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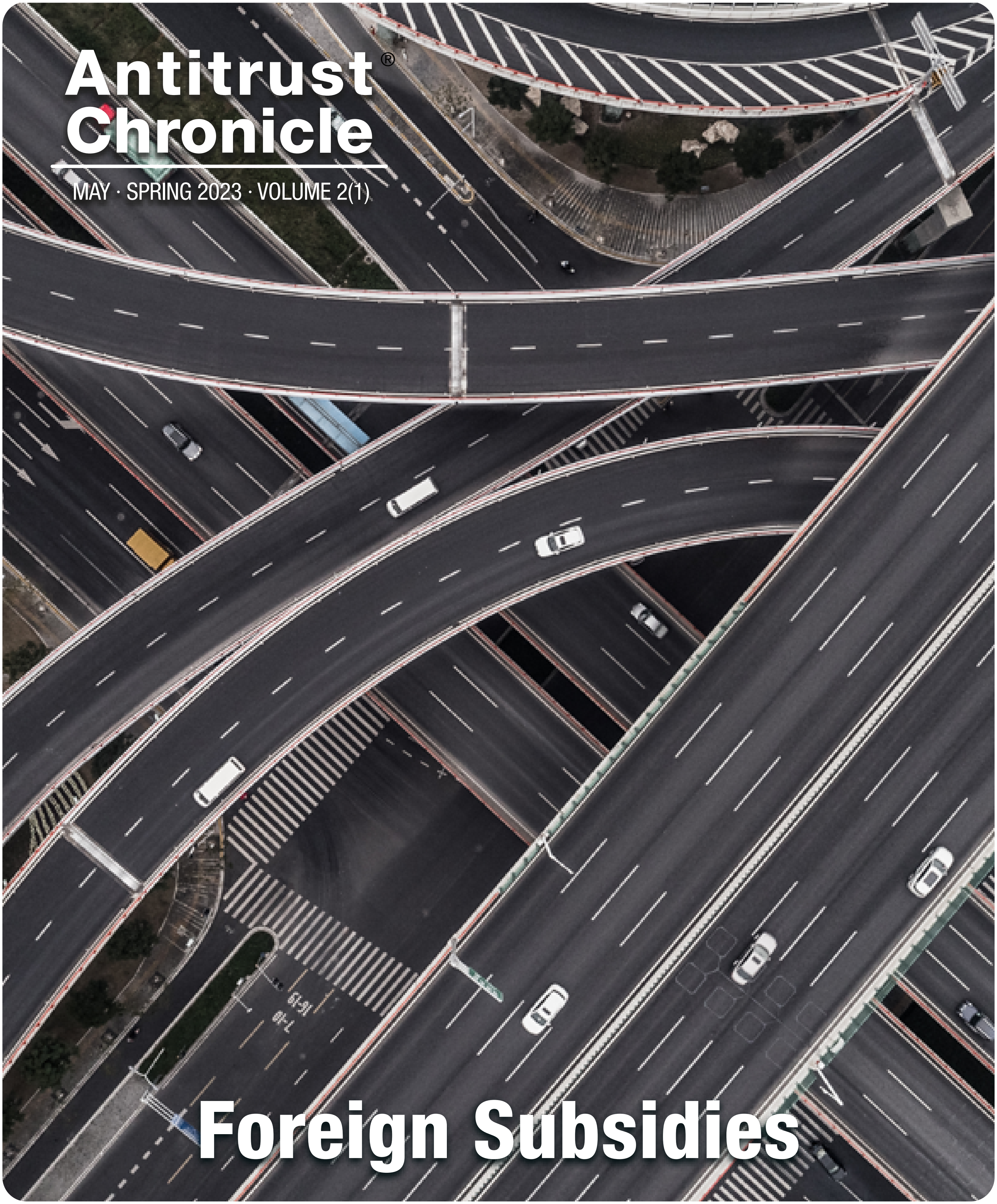

Foreign Subsidies

CPI COMPETITION POLICY® INTERNATIONAL

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LETTER FROM THE EDITOR

Dear Readers,

The EU Foreign Subsidies Regulation ("FSR") entered into force on January 12, 2023 and will start to apply from July 12, 2023. As **João Azevedo** describes, the stated aim of the FSR is to protect the EU's internal market from foreign subsidies which allegedly distort competition and thereby create a level playing field. The FSR grants the European Commission ("EC") extensive powers to intervene against such potential distortions in relation to any economic activity, and a new notification regime for certain M&A transactions and public tenders, which is independent from current EU/national merger control and foreign direct investment ("FDI") notification requirements.

These new powers will enter into force in parallel with the existing State Aid and merger control rules that already apply within the EU and its Member States. Perhaps inevitably, the array of new potential regulatory obligations on extra-EU businesses operating within the EU internal market has provoked lively debate and criticisms. The articles in this Chronicle reflect the state of the art of this debate as the FSR is about to enter into force.

Christian Ahlborn & Carole Maczkovics note the extensive criticism of the draft implementing regulation of the FSR, especially in the context of large concentrations for which clearance must be obtained from the Commission where certain thresholds are exceeded. Their paper takes a close look at the potential distortion of the internal market by foreign subsidies that the FSR intends to address. The authors submit that the relevant foreign subsidies for the substantive assessment under the FSR are limited to those that have a link to the concentration, because they are granted to undertakings that use them to fully or partially finance the concentration. The authors conclude that a focus on likely concerns will allow the Commission to significantly narrow the reporting requirements required under the notification form.

Drawing on existing experience, **Nicole Robins & Francisco** Couto highlight that, in the Commission's own words, "in substance," the FSR will be similar to State aid control. Drawing on insights from assessments in the State aid context. In particular, however, in the context of the assessment of concentrations and public procurement procedures, this is likely to require relatively new theories of harm to be examined. This article therefore also discusses, from an economics perspective, how the assessment of the distortions to competition could be carried out in practice, and the possible interactions with the EU Merger Regulation (the "EUMR").

Juan Jorge Piernas López also notes that the FSR has a very far-reaching scope, which poses challenges for legal certainty. The definition of financial contribution is significantly broad, and there is notable uncertainty as to how the Commission will apply the criteria for distortion or the balancing test. In this regard, the regulation tasks the European Commission to "publish and regularly update guidelines regarding the criteria for determining the existence of a distortion caused by a foreign subsidy on the internal market." In this regard, as the author underlines, such clarifications will certainly be welcomed, and the EU Courts will probably be called upon to further refine the different tests. The implementation of the new instrument in future years will also be key to assess whether the FSR will trigger a global reaction or a risk of retaliation by trade partners that could set up similar schemes to the detriment of the multilateral control of subsidies. The reaction might also be positive, as stakeholders around the world might become more aware of the often distortive and wasteful character of many subsidies, for instance to ailing firms, and their negative effect on competition and public finances.

Taking a critical perspective, **Lena Hornkohl** questions the existence of the perceived regulatory gap that led to the adoption of the FSR in its current scope. In the author's view, although EU law lacks an instrument guaranteeing equality of opportunity with EU State Aid law for subsidies granted by third states, the new notification-based tools for concentrations and public procurement procedures in the FSR go beyond that and what is necessary, putting third-country subsidies at a disadvantage compared to undertakings receiving Member State subsidies which are subject to EU state aid law.

Looking to broader questions relating to the impact of the FSR on foreign trade and FDI, **Georgiana Pop & Ana Amador** discuss the notion of transnational subsidies, the existing gap in the international regulation, and the initiatives adopted to discipline transnational subsidies to minimize trade and competition distortions. Their timely article questions whether these regulatory initiatives lead to increased protectionism and undermine the expansion of trade in low- and middle-income economies.

Of course, regulation of foreign subsidies cannot be examined in isolation from world trade law, specifically the WTO rules governing subsidies and countervailing measures. **Liliane Gam & Argyrios Papaefthymiou** focus on the "extraterritorial"' perspective of recent initiatives (i.e. efforts to counter within one jurisdiction the effects of subsidies stemming from another), in order to probe how these competing approaches will play out under the international trade rules that are established on a multilateral level under the WTO. The article examines the FSR in the context of the brewing green subsidies war – specifically the likely implications of the new EU regime on the U.S. Inflation Reduction Act'' green subsidies – as a case study on the likely interaction of these different legal disciplines at the international level.

In sum, as reflected in the contributions to this Chronicle. while many agree that the FSR could have some potential benefits in terms of promoting fair competition and protecting EU interests, it also raises concerns about trade tensions, protectionism, and its potential impact on green initiatives and emerging economies. It remains to be seen how these issues will be addressed as the FSR is implemented in practice.

As always, many thanks to our great panel of authors.

Sincerely,

CPI Team

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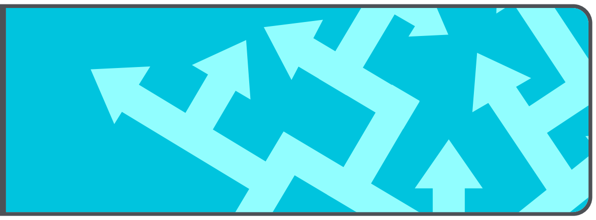

WHAT IS THE INFORMATION NEEDED FOR THE COMMISSION TO CONDUCT ITS SUBSTANTIVE ASSESSMENT UNDER THE NEW EU FOREIGN SUBSIDIES REGULATION?

By Christian Ahlborn & Carole Maczkovics

The new EU Foreign Subsidies Regulation ("FSR") adopted at the end of 2022 is not yet applicable but it has already been subject to extensive criticism due to its draft implementing regulation, especially in the context of large concentrations for which clearance must be obtained from the Commission where certain thresholds are exceeded. This paper takes a closer look at the distortion of the internal market by foreign subsidies that the FSR intends to address. It will then submit that, in the context of notifiable concentrations, the relevant foreign subsidies for the substantive assessment under the FSR are limited to those that have a link to the concentration, because they are granted to undertakings that use them to fully or partially finance the concentration. The paper will then conclude that a focus on likely concerns will allow the Commission to significantly narrow the reporting requirements required under the notification form.

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FAMILIAR TOOLS IN FOREIGN SETTINGS: PRACTICAL CONSIDERATIONS FOR COMPLYING WITH THE NEW FOREIGN SUBSIDIES REGULATION

By Nicole Robins & Francisco Couto

The introduction of the Foreign Subsidies Regulation ("FSR") aims to address an existing regulatory gap in ensuring a level playing field in the internal market. The FSR will have far-reaching consequences for companies operating in the EU, particularly those that are planning mergers or acquisitions or engaging in large public tenders. The European Commission has highlighted that, "in substance," the FSR will be similar to state aid control. Therefore, drawing on insights from assessments in the state aid context, this article discusses the economic tools that could be used to assess whether a financial contribution from a third country confers a benefit on an undertaking. If a financial contribution is found to constitute a foreign subsidy, the Commission has indicated that an assessment of the likely distortions to competition caused by the foreign subsidy will be particularly important. In the context of the assessment of concentrations and public procurement procedures, this is likely to require relatively new theories of harm to be examined. This article therefore also discusses, from an economics perspective, how the assessment of the distortions to competition could be carried out in practice, and the possible interactions with the EU Merger Regulation (the "EUMR").

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MANAGING FOREIGN SUBSIDIES IN THE EU

By João Azevedo

In this paper, we describe the European Union's approach to control harmful effects of foreign subsidies on the EU internal market. The EU policy in this area is set out mainly in the EU State aid rules. The purpose has been to identify and avoid harmful support measures while allowing governments to continue to use State aid to facilitate the development of certain economic activities. The effect of subsidies has – to a limited extent - also played a role in the EU antitrust and merger policy. In recent years, the need for the control of EU State aid to be complemented by a control of subsidies granted by non-EU government has been increasingly recognised. The Commission identified a regulatory gap that is captured neither by existing competition, nor by trade instruments. The EU legislators agreed on a new Regulation on foreign subsidies distorting the EU internal market in 2022. This Regulation entered into force in January 2023. The Regulation lays down rules and procedures for investigating foreign subsidies that favour companies in a way that negatively affects competition in the EU internal market and for addressing such distortions and its main lines will be presented in this paper.

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DO WE REALLY NEED THE EU FOREIGN SUBSIDY REGULATION?

By Lena Hornkohl

This article critically questions the regulatory gap and the need for the new Foreign Subsidy Regulation in its current scope. EU law lacks an instrument guaranteeing equality of opportunity with EU State Aid law for subsidies granted by third states. Without a State Aid equivalent, companies subject to EU state aid law would be at a disadvantage compared to their competitors receiving foreign subsidies. The new notification-based tools for concentrations and public procurement procedures in the Foreign Subsidy Regulation go beyond that and what is necessary, putting third-country subsidies at a disadvantage compared to undertakings receiving Member State subsidies which are subject to EU state aid law not containing specific merger or public procurement obligations. The Foreign Subsidy Regulation puts an extra regulatory burden on third country subsidized companies.

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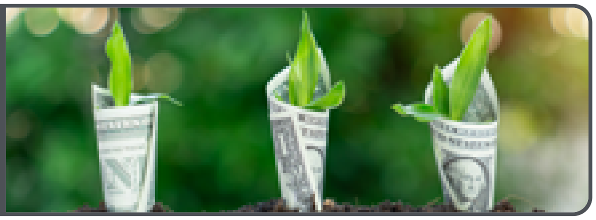

THE EU FOREIGN SUBSIDIES REGULATION: GREEN SUBSIDIES TREADING THE LINE BETWEEN THE FSR, STATE AID, AND WTO LAW

By Liliane Gam & Argyrios Papaefthymiou

This article provides an overview of the ongoing regulatory 'competition' between major global economies to boost renewable energy through public resources, i.e. through subsidies. Against this backdrop, the article focuses on the 'extraterritorial' perspective of these initiatives (i.e. efforts to counter within one jurisdiction the effects of subsidies stemming from another), in order to probe how these competing approaches will play out under the international trade rules that are established on a multilateral level under the WTO. The article examines the new EU Foreign Subsidies Regulation and the brewing green subsidies war – specifically the likely implications of the new EU regime on the U.S. Inflation Reduction Act's green subsidies – as a case study on the likely interaction of these different legal disciplines at the international level.

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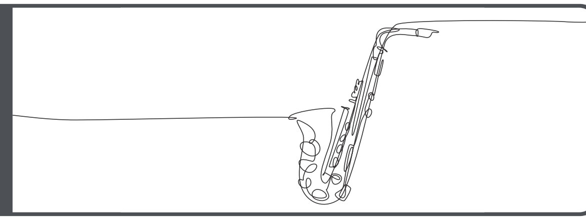

THE FOREIGN SUBSIDIES REGULATION: AN AMBITIOUS INSTRUMENT THAT RAISES SIGNIFICANT CHALLENGES

By Juan Jorge Piernas López

This contribution discusses the recently adopted Regulation (EU) 2022/2560 on foreign subsidies distorting the internal market, usually referred to as the Foreign Subsidies Regulation or “FSR”. After providing some context, the contribution reviews the main steps followed by the EU towards the adoption of the FSR as well as its main content. The FSR is a complementary instrument aimed at limiting distortions in the internal market caused by subsidies granted by non-EU countries and appears to be in line with EU’s previous initiatives. In particular, the FSR addresses a gap in EU Law that has been identified for some time. The paper concludes that, while generally positive, the FSR’s far-reaching scope and reporting obligations pose some challenges for legal certainty and implementation.

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TRANSNATIONAL SUBSIDIES: ACHILLES’ HEEL FOR FOREIGN INVESTMENT, TRADE, AND COMPETITION

By Georgiana Pop & Ana Amador

In the recent years, the discussion around transnational subsidies is gaining momentum, and there is some debate about of how these government interventions should be regulated. The present article discusses the notion of transnational subsidies, the existing gap in the international regulation, and the initiatives adopted to discipline transnational subsidies to minimize trade and competition distortions. At the same time, it questions whether these regulatory initiatives lead to increased protectionism and undermine the expansion of trade in low- and middle-income economies.

