



CPI EU News Presents:

Foreign Subsidies Regulation: Making Sense of the Commission's New White Paper

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On June 17, 2020, the EU Commission published a new White Paper on the regulation of foreign subsidies, which is intended to establish a level playing field in the internal market *vis-à-vis* subsidies from third countries such as China.² The instrument will apply towards all undertakings active in the EU that benefit from foreign subsidies. This article outlines the basic features of the new EU initiative. The German Monopolies Commission will discuss the competition implications of Chinese state capitalism in its XXIII. Biennial Report, which will be available in July. The Biennial Report will follow up on also in the new EU initiative.

Background

In its Strategic outlook on China published in March 2019, the EU described China as a systemic rival, pointing to a number of distortions of competition and security risks.³ In the course of last year, several EU Member States, including Germany, called for a reform of EU competition law to better address unfair competition from Chinese companies.⁴ In this context, also the tightening of foreign direct investment (“FDI”) screening by the new EU FDI framework regulation and on the national level indicates that the stance towards China is hardening in the EU.⁵ The main competition concerns in connection with Chinese state capitalism are (1) the direct state influence on SOEs and private Chinese companies; and (2) the numerous subsidies provided by the Chinese state. Against this background, an increasing number of companies and associations support the calls for reform of the EU legal framework.⁶ The European Commission shares the concerns of European businesses. This was already indicated in the Strategic outlook, but also a comprehensive Commission report on the basis of Article 2(6a) of the EU anti-dumping Regulation identified a number of significant distortions arising from Chinese state capitalism. Moreover, in its industrial strategy paper published in March this year, the Commission announced a new instrument for dealing with foreign subsidies.⁷

Main Ideas of the White Paper

The starting point of the White Paper is the Commission's observation that the common market is open to foreign investment while, at the same time, no State Aid control is available in relation to foreign subsidies. This legal gap leads to distortions of competition which need to be addressed. In addition, there is a lack of transparency when it comes to international subsidization, although WTO members are required to notify subsidy programs under the Agreement on Subsidies and Countervailing Measures (“ASCM”). The Commission proposes three different options (Modules 1 - 3) that could be implemented individually or in combination.

Module 1

Module 1 is a general instrument that would cover foreign subsidies granted to a recipient resident or operating in the EU. The instrument would allow for intervention where the foreign subsidies cause (competitive) damage within the internal market. The instrument would apply to any kind of market behavior, including mergers. Subsidies already covered by the EU's trade defense instruments would be excluded, as

would be subsidies granted in connection with a procurement procedure. The scope of application could either be limited to companies established in the EU or extended to all companies operating in the internal market. The latter would be in line with the antitrust system. However, the Commission prefers an application to companies established in the EU and/or to specific economic activities, such as the acquisition of EU companies. In any case, subsidies would be covered regardless of whether they have already been received or only been promised.

The central question is when a subsidy should be classified as distorting competition. To this end, the Commission proposes a two-pronged approach:

- A catalogue of certain subsidies should be considered to have distortive effects. This would include, for example, subsidies that directly facilitate acquisitions. However, the company would have the opportunity to rebut the presumption of a competition distortion.
- All other subsidies would be subject to a detailed analysis based on a non-exhaustive list of individual criteria, such as the amount of the subsidy, the market position of the recipient, the market situation, market behavior or the level of economic activity. The Commission also proposes that account should be taken of the openness of the market in the third country granting the subsidy.

Where a distortive effect exists, the distortion should be weighed against possible positive effects (balancing test). In any event, the Commission considers that a subsidy of up to EUR 200,000 should be considered negligible, which would be in line with State aid law.

The procedure would be structured in two stages:

- The first stage (preliminary review) would be initiated by the competent authority or authorities themselves (*ex officio*). This means that a subsidized merger would normally be examined only after its implementation. The Commission stresses that information from market participants would be crucial in the course of the investigation. Therefore, the authorities should be authorized to request information from the companies concerned. If the authorities conclude that there is a possibility of a foreign subsidy distorting EU competition, they could open an in-depth investigation.
- During the in-depth investigation, the authorities would enjoy comprehensive information rights. If the authorities conclude that a foreign subsidy is distorting EU competition, they could impose “redressive measures” or accept commitments; otherwise they would terminate the proceeding. Redressive measures could mean the obligation to repay the subsidy, although the Commission intends to allow this only if the third country in question has infrastructure available for monitoring subsidies. Otherwise, a wide range of other measures could be imposed, such as unbundling, access to licenses, investment or conduct bans or even the publication of research results. When selecting the specific measure, the specific features of the subsidy and its effects should be taken into account. In any case, transparency and reporting obligations should be imposed for the future.

In the Commission's view, the allocation of responsibilities should in principle be based on the model of antitrust law, where purely national cases are investigated by national authorities and cross-border cases centrally by the Commission. There should in any case be extensive cooperation mechanisms.

