

A Tool to Investigate M&A Transactions with Regard to Foreign Financial Contributions

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Table of Contents	
A. Introduction	478
B. Regulatory gap?	478
C. Mechanisms introduced by Chapter 3	481
I. Inspection process	481
II. Scope of application	482
1. Concentration	482
2. Thresholds	482
III. Prohibition criteria	484
IV. Interim results	484
D. Aptitude to tackle the regulatory gap?	484
E. Suggestions	485

Abstract

As a result of an alleged regulatory gap, Chapter 3 of the Proposal for a Foreign Subsidies Regulation introduces a new tool to investigate M&A transactions involving a financial contribution from a non-EU government. This paper takes a closer look at this new tool, in particular comparing it to the existing Merger Regulation. In addition, the existence of the supposed regulatory gap will be assessed – as well as the new tool’s aptitude to tackle it.

Keywords: M&A Transaction, Foreign Financial Contribution, Concentration, Regulatory Gap

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A. Introduction

Chapter 3 of the Proposal for a Foreign Subsidies Regulation¹ introduces a new tool to investigate mergers and acquisitions. In general, these transactions are already addressed by the European Merger Regulation.² Yet, the FSR Proposal introduces a separate procedure. According to the grounds of the law, this is because there is a regulatory gap regarding M&A and financial contributions received from foreign states.³

Given their similarity in scope but different objectives, several questions emerge: First of all, whether the alleged regulatory gap does in fact exist (see B.). Furthermore, which mechanisms Chapter 3 introduces – especially in comparison to the Merger Regulation (see C.). Finally, if the tool can successfully tackle the regulatory gap, and if so, whether this takes place without undue impediment to M&A transactions (see D.). If not, how certain problematic aspects can be mitigated (see E.).

B. Regulatory gap?

Regarding the alleged regulatory gap, it is opportune to commence with the Merger Regulation and the concrete hazards it addresses: According to its Recital 2, the Merger Regulation aims at safeguarding competition in the internal market. Recital 5 points at reorganisation processes, that is mergers and acquisitions. The underlying idea is that lasting damage may result if the reorganisation process led to the creation or strengthening of a dominant market position.

According to classic economic theory, in a scenario of perfect competition, the price and amount are determined by supply and demand.⁴ Consumers willing to pay more than the market price gain welfare by acquiring the good or service.⁵ In Graph 1, this so-called consumer surplus is illustrated by the light grey triangle. Meanwhile, producers gain the producer surplus illustrated by the dark grey triangle.

1 *European Commission*, Proposal for a Regulation on foreign subsidies distorting the internal market (FSR Proposal), 5/5/2021, COM(2021) 223 final.

2 *European Council*, Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (Merger Regulation), 2004 OJ L 24, p. 1.

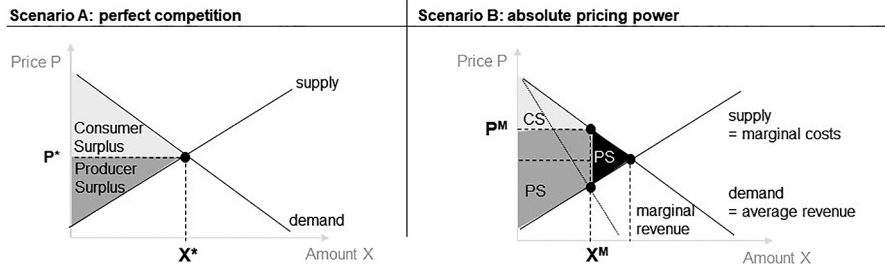
3 *European Commission*, FSR Proposal, p. 51.

4 See *Varian*, p. 293 ff.

5 *Pindyck/Rubinfeld*, p. 327 ff.