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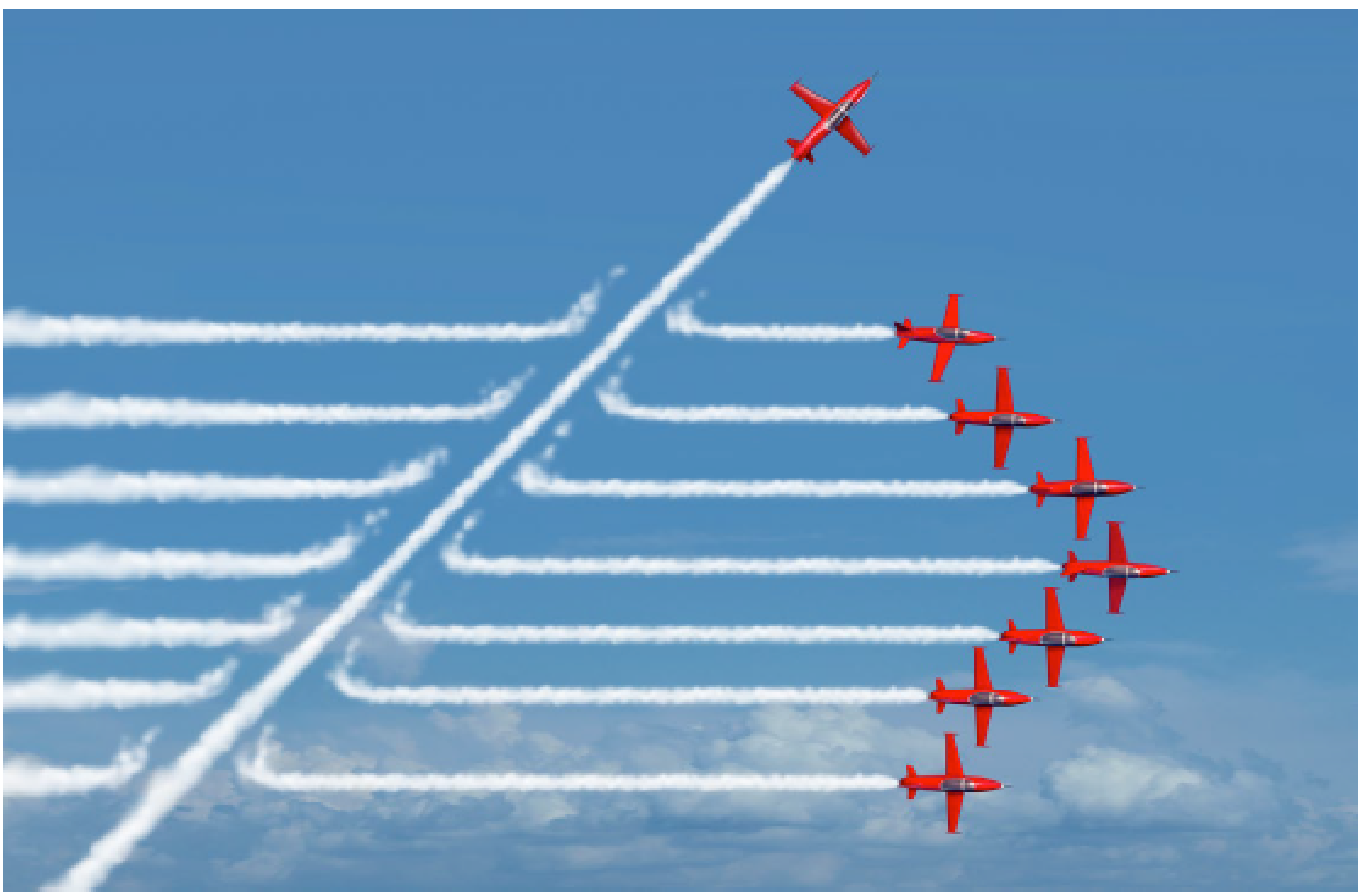
Contributions to the Antitrust Chronicle are about 2,500 – 4,000 words long. They should be lightly cited and not be written as long law-review articles with many in-depth footnotes. As with all CPI publications, articles for the CPI Antitrust Chronicle should be written clearly and with the reader always in mind.

Interested authors should send their contributions to Sam Sadden (ssadden@competitionpolicyinternational.com) with the subject line "Antitrust Chronicle," a short bio and picture(s) of the author(s).

The CPI Editorial Team will evaluate all submissions and will publish the best papers. Authors can submit papers on any topic related to competition and regulation, however, priority will be given to articles addressing the abovementioned topics. Co-authors are always welcome.



WHAT IS THE INFORMATION NEEDED FOR THE COMMISSION TO CONDUCT ITS SUBSTANTIVE ASSESSMENT UNDER THE NEW EU FOREIGN SUBSIDIES REGULATION?

BY CHRISTIAN AHLBORN & CAROLE MACZKOVICS[1]

1 Christian Ahlborn is partner and Carole Maczkovics is of Counsel at Covington & Burling LLP.

After less than two years of debate, the European Union ("EU") has adopted the Regulation on foreign subsidies distorting the internal market ("FSR").[2] This brand-new regime constitutes an important policy instrument intended to capture distortions of the EU internal market caused by foreign subsidies. The FSR is based on the consideration that whereas companies active in the EU are subject to State aid rules when they are granted support from a public entity of an EU Member State, in general, companies financially supported by non-EU countries are not. This may result in a competitive advantage for companies supported by non-EU countries over companies supported by EU Member States or not supported at all. The FSR aims in substance at levelling the playing field by extending its State aid regime to subsidies in the rest of the world to the extent that those subsidies impact on the internal market.

According to its preamble, the FSR should be applied and interpreted in light of the relevant EU legislation, including rules relating to State aid, merger control and public procurement.[3] Such general reference notwithstanding, there is currently a lack of guidance how the substantive rules of the FSR are supposed to apply in practice. This lack of guidance has been exacerbated by the very far reaching information requests set out in the notification form of large concentrations that are subject to Commission's clearance where they exceed certain thresholds, as annexed to the draft implementing regulation for the FSR.[4]

The remainder of this paper is structured as follows: Section I takes a closer look at the distortion of the internal market from foreign subsidies that the FSR intends to address. Section II focuses in particular on foreign subsidies in the context of notifiable concentrations and identifies the nexus required for foreign subsidies to be caught by the FSR, namely that foreign subsidies are used by undertakings to fully or partially finance the concentration in question. Section III provides suggestions on how the notification requirements (in particular in relation to concentrations) can be narrowed in light of the scope of the substantive concerns. Section IV concludes.

I. THE DISTORTIONS OF COMPETITION BY FOREIGN SUBSIDIES IN THE INTERNAL MARKET

The purpose of the FSR is "to contribute to the proper functioning of the *internal market* by establishing a harmonized framework to address *distortions* caused, directly or indirectly, by *foreign subsidies*, with a view to ensuring a level playing field" (emphasis added).[5] The Commission's substantive assessment (i) relates to foreign subsidies, and not merely foreign financial contributions as suggested in the draft implementing regulation, (ii) the foreign subsidies have to lead to a distortion (actual or potential negative effects on competition) and (iii) the distortion has to occur on the internal market.

A. Foreign Subsidy: Foreign Financial Contributions Conferring an Undue Advantage to Certain Undertakings

A foreign subsidy is deemed to exist "where a third country provides, directly or indirectly, a financial contribution which confers a benefit on an undertaking engaging in an economic activity in the internal market and which is limited, in law or in fact, to one or more undertakings or industries."[6]

The concept of a foreign subsidy presents significant similarities with the notion of State aid which requires a measure granted by the State and through State resources, that confers, on a selective basis, an economic advantage, that is not available on the market and which is liable to affect trade between Member States and to distort competition.

Foreign subsidies can cover a wide range of public interventions, including from public and private entities whose actions can be attributed to the third country.[7] Financial contributions could relate to virtually any transfer of value such as direct grants, capital injections, debt forgiveness, loan guarantees, etc. but also the foregoing of revenues such as tax exemptions or the granting of special or exclusive rights without adequate remuneration, and even the provision or purchase of goods or services.[8]

2 Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market [2022] OJ L330.

3 Recital 9 FSR.

4 Draft implementing regulation on detailed arrangements for the conduct of proceedings by the Commission pursuant to Regulation (EU) 2022/2560 of the European Parliament and of the Council on foreign subsidies distorting the internal market ("draft implementing regulation").

5 Article 1(1) FSR.

6 Article 3(1) FSR.

7 Article 3(2) second lid FSR.

8 Article 3(2) first lid FSR.

However, as under State aid law, the presence of foreign financial contribution is not sufficient to trigger a Commission's investigation. A foreign subsidy only exists if the foreign financial contribution is granted on a selective basis and confers a benefit on an undertaking that it could not have obtained under normal market conditions.[9] To determine whether a benefit accrues to an undertaking, the preamble of the FSR suggests using comparative benchmarks such as investment practices of private investors or financing rates obtained on the market. Where such direct benchmarks are unavailable, alternative, generally accepted assessment methods can be used. The detection of a benefit follows the same logic as developed in State aid law with the market economy operator test. This test consists of comparing the behavior of public entities with that of similar private economic operators operating under normal market conditions, in order to determine whether an economic transaction carried out by the public entities confers an advantage to their counterparts.

B. Distortion: Actual or Potential Negative Effects on Competition

A distortion would be found "where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market *and where, in doing so,* that foreign subsidy *actually or potentially negatively* affects competition in the internal market" (emphasis added).[10]

By way of comparison, Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU") prohibits State aid "when it is *liable* to improve the competitive position of the recipient compared to other undertakings with which it competes" (emphasis added).[11] That would be the case even in the absence of any *actual or potential negative effects*, e.g. if the aid does not help the recipient undertaking to expand and gain market share.[12] To establish a distortion under State aid rules, it is sufficient to demonstrate that a recipient of an aid has received an economic advantage ("something for nothing") and that there is competition on or for the market in which the recipient is active.[13] If distortion of competition does not need any effects-based competition analysis to find that there is an aid,[14] such distortion may nevertheless impede the Commission from declaring aid compatible with the internal market under Article 107(3)(c) TFEU where the positive effects of aid cannot outweigh the negatives.[15]

While the wording used in the FSR is similar to that in State aid provisions, contrary to Article 107(1) TFEU, in the context of the FSR the distortion can generally not be presumed but has to be established by an effects-based analysis.

The FSR invites the Commission to determine the existence of a distortion on the basis of a non-exhaustive set of indicators.[16] The choice of indicators reflects the potential lack of transparency of foreign subsidies - contrary to State aid that is supposed to be publicized - and the complexity of the commercial reality, making it "difficult to unequivocally identify or quantify the impact of a given foreign subsidy on the internal market."[17] The indicators to take into account include (a) the amount of the foreign subsidy, in absolute terms or in relation to the size of the market or to the value of the investment;[18] (b) the nature of the foreign subsidy; (c) the situation of the undertaking, including its size and the markets or sectors concerned, for instance, foreign subsidies in markets characterized by overcapacity or leading to overcapacity by sustaining uneconomic assets or by encouraging investment in capacity expansions that would otherwise not have been built are likely to

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9 Recital 13 FSR.

10 Article 4(1) FSR.

11 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ [2016] C 262/1 point 187.

12 *Ibid.* point 189.

13 For an analysis of the application of the standard of proof of the criterion of distortion of competition in the definition of State aid under Article 107(1) TFEU, see C. Ahlborn & C. Berg, "Can State Aid Control Learn from Antitrust? The Need for a Greater Role for Competition Analysis under the State Aid Rules," in *The Law of State aid in the European Union*, (2004).

14 C. Ahlborn & C. Berg, *supra* note 13, 46.

15 This approach has been refined by the Commission following Case C-594/18 P *Commission v. Austria (Hinkley Point C)*, see also the Communication from the Commission – Guidelines on State aid for climate, environmental protection and energy 2022, points 63-69.

16 Article 4(1) and recital 18 FSR.

17 Recital 18 FSR, the wording of which stems from the European Commission's White Paper on levelling the playing field as regards foreign subsidies, 16 at s.4.1.3.2, COM(2020) 253.

18 Recital 19 FSR, in which the legislator indicated that a concentration, in the context of which a foreign subsidy covers a substantial part of the purchase price of the target, is likely to be distortive.

cause distortions;[19] (d) the level and evolution of economic activity of the undertaking on the internal market; (e) the purpose and conditions attached to the foreign subsidy as well as its use on the internal market. The Commission will publish guidelines on the application of those criteria by 2026.[20]

The FSR is concerned that companies would benefit from a competitive advantage over other companies that have not received State support and could outbid,[21]create dominance[22] or lead to inefficient overall resource allocation and loss of competitiveness and innovation of these other companies.[23] It is feared that foreign subsidies are granted to pursue strategic objectives "to establish strong presence in the EU or to promote an acquisition and later transfer technologies to other production sites, possibly outside of the EU."[24]

Companies which are seen as deserving protection via the FSR include those that were prohibited from acquiring other companies because they obtained State aid,[25] as well as companies that have received State support, but which was deemed to be necessary, proportionate and not unduly affecting trade conditions, under State aid law.

These theories of harm are not relied upon in EU merger control and there have been to date only a handful cases where subsidies were considered in the competition assessment.[26]

Similar to the State aid rules,[27] the FSR also allows the Commission to balance the distortion of competition on the internal market caused by a foreign subsidy with its positive effects in terms of the development of the activity in the internal market and in terms of policy objectives,[28] in particular those of the EU, such as environmental or social protection.[29]

In certain limited circumstances, there would not be any need for the Commission to proceed to an effects based analysis but instead the Commission can rely on presumptions.[30] Article 5 FSR presumes that foreign subsidies distort the internal market when they fall under one of the following categories (hereafter referred to as the categories of foreign subsidies deemed to be the most distortive): (a) a foreign subsidy granted to an ailing undertaking, which would likely go out of business without the subsidy, unless there is a restructuring plan to restore the long-term viability of the company and which includes a significant own contribution by the subsidy recipient itself; (b) a foreign subsidy in the form of unlimited guarantee for the debts or liabilities of the undertaking; (c) an export financing measure that is not in line with the OECD Arrangement on officially supported export credits; (d) a foreign subsidy directly facilitating a concentration and (e) a foreign subsidy enabling an undertaking to submit an unduly advantageous tender. The three first categories of subsidies correspond to the types of State aid considered as unduly creating

19 *Ibid*.

20 Article 46(1)(a) FSR.

21 See European Commission's White Paper, *supra* note 17. In Annex 1 relating to the notifiable concentrations to the draft implementing regulation, the Commission requests detailed information on the bidding process, if there had been one organized by the seller, and on any due diligences conducted and discussing notably the value of the transaction.

22 Subsidies, Competition and Trade, OECD Competition Policy Roundtable Background Note, 2022, 20. In sub-section 6.6 of Annex 1 to the draft implementing regulation, the Commission requests from the merging parties to explain in the notification, for each foreign financial contribution having a link with the concentration, whether and how it is liable to improve, directly or indirectly, the competitive position in the internal market (as compared to the situation before the concentration) of the merging parties.

23 European Commission's White Paper, *supra* note 17.

24 *Ibid*.

25 See for instance Communication from the Commission - Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, OJ [2014] C 249/1 ("R&R aid guidelines"), points 55 and 84; Communication from the Commission - Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (2020/C 91 I/01), point 71.

26 OECD Competition Policy Roundtable Background Note, *supra* note 22, footnote 35 and cases referred into.

27 Article 6(2) FSR.

28 *Ibid*.

