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White & Case

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On May 5, 2021, the European Commission ("Commission") issued a proposal for a far-reaching Regulation to tackle foreign subsidies.[2] This is a key element of the European Commission's updated industrial strategy,[3] which was published on the same day. The proposal aims to close a perceived regulatory gap whereby subsidies granted by EU Member State are closely scrutinized while subsidies granted by non-EU governments currently go largely unchecked.

The proposal creates a new hybrid tool derived from existing antitrust and trade instruments, which, if adopted, will increase the regulatory risk for companies operating or investing in the EU with backing from non-EU States.

Going forward, it may be the case that, prior to closing transactions, merging parties may have to file notifications under new EU foreign subsidy mandatory procedures, as well as under "regular" merger control at EU or national level, and pursuant to national FDI regimes.

In addition to transactions, the instrument targets any kind of subsidised commercial activity affecting EU markets, including bidding for public contracts.

Why the New Tool?

The Commission has concerns that subsidies granted by non-EU governments ("foreign subsidies") may distort competition within the EU but, unlike subsidies granted by EU Member States, foreign subsidies are escaping its control because it believes that there is an enforcement gap in its current toolbox.

- Neither EU antitrust rules nor EU merger control regulations specifically take into account whether an economic operator may have benefited from foreign subsidies (even if in principle it could form part of the assessment) and they do not allow the Commission (or Member States) to intervene and decide solely or even mainly on this basis.
- The financial support granted by third countries (either to undertakings active in the EU or to their parent companies outside the EU) is not covered by EU State aid rules.
- Under national FDI screening mechanisms and the EU FDI Screening Regulation, authorities may assess and block FDI based on security and public order grounds, but this does not explicitly include considerations of foreign state subsidies.
- EU anti-dumping and anti-subsidy rules, themselves based on WTO Agreements, apply to the import into the EU of goods only, and – importantly – do not cover trade in services, acquisitions of EU companies or other financial flows in relation to the activities of undertakings in the EU. Moreover, they only usually apply to subsidies granted by the State in which the goods were produced.
- The EU public procurement framework does not specifically address distortions to the EU procurement markets caused by foreign subsidies.

The Commission considers it necessary to complement existing instruments with a new tool, which lies at the intersection of traditional competition and trade rules, to address distortive foreign subsidies. Following the public consultation of its June 2020 white paper

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[2] See https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.
[3] See https://ec.europa.eu/info/sites/default/files/communication-industrial-strategy-update-2020_en.pdf.

on foreign subsidies,[4] the Commission believes that there is strong support for such an intervention.

The proposed Regulation is supported by an Impact Assessment,[5] which explains in detail the rationale behind the proposal and describes several situations in which foreign subsidies may cause distortions.

A Three-tiered Investigation Tool

The Proposed Regulation would apply to all sectors and to a wide variety of situations. It establishes a three-tiered investigative tool for investigating foreign subsidies with the following components:

A notification-based investigative tool for certain transactions involving a financial contribution by one or more non-EU government(s) where the turnover of the EU target (or at least one of the merging parties) exceeds EUR 500 million and the foreign financial contribution exceeds EUR 50 million over the previous 3 years;

A notification-based investigative tool for bids in public procurements involving a financial contribution by a non-EU government, where the estimated value of the procurement is EUR 250 million or more; and

A general investigative tool for the Commission to investigate all other market situations, smaller transactions, and public procurement procedures, which the Commission can start on its own initiative (*ex officio*).

The Commission would be exclusively responsible for enforcement of the Regulation. The Commission considered whether the Member States should be empowered to enforce parts of the Regulation, but rejected this possibility to ensure the uniform application of the rules across the EU.

A *de minimis* rule is proposed: financial contributions below EUR 5 million (in the past 3 years) are presumed not to be distortive.

Substantial Investment in Enforcement

The Commission plans to make substantial investment into the enforcement of the Regulation. The Commission envisages an additional 145 full-time employees to monitor and investigate compliance with these new rules. That is significant compared to the total current staff in DG COMP of around 800 who currently enforce the full range of competition rules. It is also much bigger than the 80 full-time staff expected to police the much-debated Digital Markets Act, applying to digital gatekeepers.

Foreign Subsidies

A foreign subsidy shall be deemed to exist if an undertaking engaging in an economic activity in the EU receives financial support from the public authorities of a non-EU country. Financial contribution has been broadly defined to include not just the transfer of funds, but the transfer of zero-interest loans and other below-cost financing, unlimited guarantees, compensation, export financing that is not in line with the OECD Arrangement on officially supported export credits, preferential tax treatment, tax credits, or direct grants.

The definition is largely based on the definition of subsidy in the WTO Agreement on Subsidies and Countervailing Measures ("SCM"), which has a broad interpretation. There is therefore the potential for all kinds of measures to be caught.

Distortion of Internal Market

Once the existence of a foreign subsidy is established, the Commission has to determine whether the foreign subsidy distorts the EU internal market. There are broad indicators for

[4] See https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf.
[5] See https://ec.europa.eu/competition/international/overview/impact_assessment_report.pdf.

this assessment, including the amount and nature of the subsidy, the situation of the undertaking and the markets involved, the level of economic activity of the undertaking concerned on the internal market, and the purpose and conditions attached to the foreign subsidy as well as its use on the internal market.