Graph 1: Hazards of a dominant market position⁶

Welfare



In a scenario of pricing power, prices are elevated. An undertaking with absolute pricing power would reduce traded goods or services to an amount where marginal revenue equals supply and charge a price accordingly.⁷ Regarding consumer and producer surplus, first of all and unsurprisingly, there is a shift from consumers to producers. However, there is more: The former gains realised by the goods or services which have ceased to be traded have disappeared. The black triangle demonstrates this so-called deadweight loss.⁸

This is where the Merger Regulation intervenes. By prohibiting concentrations resulting in the creation or strengthening of a dominant market position (or at least imposing mitigating commitments), the Regulation intends to prevent deadweight loss following external growth.⁹

Correspondingly, the Merger Regulation focuses on the markets the concerned undertakings operate on.¹⁰ The most important criterion for determining which concentrations to impede is the current market position.¹¹ Moreover, according to Art. 2(1)(b) Merger Regulation, “economic and financial power” should be considered. Therefore, even foreign subsidies might be taken into account¹² – but only, if they bear the risk of market dominance.¹³

Yet, these operational markets are not the only ones in danger of disruption. Regarding concentrations, there is also the company purchase market. That is the market for M&A transactions itself. And unlike the operational markets, this market is

6 Inspired by Pindyck/Rubinfeld, p. 328, 330.

7 Varian, p. 458 ff.

8 Pindyck/Rubinfeld, p. 330.

9 Ewald, in: Wiedemann, § 7, para. 114.

10 Cf. European Commission, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (Horizontal Merger Guidelines), 2004 OJ C 31, p. 5, para. 9 ff.

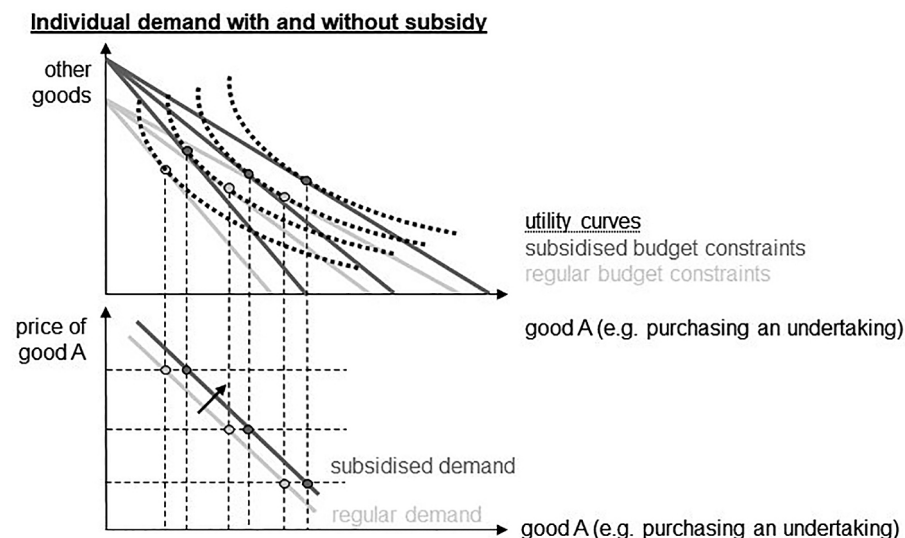
11 European Commission, Horizontal Merger Guidelines, para. 14 ff.

12 Monopolkommission, para. 841.

13 Monopolkommission, para. 844. Cf. Bundeskartellamt, case B4-115/19, CRRC/Vossloh, para. 137 regarding a German merger control case.

of no interest to the Merger Regulation.¹⁴ Yet, it is this company purchase market which might be affected by foreign subsidies.

Graph 2: Hazards of subsidies¹⁵



As shown by Graph 2, the individual demand curve reflects both individual budget constraints and the utility gained by purchasing a certain product. By depicting budget constraints regarding different prices for a certain good or service and their intersection points with utility curves, the concrete demand function for that very good or service is derived.¹⁶ In the context of purchasing an undertaking, instead of utility, one can think of the additional revenues an undertaking is to obtain by acquiring the asset. All else being equal, if the budget is increased – for example because of a foreign subsidy – the price an undertaking is willing to pay is augmented, too. Id est, the demand function goes up.

At first glance, it might appear beneficial to European markets if foreign undertakings were willing to pay higher purchasing prices. And yes, for sellers, increased prices would indeed be welcome. Yet, there are also other potential buyers to be considered. Their individual demand function is not raised by a foreign subsidy but remains in place. In a scenario without foreign subsidies, the undertaking realising the highest increase in revenue would make the deal. However, because of foreign subsidies, the willingness to pay more might not result from an increase in revenue but from an elevated budget. Therefore, foreign subsidies result in the imminent danger of creating an inefficient allocation of assets.¹⁷

14 Cf. *Brown*, P.P.L.R. 2020/6, p. 247; *Williams*, P.P.L.R. 2020/6, p. 257.

15 Inspired by *Pindyck/Rubinfeld*, p. 133, 135.

16 *Pindyck/Rubinfeld*, p. 132 ff.