29 Article 5 FSR.

30 Recital 20 FSR.

negative effects on competition because of their nature or their form,[31] and therefore to be incompatible with the internal market.[32] Under the FSR, these presumptions can be rebutted.[33]

C. Impact on the Internal Market

Article 1(2) FSR specifies that "[t]his Regulation addresses foreign subsidies granted to an *undertaking,* including a public undertaking which is directly or indirectly controlled by the State, *engaging in an economic activity in the internal market*. Among others, an *undertaking acquiring control of or merging with an undertaking established in the Union* or an undertaking participating in a public procurement procedure in the Union is considered to be engaging in an economic activity in the internal market" (emphasis added). Hence, for the substantive assessment, irrespective of whether the tool is an *ex officio* investigation, a notifiable concentration, or a notifiable public procurement procedure (i.e. a concentration or public procurement above certain thresholds), there must be a *link* between the foreign subsidy and the economic activity of an undertaking in the internal market.

Although foreign subsidies may possibly distort competition, there must be a nexus with the EU for the Commission to investigate foreign subsidies which links the distortion to the internal market, i.e. with an economic activity in the EU.

In *ex officio* cases, for a foreign subsidy to be investigated, it must have a link to any type of economic activity engaged into in the EU, provided that it is not already subject to other legislation, such as for instance the import of goods in the EU subject to the Anti-subsidy Regulation[34] implementing the World Trade Organization Agreement on Subsidies and Countervailing Measures in the Union.[35] This may also involve investigations into non-notifiable concentrations in which case the investigation would not relate to the concentration itself, but to the foreign subsidy as it benefits the entity resulting from the concentration.

II. FOREIGN SUBSIDIES IN THE CONTEXT OF NOTIFIABLE CONCENTRATIONS

The economic activity triggering an investigation by the Commission depends on the tool used: *ex officio* investigation, notifiable concentration, or notifiable public procurement procedure. When considering a notifiable concentration, the economic activity envisaged is the notifiable concentration. This is confirmed by Article 19 FSR:

When assessing whether a foreign subsidy in a concentration distorts the internal market (…), that assessment shall *be limited to the concentration concerned. Only foreign subsidies* granted in the three years prior to the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest shall be *considered in the assessment.* (emphasis added).[36]

To assess relevance of the foreign subsidy in the context of a notifiable concentration, it ought to be determined whether the concentration was fully or partially financed through that foreign subsidy, either directly or where there is a sufficiently close link between the merging entity and the beneficiary of the subsidy.

The concern of the FSR as regards concentrations is that "foreign subsidies can distort the internal market and undermine the level playing field for various economic activities in the Union. This could in particular occur in the context of concentrations entailing a change of control over Union undertakings, where such concentrations are *fully or partially* financed through foreign subsidies (…)" (emphasis added).[37]

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31 *Ibid.*

32 R&R aid guidelines, *supra* note 25, point 6; Case C-559/12 *France v. Commission (La Poste)*; Case C-438/16 P *Commission v. France and IFP Énergies nouvelles.*

33 Article 5(2) FSR and recital 20 FSR. The FSR also establishes an irrebuttable presumption for the absence of distortions, namely some foreign subsidies would be considered not to distort the internal market where its total amount does not exceed the *de minimis* aid amount under Regulation (EU) No 1407/2013, currently set at €200,000 per third country over any consecutive period of three years (Article 4(3) FSR). Such foreign subsidies are outside the scope of the FSR. There also exists a rebuttable presumption of absence of distortion that the Commission can rebut is that a foreign subsidy where the total amount of which a foreign subsidy does not exceed €4 million over any consecutive period of three years, is unlikely to distort the internal market (Article 4(2) FSR).

34 Regulation (EU) 2016/1037 of the European Parliament and of the Council of 8 June 2016 on protection against subsidised imports from countries not members of the European Union, OJ [2016] L 176/55.

35 Article 44(2) FSR.

36 See also recital 37 FSR.

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Therefore, when notified with a concentration under the FSR, it would appear from the preamble of the FSR that the Commission would be empowered to examine foreign subsidies granted to undertakings that effectively use such foreign subsidies to fully or partially finance the concentration.

In certain circumstances, it may be obvious that a foreign subsidy is granted to fully or partially finance a concentration. This may appear from the intention of the grantor (e.g. because the subsidy is granted to specifically expand an activity in the EU) or from the context (e.g. because it is part of a national program to expand economic activities abroad). In such cases, no further demonstration of the existence of a nexus would be required. However, in many other circumstances, this may not be obvious, and the Commission would have to demonstrate a sufficient nexus between the foreign subsidy and the concentration.

A clear nexus between the subsidy and the concentration could be if the merging entity and the beneficiary are part of the same "undertaking." When determining the recipient of foreign subsidies in the context of concentrations, the notion of "undertaking" is not defined in the FSR. As per the EU case law,[38] the contours of the relevant entity are not necessarily the same for the substantive analysis than for jurisdictional purposes.[39]

In State aid law, unlawful aid found to be incompatible with the internal market must be recovered from the *beneficiaries that actually benefitted* from it,[40] to restore competition. The actual beneficiary of an aid could be the legal entity that has received the aid. It could also be several separate legal entities if they form a single economic unit,[41] i.e. there is between the entities "a controlling share and the existence of other functional, economic and organic links."[42] In that respect, the EU Courts recognize that the Commission "has a wide discretion in determining whether companies forming part of a group must be regarded as an economic unit or as legally and financially independent for the purposes of applying the State aid rules."[43]

In its decisional practice, the Commission already considered that "the fact that several companies belong to the same corporate group (as sister companies or parent/subsidiary companies) does not necessarily mean that all those companies are ipso facto beneficiaries (within the meaning of State aid rules)(…)."[44]

When considering redressing potential distortions of competition on the internal market caused by foreign subsidies, the relevant EU legal framework appears to be State aid law and therefore, the *actual* beneficiary must be identified.

As the FSR's remit is limited to the EU, the starting point is to verify whether the legal entity party to the notified concentration has received, *directly or indirectly*, a foreign subsidy. If that legal entity has directly received a foreign subsidy, the necessary nexus with the concentration would be established. If however that legal entity has not itself directly received a foreign subsidy, further analysis would be needed to assess whether the necessary nexus with the notifiable concentration exists. The preamble of the FSR gives as an example that "[t]ransfer pricing in the context of goods and services exchanged within an undertaking can confer a benefit if that *transfer pricing is not in line with normal market conditions*" (emphasis added).[45] More generally, it states that "[t]he benefit conferred by a financial contribution may be *passed to* an undertaking engaging in an economic activity in the Union" (emphasis added).[46] Hence, although a legal entity has not directly received a foreign subsidy, it could have received indirectly a foreign subsidy because of an advantageous transfer of value from another legal entity of the single economic unit having received a foreign subsidy.

38 See for instance Case T-541/08 *Sasol v. Commission ("Candle waxes")* paras 49-50.

39 Please note that at the time of writing this paper, the draft implementing regulation seem to rely on the same perimeter of undertaking for the substantive analysis as for the jurisdictional purposes (i.e. all group entities).

40 Case C-277/00 *Germany v. Commission ("SMI")* para 75.

41 Communication from the Commission — Commission Notice on the recovery of unlawful and incompatible State aid, OJ [2019] C 247/1, points 85 and subs.

42 Case T-643/20 *Ryanair v. Commission* para 45.

43 Case T-234/95 *DSG v. Commission* para 124; Joined Cases T-371/94 and T-394/94 *British Airways v. Commission* para 314.

44 Commission decision of 16 July 2021 on State Aid measure SA.57116 (2020/N) – The Netherlands, COVID-19: State loan guarantee and State loan for KLM, referring to Case C-457/00 *Belgium v. Commission (Verlipack)* paras 55-60; Joined cases T-111/01 and T-333/01 *Edelmetalle v. Commission* paras 84 and 121-125; Case T-371/94 *British Airways and others and British Midland Airways v. Commission* paras 297, 314 and 315.

45 See recital 13 FSR.

46 *Ibid.*

III. THE IMPLICATION OF THE SUBSTANTIVE ASSESSMENT OF THE FSR ON THE NOTIFICATION REQUIREMENTS

In its draft implementing regulation, the Commission requires from the parties to a notifiable concentration to report all foreign financial contributions received by all group entities over the past three years that are above a certain amount, irrespective of whether or not they amount to foreign subsidies, whether they are likely to distort competition or have any link to the internal market.

This request has been severely criticized by companies, including EU businesses.[47] The most common criticism is that the draft implementing regulation requests too far reaching information to be reported, which creates "a disproportionate burden for EU and non-EU businesses with a global presence,"[48] or "will result in an extremely complex administrative ordeal" and "is practically impossible to implement."[49] Companies consider that they are not equipped to monitor all foreign financial contributions.[50] They also stress that this administrative burden is "not necessary for the FSR to reach its objective."[51] They advocate to limit the reporting to the categories of foreign subsidies deemed to be the most distortive.[52]

Given the mismatch between the focus of the FSR (as described in the previous sections above) and the extensive information request, such information request is clearly disproportionate since many if not most interactions with third countries would not be within the scope of the FSR.

Therefore, the information request for notifiable concentrations should focus on the elements that are necessary for the Commission to conduct the substantive assessment under the FSR.

First, where the legal entity that is party to the notifiable concentration has been directly granted financial contributions by a third country, information on that source of finance should be provided if it is likely to amount to a foreign subsidy. That would exclude reporting foreign financial contributions that are granted at market terms (e.g. a loan from a public bank concluded at market terms).

Second, the information request should also be limited to foreign subsidies that are likely to distort the internal market. Would be excluded at least the subsidies presumed not to distort the internal market under the FSR.

Third, where the legal entity is part of a group, (additional) information on foreign subsidies likely to distort the internal market may be requested if it is likely that this entity has received an advantageous transfer of value from other legal entities that have received foreign subsidies and with which it forms a single economic unit, in the meaning of State aid law.

IV. CONCLUSIONS

By filling a regulatory gap left by EU State law that only applies to support granted to companies by EU Member States but not by foreign countries, the FSR has created a new instrument to address distortive foreign subsidies granted to undertakings engaging in an economic activity in the internal market. Among the economic activities that fall in the scope of the FSR are concentrations, above certain thresholds, that must be notified to the Commission. This paper examined how the substantive assessment of the FSR should apply to notifiable concentrations and its consequences in terms of the information request in the notification form.

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47 Comments available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13602-Distortive-foreign-subsidies-procedural-rules-for-assessing-them_en.

48 See for instance the Joint Statement of various associations (American Chamber of Commerce to the European Union, InvestEU, Japan Business Council in Europe, British Chamber of Commerce I EU and Belgium, Korea Business Association Europe, etc.) accessible at : https://www.amchameu.eu/system/files/position_papers/fsr_ir_joint_industry_statement_4th_april_2023_final.pdf.

49 See the Multi-Company letter of AstraZeneca PLC, Intel, Solvay, Siemens Energy AG, Deutsche Telekom, BASF SE, etc. published by MLex and accessible at https://content.mlex.com/Attachments/2023-03-29_8EX94G2C4K726V7Y%2FFSR%20Multi-Company%20Letter.pdf.

50 *Ibid.*

51 *Ibid.*

52 *Ibid.*

In our view, the FSR is concerned with distortive foreign subsidies linked to the notified concentration. As suggested in the preamble of the FSR, the Commission would be empowered to examine foreign subsidies that can be used by the undertaking engaged in the merger to fully or partially fund the concentration in the EU. Only foreign subsidies granted to the undertaking, i.e. the single economic unit, and actually benefitting the legal entity engaging in the concentration in the EU would appear to be relevant to examine.

Distortion of the internal market should be determined keeping in mind the relevant theories of harm under the FSR, and examining the set of indicators laid down therein. To conduct its substantive assessment, the Commission should request information that is relevant for the purposes of the FSR.

Information requests should be proportionate and reflect the substantive concerns. In particular, they should be limited to third countries' measures that can be used by the undertaking, party to the concentration, to finance fully or partially the notifiable concentration, when these measures are likely to amount to foreign subsidies, because they are not market conform or not generally available to any company, and are likely to distort the internal market, i.e. they are of a certain amount. Where the legal entity is part of a group, (additional) information on foreign subsidies likely to distort the internal market may be requested if it is likely that this entity has received an advantageous transfer of value from other legal entities that have received foreign subsidies and with which it forms a single economic unit, in the meaning of State aid law.

FAMILIAR TOOLS IN FOREIGN SETTINGS: PRACTICAL CONSIDERATIONS FOR COMPLYING WITH THE NEW FOREIGN SUBSIDIES REGULATION

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I. INTRODUCTION

The European Commission's Foreign Subsidies Regulation ("FSR") entered into force on January 12, 2023. This new instrument gives the Commission the authority to assess the existence, and impact, of foreign subsidies provided by public entities outside the EU to companies operating within the EU. The instrument is designed to address a gap in the existing toolkit of EU state aid control, the World Trade Organization's anti-subsidy rules, and the monitoring of foreign direct investments.

Under the FSR, the Commission will be able to investigate whether distortive foreign subsidies exist in the following situations.

- **Merger control**: Companies involved in a concentration, where one or both parties have a turnover in the EU in excess of €500m, will have to notify the Commission of individual financial contributions received from third countries over the last three years, if the total amount of the financial contribution received by one of the parties exceeds €50m.[2]
- **Public procurement**: As part of the tender process for projects with an estimated value of at least €250m, the bidder and the main sub-contractors will need to disclose any financial contributions received from third countries, if the amount of the financial contributions exceeds €4m from any third country over the previous three years.[3]
- ***Ex officio* investigations**: The Commission will have the power to start investigations into specific instruments or companies where it suspects that foreign subsidies may have distortive effects on the EU market, or require ad hoc notifications for mergers or public procurement procedures below the above thresholds.[4]

The Commission can also start market investigations into certain sectors, economic activities or subsidy instruments, the findings of which may be used to support its assessment of foreign subsidies in the context of the three procedures outlined above.[5]

As of July 12, 2023, the Commission can start *ex officio* and market investigations, with the notification requirements for public procurements and concentrations applying as of October 12, 2023.[6]

The FSR is a far-reaching tool that aims to preserve a level playing field in the Single Market by limiting the potentially distortive impact of foreign subsidies on competition. However, the legislation also recognizes that not all foreign subsidies are detrimental to the Single Market, and that they can help to achieve the EU's economic and policy objectives.

If, however, the Commission deems that the foreign subsidy will cause significant distortions in the EU, it can impose behavioral or structural measures, including requirements on the beneficiary to divest certain assets. The remedies could also include the repayment of the foreign subsidy (with interest).

In light of its broad scope, the FSR is likely to have a considerable impact on large companies operating in the EU, particularly those with significant operations in countries where governments play a prominent role in the economy. In the recent responses to the Commission's Draft Implementing Regulation, which sets out the notification forms that companies would need to complete for mergers and public procurements, stakeholders have highlighted the substantial burden that the FSR places on both EU and non-EU companies. In particular, significant concerns have been raised about the reporting obligations of the FSR and that the FSR will have a "*chilling effect*" on foreign companies operating in the EU.[7]

2 A financial contribution is defined as:"*(a) the transfer of funds or liabilities, such as capital injections, grants, loans, loan guarantees, fiscal incentives, the setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps or rescheduling; (b) the foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration; or (c) the provision of goods or services or the purchase of goods or services.*" See European Commission (2022), "Regulation (EU) 2022/2560 of the European Parliament and of the Council of December 14, 2022 on foreign subsidies distorting the internal market," December 14, 2022, *Official Journal of the European Union*, Articles 3 and 20. In the remainder of this article, we subsequently refer to this as the FSR.

