. An addressee failing to comply with such an order will have to face fines and periodic penalty payments. The exercise of these instruments are to be subject to a limitation period of ten years which would start to run on the day on which a subsidy is granted but be interrupted by investigative measures. This provision – which is based on the limitation period rule in Article 17 of Regulation 2015/1589 – would most likely mean that the limitation period would virtually never expire.[19] This can cause a long period of legal uncertainty.

Finally, the Working Group observes that the EU State aid rules only allow intervention where the aid measure under review will likely "*affect trade between Member States*".[20] This phrase appears at no point in the White Paper. Arguably *any Module 2 legislation should also contain a requirement that the Commission must demonstrate that any acquisition not only gives rise to a significant distortion to the internal market, but that it also is likely to affect trade between Member States*.

As explained above, the new system will run in parallel to the already existing competition instruments at EU and national level, such as the (often numerous affected) merger control systems. The national FDI rules will obviously also have to be checked. This will mean an increase in the complexity of transactions involving foreign investors. Although it does appear conceivable for State aid control and merger control as well as other regulatory systems to coexist in principle, coordinating the different work streams will most likely pose a challenge for M&A practitioners.

[19] See, See e.g. *Nelson Antunes da Cunha Lda v FAP* (C-627/18) ECLI:EU:C:2020:321; *Presidenza del Consiglio dei Ministri* (C-387/17) ECLI:EU:C:2019:51.

[20] See, Article 107 TFEU.

3. Do you agree with the scope of Module 2 (section 4.2.2) in terms of

- **definition of acquisition**
- **definition and thresholds of the EU target (4.2.2.3)**
- **definition of potentially subsidized acquisition**

As regards thresholds, please provide your views on appropriate thresholds.

Definition of Acquisition (4.2.2.1)

The Working Group understands that the Module 2 proposal is designed to not only cover the acquisition of "*control*", but also acquisitions "*of at least [a specific percentage] % of the shares or voting rights or otherwise of "material influence" in an undertaking*".[21] The scope of Module 2 legislation is therefore potentially extremely broad - wider than the EU Merger Regulation.

The Working Group believes that Module 2 legislation should be limited to acquisitions of control only.

Definition and Thresholds of the EU Target (4.2.2.3)

The Working Group considers that the definition of an "EU Target" is insufficiently defined. Reference to "*any undertaking established in the EU*" meeting a certain turnover threshold is extremely broad. This could include, for example, a foreign company that makes significant EU sales from outside the EU but has a European subsidiary with immaterial operations, or a local subsidiary incorporated for tax purposes or for the purpose of holding IPRs, or a registered office, or a representation office, or a branch which does not make significant sales in the internal market.

The Working Group believes that a clear definition is required for an EU Target which should contain a meaningful nexus to the internal market that is sought to be protected from distortion by the Module 2 regime (as well as an appropriate materiality level in the threshold - see further comments below on the thresholds).

For example, an "EU Target" could be defined as "*an undertaking, however constituted, having its principal place of business within the European Union,*" where "*principal place of business*" means "*the head office or registered office within which the principal financial functions and operational control, including strategic and day-to-day management, of the undertaking are exercised*".[22]

In respect of thresholds, the Working Group believes that clear and objective turnover-based or valuation-based thresholds should be utilized so that the applicability of the Module 2 regime is readily discernible by companies inside and outside the EU and their advisors.

In addition, *the Working Group recommends that thresholds should be set a sufficiently high level so that only significant distortions to an effective internal market are caught*.

---

[21] See, White Paper, Section 4.2.2.1.

[22] See, by analogy, Regulation 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community, https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32008R1008.

The Working Group would suggest the following Module 2 thresholds for further consideration by the Commission:

"*This Regulation shall apply to all acquisitions with an EU dimension as defined in this Article. An acquisition has an EU dimension where:*

(a) the value of the consideration paid or to be paid for the EU Target exceeds EUR 500 million; or

(b) the aggregate EU-wide turnover of the EU Target is more than EUR 250 million, provided that aggregate combined worldwide turnover of the EU Target and all other undertakings involved in the acquisition is more than EUR 2.5 billion".