17 Cf. *Monopolkommission*, para. 846.

Moreover, depending on the motivation for the foreign subsidy further consequences may arise: There is the danger that foreign subsidies may be driven by a strategic objective, especially for gaining access to key technologies, establishing a strong presence in the EU or transferring technologies to other production sites, possibly outside of the EU.¹⁸

In conclusion, foreign subsidies may lead to an inefficient allocation of assets and moreover, there are certain long-term dangers depending on the objective of said subsidies. Yet, because of its focus on operating markets, the Merger Regulation is blind to hazards arising on the market for company purchases. Or as the Commissioner for Competition *Margrethe Vestager* puts it: European “merger rules look at how a merger affects competition in Europe – but don’t go into how that merger is paid for”.¹⁹

For completeness’ sake, a very brief look shall be taken at Art. 107 TFEU. It has been argued that regarding foreign subsidies in general, there is no regulatory gap because Art. 107 TFEU might be applied to these financial contributions as well.²⁰ Irrespective of whether such an extension would work in general, it would not suffice in the context of concentrations: If an undertaking from outside the European Union were seeking to purchase an undertaking operating within EU territory, before having realized the transaction, there would not be a sufficient link to the EU to address the subsidy. That is why the problem of subsidy-facilitated acquisitions cannot be eliminated by a wider interpretation of Art. 107 TFEU.

Thus, there is indeed a regulatory gap with regards to foreign subsidies and M&A.

C. Mechanisms introduced by Chapter 3

Regarding the mechanisms Chapter 3 introduces and their comparison to traditional merger control, the inspection process (I.), the respective scope of application (II.), and the different prohibition criteria (III.) will be examined.

I. Inspection process

According to both Art. 4(1) Merger Regulation and Art. 19(1) FSR Proposal, the undertaking or undertakings in control must notify the Commission of the concentration prior to its implementation.

Thereafter, Phase 1 begins. The Commission has 25 working days to examine the transaction, either resulting in a decision of no objection or the decision to continue with an in-depth investigation (Art. 4(4)(4) Merger Regulation, 23(1) FSR Propos-

18 *Monopolkommission*, para. 846, 921. Cf. *Brauneck*, WM 2021, p. 2320f. who sees within the latter the main objective of the new merger control tool and therefore criticizes the approach.

19 *European Commission*, STATEMENT/20/1121.

20 *Martin-Ehlers*, EuZW 2020, p. 907.

al). The in-depth investigation – that is Phase 2 – is generally restricted to 90 working days and may end with a decision of no objection, a decision of prohibition or a decision with commitments (Art. 10(3), 8 Merger Regulation, 24(4), (3) FSR Proposal). In other words, the inspection process outlined by the Merger Regulation and the one of the FSR Proposal are almost completely alike. Yet, it is important to note that they are designed as two separate procedures.

II. Scope of application

The circumstances under which an undertaking has to make a notification with the Commission – id est, the respective scope of application – are defined by two elements: A specific M&A transaction (1.) and certain thresholds regarding the undertakings concerned (2.).

1. Concentration

Art. 1(1) and 3 Merger Regulation introduce the notion of concentration as an umbrella term for M&A. A concentration is defined by a lasting change of control whereby control may be constituted by rights, contracts or any other means. Examples given are the ownership of an undertaking and contracts which confer decisive influence. Art. 3(1)(a), (b) specifically denominates mergers and acquisitions. Moreover, according to Art. 3(4), the creation of a full-function joint venture is considered a concentration as well.

Art. 18(1) and (2) FSR-Proposal repeat these norms almost word for word. By contrast, the former White Paper²¹ used the term acquisition defined by either a change of control, the acquisition of a certain, yet to be defined percentage of shares or voting rights, or otherwise of “material influence”. Depending on the concrete threshold, the percentage-option could either have resulted in a significantly broader scope of application,²² or simply have reduced the burden of justification for the Commission. Either way, the path of alignment now chosen by the FSR Proposal ensures both legal certainty and a simplification of procedure and is thus beneficial.