3 Article 28 of the FSR.

4 Chapter 2 and Article 9 of the FSR.

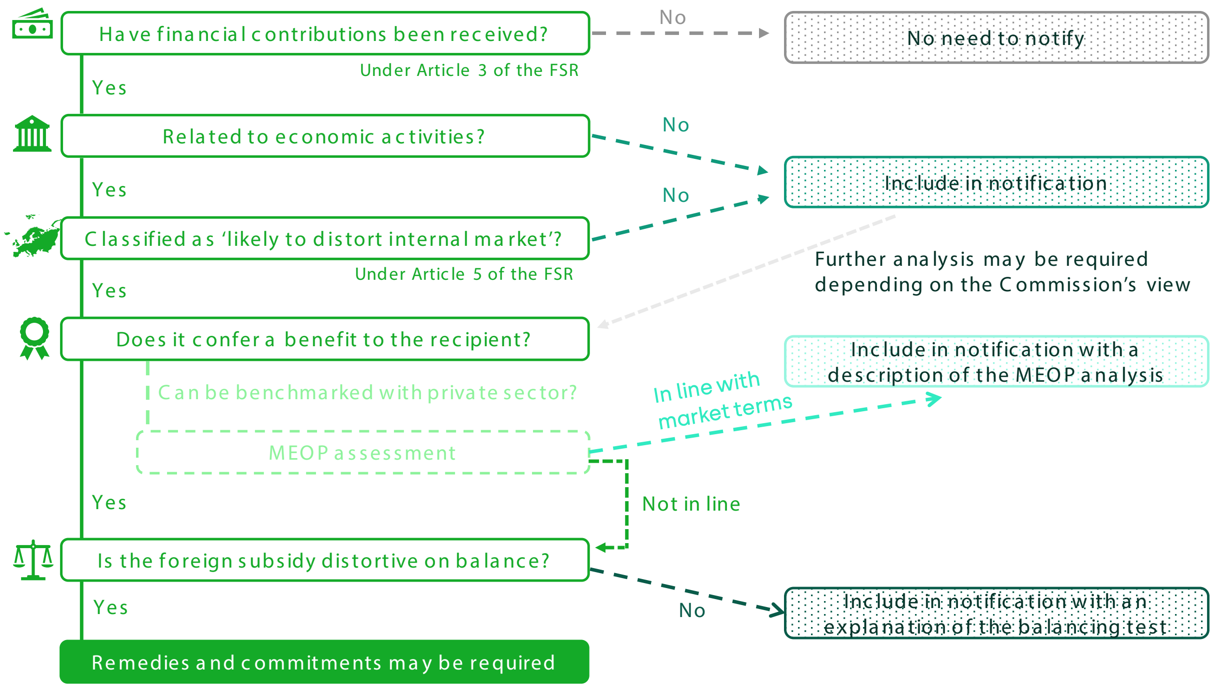
5 Chapter 5 of the FSR. Article 36 of the FSR states: "*Where the information available to the Commission substantiates a reasonable suspicion that foreign subsidies in a particular sector, for a particular type of economic activity or based on a particular subsidy instrument may distort the internal market, the Commission may conduct a market investigation into the particular sector, the particular type of economic activity or into the use of the subsidy instrument concerned.*"

6 Article 54 of the FSR.

7 Pronina, L. (2023), "EU Subsidies Rule Would Hurt Global Firms, Business Groups Warn," *Bloomberg*, 4 April; and Mackrael, K. (2023), "Intel, Raytheon, Other Big Companies Push Back on EU Subsidy Rules," *The Wall Street Journal*, March 28, 2023.

Figure 1 illustrates the different steps, from an economics perspective, that could be followed by companies engaging in large concentrations and public procurement procedures in the EU to assess any financial contributions that they might have received from third countries, in order to determine the appropriate course of action.

Figure 1: Illustration of the Steps to Assess Financial Contributions



Note: The figure provides a stylized representation from an economics perspective.
Source: Oxera, based on the FSR and the Draft Implementing Regulation.

While the Commission has highlighted that guidance on concepts that are key to the application of the FSR can be provided only over time with decisional practice, it has indicated that the application of the FSR will, "*in substance*," be similar to state aid control.[8] Therefore, in this article, drawing on insights from state aid cases, we explain the potential role for economic and financial analysis in helping to ensure compliance with the FSR. We first discuss how it could be determined whether financial contributions confer a benefit (and therefore fulfil one of the main criteria for the existence of a foreign subsidy). Secondly, as the Commission has suggested that the assessment of the impact of foreign subsidies on competition will be particularly important,[9] we set out how this assessment could be undertaken from an economics perspective.

II. DOES A FINANCIAL CONTRIBUTION CONFER A BENEFIT ON AN UNDERTAKING?

The Commission has adopted a wide definition of a financial contribution, which includes the transfer of funds (e.g. capital injections, loans), the "*foregoing of revenue*" (e.g. tax exemptions or the granting of special or exclusive rights), and the provision or purchase of goods and services.[10]

In light of its broad definition, companies could face challenges in determining whether certain measures should be classified as a financial contribution, particularly in relation to the "*foregoing of revenue*," which is considered a financial contribution only if the remuneration is not "*adequate*."[11] In order to assess whether a tax reduction or exemption received by, for example, an entity of a multinational constitutes a financial contribution, an analysis of whether the transfer pricing arrangements between the relevant entities of the multinational are on an

8 See Mlex (2023), "EU's foreign subsidies instrument must be fair and go after the 'big fish,' Vestager says," March 6, 2023; and the Commission's comments at a seminar on the FSR on February 2, 2023, available at: https://www.oxera.com/insights/events/seminar-on-the-foreign-subsidies-regulation/ (subsequently referred to as the "February 2, 2023 FSR seminar").

9 See the Commission's comments at the February 2, 2023 FSR seminar.

10 Article 3 of the FSR.

11 *Ibid.*

arm's-length basis would be required. Similarly, the assessment of whether the remuneration of special or exclusive rights is "*adequate*" would, in principle, require analysis of a market-conforming level of remuneration.

If a financial contribution is found to confer a benefit on an undertaking, under certain circumstances it will be considered a foreign subsidy.[12] The Commission highlights that the assessment of whether a financial contribution confers a benefit will depend on whether the characteristics of a given financial contribution are consistent with "*normal market conditions*," based on benchmarks from the private sector.[13] If the terms and conditions of a financial instrument are in line with those that would be available in the private sector, it is unlikely that the instrument confers a benefit. This appears to be akin to the market economy operator principle ("MEOP") in the state aid context.[14]

As companies will be required to identify which financial contributions confer a benefit, the onus will be on companies themselves to assess the contributions that fall under the categories that the Commission has identified as being potentially problematic, which include:[15]

- Support to an ailing undertaking in the absence of a comprehensive restructuring plan;
- Unlimited guarantees;
- Export financing measures;
- Support that directly facilitates a concentration;
- Support that enables an undertaking to bid for a tender with unduly advantageous conditions.
- While some financial contributions are likely to confer a benefit (e.g. unlimited guarantees), whether other instruments, such as loans or equity injections, confer a benefit is likely to need to be assessed. This could be undertaken using similar techniques to those that are used in the state aid context to apply the MEOP. However, the assessment in the FSR context could be more challenging, particularly if the financial contributions are provided by public entities from countries with less developed or transparent capital markets.

In the following sub-sections, we discuss how one could analyze whether financial instruments, such as loans and equity injections, confer a benefit. Such an assessment could be prioritized for those large financial contributions that are shown to, or are suspected to, have directly funded an acquisition or influenced a company's bid in a public tender.

A. Loans

A loan is likely to confer a benefit on an undertaking if it is provided on terms and conditions that are more favorable than the company would be able to obtain from private lenders.

If the terms and conditions of a loan provided by a third country, such as the interest rate, are in line with the company's existing commercial loans from privately owned lenders, this provides evidence that the loan does not confer a benefit.[16] Such direct benchmarking is possible if the characteristics of the loan from the third country (including the principal amount, currency, duration, level of collateral and seniority) are sufficiently comparable to those of its existing commercial loans.

However, such benchmarking may not always be possible as companies may not have an extensive portfolio of loans (or bonds), and therefore it might prove difficult to identify sufficiently comparable instruments.[17] In such cases, the terms and conditions of the loan from the third country could be compared with debt instruments from other similar companies. Such external benchmarking can be particularly useful during periods of

12 Article 3 of the FSR states that a "*foreign subsidy shall be deemed to exist where a third country provides, directly or indirectly, a financial contribution which confers a benefit on an undertaking engaging in an economic activity in the internal market and which is limited, in law or in fact, to one or more undertakings or industries." Ibid.*

13 According to the Commission, "*[a] financial contribution should be considered to confer a benefit on an undertaking if it could not have been obtained under normal market conditions. The existence of a benefit should be determined on the basis of comparative benchmarks, such as the investment practice of private investors, financing rates obtainable on the market, a comparable tax treatment, or the adequate remuneration for a given good or service. If no directly comparable benchmarks are available, existing benchmarks could be adjusted or alternative benchmarks could be established based on generally accepted assessment methods.*" European Commission (2022), op. cit., December 14, para. 13.

14 See the Commission's comments at the February 2, 2023 FSR seminar.

15 See Article 5 of the FSR.

16 Information regarding a company's existing commercial loans (and bonds) can normally be obtained from its financial statements and/or management accounts. In addition, financial data providers such as Bloomberg or Refinitiv Eikon will usually report this information.

17 For example, if a loan provided by a third country is unsecured (i.e. the company is not required to pledge collateral in case of default), it should, all else being equal, have a lower credit rating.

interest rate volatility, which may render comparisons with older instruments from the same company less reliable. However, it is important to ensure that the debt instruments that are considered are from private investors with similar characteristics to the loan provided by the third country.

Interest rates on debt instruments are influenced by country-specific and currency-specific dynamics. The interest rate on debt instruments reflects the risk-free rate (i.e. the rate that is free of default risk, which is usually proxied by yields on AAA rated government bonds), plus the additional premium required by investors for investing in risky corporate debt. In the context of the FSR, such an assessment may be challenging if the loan has been provided by a third country that does not have the AAA credit rating that is usually associated with a "risk-free" status, and where there may be limited examples of comparable debt issuance from private investors in the country. In such circumstances, the benchmarking could be based on transactions from other countries where the state may have a higher credit rating, with appropriate adjustments to reflect the additional remuneration required by investors for exposure to additional risk in the third country in question (so-called country risk).[18]

If a loan is denominated in the currency of a country with a fairly small capital market, there might be only a limited number of debt instruments in the same currency. Similarly, in countries where the state is significantly involved in the economy, the number of debt instruments issued by privately owned companies could be limited. In these circumstances, the analysis could instead be based on corporate bonds from larger capital markets, with appropriate adjustments to reflect the additional risk faced by investors in these markets. Therefore, while the context of the FSR may make such an analysis more complicated than in the state aid context (where benchmarks are more likely to be readily available), the economic toolkit could be used to apply the necessary adjustments to the available data to enable the benchmarking exercise.[19]

B. Equity Injections

In order to determine whether an equity injection confers a benefit, two questions need to be considered:

- What level of commercial return does the third country expect to obtain from providing the equity injection?
- Is the expected return sufficiently high such that a private investor operating in similar circumstances would be likely to undertake a similar investment?

If the commercial return expected by the third country is in line with, or higher than, that required by a profit-driven investor, the financial contribution is unlikely to confer a benefit. The return required by such an investor could be approximated based on the cost of equity for a similar company, which will depend on its risk exposure (with higher returns required for riskier investments) and the capital structure (as a higher share of debt financing will lead to greater risk for equity holders). The appropriate return could be estimated using the Capital Asset Pricing Model ("CAPM"), a well-established methodology that relates the expected return of an equity investment to its risk.[20] While it is not unusual for corporate finance practitioners to use the CAPM in countries with less developed capital markets, as with the assessment of the interest rate on debt instruments it is possible that investors may require an additional return for exposure to greater country risk.

In order to estimate the commercial return expected by the third country from the equity injection, it is necessary to forecast its expected cash flows. This will require an estimation of the value of the initial equity stake, any dividends expected over the period when the third country holds the equity stake, and the value of the equity when the third country expects to sell its stake. These estimates will then need to be "discounted" to their present value using the CAPM cost of equity. If the outcome from this discounting exercise (known as the net present value of an investment, or its risk-adjusted profitability) is positive, this indicates that a private sector investor would be likely to make the same equity investment in similar circumstances.

While data constraints may mean that the assessment would be more challenging in the context of the FSR than in the state aid context, as discussed above, it is possible that adjustments could be applied to the available benchmarks to tailor their applicability to the third country in question. Furthermore, a detailed assessment could be prioritized for the largest financial contributions, for which a MEOP-type defense might

18 It is common practice for practitioners to include a measure of country risk in the estimate of the cost of debt to reflect exposure to the riskier credit profile of such governments.

19 If it can be established that the main terms and conditions of the loan provided by the third country are in line with market terms, for the largest debt instruments it might help to strengthen the evidence base by assessing whether, under a reasonable set of assumptions, the company expects to be able to service its obligations on the loan, based on reasonable cash flow projections.

20 Under the CAPM, the expected return on equity is calculated as the risk-free rate (as proxied by yields on government bonds with a AAA credit rating) plus the product of the equity risk premium and the equity beta of the company. The equity beta measures the systemic (i.e. undiversifiable) risk of the company, which is a function of the underlying risk of the company and its leverage (i.e. the extent of debt financing). The equity risk premium refers to the additional return that is required to invest in the equity market as opposed to a risk-free security.

be possible, and where there is evidence, or it might be suspected, that the financial contribution has directly affected a company's bid in the concentration or public tender. While the assessment may need to be undertaken separately for each financial contribution, there may also be instances where a company has received a number of financial contributions from a third country at a similar point in time. This might require the financial contributions to be assessed together in order to determine whether they confer a benefit in aggregate on the company in question.

III. BALANCING THE POSITIVE IMPACTS OF FOREIGN SUBSIDIES AGAINST THEIR DISTORTIONS

For those financial contributions that meet the definition of a foreign subsidy, the Commission will assess whether they create any distortions to competition in the Single Market, and particularly whether they provide an unfair advantage to a company vis-à-vis its competitors. The Commission may then balance any distortions against the potential positive effects of the foreign subsidy on the internal market.[21]

The FSR recognizes that foreign subsidies could have a beneficial effect on the economic objectives of the EU. As such, companies are required to articulate how foreign subsidies could play an important role in developing economic activities or achieving relevant policy objectives within the Single Market.[22] Examples provided by the FSR include "a high level of environmental protection and social standards, and the promotion of research and development."[23]

At this stage, it is uncertain how the Commission will assess the positive effects of foreign subsidies, as well as the threshold that it will adopt to determine what constitutes a distortion to competition. Indeed, the Commission has stated that the application of the balancing test, including how it will determine the existence of a distortion, will be "*by large, a matter of decisional practice.*"[24]

In contrast to the State aid framework, where it is usually presumed that aid will create distortions, there does not appear to be any such a priori presumption underpinning the FSR.[25] It is therefore possible that the assessment of the impact of a foreign subsidy on competition could be explored in more detail than in the state aid context. Indeed, Commissioner Vestager has highlighted that "*[t]he concept of a "distortion" is not defined in the Regulation, nor is it presumed, which means that distortions will have to be proved. This will certainly be at the core of the future enforcement […].*"[26]

The Commission highlights that the competitive distortions created by any foreign subsidy will be assessed on a case-by-case basis.[27] Such an assessment could be prioritized for those large foreign subsidies with characteristics that have been identified by the Commission as being more likely to distort competition, such as unlimited guarantees or subsidies granted to an undertaking in difficulty that is likely to exit the market in the short or medium term in the absence of the subsidy. However, in contrast to state aid control, where either an individual aid measure or a scheme covering a number of beneficiaries is being examined, in the context of the FSR it is possible that a company could have received a number of foreign subsidies.