Lower thresholds should be avoided, to reduce the burden on companies engaged in M&A activity in the EU (both investors, and EU Targets seeking to raise capital) as well as on the Commission or other supervising authority that will be responsible for assessing every notified transaction and to ensure the Commission (or other supervising authority) focusses its limited resources on those cases most capable of producing significant distortions.

Definition of potentially subsidized acquisition

The White Paper considers the introduction of a further threshold based on the quantum of financial contribution received from by the acquirer from a non-EU government.[23]

Reference is made above to the summary remarks and the identification of different types of acquisition scenarios. As noted above, *the Working Group believes that passive financial investments and portfolio investments should be exempted from the ex-ante notification requirement* (though these could remain subject to an *ex officio* investigation for a limited period (such as one year) should there be sufficient grounds to believe that a significant distortion to an effective internal market has taken place).

For trade investments in scenarios Types 5 and 6 identified above), the financial contribution threshold also does not make immediate sense. This is because an SWF or an SOE acquirer is in fact an arm of the foreign state, and its entire capital would therefore appear to be a "*financial contribution*". Virtually all SWFs and SOEs would have balance sheet assets above any monetary threshold that is likely to be contemplated under Module 2 legislation.

Only in the Type 7 scenario of trade investment does the financial contribution threshold make intuitive sense. However, the quantification of the actual financial contribution may be difficult.

The White Paper suggests that the relevant period for quantification is "*the last [three] calendar years prior to the notification and financial contributions granted after notification and up until one year following the closing of the acquisition*".[24] *A shorter historic period (for example, one year prior to notification) would appear to the Working Group to be sufficient to identify subsidies that are linked to acquisitions, and would be less burdensome for the parties and the Commission to apply. A test based on future financial contributions appears to be*

[23] See, White Paper, Section 4.2.2.3.
[24] Ibid.

indeterminate for both merging parties and the Commission when consider ex ante notification and should be avoided.

4. Do you consider that Module 2 should include a notification obligation for all acquisitions of EU targets or only for potentially subsidized acquisitions (section 4.2.2.2)?

As noted above, the Working Group believes that the ambit of any Module 2 legislation should be tightly prescribed, so as to only catch trade investments and potentially only those involving potentially subsidized acquisitions of EU Targets in difficulty. Only cases that have a significant likelihood should be targeted with a notification burden (and the resulting impact of filing expenses, commercial timetable delay, and the risk of intervention). In the Working Group's view, the review of market economy passive financial investments and portfolio investments would usually constitute an unnecessary use of the Commission's scarce resources and impose unnecessary burdens on both foreign and EU companies.

5. Do you agree with the substantive assessment criteria under Module 2 (section 4.2.3) and the list of redressive measures (section 4.2.6) presented in the White Paper?

The Working Group does not consider that the substantive assessment criteria are sufficiently articulated in order to provide a view on whether they are acceptable or not. As noted above, *the Working Group believes that a further Green Paper and public consultation would be important for these complex issues*.

Substantive Criteria

The Working Group understands that the Module 2 proposal seeks to remedy two potential distortions namely: (a) acquisitions facilitated by a foreign subsidy; and (b) any resulting distortions of the internal market (i.e. related to the support obtained by the Target through subsidized investment). Further clarity and guidance in both areas is recommended.

As noted above, any structural presumption that such acquisitions are "*bad*" (*ab initio*) should be avoided.

Further guidance should be provided on the "*theory of harm*" that would constitute the foundation for asserting a distortion on the EU internal market. The list of "*indicators*" is a helpful beginning, but the Working Group considers that more concrete economic evidence and analysis (e.g. case studies) would be important to demonstrate more concretely what the concerns would be and how they would be identified, assessed and rebutted/addressed.

The Working Group suggests that the Commission should hold the burden to establish that "*an acquisition results in a significant distortion to an effective internal market*". *The burden of proof should be on the balance of probabilities, and to the same evidentiary standard of proof as contained in the EU Merger Regulation. There should no presumption of distortion, and such acquisitions should not be deemed to positive or negative (i.e. Module 2 should proceed on the basis that all such acquisitions are ab initio neutral).*

Further, as noted above, the Working Group suggests that a requirement that the subsidization be likely to "*affect trade between Member States*" should be considered.

