Axon Advisory Research

State-backed investors in the EU: the new rules of the game

A new proposal from the European Commission targets subsidies from non-EU countries that could distort the internal market.

This article provides a snapshot of this proposed new screening mechanism and how it could affect non-EU companies and investors.

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1. Introduction

On 5 May 2021, the European Commission published its proposal for a **Regulation 'on foreign subsidies distorting the internal market'** (the 'Regulation'). This new measure, if adopted, will give the European Union sweeping powers to address a gap in its trade tools against foreign state subsidies.

The European Commission is proposing a new regulation targeting subsidies from foreign states that lead to distortions in the internal market

Subsidies by EU member states to their enterprises are already prohibited by EU State aid rules, with various regulated exceptions. Further, non-EU ('foreign') subsidies to products exported to the EU can be offset through EU countervailing duties. There is a **gap**, however, when it comes to possible EU defensive actions against foreign subsidies used to finance acquisitions or procurement bids in the EU. This is perceived as a problem by the Commission, and the Regulation is supposed to address it.

The measures targeted are **subsidies through financial contributions**, such as all types of fund or liability transfers, state guarantees, the foregoing of revenue, or the provision of goods and services by foreign states. Such financial contributions may come from a (foreign) state directly, but also via other public or private entities as long as they can be ultimately attributed to a foreign state.

Once adopted, the Regulation will allow the Commission to take action against foreign subsidies if these lead to **distortions on the internal market**. However, the indicators given for such distortions are only broadly defined by the Regulation. This will likely render the whole exercise very discretionary and politicized. Foreign subsidies will be safely exempted only if their total amount is below 5 million over any consecutive three-year period.

The first main area affected by the Regulation would be **EU acquisitions by foreign state-backed entities**. These would have to be screened by the Commission for clearance prior to their completion if (i) any of the parties concerned is established in the EU and has EU turnover of at least € 500 million, and (ii) the parties concerned have received an aggregate financial contribution, in the three last years, of more than EUR 50 million. Moreover, the Commission will have the power to investigate other transactions, below these thresholds, if it suspects that the companies concerned have benefited from such financial support in the last three years.

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The second main area concerned by the Regulation is **public procurement**. The European Commission wants to prevent the use of foreign subsidies that allow a company to make an unduly advantageous offer for works, supplies or services contracts with a value of at least EUR 250 million. Participants in such contracts would have to notify all the foreign financial contributions they have received in the last three years or confirm they have not received any such contributions.

The European Commission also wants to prevent the use of foreign subsidies to make unduly advantageous offers in public tenders

2. What's Next?

Even if the proposal has to go through the usual EU legislative process, the Commission is reportedly in a hurry to get to adoption as soon as possible. Apparently, the current expectation is that between 30 and 50 transactions will be caught by the Regulation's screening mechanism each year.

It is clear the Regulation's main target is China, given its dominating presence in the world economy, the part played by Chinese companies in M&A activity in Europe, and the role of the Chinese state in this geopolitical process. Nevertheless, non-Chinese state-backed acquisitions will be caught too, even if this is just 'collateral damage' to any trade tensions between the EU and China. For example, sovereign investment funds from Latin America, the Middle East or East Asia are likely screening candidates under the Regulation, even if any associated EU political sensitivities are not of the same order as those for China.

The Regulation's main target seems to be China. Nevertheless, non-Chinese state-backed acquisitions will be caught too.

As a service to be offered through its Consulting Division, Axon will assess the associated regulatory risks to its non-EU based clients and investors, and support them in any preventive action they can take in connection with this EU initiative, drawing from Axon's multi-disciplinary expert resources in Europe, the Middle East and Latin America.

The details of the proposed new screening mechanism are clearly inspired by the existing EU merger review procedure and EU State aid rules. Familiarity with these rules and, more generally, ties with the EU decision-making mechanism will be key in ensuring a smooth sailing through the new rules, and Axon's expert team brings together very relevant experience and knowledge in these areas.

3. About Axon

Axon Partners Group ('Axon') is an international investment and advisory firm offering world-class investment, consulting and corporate finance services to a global client base in the broad technology sector.

In the last 10 years, Axon has executed +500 projects in +60 countries for major private companies, governments, institutional bodies, and technology companies worldwide.

Axon is at the forefront of ICT regulation, having advised policymakers, regulators and market players across the globe in a wide range of issues, including the definition of policy and regulatory roadmaps, and the design of strategies in the new digital ecosystem.

Experts Team at Axon Partners Group[1]

[1] The views and opinions expressed in this article are those of the authors and do not necessarily reflect the view of Axon Partners Group.