Therefore, the analysis might need to be undertaken at an aggregate level by grouping together certain categories of subsidy. It will be important to examine the cumulative effects of foreign subsidies received by an undertaking at a similar point in time, as their combined impact may

21 Article 4 of the FSR states that "*[a] distortion in the internal market shall be deemed to exist where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market and where, in doing so, that foreign subsidy actually or potentially negatively affects competition in the internal market.*" Article 6 of the FSR goes on to state: "*[t]he Commission may, on the basis of information received, balance the negative effects of a foreign subsidy in terms of distortion in the internal market, according to Articles 4 and 5 against the positive effects on the development of the relevant subsidised economic activity on the internal market, while considering other positive effects of the foreign subsidy such as the broader positive effects in relation to the relevant policy objectives, in particular those of the Union.*"

22 Section 7 of the Draft Implementing Regulation for concentrations (section 5 in the case of public procurements) asks parties to "*list and substantiate any possible positive effects on the development of the relevant subsidised economic activity on the internal market. Please also list and substantiate any other positive effects of the foreign subsidy such as broader positive effects in relation to the relevant policy objectives, in particular those of the Union, and specify when and where those effects have or are expected to take place.*" See European Commission (2023), "Annex to the Commission Implementing Regulation (EU) …/… on detailed arrangements for the conduct of proceedings by the Commission pursuant to Regulation (EU) 2022/2560 of the European Parliament and of the Council on foreign subsidies distorting the single market."

23 Para. 21 of the FSR.

24 Mlex (2023), *op. cit.*, March 6, 2023.

25 See the Commission's comments at the February 2, 2023 FSR seminar.

26 Mlex (2023), *op. cit.*, March 6, 2023.

27 Para. 17 of the FSR.

differ from the effects arising from an individual foreign subsidy. At this stage, although the Commission has highlighted that certain indicators will be examined, such as the magnitude and nature of the foreign subsidy, it remains to be seen how the Commission will approach the assessment.[28]

While the level of detail at which the Commission may undertake the analysis remains to be seen, in the sub-sections below we present an economic framework that could be followed to assess the possible distortive effects of foreign subsidies, and we outline possible theories of harm that might need to be considered.

A. Possible Economic Framework to Assess the Distortive Effects of Foreign Subsidies

In the state aid context, the focus is on assessing the effect of a change in the beneficiary's behavior as a result of the aid received.[29] This requires the products and the relevant geographic market that might be affected by a change in the aid beneficiary's behavior, as well as the relevant competitors, to be identified. However, the relevant product and geographic markets are often not defined precisely.

In the context of the FSR, in contrast to state aid control, the competitive assessment is likely to focus on any distortions created by the foreign subsidies on concentrations or the public procurement process. In the context of concentrations, however, the Commission has indicated that it may also assess the wider implications of foreign subsidies on competition in the relevant markets.[30]

Therefore, building on the approach in state aid control, in order to assess the likely impact of foreign subsidies on competition, three steps could be followed:

- Identifying the main characteristics of the foreign subsidies and the market(s) that might be affected;
- Developing the hypotheses to be tested — i.e. the theories of harm — regarding the likely impact of the foreign subsidies on concentrations and the public procurement process, which would require a counterfactual scenario to be developed that sets out what would have been likely to occur in the absence of the subsidies;
- Assessing the actual impact of the foreign subsidies on competition relative to the counterfactual scenario.[31]

As set out below, the relevant theories of harm are likely to differ across concentrations and public procurement cases. As indicated by the Commission, in the context of the FSR, some of the theories of harm that might need to be examined might be "*relatively novel*."[32]

C. Concentrations

In cases of notified mergers, the FSR assessment will be conducted in parallel with the filing under the EU Merger Regulation ("EUMR"). While the focus of merger control tends to be on the effects of the proposed concentration on consumers (i.e. prices, quality, choice, and innovation), the assessment in the FSR context may more closely mirror state aid control by focusing on how the foreign subsidies affect the position of the beneficiary vis-à-vis its competitors.[33]

In relation to concentrations, foreign subsidies could support a prospective acquirer by enabling access to financing on more favorable terms. The relevant theories of harm will ultimately depend on the counterfactual scenario, which could include:

- Another competitor that does not receive any significant foreign subsidies purchases the target instead in those cases where there is a competitive bidding process;
- If there are no other potential buyers, and the prospective buyer cannot conduct the acquisition without the subsidies, the target company remains independent.

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28 Article 4 (1) of the FSR.

29 See European Commission (2009), "Common principles for an economic assessment of the compatibility of state aid under Article 87.3," para. 51, available at: https://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf.

30 See the Commission's comments at the February 2, 2023 FSR seminar.

31 In the state aid context, the impact of aid on competition is examined in more detail as part of *ex post* evaluations of aid schemes. In this context, for details regarding the economic framework, see Oxera (2017), "Ex post assessment of the impact of state aid on competition," prepared for European Commission, November, available at: https://ec.europa.eu/competition/publications/reports/kd0617275enn.pdf.

32 Crofts, L. (2023), "EU subsidy screening will see draft "implementing" rules next week," *Mlex*, February 2, 2023.

33 See the Commission's comments at the February 2, 2023 FSR seminar.

In the first case, where a prospective buyer that has not received a substantial amount of foreign subsidies would have acquired the company, the foreign subsidies significantly alter the outcome of the competitive process. However, it remains to be seen whether the Commission would consider that this represents a sufficient distortion to competition without assessing the other effects of this alternative outcome of the process, such as the differences in market shares of the main players under this outcome.

In the second case — where the target remains independent — potential theories of harm could relate to whether competition might be impeded as a result of the merger strengthening the beneficiary's market power and contributing towards, or raising, barriers to entry. In this scenario, there could be a significant overlap with the assessment under the EUMR, as the competition distortions relative to the counterfactual scenario will also depend on the nature of the merger — i.e. whether the merger is between companies operating at different levels of the supply chain (i.e. a vertical merger) or between companies operating in closely related markets (i.e. a conglomerate merger), or a combination of both.[34] It remains to be seen how the analysis and the conclusions of the assessment in the context of the FSR will interact with the EUMR assessment. For example, it is possible that the Commission might determine that the concentration is not sufficiently problematic from the perspective of the EUMR, while simultaneously concluding that foreign subsidies were instrumental in enabling the concentration, and that the concentration negatively affects competitors.

The assessment in the FSR context may be complicated due to the lack of transparency concerning foreign subsidies and the complexity of the commercial reality. For example, assume that a third country has provided funding that confers a benefit on a company, and this company is bidding to acquire an EU target. If the company benefiting from the foreign subsidies outbids competitors, its decision to purchase the company may be unrelated to the foreign subsidies that it has received. It might instead be due to its valuation of the target being significantly higher, as a result of significant synergies expected from the deal. If this is indeed the case, then any distortions to competition caused directly by the foreign subsidies should be more limited.

If, however, the company outbids competitors as a result of increased willingness to pay due to the foreign subsidies, this is more likely to distort competition. Therefore, as a result of the introduction of the FSR, there may be a need for more detailed due diligence by the bidder and the target. In particular, in cases where a company receiving foreign subsidies outbids competitors that have not received such subsidies, more detailed evidence might help to demonstrate that it is due to a significantly higher valuation (as a result of substantial expected synergies, for example), as opposed to increased willingness to pay due to the foreign subsidies (for example, by lowering the company's cost of capital).

D. Public Procurement

As the price, alongside quality and experience, are key components of any public tender, foreign subsidies can pose a risk to the Single Market if they give certain bidders an unfair advantage. In the context of public tenders, to assess the competitive effects of the foreign subsidies, it would be particularly important to identify the magnitude of the subsidies received by the bidder relative to the value of the tender. A foreign subsidy may help the beneficiary to bid at a lower price through means such as more favorable financing terms, and/or subsidized access to labor, raw materials (e.g. electricity) and technology from state-owned companies.

In this context, a possible counterfactual scenario is that the second-best bidder would have instead been awarded the project. Similar to the case with concentrations, it remains to be seen whether this would be sufficient for the Commission to conclude that the foreign subsidies have distorted competition, or whether other theories of harm, such as the impact on companies across the value chain associated with the second-highest bidder, would also need to be examined.[35]

IV. CONCLUSIONS

The FSR represents a major piece of legislation that provides the Commission with far-reaching tools to address a gap in its existing policy instruments. However, significant concerns have been raised by businesses both within and outside the EU that complying with the regulation will be complex and burdensome. While the Commission has clarified that it will only go after *"big fish,"* the Commission's priorities, particularly in relation to the use of the *ex officio* tool and market investigations, are unclear at this stage.[36]

34 It is typically considered that non-horizonal mergers are less likely to impede competition, as they do not entail the loss of direct competitors. See European Commission (2008), "Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings," *Official Journal of the European Union*, C 265/6, October 18, 2008, para. 12.

35 Users may also suffer if the firm that receives the foreign subsidies wins the project due to its cheaper bid despite the lower appraised quality.

36 Mlex (2023), op. cit., March 6, 2023.

As discussed in this article, from an economics perspective there appear to be significant parallels between the state aid framework and the FSR. However, at this stage a number of important questions are still to be addressed, such as how the Commission will assess what constitutes a significant distortion, and the type and magnitude of the positive effects that would be sufficient to outweigh any distortions. In the context of a concentration under the FSR, if the Commission deems that a foreign subsidy is distortive, and therefore requires remedies, it is not yet clear how these will be imposed, and how they would interact with any remedies required under the EUMR. These questions may only be answered in time and when guidance becomes available from the Commission.

In the meantime, it is advisable that companies that are planning mergers or acquisitions or engaging in large public procurement procedures in the EU assess whether they might have received any large financial contributions from third countries. For those large financial contributions, particularly those that fall within the Commission's "most distortive" categories, it would also be advisable to assess whether they were made on market terms. If, however, companies are aware that they have received or are receiving large "favorable" deals from third countries, it would be prudent to consider developing evidence regarding their potential positive effects on the EU market, and how these potential positive effects might outweigh any distortions to competition.

MANAGING FOREIGN SUBSIDIES IN THE EU

BY JOÃO AZEVEDO[1]

1 DG COMP, EU Commission. The information and views set out in this text are those of the author and do not necessarily reflect the official opinion of the European Commission. This paper updates and follows a previous contribution from DG COMP to the OECD on December 1, 2022: https://one.oecd.org/document/DAF/COMP/GF/WD(2022)40/en/pdf.

I. INTRODUCTION

In this paper, we describe the European Union's approach to control harmful effects of foreign subsidies on the EU internal market.

A new Regulation on foreign subsidies ("FSR") distorting the EU internal market was agreed on in 2022. This agreement followed the idea that the control of EU State aid needed to be complemented by a control of subsidies granted by non-EU governments that have an impact on the EU internal market, due to a regulatory gap identified by the Commission.

The agreed Regulation lays down rules and procedures for investigating foreign subsidies that favor companies in a way that negatively affects competition in the EU internal market and for addressing such distortions. There is a particular focus on large concentrations and large public procurement procedures for which notifications are required, but the Commission can on its own initiative launch investigations in any other economic activity for which a distortive foreign subsidy was granted.

The new Regulation will start to apply mid-2023. While this Regulation constitutes a unilateral approach to ensure a level playing field in the EU internal market, the EU remains firmly committed to developing the effectiveness of the multilateral framework in addressing distortions caused by subsidies.[2]

II. PAST EU POLICY ON SUBSIDY CONTROL

The EU policy in this area has been set out mainly in the EU State aid rules, that go back to the founding years of the Union in the 1950s. The EU State aid policy is based on the idea of establishing a level playing field between economic operators active on the internal market where goods, services, persons, and capital can circulate freely between Member States and where discrimination between economic operators is prohibited. If certain economic operators are unfairly favored over others by selective State (aid) measures, the playing field becomes uneven. State aid control as provided for in the Treaty of Rome was therefore conceived as a necessary complement to the free movement rules. In addition, State aid, when granted to companies that would not be rewarded by market forces alone, can provoke a misallocation of resources, decreasing the EU's competitiveness in an environment where global markets become more and more integrated and EU industry faces increasingly strong competition from abroad.

Over the decades, the EU has refined its State aid policy for example through a sophisticated set of guidelines and block-exemption rules. The purpose has been to identify and avoid harmful support measures while allowing governments to continue to use State aid to facilitate the development of certain economic activities.

III. FOREIGN SUBSIDIES IN TRADITIONAL COMPETITION LAW INSTRUMENTS

Under current EU competition law, foreign subsidies can – to a limited extent - be taken into consideration when assessing whether the recipient undertaking holds a dominant position under Article 102 TFEU or in the context of a concentration.

Economic and financial power has been considered relevant in several cases to assess the existence of dominance.[3] Given that foreign subsidies may strengthen the economic and financial power of undertakings, it follows that foreign subsidies may be taken into account when assessing whether the recipient undertaking is dominant under Article 102 TFEU or when assessing a concentration (i.e. to determine whether the concentration may create or strengthen a dominant position). This was confirmed in the RJB Mining ruling with respect to concentrations and State aid.[4]

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2 See the joint declaration of the European Parliament, the Council and the European Commission in: https://www.europarl.europa.eu/doceo/document/TA-9-2022-0379_EN.pdf.

3 See for instance *Continental Can* and *AstraZeneca.*

4 In this ruling, the General Court held that when assessing a concentration *"the Commission cannot ignore the consequences which the grant of State aid to those undertakings [i.e. the parties to the concentration] has on the maintenance of effective competition on the market,"* T-156/98, ECR II-337, para. 114. With respect to merger investigations, Art. 2(1)(b) expressly states that when assessing a concentration, *"the Commission shall take into account: […] the market position of the undertakings concerned and their economic and financial power."*

Following this ruling, the Commission took into consideration State aid and foreign subsidies in several merger cases.[5.] However, the Commission in its decision-making practice[6], has only taken State aid or foreign subsidies into consideration under strict conditions, requiring in essence:

· *First*, clear evidence proving the existence of such aid or subsidies;

· *Second*, evidence showing that the current market shares of the parties do not already reflect the net advantage associated with such subsidies. To this end, it should be established that the subsidies are liable to improve the merged entity's competitive position and potentially negatively affect competition in the internal market.

These strict conditions explain why foreign subsidies have not played a decisive role for the assessment of concentrations to date.

Foreign subsidies can in principle also be relevant if such foreign subsidies are used **by a dominant undertaking in a way which may be abusive under Article 102 TFEU**. [7]

However, the General Court clarified that the mere use by a dominant undertaking of State funds received through a legal monopoly for the purpose of acquiring control of another company does not amount to an abuse in itself.[8] Accordingly, the use of State funds (i.e. State aid or foreign subsidies) does not amount to a standalone form of abuse, but can nevertheless be abusive if it enables a dominant undertaking to distort competition in the internal market.

IV. FOREIGN SUBSIDIES IN ECONOMIC CONTEXT

The EU is the largest trading block in the world. In 2021, the EU27 trade in goods and services with the rest of the world amounted to EUR 6 275 billion, that is 16.2 percent of global trade, or alternatively – around 43 percent of EU's GDP[9]. Around 38 million jobs in the EU are dependent on exports, a figure which has been steadily growing in the past decades.[10]

The EU is also among the top providers and destinations for foreign direct investment, accounting for 32 percent of the global outward FDI stock and 25 percent of global inward FDI stock in 2021[11]. As an open economy, the EU benefits from trade and investment, making its economy closely interlinked with the rest of the world.