Redressive Measures

The White Paper states "*redressive payments and transparency obligations may in practice be less likely to be effective redressive measures under Module 2*".[25] This appears to suggest that, when a distortive subsidized acquisition has been identified, it may not be able to be remedied. In effect, the White Paper appears to suggest that such acquisitions should simply be prohibited.

Careful further analysis is required before the Commission adopts this type of presumption. Whilst State aid decisions can rule aid measures to be unlawful, conditional approval decisions are also possible. *The Working Group believes that a comprehensive survey of remedial measures in State aid cases could provide further guidance on the potential redressive measures that could be potentially available to the Commission if Module 2 legislation were to be developed*.

To take one notable example, in the 2005 *British Energy restructuring case*,[26] the Commission required the UK Government to:

- implement and report on a restructuring plan with a defined timetable;
- require British Energy to:
    - extract its electricity supply business from British Energy Generation Limited and incorporate it as a separate subsidiary company of British Energy;
    - consolidate the existing nuclear generation activities in a single company; and
    - use all reasonable endeavors to obtain licence modifications to the effect that:
        - British Energy would treat its existing nuclear and non-nuclear generation businesses as separate businesses for licensing purposes; and
        - the existing nuclear generation business would not provide any cross-subsidy to any other business in the British Energy group;
    - undertake, for a period of six years from the date of the decision, not to own or have rights of control over:
        - registered operational fossil-fueled generating capacity in the European Economic Area, or
        - large scale registered hydro-electric generating capacity in the United Kingdom;
    - undertake, for a period of six years following the appointment of the Independent Expert, not to offer to supply non-domestic end-users (who purchase electricity directly from British Energy) on terms where the price of the energy element of the contract with the user is below the prevailing

[25] See, White Paper, Section 4.2.6.
[26] See, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2005.142.01.0026.01.ENG&toc=OJ:L:2005:142:TOC.

wholesale market price (except in exceptional market circumstances where certain objective tests are judged by the independent expert to be satisfied); and

- cooperate in good faith with the independent expert, and to comply with all reasonable requests from the Independent Expert in a timely manner including requests for information, documents or access to staff or management.

Further guidance based on case studies for various potential types of commitments that could be acceptable redressive measures in appropriate circumstances would be welcome.

6. Do you consider it useful to include an EU interest test for public policy objectives (section 4.2.4) and what should, in your view, be included as criteria in this test?

The Working Group considers that it is appropriate to include an EU interest test to allow consideration of situations where foreign subsidization may be acceptable, even if there is some distortion of the internal market. A carefully articulated EU Interest-based test should be feasible, but note the comments above about the complexity arising from assessment of the EU Interest Test and the importance of a timely review process that avoids unnecessary burdens. Any test should be clear, precise and legally certain for companies and their advisers. The Commission would be well-advised to provide guidance on the criteria which will be taken into account in the assessment of (a) what constitutes a distortion, (b) what is in the EU Interest, and (c) how these considerations will be weighed in reaching a determination.

As also noted above, greater clarity is required to properly define the appropriate legal test for Module 2 legislation and the burden of proof should reside with the Commission. If the Commission proceeds with an EU Interest Test, *the Working Group recommends that the Commission would have the burden of demonstrating (presumably on the usual balance of probabilities standard) that an acquisition results in a significant distortion to an effective internal market, taking into account the EU Interest.*

7. Do you agree that the enforcement responsibility under Module 2 should be for the Commission (section 4.2.7)?

For reasons discussed above, *the Working Group agrees that any legislation adopted pursuant to Module 2 should be the exclusive competence of the Commission under the one-stop-shop principle*. The Commission would appear to be the best-placed agency to assess distortions to the internal market and to apply an EU Interest test. A shared competence system would risk generating divergent outcomes, increased administrative burdens (for companies and agencies), and individual Member States utilizing Module 2 tools for national economic interests.

Given the importance and time-sensitivity of M&A transactions in European capital markets, and the complexity of the assessments required to determine whether internal market distortions are likely (as well as the nature and significance any applicable EU interests), *the Working Group believes that decisions of the Commission should be appealable to the European Courts, with the option of an expedited procedure – consistent with the approach under the EU Merger Regulation*.

***