2. Thresholds

Additionally, the undertakings concerned must trigger certain thresholds: In general, according to Art. 1(2) Merger Regulation, a concentration must be notified if the combined aggregate worldwide turnover of all undertakings concerned is more than EUR 5 billion and if the aggregate EU-turnover of each of at least two of them is more than EUR 250 million. According to Art. 1(3), there is the additional option

21 *European Commission*, White Paper on levelling the playing field as regards foreign subsidies (White Paper), 17/6/2020, COM(2020) 253 final, p. 23. See also *Trapp*, EuZW 2020, p. 966.

22 *Brown*, P.P.L.R. 2020/6, p. 249.

of a lower worldwide turnover balanced out by various links to the European Union.

In comparison, Art. 18(2) and (4) FSR Proposal also refer to EU turnover but as a second criterion, they install the receipt of a financial contribution. In numbers: A concentration must be notified if the EU turnover of the company to be acquired or of at least one of the merging parties amounts to EUR 500 million and the foreign financial contribution is at least EUR 50 million. During the trilogue negotiations, the European Parliament suggested a threshold of EUR 400 million²³ and the Council recommended EUR 600 million,²⁴ yet the final agreement entails the original threshold.²⁵ The relevant time span for having received a financial contribution are the last three calendar years prior to the notification.

Regarding the second threshold of foreign financial contribution, at least two aspects are worth pointing out: First of all, the financial contribution threshold is an aggregate threshold. *Id est*, it could be triggered if a number of different countries would make smaller contributions yet accumulating to EUR 50 million. Secondly and more importantly, the criterion does not refer to subsidies, but uses the term foreign financial contribution. The choice of wording is deliberate as the concepts differ: According to Art. 2(2), a financial contribution only refers to the receipt of funds or provision of goods or services, etc. A subsidy, however, requires more: According to Art. 2(1), it is a financial contribution which confers a benefit to an undertaking and which is limited to an individual or several undertakings or industries. Therefore, the second threshold only refers to the amount received and excludes the consequences. This shall transfer assessment difficulties to the decision-making competence of the Commission.²⁶ Yet, other problems thereby emerge. In particular, by ignoring the aspect of being limited to certain undertakings, delimitation is complicated.²⁷

Regarding the comparison of thresholds within the Merger Regulation and the FSR Proposal, at least two aspects are worth highlighting: Two undertakings having a turnover of EUR 250 million roughly equals a turnover of EUR 500 million for one undertaking. Thus, both regulations operate on a similar scale. Yet, the point of reference is different: As for merger control, the focus is on two relatively large undertakings merging or one of them being acquired by the other. By contrast, the FSR Proposal focuses strictly on the target. Therefore, even with regard to this rather similar criterion of EU-turnover, their respective scopes differ widely.

Regarding the second criterion, there is not even the pretence of alignment: While the Merger Regulation takes worldwide turnover into account, the FSR Proposal focuses on foreign financial contributions. Thus, neither having to notify an M&A transaction under the Merger Regulation suggests the notification of foreign subsi-

23 *European Parliament*, Draft Legislative Resolution on the proposal for a regulation, 28/4/2022, PE703.002v02-00, p. 35.

24 *Council of the European Union*, negotiating mandate, 4/5/2022, 2021/0114(COD), p. 39.

25 *European Commission*, IP/22/4190.

26 Cf. *European Commission*, White Paper, p. 21.

27 Therefore sceptical: *Soltész*, E.C.L.R. 2020/12, p. 613.

dies nor vice versa. Of course, with respect to their different approaches and aims, these different thresholds make sense – an alignment would not be advisable. Yet, it bears the risk of two separate investigations – one on the creation or strengthening of a dominant market position, and one on a foreign financial contribution.

Additionally, there is another aspect resulting in complication which is neither reflected in the Merger Regulation nor in the FSR Proposal: If a concentration does not fall within the scope of the Merger Regulation, there is the possibility of a notification duty with national competition authorities.²⁸ In particular, If European thresholds are not triggered, national merger control law may apply and lead to a national investigation. As the thresholds of the Merger Regulation and the FSR Proposal are different, it is possible that a concentration must be both notified with the Commission because of having received a foreign financial contribution, and with a national competition authority because of the triggering of the thresholds of national merger law. Therefore, there is not only the problem of two separate investigations at the same time, but having them being carried out by two separate competition authorities as well.