While aid granted by EU Member States is subject to EU State aid control, subsidies granted by non-EU countries to undertakings active on the EU internal market are generally not subject to the same level of scrutiny in the EU. This difference in treatment may result in distortions to the EU internal market, notably where certain foreign subsidies would not have been allowed under State aid rules if granted by an EU Member State.[12]

This situation may be exacerbated by the fact that the use of subsidy measures around the world is widespread and has become much more contentious in recent years. For instance, the number of countervailing duty investigations and WTO disputes over subsidies has been

5 See e.g. *STX/Aker Yards*, case COMP/M.4956; *Abu Dhabi Mar/ThyssenKrupp Marine Systems*, COMP/M.5943 and *Alitalia/Etihad*, case COMP/M.7333. This explains why the Form CO expressly asks for a list and description of "any financial or other support received from public authorities by any of the parties and the nature and amount of this support" (Form CO, Section 3.4).

6 See e.g. *Deutsche Post/DHL (II)*, COMP/M.2908.

7 See e.g. *Deutsche Post AG*, COMP/35.141.

8 *UPS Europe SA v. Commission*, T-175/99, para. 55.

9 DG Trade Statistical Guide, August 2022, excluding intra-EU trade. DG Trade statistical guide - Publications Office of the EU (europa.eu).

10 DG Trade, EU exports to the world: effects on employment, 2021. EU Exports to the World: Effects on Employment (europa.eu).

11 UNCTAD, World Investment Report 2022, Statistical Annex. https://unctad.org/topic/investment/world-investment-report.

12 European Court of Auditors. The EU's response to China's state-driven investment strategy, March 2020. https://www.eca.europa.eu/Lists/ECADocuments/RW20_03/RW_EU_response_to_China_EN.pdf.

growing over the past decade.[13] The increased use of subsidies after the global financial crisis has also shown that subsidy measures are a popular policy tool in response to economic downturns, a trend which has been confirmed in the wake of the COVID-19 crisis. Finally, subsidies might also be considered as a means to support decarbonization efforts or to compensate for increasing energy prices and other inflationary pressures. It is therefore expected that subsidies will gain even more importance in the near future.

Such foreign subsidies can have a negative effect on non-subsidized competitors, which are at risk of being crowded out of the EU, which in turn translates into worse conditions for consumers in terms of price and quality. Foreign subsidies may be distortive across various sector when providing an unfair advantage to its beneficiary and thus resulting in strengthening its competitive position.

This may be the case, for instance, when a subsidy distorts competition between the merged entity and its competitors in the internal market. This may happen if, for instance, the subsidy helps to reduce the company's operating costs (by improving the company's financial power compared to its competitors, perhaps via an unlimited guarantee).

A subsidy may also be used to finance a loss-making enterprise without a restructuring plan that would ensure its long-term viability, keeping it from having to leave the market and allowing it to distort competition.

A subsidy may be used to enter new markets or increase a market presence relatively swiftly (compared with greenfield investment, for instance), namely through mergers and acquisitions of existing companies (e.g. through overbidding in a competitive acquisition process), or through winning public procurement contracts that the company would otherwise not have been able to win (e.g. through undercutting the price).[14]

V. FSR SUMMARY

In November 2022, the European Parliament formally approved the Regulation on foreign subsidies distorting the internal market, which had been politically agreed between the negotiators of the European Parliament and of the Council of the European Union earlier that year. The FSR entered into force on January 10, 2023. This Regulation closes the regulatory gap within the internal market described above by setting out three different procedures that allow the Commission to investigate foreign subsidies that distort the internal market, and to redress such distortions: (i) a notification procedure for large concentrations;[15] (ii) a notification procedure for tenders in large public procurement procedures;[16] and (iii) an *ex officio* procedure, which can be used in all market situations.

If the investigation under one of these three procedures reveals that there is a foreign subsidy that distorts the EU internal market, and if this distortion is not fully outweighed by positive effects, the Commission may impose redressive measures on the undertaking or accept its commitments to redress the distortion.

As regards the definition of a **foreign subsidy**, the Regulation sets out a number of cumulative conditions. There first needs to be a **financial contribution** granted by a **third country**. Such a financial contribution may consist, for example, of a capital injection, a direct grant, or a tax exemption. A "**third country**" may cover not only public authorities at all levels, but also the actions of other entities, in so far as they can be attributed to the third country. The financial contribution needs to confer a **benefit** on an undertaking engaging in an economic activity in the EU internal market. Finally, the financial contribution has to be "**selective**," i.e. if it is limited, in law or in fact, to one or more undertakings or industries.

If there is a foreign subsidy, the Commission needs to assess whether that subsidy causes a **distortion** on the EU internal market: whether it is likely to improve the competitive position of the undertaking and thereby negatively affect competition in the EU internal market. The

13 Evenett, S.J. & Fritz, J. Subsidies and Market Access: Towards an Inventory of Corporate Subsidies by China, the European Union and the United States. The 28th Global Trade Alert Report. CEPR, 2020 https://www.globaltradealert.org/reports/gta-28-report.

14 For further examples, see European Commission. Impact assessment report accompanying the Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market. May 5, 2021. https://ec.europa.eu/competition/international/overview/impact_assessment_report.pdf.

15 Concentrations only need to be notified if the undertakings involved in the concentration received at least EUR 50 million of aggregate financial contributions over the last three years, and one of the merging undertakings or the acquired undertaking or, in the case of acquisition of joint control, the joint venture has an EU turnover of more than EUR 500 million.

16 Tenders only need to be notified if the public procurement has an estimated value of more than EUR 250 million (as well as lots above a threshold of EUR 125 million), and the economic operator participating in the public procurement procedure has received an aggregate amount of EUR 4 million of financial contributions over the last three years.

existence of a distortion of the EU internal market is determined on the basis of indicators such as the amount, nature and purpose of the subsidy, or the extent of the undertaking's economic activity on the EU internal market. Certain subsidies, such as unlimited guarantees, are considered particularly likely to distort the internal market, while subsidies below EUR 4 million per undertaking over any period of three years are considered unlikely to do so. Moreover, subsidies below EUR 200.000 per undertaking, per third country and over any period of three years are considered not to distort the internal market.

The Regulation also sets out a **balancing** test. On the basis of information received, the Commission may balance the said negative effects of a foreign subsidy on the EU internal market against its positive effects on the development of the relevant subsidized economic activity, or other relevant policy objectives, in particular on the EU internal market. The Commission will take that balancing into account when deciding on the appropriate remedies or commitments offered by the undertaking under investigation. If the positive effects outweigh the negative ones, there is no need for commitments or redressive measures. Where the positive effects do not outweigh the negative ones, the Commission will take the positive effects into account when determining the nature and level of redressive measures or commitments.

The Regulation provides a non-exhaustive list of possible **redressive** measures or commitments. They can consist of structural measures, such as the sale of an asset; or of behavioral measures, such as the provision of access to infrastructure, or the repayment of the foreign subsidy and have to fully and effectively remedy the distortions in the EU internal market. If need be, the Commission may also prohibit a concentration or the award of the contract. Furthermore, the Commission may impose reporting and transparency obligations, including reporting on future participation in concentrations or public procurement procedures.

VI. WHERE WE STAND NOW

The FSR entered into force on January 12, 2023 and will start to apply 6 months after the entry into force. After the start of application, there will be an additional 3-month period before the notification obligation kicks in. This should provide companies and public authorities with sufficient time to familiarize themselves with the obligations set out in the Regulation.

DO WE REALLY NEED THE EU FOREIGN SUBSIDY REGULATION?

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I. INTRODUCTION

After a short legislative period, a new and far-reaching EU instrument recently saw the light of the day: The Foreign Subsidy Regulation ("FSR") was published in the Official Journal on December 23, 2022.[2] The FSR empowers the Commission to investigate subsidies granted by non-EU countries to undertakings engaged in economic activities within the EU. Under the FSR, the Commission has access to three instruments to assess foreign subsidies. Firstly, the general *ex officio* tool grants the Commission the authority to investigate any market behavior of foreign subsidized undertakings active on the EU internal market. Secondly, two notification-based procedures were introduced to investigate large concentrations and public procurement bids. The Commission can implement corrective measures to address any distortions to the internal market if it finds foreign subsidies to be distortive.

The Commission has emphasized, time and again, that the FSR serves to close a regulatory gap in EU economic law.[3] This article critically questions the regulatory gap and the need for the FSR in its current scope. Foreign subsidies can cause distortions in the internal market.[4] Companies subsidized by third countries may gain a comparative advantage over their competitors due to the subsidies. They might force more efficient companies without access to comparable funding out of the market. This can lead to a decline in efficiency and competition, which could eventually have a negative impact on consumers. The root cause of the issue lies in the industrial policy of third states. The ultimate impact of their subsidies within the internal market, however, hinges on the presence and effectiveness of regulatory mechanisms to prevent distortions in the EU internal market. The key issue at hand is, however, to determine whether this can be attributed to a gap in EU law or its implementation.

First, I will present an overview (II.) of the existing and continuing Union law instruments but for the FSR, and whether they are capable of addressing third-country subsidies distorting the internal market or if additional instruments are necessary. The analysis confirms the existence of a regulatory gap for a State Aid equivalent instrument. Nonetheless, it also emphasizes that undertakings operating on the internal market are to some extent already subject to varying EU rules when it comes to foreign subsidies. Therefore, as a second step (III.), the question arises whether the specific notification-based tools for concentrations and public procurement procedures are truly indispensable, or whether the *ex-officio* tool would have sufficed.

II. WHAT WE HAVE

A. State Aid Law

EU State Aid law is the domestic legal instrument for dealing with subsidies from Member States distorting the internal market. Third country subsidies can lead to similar distortions to financial contributions from Member States.[5] Yet, according to the explicit wording of Article 107(1) Treaty on the Functioning of the European Union ("TFEU") in its various language versions, only aid granted *by a Member State*, not a third state, falls within the scope of EU State Aid law.

Nevertheless, there are discussions in academia and practice as to whether existing State Aid law can also be applied to third-country subsidies. On the one hand, third country subsidies could be attributed to the Member State that helps to ensure that such investments take place in the EU, for example, through the onward transfer of foreign funds.[6] The wording of Art. 107(1) TFEU "state resources or resources derived from state resources" suggests that free Member State availability of financial resources should be sufficient. However, the European Court of Justice ("ECJ") has ruled that aid must lead to a burden or a concrete risk of a burden on a Member State's budget.[7] This is not the case for subsidies

2 Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market.

3 See e.g. European Commission, Commission Staff Working Document – Impact Assessment Accompanying the Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market (SWD(2021) 99 final) (May 5, 2021), https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=SWD:2021:99:FIN, 29 ("Impact Assessment").

4 On the distortive effects of subsidies in general Philipp Werner & Vincent Verouden, *Chapter 1: Introduction – The Law and Economics of EU State Aid Control*, in EU STATE AID CONTROL: LAW AND ECONOMICS 7, 41 (Philipp Werner & Vincent Verouden eds., 2017).

5 See, in detail, Lena Hornkohl, *Protecting the Internal Market From Subsidisation With the EU State Aid Regime and the Foreign Subsidies Regulation: Two Sides of the Same Coin?*, 14 JECLAP (2023), forthcoming, preprint available https://doi.org/10.1093/jeclap/lpad005.

6 Corresponding to similar practices known from EU trade defense law: *Hengshi Egypt Fiberglass Fabrics and Jushi Egypt for Fiberglass Industry v. Commission*, Case T-480/20 and T-540/20 (General Court).

7 *Germany v. Commission*, Case C-405/16 P (ECJ).

stemming from the budget of a third country. Furthermore, it will probably remain the exception that a Member State intervenes; in most cases of problematic foreign subsidies, Member States are not involved.

On the other hand, some have argued that the so-called qualified effects doctrine usually applicable in EU competition law should be transferred to State Aid law.[8] According to the qualified effects doctrine, EU competition law is applicable to anti-competitive conduct with "foreseeable, immediate and substantial" effects in the internal market.[9] Admittedly, a holistic-systematic concept of the effects doctrine given the uniform importance of EU competition and State Aid law for the EU internal market certainly argues in favor of transferring the qualified effects doctrine to State Aid law. However, the precise wording in Art. 107(1) TFEU referring to the "Member State" cannot be disregarded; wording serves as the outer limit of EU law interpretation.

Otherwise, the EU would also overstretch the limits of its extraterritorial jurisdiction permitted by customary international law.[10] When it comes to the mentioned qualified effects doctrine applicable in competition law, the relevant conduct having an effect on the internal market is carried out by a private undertaking. EU State Aid law is linked to state behavior, the granting of aid. Thus, any transferal of the principle of qualified effects for State Aid law would be directly linked to state action by third countries, i.e. non-EU states. Those would then be obliged to notify aid to the Commission in accordance with Article 108(3) TFEU without being a Member State of the EU. *Directly* applying the current State Aid regime to foreign subsidies would therefore violate their sovereignty.

A. Trade Law

The lack of a state-aid-equivalent instrument cannot be compensated for by trade law either.[11] Generally, foreign trade law encompasses the safeguarding of the domestic economy against subsidized foreign import.

Under the law of the World Trade Organization ("WTO"), it is possible for the EU to initiate a case against another WTO member before a WTO panel. Subsidies are in principle covered by the Agreement on Subsidies and Countervailing Measures ("SCM"). Nonetheless, firstly, the SCM only covers trade in goods, not trade in services.[12] Secondly, the rules only provide for measures such as countervailing duties on imports of goods.[13] Subsidies in support of undertakings operating on the EU internal market are only exceptionally covered in the case of export subsidies and import substitution subsidies, i.e. subsidies aimed at increasing the use of domestic over imported products by the recipient enterprises.[14] Moreover, subsidies in trade in services are currently not subject to any measures under WTO law. Subsidies are admittedly not excluded from the scope of the WTO's General Agreement on Trade in Services ("GATS"). The GATS even contains an integrated mandate for further negotiation of measures against services subsidies.[15] Such negotiations have not yet taken place.

The case is similar for EU external trade defense instruments. Under the EU Anti-Subsidy Regulation, an additional import duty may be levied to offset the subsidization of a foreign imported product.[16] However, the Anti-Subsidy Regulation is also limited to trade in goods and does not cover services. Furthermore, it is also limited to the import of goods alone. Subsidies to support (subsidiary) companies and their activities, such as investments, business start-ups, or other economic activities, in the EU internal market remain an absolute exception.

8 Jens Brauneck, *Zum Vorschlag einer EU-Verordnung über den Binnenmarkt verzerrende drittstaatliche Subventionen,* WM 2319, 2322 (2022); Nuno Cunha Rodrigues, *Filling the Regulatory Gap to Address Foreign Subsidies: The EC's Search for a Level Playing Field Within the Internal Market,* in EXTRATERRITORIALITY OF EU ECONOMIC LAW 197, 200-204 (Nuno Cunha Rodrigues eds., 2022).

9 *Intel v. Commission*, Case C-413/14 P (ECJ).

10 See, in detail, Hannah Buxbaum & Thibaut Fleury Graff, EXTRATERRITORIALITY / L'EXTRATERRITORIALITÉ (2022).

11 See, also, Marc Bungenberg & Pieter Van Vaerenbergh, *Countervailing Measures und das Chinesische Beitrittsprotokoll zur WTO*, 23 ZEuS 267 (2020).

12 The ASCM itself is based on Articles VI and XVI of the WTO General Agreement on Tariffs and Trade ("GATT").

13 Article 19 SCM.

14 Article 3 SCM.

15 Article XV(1) GATS.

16 Article 1 Regulation (EU) 2016/1037 of the European Parliament and of the Council of 8 June 2016 on protection against subsidised imports from countries not members of the European Union ("Anti-Subsidy Regulation").