As noted above, a foreign subsidy is presumed unlikely to distort the internal market if its total amount is below EUR 5 million over any consecutive period of three fiscal years.

Certain categories of foreign subsidy are considered “most likely” to distort the internal market, and therefore do not require a detailed assessment based on indicators. These include: foreign subsidies granted to an ailing undertaking, unlimited guarantees for debts/liabilities, foreign subsidies directly facilitating a transaction, and foreign subsidies that allow an undertaking to submit an unduly advantageous tender.

The Commission will weigh the negative effects of a foreign subsidy in terms of distortion on the internal market against any positive effects on the development of the relevant economic activity, and use this determination to decide on an appropriate redressive measure or commitments. The lack of detail in the proposal on how the Commission will undertake this balancing exercise is striking. In the EU State aid field, there are the “positive effects” set out Article 107(2) and (3) TFEU, and detailed in extensive Commission guidelines. For predictability and accountability, it is to be hoped that the Commission will issue guidelines on how it will assess whether a foreign subsidy distorts the internal market, and the situations in which the positive effects of the subsidy may be considered to outweigh the negative effects.

Redressive Measures and Commitments

The Commission has the power to impose structural and behavioral redressive measures on an undertaking to remedy any distortion, or indeed any potential distortion, caused by the subsidy. The undertaking concerned also may offer commitments to remedy the distortion. For example, it may offer to repay the subsidy to the third country that granted it, with appropriate interest.

Because the draft proposes that the Commission be empowered to address actual and potential distortions on the internal market, there is great scope for the Commission to impose wide-ranging remedies.

Fines

The Commission can impose fines and periodic penalty payments for procedural infringements, such as the supply of incorrect, incomplete or misleading information in the context of an investigation, and for non-compliance with Commission decisions imposing redressive or interim measures, or failure to make good on commitments.

The Notification-based Tool for Transactions

This element requires that the Commission be notified in advance of “concentrations” which are “notifiable” when they meet certain prescribed financial thresholds.

The definition of concentration is the same as under the EU Merger Regulation and covers a lasting change of control. This can arise from:

The merger of two or more previously independent undertakings (or parts of them)

The acquisition by one or more undertakings of direct or indirect control of the whole or parts of another undertaking

The creation of a full-function joint venture (i.e. performing on a lasting basis all the functions of an autonomous economic entity)

The acquisition of a minority shareholding may constitute a concentration if the buyer will be able to exercise decisive influence over the

target, for instance by holding a "golden share/casting vote," or through a right of veto over strategic commercial decisions, such as budget approval or appointing the CEO.

A notifiable concentration will arise where:

(a) the acquired undertaking or at least one of the merging undertakings is established in the EU and generates an aggregate turnover in the EU of at least EUR 500 million; and

(b) the undertakings concerned received from third countries an aggregate financial contribution in the three calendar years prior to notification of more than EUR 50 million.

In the case of joint ventures, a notifiable concentration will arise where:

(a) the joint venture itself or one of its parent undertakings is established in the EU and generates an aggregate turnover in the EU of at least EUR 500 million; and

(b) the joint venture itself and its parent undertakings received from third countries an aggregate financial contribution in the three calendar years prior to notification of more than EUR 50 million.

It is disappointing that the joint venture rules seem to capture joint ventures operating wholly outside the EU because one parent is active inside the EU. This could lead to the same needless notifications that we see under the Merger Regulation.[6]

It is worth highlighting that the EUR 50 million financial contribution threshold is an aggregate threshold, so this threshold could be triggered if a number of different countries contribute. That provision carries – to put it mildly – the potential to complicate notifications.

The notification procedure would be similar to that under the EU Merger Regulation. The merging parties must notify the transaction to the Commission prior to implementation. The Commission will have 25 working days to review the transaction following receipt of a complete notification in Phase I and an additional 90 working days (extended by 15 working days where commitments are offered) if it decides to open a Phase II investigation. The Phase II investigation period can be extended once by the merging parties on request, and by the Commission with the agreement of the merging parties. The total duration of an extension cannot exceed 20 working days. The Commission has discretion to "stop the clock" if it considers that the merging parties have not supplied complete information.

The overall review period may be lengthy. This is because the 25-working-day Phase I period will only start once the Commission deems the notification to be complete. The experience of trade investigations shows that subsidy investigations can be very complicated and data-intensive, and in certain cases it may take many months to gather the information necessary for a notification to be declared complete and for the investigation clock to begin.

The Commission can impose fines of up to 10 percent of aggregate turnover for failure to notify, and up to 1 percent of aggregate turnover for supplying incorrect or misleading information.

The Notification-based Investigative Tool for Bids in Public Tenders

This component requires companies bidding in public procurement tenders to notify the contracting authority of all foreign financial contributions received in the previous three years or confirm in a declaration that they did not receive any foreign financial contributions. It applies to EU public procurement procedures of an estimated value of EUR 250 million or above.