III. Prohibition criteria

The Merger Regulation asks whether the concentration will lead to a significant impediment to effective competition.²⁹ In accordance with its objective, the prohibition criterion of the FSR Proposal is a different one: the distortion of the internal market.³⁰ According to Art. 3, it is determined by the foreign subsidy both improving the competitive position of the undertaking and negatively affecting competition. Due to it being part of the general section and thus non-specific to concentrations, the assessment is a joint feature of all tools of the FSR Proposal.

IV. Interim results

In summary, comparing Chapter 3 of the FSR Proposal and the Merger Regulation, there is close alignment in the investigation procedure. Yet, it is important to highlight that the Proposal suggests a second, separate procedure. Regarding their scopes of application, the alignment is reflected largely in appearance rather than substance. However, because of their different purposes, this divergence makes sense. Moreover, due to their different objectives, the prohibition criteria have nothing in common.

D. Aptitude to tackle the regulatory gap?

In order to assess whether Chapter 3 has the potential to tackle the regulatory gap without excessively impeding M&A transactions, the positive and negative aspects

28 Cf. e.g. Sec. 35 ff. of the German Competition Act.

29 Cf. Recitals 25, 26 and Art. 2(3) Merger Regulation.

30 *European Commission*, FSR Proposal, p. 48.

of the FSR Proposal with regards to the inspection process, the scope of application and the prohibition criteria will be highlighted.

Regarding the inspection process, the notification obligation stands out as a positive aspect: Obliging undertakings to take action (instead of waiting for the Commission to investigate a certain merger) results in the tool being effective. Another element on the plus side are the strict time limits: They give an incentive for efficiency and will thus reduce impediments to M&A transactions. Yet, with a glance at past merger investigations, this may be an advantage on paper only as the notification is often delayed to allow for preliminary investigations. Moreover, the fact remains that a new procedure is established and thus, M&A transactions will include more red tape.³¹

Regarding the scope of application, on the positive side, the identical definition of concentration can be highlighted: Applying the same definition will simplify the undertaking's self-assessment and result in legal certainty. Another plus point involves the concrete thresholds as they both capture the EU and the subsidy nexus. Furthermore, the EU turnover criterion is of a similar scale to the one from the Merger Regulation. On the negative side, concerning the term foreign financial contribution, there will most certainly be delimitation problems. Moreover, because of the different scopes of application, and the institution as a separate procedure, there is the very real possibility of two investigations taking place at the same time, possibly even being carried out by two different competition authorities. This will lead to a duplication of efforts and, in a worst-case scenario, contradictory decisions.

Finally, with regard to the prohibition criteria, on the positive side, they are in accordance with the Regulation's purpose. Yet, they are relatively vague, possibly creating a problem of legal uncertainty.

Contemplating these pros and cons, Chapter 3 has the potential to successfully tackle the regulatory gap. Yet, it definitely has some weak spots as well. These weak spots mostly concern undue impediments to M&A transactions with the most problematic aspect being the possibility of having separate investigations by separate competition authorities resulting in contradictory decisions.

E. Suggestions

As closing remarks, some mitigation measures regarding the most prominent hazard of separate investigations shall be suggested: A large-scale solution would be the establishment of a joint procedure, possibly by extending the Merger Regulation's scope of application. Yet, as traditional merger control and the new subsidy tool serve different objectives, different notification criteria make sense. Also, to allow for an assessment of the problematic aspects only, establishing separate notification obligations is sensible. Thus, in principle, the tools should remain separate.

As the paramount problem is the possibility of contradictory decisions, a small-scale solution could be the establishment of internal alignment mechanisms. Yet,

31 Therefore sceptical *Soltész*, BB 2020, p. 1733; *Soltész*, E.C.L.R. 2020/12, p. 613.

this would not tackle the disadvantage of a duplication of effort. Moreover, with regard to a European and a national investigation, sufficient coordination tools seem rather utopic.

As an intermediary solution, in case of both thresholds being triggered or – as a lesser intervention – both investigations entering Phase 2, a mandatory consolidation of investigations comes to mind. However, in the case of a national competition authority investigating, this could only be realised by passing on the procedure. Obviously, this would transfer the Merger investigation to the Commission and thus to a competition authority further away from the problems arising on a national market. Yet, this might still be in the lesser evil in comparison with having two separate investigations taking place.

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