Subsidies are specifically addressed in some of the EU's bilateral free trade agreements ("FTA"). However, the rules vary widely. Most FTAs mainly provide for transparency and consultation requirements regarding subsidies.[17] In association agreements under the European Neighborhood Policy, for example with Ukraine, neighboring countries are required to introduce a subsidy control system modelled on EU State Aid law and applicable to subsidies that affect trade between the EU and the third country in question.[18] Such agreements are still very limited in number to make up for the gap in trade law.

B. Foreign Direct Investment Screening Law

EU foreign direct investment ("FDI") screening law does also not cover foreign subsidies. The FDI Screening Regulation[19] does not provide for a FDI screening mechanism on EU level, nor does it contain obligations for Member States to establish FDI screening. It merely creates a legal framework for investment control, in particular for communication and cooperation, and sets out minimum requirements for Member States' FDI screening mechanisms.[20] Even in these cases, FDI control only concerns public security and public order considerations. These are, for example, impacts on critical assets and infrastructure, not the potential distortive effects of subsidized investments.

C. Competition Law

The prohibitions on cartels, anti-competitive agreements and concerted practices under Article 101(1) and the abuse of dominance under 102 TFEU are neutral. Both provisions cover anti-competitive behavior by undertakings that have received subsidies from third countries as long as and to the extent that the behavior, not the foreign subsidy itself, falls within the scope of Articles 101(1) and 102 TFEU.

In that sense, third country subsidies could specifically play a role in abuse of dominance cases. They do not in and of themselves lead to a dominant position. The overall evaluation of dominance may take into account financial resources, such as the availability of unrestricted refinancing funds, and the ability of a company to operate without substantial competitive pressure.[21] Without any dominance, possible abusive behavior influenced by third country subsidies cannot be covered. Yet, third country subsidies could encourage and facilitate abusive behavior, for example, predatory pricing strategies.[22] Predatory pricing constitutes an abuse under Article 102 TFEU when an undertaking intentionally incurs losses or gives up profits (sacrifice) in order to foreclose actual or potential competitors, based on the reasonable expectation that future monopoly profits will offset the loss, thereby resulting in harm to consumers (recoupment).[23] Yet, the economic test for predatory pricing developed on the basis of *Areeda/Turner*[24] is only applicable to some extent in the context of foreign subsidies and would have to be adapted to the particular deep pockets of third state-subsidized companies, especially in cases of state-owned enterprises ("SOE") from state capitalistic systems. The potential for recoupment does not provide any relevant information on the likelihood of a predatory pricing strategy since the resources for such SOEs are generally almost unlimited.

D. Merger Control

Given the FSR now foresees a special concentration control tool, the question arises of whether the current merger control rules are capable of addressing competitive distortion concerns resulting from subsidies provided by third countries.[25] Within the framework of EU merger control, the Commission or the Member State competition authorities examine whether a merger subject to notification would significantly impede effective

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17 Articles 12.1 et seq. Agreement between the European Union and Japan for an Economic Partnership.

18 Articles 262 et seq. Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part.

19 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.

20 See, in detail, Wolf Zwartkruis & Bas J. de Jong, *The EU Regulation on Screening of Foreign Direct Investment: A Game Changer?,* 31 EUR. BUS. LAW REV. 447 (2020).

21 *Michelin v. Commission*, Case 322/81 (ECJ).

22 Mathew Heim, *How can European competition law address market distortions caused by state-owned enterprises?*, BRUEGEL POLICY CONTRIBUTION ISSUE N°18, https://www.bruegel.org/sites/default/files/wp_attachments/PC-18_2019-181219.pdf (December 19, 2019).

23 *AKZO v. Commission,* Case C-62/86 (ECJ).

24 Philip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 HARV. LAW REV. 697 (1975).

25 See, in detail, Lena Hornkohl, *Artikel 19 Drittstaatensubventionsverordnung*, in: EU-Außenwirtschafts- und Zollrecht (Christoph Herrmann and Marian Niestedt eds., 22. Ergänzungslieferung 2023), forthcoming.

competition in the internal market or in a substantial part of it, in particular by creating or strengthening a dominant position (the "SIEC" test).[26] According to Art. 2(1)(b) EU Merger Control Regulation ("EUMR"), one element of this assessment is to take into account, among other things, "the economic power and the financial strength of the undertakings concerned." The Commission's practice has already taken into account the granting of access to state funds, as well as their corresponding economic and financial influence.[27] However, without other indicators, the financial strength of an undertaking alone is insufficient to fulfil the SIEC test.

The German Bundeskartellamt's *CRRC/Vossloh* decision is an example of a thoroughly in-depth examination of an impediment to effective competition caused by third-country subsidies, especially possible low-price strategies in a certain forecast period, in the context of merger control.[28] In 2020, CRRC Zhuzhou Locomotive ("CRRC"), a Chinese SOE which received several million euros in foreign subsidies in the run-up to the merger, acquired the German company Vossloh Locomotives ("Vossloh"). The Bundeskartellamt examined how low-price strategies due to foreign subsidies and the general access to financial resources could be harmful to the competitive structure. In particular, with regard to access to financial resources, the Bundeskartellamt concluded, with reference to an EU Commission foreign trade law report on Chinese state capitalism,[29] that CRRC has access to an exceptional amount of financial resources, in particular through extensive state subsidies, which would not have been possible in the EU due to State Aid law. Moreover, the Bundeskartellamt, by referring to Commission trade defense and anti-dumping decisions,[30] also noted CRRC's past practice in other markets, which has shown that CRRC strategically uses low prices to expand its market position in foreign markets. In the end, the Bundeskartellamt cleared the merger despite these concerns because the acquired company Vossloh had lost significant market shares in recent years and new competitors with innovative technologies had entered the market. The decision nevertheless illustrates the extent to which third-country subsidies can themselves become important in the examination of problematic market positions under merger control law.

E. Public Procurement Law

Lastly, foreign subsidies distortions in public procurement procedures also deserve attention, due to the special procurement tool of the FSR. Under the EU Public Procurement Directives, contracting authorities can reject abnormally low tenders if a tenderer has demonstrably received State Aid that is incompatible with the internal market.[31] No corresponding possibility exists for third-state subsidies. Yet, in EU public procurement law, a tender can otherwise be rejected if it is abnormally low. However, this requires demonstrating that only the third country subsidy would allow such a low bid and that the viability of the bid and the ability of the bidder to conclude the contract on the abnormally low terms is hampered by the third country subsidy.[32] Due to a lack of investigative powers regarding third country subsidies, this would be a difficult endeavor. Moreover, such considerations would only be part of an overall assessment in discretion of the contracting authority. Furthermore, also the new EU Regulation on the International Procurement Instrument[33] is not sufficient. It entails a trade policy tool that aims at facilitating EU companies' access to third country public procurement markets on equal terms in reciprocity to access to EU procurement markets and does not focus on third country-subsidized activities on the EU public procurement market.

III. WHAT WE NEED?

The above analysis indeed demonstrates a regulatory gap: EU law seems to lack an instrument guaranteeing equality of opportunity and therefore an instrument, *which corresponds to State Aid law for subsidies granted by third states* but adapted to the third country context – as least as long as no uniform rules for subsidies have been introduced in international trade law. Without a State Aid equivalent, companies subject to EU State

26 Art. 2(3) EUMR.

27 *Deutsche Post/DHL*, Commission, COMP/M. 2908 (European Commission).

28 *CRRC/Vossloh*, Case B4-115/19 (Bundeskartellamt).

29 European Commission, Commission Staff Working Document on Significant Distortions of the Economy of the People's Republic of China for the Purposes of Trade Defence Investigations (SWD(2017) 483 final/2) (December 17, 2017), https://trade.ec.europa.eu/doclib/docs/2017/December/tradoc_156474.pdf.

30 See, for example, Commission Implementing Regulation (EU) 2019/73 of 17 January 2019 imposing a definitive anti-dumping duty and definitively collecting the provisional duty imposed on imports of electric bicycles originating in the People's Republic of China.

31 See, for example, Art. 69(4) Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC ("Directive 2014/24/EU").

32 See, for example, Article 69 Directive 2014/24/EU.

33 Regulation (EU) 2022/1031 of the European Parliament and of the Council of 23 June 2022 on the access of third-country economic operators, goods and services to the Union's public procurement and concession markets and procedures supporting negotiations on access of Union economic operators, goods and services to the public procurement and concession markets of third countries ("International Procurement Instrument").

Aid law would be at a disadvantage compared to their competitors receiving foreign subsidies. Once third-country subsidized undertakings are active in the EU's internal market, competition law in particular is not sufficiently helpful. The question of whether a third state subsidy in itself leads to distortions on the internal market is not dealt with by competition law or another EU instrument and would require an instrument *conceptually equivalent* to State Aid, which works under the principle of equality of opportunity.[34] As mentioned above, existing EU State Aid law cannot be replicated identically; the notification obligation incumbent on third states would interfere with third countries' sovereignty. Instead, it would be necessary for the undertaking that receives foreign subsidies and operates in the internal market to bear the responsibility for notification or transparency obligations, so the Commission could assess the distortive effects.

In the new FSR, the *ex officio* tool applicable to all market activities at least conceptually takes the position of a missing State Aid regime for third country subsidies. At the same time, it preserves the limits of the Union's extraterritorial jurisdiction and third states' sovereignty. By requiring "an economic activity in the internal market"[35], the *ex officio* tool avoids a link to the act of providing the subsidies by the third country itself and, thus, at the same time interfering with the sovereignty of the third country. Accordingly, a territorial nexus to the internal market is established. Whether the *ex officio tool* in detail is indeed providing equal opportunities with EU State Aid law, is beyond the scope of this paper and highly questionable.[36] The aim, spirit, basic idea, and concept of a third-country State Aid instrument is at least identifiable.

The other two notification-based tools already conceptually go well beyond a third-country State Aid instrument. Nevertheless, taking a view on the concentration tool specifically, one could argue that merger control is insufficient in addressing foreign subsidy control concerns since it solely concentrates on the *operational* markets, that is, the applicable product market on which the merging firms operate, rather than examining the *market for company acquisitions*. On the market for company acquisitions, foreign subsidies could also be distortive, because they could lead to excessive purchase prices for companies not corresponding to their actual asset value and thus cause an overall inefficient allocation of resources.[37]

Especially compared to EU State Aid law, however, the necessity of a special concentration tool still remains doubtful.[38] Insofar as distortions on the market for company acquisitions are concerned, EU State Aid law itself is neutral. State Aid law does not specifically apply to concentrations but is linked to the provision of aid by EU Member States to undertakings. The economic activities of such undertakings can also include, among other things, M&A activities. State Aid law can thus, in the longer term and indirectly, also prevent distortions of competition in the market for company acquisitions, but it is not targeted at this market alone.

Under the concentration tool of the FSR, foreign subsidy control is now specifically aimed at the market for company acquisitions. Yet, *CRRC/Vossloh* has shown that merger control law already provides sufficient mechanisms to the extent that third-country subsidies contribute to problematic market positions and distortions of competition on the operational product markets. Insofar as third-country subsidies *as such* have distortive effects on competition – even if the third-country subsidy occurs in the context of a concentration and affects the market for company acquisitions – a regulatory gap exists for a State Aid equivalent tool, not another merger control tool. The necessity of foreign subsidies control relates to the impact of such subsidies *on equal opportunities in the EU internal market.* Such an approach aligns with the EU State Aid law aim of promoting equal opportunities as laid down in primary EU law.

The same conclusions can be reached with regard to the public procurement tool. Foreign subsidized companies might indeed undercut other more efficient non-subsidized (European) bidders when participating in procurement procedures due to their increased financial strength. However, if the EU public procurement directives were modified to reflect the aforementioned treatment of bids from tenderers who have received foreign subsidies, a State Aid equivalent instrument alone would have been enough to tackle these issues without the need for a specific additional procurement tool.

34 Similar: German Monopolies Commission, *Chinese state capitalism: A challenge for the European market economy, Chapter IV of the Biennial Report XXIII of the Monopolies Commission ("Competition 2020") pursuant to Section 44 (1) sentence 1 of the Act Against Restraints on Competition* (July 29, 2020) https://monopolkommission.de/images/HG23/Main_Report_XXIII_Chinese_state_capitalism.pdf.

35 Article 1(2) FSR.

36 See, in detail, Hornkohl, *supra* note 5.

37 Tabea Bauermeister, *A Tool to Investigate M&A Transactions with Regard to Foreign Financial Contributions*, 25 ZEuS 477, 479 (2022).

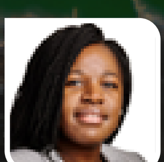
38 See, in detail, Hornkohl, *supra* note 25.

IV. CONCLUSION

EU law lacks a State Aid equivalent tool for foreign subsidies, so all undertakings active on the internal market, especially the third country subsidized, and the EU Member State subsidized, can operate on a level playing field. Yet, the two notification-based tools go beyond what is necessary and put third-country subsidies at a disadvantage when compared to those controlled under EU State Aid law. Although the notification tools do bring foreign subsidies to the Commission's attention, the *ex officio* tool alone would have been sufficient if it had been accompanied by a notification obligation for foreign subsidized undertakings operating on the internal market. The decision to introduce a concentration and public procurement tool in the FSR was ultimately political. In theory, the notification thresholds aim to curtail both tools to potentially significantly distortive economic activities, therefore at least mitigating the concerns that have been raised herein.

THE EU FOREIGN SUBSIDIES REGULATION: GREEN SUBSIDIES TREADING THE LINE BETWEEN THE FSR, STATE AID, AND WTO LAW

BY LILIANE GAM & ARGYRIOS PAPAEFTHYMIOU[1]



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I. INTRODUCTION

On December 23, 2022, the European Union adopted the Foreign Subsidies Regulation ("FSR"),[2] which introduces mandatory notification requirements for concentrations and public tenders involving financial contributions from non-EU countries (if certain thresholds are met). The FSR, which entered into force on January 12, 2023, also gives the European Commission ("EC") the power to investigate all other market situations (including M&A and public tenders falling below the thresholds) where there may have been financial contributions from non-EU countries (*ex-officio* investigations).

While as of July 12, 2023 the FSR will start to apply and the EC will be able to commence *ex officio* investigations, the notification obligation for M&A deals and public procurement will only be effective as of October 12, 2023.

It is timely that the adoption of the FSR comes at a time when subsidies in general, and subsidies to boost green energy transition in particular, are on the rise. This new regulatory tool sits within a broader context of EU nervousness about falling behind the other global economies' efforts to support their own national champions through subsidies, with EU countries unable to strike back due to the combined effect of a strict competition policy and an adherence to international trade rules. There was uproar in France and Germany in 2019 when the EC blocked the proposed acquisition of French Alstom by German industrial powerhouse Siemens.[3] At the core of this criticism was the perception that, without consolidating their power, the two European railway market leaders would soon collapse under intense competitive pressure from CRRC, a Chinese State-controlled supplier of trains, which benefits from intense subsidization by the Chinese State.

In response to this criticism, EU Competition Commissioner, Margrethe Vestager turned the focus on the trade dimension, noting that, although competition rules in the EU will continue to be enforced on a merits-based, case-by-case basis, "*we must also ensure a global level playing field for European companies. Control of subsidies is weaker outside the EU […]*."[4] The FSR is the EU's response to the perceived need to neutralize distortive foreign subsidies at their source, thereby ensuring a level playing field for all the companies operating in the EU.

This article discusses the broader context under which the FSR was adopted as well as its policy drivers (including the ongoing green subsidies race) (II), before providing an overview of its key provisions, while highlighting their similarities/differences with State aid and international trade rules (III). The article then examines the U.S. Inflation Reduction Act's ("IRA") subsidies for electric vehicles ("EVs"), as a test study on the potential interaction between the FSR and the World Trade Organization ("WTO") Agreement on Subsidies and Countervailing Measures ("SCM Agreement") (IV).