Module 2

Module 2 would introduce a special instrument allowing for the review of company acquisitions where the investor benefits from foreign subsidies. The White Paper provides for thresholds similar to those used in merger control. The concept of control would be broader than in Regulation 139/2004 because it would also include minority shareholdings. The thresholds would also take into account the fact that this is a strategically important sector or that high sales are expected in the future. A “potentially subsidized acquisition” would be defined as a proposed acquisition of an EU-based company (with sales above, e.g., EUR 100 million) where the merging parties could benefit from a financial contribution from a third party.

The concentration would be reviewed for possible distortive effects of the subsidy on the common market. In the case of targeted subsidies (direct facilitation), it would be presumed that they distort competition, otherwise (de facto facilitation) a case-by-case analysis would be required. To address the lack of transparency regarding third country subsidies, certain indicators would be used that are similar to those used in Module 1 to show the distortive effects of the subsidy (including reciprocity considerations). Module 2 also weighs up the benefits of subsidies.

The procedure would be based on that of the EU Merger Regulation (in particular 2 phases) and triggered by notification. Where companies fail to notify, an ex-officio procedure would be possible. Decisions could be clearance with and without conditions, and the prohibition of the merger. As remedies for clearance with conditions, redressive payments or transparency obligations would generally not be considered to be sufficient.

In terms of responsibilities, the Commission prefers a centralized system in order to save costs and prevent inter-agency coordination problems.

Module 3

Under Module 3 companies participating in public procurement procedures in EU Member States would be obliged to inform the contracting authority from foreign subsidies. To limit the administrative burden, thresholds, and additional conditions for notifications could be introduced. The notification would be transmitted to the competent authority to make an assessment whether the subsidy is distorting competition in the common market. Where this is the case, the company benefitting from foreign subsidies could be barred from participation in the tender.

Foreign Subsidies in the Context of Access to EU Funding

In addition to the public procurement at the EU Member State level, the Commission notes a similar problem in relation to EU funding. In the field of direct, shared, and indirect management, it therefore proposes that, when awarding contracts and grants,

a similar examination should be carried out to that required under Module 3, meaning that the relevant companies would have to indicate whether either this company or a member of its consortium has received foreign subsidies in the three years preceding the EU-funded project, or intends to receive them in the future for the duration of the contract or financing. In addition, there should be reporting obligations to the Commission, especially in the case of an indirect management.

Interplay with Existing EU and International Law

The Commission intends to apply the new instrument in parallel with the existing rules of competition and trade law. In relation to subsidy provisions in free trade agreements, provision should be made for a co-ordination of the instrument with the initiation of a dispute settlement procedure. The Commission points out that any concrete design must be checked for its conformity with WTO law.

Outlook

The Commission's White Paper contains a far-reaching reform of European law in relation to foreign subsidies. The issue has gained traction following the EU's Strategic outlook on China, which highlighted the systemic rivalry between the EU common market order and Chinese State capitalism. However, the competition issues go even beyond what is being discussed in the White Paper. The Monopolies Commission will publish its XXIII Biennial Report in July this year. In it, the Monopolies Commission will present an in-depth analysis of Chinese state capitalism, which will include both competition law and trade law elements. The Monopolies Commission will also position itself on the EU Commission's initiative and present its own ideas for reform.

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- ² European Commission, White Paper on levelling the level playing field as regards foreign subsidies, June 17, 2020, COM(2020) 253 final, https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf.
- ³ European Commission, EU-China – A strategic outlook, March 12, 2019, <https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf>.
- ⁴ Bundesministerium für Wirtschaft und Energie/ Ministère de l'Économie et des Finances/Ministerstwo Przedsiębiorczości i Technologii, Modernising EU competition policy, July 4, 2019, https://www.bmwi.de/Redaktion/DE/Downloads/M-O/modernising-eu-competition-policy.pdf?__blob=publicationFile&v=4.
- ⁵ Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ L 79I , 21.3.2019, p. 1–14; Verordnung der Bundesregierung, Fünfzehnte Verordnung zur Änderung der Außenwirtschaftsverordnung, May 11, 2020, https://www.bmwi.de/Redaktion/DE/Downloads/F/fuenfzehnte-verordnung-zur-aenderung-der-aussenwirtschaftsverordnung-regierungsentwurf.pdf?__blob=publicationFile&v=10.
- ⁶ BusinessEurope, The EU and China – Addressing the systemic challenge, January 2020, https://www.businesseurope.eu/sites/buseur/files/media/reports_and_studies/the_eu_and_china_full_february_2020_version_for_screen.pdf.
- ⁷ European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - A New Industrial Strategy for Europe, COM(2020) 102 final, March 10, 2020, https://ec.europa.eu/info/sites/info/files/communication-eu-industrial-strategy-march-2020_en.pdf.