The contracting authority must transfer the notification to the Commission immediately, and the Commission has 60 days after it

[6] See http://awa2014.concurrences.com/business-articles-awards/article/time-to-end-the-eu-s-needless.

receives the notification to conduct a preliminary review. It must complete any in-depth investigation no later than 200 days after having been notified.

During the Commission's preliminary and in-depth review, the evaluation of tenders may continue, but the contract cannot be awarded to an undertaking that has submitted a notification unless the time limits for Commission review have elapsed or the Commission has, following an in-depth investigation, determined that the foreign subsidy does not distort the internal market. The proposed Regulation applies to foreign financial contributions granted in the three years prior to the start of application of the Regulation.

The assessment of whether there is a distortion on the internal market and of the unduly advantageous nature of the tender shall be limited to the public procurement concerned.

The Commission may impose fines of up to 10 percent of aggregate turnover for failure to notify a subsidy, and up to 1 percent for supplying incorrect or misleading information.

The General "*Ex Officio*" Investigation Tool – Whose Procedures Apply to All Three Tools

This component is a general instrument enabling the Commission to act on its own initiative to investigate possible distortions of the EU market caused by a foreign subsidy.

The Commission has extensive powers to conduct a preliminary review, including powers to issue information requests and conduct dawn raids/inspections. The information request powers are broad, and comprise not just the capacity to request information from the undertakings concerned but also from other undertakings or associations of undertakings and third countries. Dawn raids can be on company premises either in or outside the EU. If the dawn raid is to take place outside the EU, the consent must be obtained from the undertaking concerned and the third country government. While antitrust experts might at first sight think it unlikely that any foreign country and undertaking would consent, this actually takes place very frequently in trade remedies cases. The only difference is one of terminology, in that it is not called a dawn raid or inspection but rather a "verification" – but it can be equally intrusive and would typically last longer than normal EC dawn raids.

The Commission also has powers to take decisions on the basis of the facts available if the undertaking concerned does not cooperate with information requests. This ability to draw on the facts available if the undertaking concerned does not cooperate draws on EU trade remedy experience, and differs from the investigation methods used in antitrust and State aid settings. If inadequate evidence is submitted by the undertaking, it can disregard it and base its finding on the "facts available" that could be publicly available data or data provided by other participants in the investigation, including complainants.

The retroactive application of the rules is far-reaching. The proposal applies to foreign subsidies granted in the ten years prior to the application of the Regulation, where such foreign subsidies distort the internal market after the start of the application of the Regulation.

The proposal does not prescribe time frames for the duration of investigations (apart from the 10-year limitation above), which can be contrasted with the existing EU State aid procedures where the preliminary investigation should be completed within 2 months (although this can be extended with requests for information) and formal investigations within 18 months. It can also be contrasted with the tight time frames for review provided by the EU Merger Regulation.

There are specific powers for the Commission to take interim measures if there is danger of substantial and irreparable damage to competition in the internal market.

The Commission may launch a market investigation of an entire sector if it has a reasonable suspicion that foreign subsidies in that sector are distorting the internal market. Following this, the Commission may publish a report on the results of its investigation and invite comments from interested parties. The Commission may use information obtained in the sector investigation to pursue individual companies.

The general "*ex officio*" investigation tool allows the Commission to investigate transactions and procurements that fall below the thresholds of the notification-based tools. This enables the Commission to conduct investigations on its own initiative, using powerful tools such as: information requests, dawn raids, and facts available. The Commission may require the notification of transactions that have yet to be realized, or of bids prior to the award of a public contract. It may also review transactions or public contracts that have already been implemented or awarded.

Impact

The proposals are extremely comprehensive and, if adopted into legislation, will intensify the regulatory burden for companies operating or investing in the EU with support from foreign States. They may also create new openings for strategic complaints by competitors.

The new measures will add complexity to the regulatory clearance path for M&A by State-backed investors involving EU targets, as companies may potentially have to file notifications under the new mandatory procedures, "regular" merger control at EU or national level, as well as according to national FDI regimes prior to closing their transactions.

There will also be increased regulatory uncertainty for international players operating in the EU, even absent a transaction. Companies will need to monitor closely the receipt of any foreign subsidies to anticipate exposure to investigation by the Commission, including when participating in tender procedures in the EU. This review needs to start now, since if the proposals are adopted, the Commission has the ability to look back three years during a foreign subsidy review. Experience from trade remedy cases suggests that identifying and quantifying all possible subsidies (potentially from multiple third countries) is not going to be easy. This hybrid instrument will also require knowledge of practice in both trade remedies and antitrust proceedings – and could potentially reverse the trend of narrow specialization seen in Brussels over the last two decades.

Next Steps

The proposal is another example of the EU's increasing robustness in international trade and industrial policy, which the EU labels as seeking "open strategic autonomy."

These proposals will spark substantial debate during the legislative process (under the ordinary legislative procedure between the European Parliament and the Council). That debate will have to weigh multiple interests: some stakeholders are keen to welcome foreign investments, while others are more apprehensive about selling assets to investors that have received subsidies in third countries. There is also an 8-week public consultation window for comments on the text.