II. THE POLICY DRIVERS BEHIND THE ADOPTION OF THE FSR

A. Green Subsidies: A Global Free-for-all

With an enhanced focus on energy transition, various measures have been deployed by governments around the world to promote green energy.

For instance, China, which is the world's largest producer of renewable energy, has promoted the growth of its renewable energy sector, by offering billions of dollars in subsidies to domestic manufacturing. A report by the Center for Strategic & International Studies ("CSIS") estimates that China spent the equivalent of 1.73 percent of its 2019 Gross Domestic Product (approx. $248 billion or €233 billion) in various 'industrial policy' instruments such as direct subsidies (e.g. grants), tax incentives, below-market credits, and state investment funds.[5] While China is outspending most economies, other countries have followed suit.

To counter China's dominance in green capacity, in August 2022, the United States passed the IRA, which provides an economic package of $369 billion for American households, in the form of grants, loans and tax credits heavily geared towards green and renewable energy.[6]

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2 Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market, OJ 2022, L 330/1–45.

3 Leigh Thomas, *France, Germany step up pressure over Alstom-Siemens deal*, Reuters (Jan. 21, 2019), https://www.reuters.com/article/us-alstom-m-a-siemens-idUSKCN1PF0PK.

4 Press Release, EC, Statement by Commissioner Vestager on the proposed acquisition of Alstom by Siemens and the proposed acquisition of Aurubis Rolled Products and Schwermetall by Wieland (Feb. 6, 2019), https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_19_889.

5 Gerard DiPippo, Ilaria Mazzocco & Scott Kennedy, *Red Ink – Estimating Chinese Industrial Policy Spending in Comparative Perspective*, CENTER FOR STRATEGIC & INTERNATIONAL STUDIES (May 2022), https://www.csis.org/analysis/red-ink-estimating-chinese-industrial-policy-spending-comparative-perspective.

6 *Inflation Reduction Act of 2022*, Pub. L. No. 117-169, 136 Stat. 1818.

The IRA provides for a consumer tax credit of $7,500 for EV purchases, but only subject to the condition that the EV is assembled in North America.

The EU is not to be outdone in this regard. The EU's "Green Deal Industrial Plan for the Net-Zero Age" announced by the EC on February 1, 2023 provides for an expansion of EU Member States' flexibility to support the deployment of renewable energy. This will take place through the Temporary Crisis and Transition Framework ("TCTF"), which allows for more lax State aid policy for "*accelerating the rollout of renewable energy and energy storage, and schemes for the decarbonisation of industrial production processes*" until the end of 2025.[7] The TCTF has been accompanied by the latest revisions to the EU General Block Exemption Regulation ("GBER")[8] to expand EU Member States' regulatory space for introducing support measures focusing on the "*transition to climate neutrality and to a net-zero industry.*" Notably, this new Temporary Framework includes the option for EU countries to implement "*investment support schemes for production of strategic net-zero technologies, including the possibility of granting higher aid to match the aid received for similar projects by competitors located outside the EU while ensuring the proportionality of such aid.*"[9] The purported rationale behind this is to address the "*real risk of investments being diverted away from Europe*" by allowing Member States to provide either the amount of support a beneficiary could receive for an equivalent investment in that alternative location ("matching aid"), or the amount needed to incentivize the company to locate the investment in the EEA (the so-called "funding gap") – whichever is the lowest.

Although there are a number of add-on requirements that need to be fulfilled for this type of aid to be lawfully granted by Member States, it is still notable to see the EU introduce this type of "matching clause" into the toolkit for clean energy State aid. Mix all of the above, and what you get is what looks like the ingredients for a green subsidies war.

While subsidies can play a positive role in supporting the transition to a more sustainable economy by incentivizing the development of clean energy sources, they may also confer an unfair advantage to their beneficiaries over foreign companies, leading to market distortions and potential harm to industries and employment in other countries.

B. The Deficiency of International Trade Rules to Tackle (Unfair) Subsidies

The EU regime is a global singularity since it is the only regime that lays down a quasi-presumption of unlawfulness for State subsidies ("State aid" in EU parlance).

Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU") provides that State aid is in principle incompatible with the common market (and therefore illegal) where the granting of aid involves the transfer of State resources, entails an economic advantage, distorts, or threatens to distort competition by selectively favoring certain beneficiaries and affects trade between Member States. The concept of State aid is very broad and covers any economic advantage to the recipient company granted through State resources. The principle of incompatibility of State aid with the common market is not absolute. Article 107(2)-(3) TFEU contains a number of exemptions under which State aid may be considered acceptable by the EC. Article 108(3) TFEU imposes a standstill obligation on EU Member States preventing them from putting into effect proposed aid measures until the EC has reviewed (following their notification) and approved them (save for the measures falling under the GBER).

Yet, these stringent rules only apply to subsidies which originate from EU Member States. Subsidies by non-EU Member States, which can distort the EU internal market just as much as "home-grown" subsidies, are not tackled by State aid rules.[10]

From the EU's standpoint, this leaves a "regulatory gap" for cases of subsidization of economic activity within the EU, by third (non-EU) countries, which are not fully addressable by trade defense instruments. As noted in Recital 5 of the FSR: "*Trade defence instruments enable the Commission to act when subsidised goods are imported into the Union, but not when foreign subsidies take the form of subsidised investments, or when services and financial flows are concerned.*"

The international trade rules that come into play for subsidies are contained in the SCM Agreement, which established detailed rules and procedures for investigating and addressing subsidies that cause market distortions and harm other WTO members. Article 1 of the SCM

7 Press Release, EC, State aid: Commission adopts Temporary Crisis and Transition Framework to further support transition towards net-zero economy (Mar. 9, 2023), https://ec.europa.eu/commission/presscorner/detail/en/ip_23_1563.

8 The GBER provides a "safe harbor" for categories of State aid whose generally non-market-distortive nature and significative positive externalities render them "benign" enough to escape the general mandatory notification and prior approval requirements.

9 *Communication from the European Commission, A Green Industrial Plan for the Net-Zero Age*, EC (Feb. 1, 2023), https://commission.europa.eu/system/files/2023-02/COM_2023_62_2_EN_ACT_A%20Green%20Deal%20Industrial%20Plan%20for%20the%20Net-Zero%20Age.pdf.

10 *White Paper on levelling the playing field as regards foreign subsidies*, EC, COM(2020) 253 final (June 17, 2020).

Agreement defines a subsidy as a financial contribution by a government or any public body within the territory of a WTO member that confers a benefit on a specific enterprise or industry. This includes direct subsidies such as grants, loans, and equity infusions, as well as indirect subsidies such as tax incentives and government procurement policies that favor domestic suppliers. The SCM Agreement distinguishes between prohibited subsidies, which are generally considered to have the greatest potential for causing market distortions (namely those contingent on exports and on the use of domestic over imported components), and actionable subsidies, which are subject to countervailing measures if they cause material injury to domestic industries in other WTO members.

The EU has criticized the effectiveness of the WTO rules on subsidies, highlighting the following limitations:

· The SCM Agreement does not apply to subsidies related to the provision of services. Within the WTO legal framework, trade in services is covered exclusively by the General Agreement on Trade in Services ("GATS"), which does not provide for controls on services subsidies.[11] This means that subsidies for services can go unregulated, potentially distorting competition;

· The EC construes Article 1 of the SCM Agreement as excluding from its scope subsidies granted by WTO members to beneficiaries located in a third country. This view provided the backdrop for the EC's imposition of countervailing duties on Egyptian importers in 2020, for subsidies which they had received from China and Chinese State-owned companies.[12] This is an issue which has not received sufficient clarity from the WTO dispute settlement body, which is the primary institution competent to interpret the WTO agreements. There is a serious argument to be made – and it has been made by some – that Article 1 of the SCM Agreement does in fact provide a remedial recourse against the WTO member granting the subsidy, even if the financial contribution itself is provided to recipients outside the granting member's territory;[13]

· The effectiveness of the rules on subsidies is hindered by the lack of transparency, as most WTO members do not provide adequate notifications of the subsidies they provide, or do not disclose the full extent of the subsidies; and

· The dispute settlement process can be slow and costly, and some WTO members have been known to ignore rulings or drag out the process in order to delay compliance. The WTO Appellate Body's inability to hear appeals (since its membership has fallen below the required minimum of three members needed to hear an appeal) has led to a backlog of cases, which has in turn resulted in a paralysis of the dispute resolution process.

This perceived regulatory gap, compounded by the inefficacy of trade rules on subsidies, led to the adoption of the FSR.

III. THE FSR, EU STATE AID LAW, AND WTO LAW: COMMONALITIES AND DIVERGENCES

The core concepts of the FSR are heavily influenced by the equivalent notions under State aid and WTO rules. The FSR also draws upon trade law in that it makes use of the experience gained in EU trade remedy investigations (anti-subsidy countervailing measures).

One key concept from which the EC will derive its jurisdiction is the notion of "financial contribution." The *ex ante* notification obligation for concentrations will apply where the EU turnover of the target (for an acquisition), the joint venture, or one of the merging parties (for a merger) is at least €500 million and the companies involved have received more than €50 million (in aggregate) of non-EU financial contributions in the three years preceding the signing of the deal, the announcement of the public bid or the acquisition of a controlling interest (Article 20(3) FSR). As for public tenders, the notification obligation will be triggered where the estimated value of the contract is at least €250 million and the companies involved have been granted non-EU financial contributions from third countries of at least €4 million (in aggregate) per third country (Article 28(1) FSR).

The notion of financial contribution is extremely broad and is capable of catching a variety of financial payments or advantages conferred by foreign governments. This includes various types of transfer of funds, foregoing of revenue that is otherwise due, but also all dealings that an entity has with governments / public entities outside the EU (e.g. the provision or purchase of goods or services). To be foreign, a financial

11 Victor Crochet & Marcus Gustafsson, *Lawful Remedy or Illegal Response? Resolving the Issue of Foreign Subsidization under WTO Law*, 20 WORLD TRADE REVIEW, 343 – 366 (2021).

12 Marios Tokas, *Playing the Game: The EU's Proposed Regulation on Foreign Subsidies*, 5 JOURNAL OF WORLD TRADE 56, 797 (2022); *Commission Implementing Regulation (EU) 2020/776*, EC (June 12, 2020); *Commission Implementing Regulation 2020/870*, EC (June 24, 2020).

13 Crochet & Gustafsson, *supra* note 11, at 349.

contribution has to be provided by a third country and this not only involves governments and public authorities, but it can involve any foreign public entity or even private entities whose actions can be attributed to a non-EU country.

This wide reach will be burdensome for companies meeting the filing thresholds, as they would need to disclose to the EC each non-EU financial contribution they have received which is equal to or in excess of €200,000, provided that the total amount of financial contributions per third country and per year is equal to or in excess of €4 million.[14] Companies would need to submit a filing, regardless of whether the non-EU financial contributions have distortive effects in the EU or whether they come from friendly countries, although this is likely to be relevant for the assessment of their potential distortive effects.

It is only after a filing has been submitted that the EC will assess whether the financial contributions received constitute distortive "foreign subsidies" by conducting a balancing exercise, taking into account the objectives pursued by the measures (e.g. whether they cover investment or operating costs), their amount, their beneficiaries (e.g. large or small companies) and whether they align with EU public policy objectives (e.g. net zero targets). The FSR provides that foreign subsidies not exceeding €4 million over a consecutive period of three years are unlikely to distort the internal market (Article 4(2) FSR), and that financial contributions which do not exceed the amount of *de minimis* aid as per State aid rules (i.e. not more than €200,000 per third country over any period of three fiscal years) are non-distortive subsidies (Article 4(3) FSR). On the other hand, certain categories of subsidies are highlighted in the FSR as most likely to be distortive, namely: (i) subsidies to a failing company (absent any restructuring plan); (ii) unlimited guarantees; (iii) an export financing measure that is not in line with the OECD Arrangement on officially supported export credits; (iv) subsidies directly facilitating a concentration; and (v) subsidies enabling an undertaking to submit an unduly advantageous tender on the basis of which the undertaking could be awarded the relevant contract (Article 5(1) FSR).

As for the notion of "foreign subsidy" itself, it mirrors the notion of State aid, as well as the notion of subsidies under the SCA Agreement, as the EC acknowledged itself in its 2020 White Paper, which laid the groundwork for the FSR: "*the definition of a subsidy according to the SCM Agreement by and large coincides with the definition of a subsidy* [in the FSR]."[15]

Apart for the "financial contribution" element, the definition of "foreign subsidy" under Article 3 of the FSR requires the (i) conferral of a benefit (ii) on a *de jure* or *de facto* basis to a limited number of undertakings. WTO and State aid law practitioners will recognize the economic advantage and selectivity requirements. The relevant case law interpretations are certainly going to affect the interpretation of those terms.

Under the FSR, the legal onus to make the relevant subsidy filing falls on the undertaking. This notification requirement comes with an additional burden, as it entails the submission of numerous internal documents as indicated in the Draft IR. For example, the Draft IR provides that the notifying parties would need to submit analyses, reports, studies surveys, presentations and any comparable documents from the grantor and the recipient of the foreign financial contribution discussing the purpose and economic rationale of the foreign financial contribution as well as its possible positive effects.[16] For concentrations, the notifying parties would need to provide detailed information regarding the bidding process, including how many other bidders were involved, how many expressed interest, who withdrew and at what stage.[17] As for the financial contributions that are likely to be distortive (as noted above), the notifying parties would need to provide copies of all the supporting official documents relating to the financial contributions granted in the three years preceding the notification.[18]

Failure to adequately understand and comply with the new FSR requirements does not come cheap, with companies facing the threat of significant fines for failing to appropriately notify the subsidy. In case of breach of the standstill and/or notification obligations, the EC can impose fines of up to 10 percent of the company's group annual turnover (Article 26(3) FSR). In addition, if companies intentionally or negligently provide incorrect, misleading, or incomplete information, the EC can impose fines of up to 1 percent of their aggregate annual turnover or periodic penalty payments of up to 5 percent of the average daily aggregate turnover to ensure compliance with the FSR (Articles 17(2)-(3) and 26(2) FSR).

This is another departure from both State aid law – where in principle the EU Member State that wants to grant the aid must make the relevant notification – as well as WTO law, which works ex post by laying out dispute settlement procedures through which a WTO Member can challenge another Member's subsidies as WTO-incompatible, although the countervailing measures (in the form of increased duties) apply to the imported goods that have benefited from government subsidies.

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14 Draft FSR Implementing Regulation ("Draft IR"), Annex 1, Article 5.1.

15 EC White Paper, *supra* note 10, at Annex 1: Definition of Foreign Subsidy.

16 Draft IR, Annex 1, Article 8.1.

17 Draft IR, Annex 1, Article 6.1.

18 Draft IR, Annex 1, Article 8.1.

IV. THE INTERPLAY BETWEEN THE FSR AND THE SCM AGREEMENT: THE IRA AS A CASE STUDY

With the FSR now in place, a key question is how this new regulatory tool will interact with the EU's obligations under international trade law.

Article 44(9) of the FSR provides that no action shall be taken under it which would amount to a specific action against a subsidy falling within the scope of the SCM Agreement.[19] This provision mirrors Article 32.1 of the SCM Agreement, which prescribes that "*no specific action against a subsidy of another* [WTO] *Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.*" This means that subsidies falling within the scope of the SCM Agreement are shielded from actions taken in application of the FSR. While companies will still be under the obligation to disclose the non-EU subsidies they received to the EC, the EC will not be able to use to FSR to implement corrective measures. If the subsidies are not subject to the SCM Agreement, the EC will be able to apply the FSR fully.

The debate on exactly which subsidies fall under the SCM Agreement, and which do not, is far from settled. The SCM Agreement only covers trade in goods and as such does not apply to subsidies related to the provision of services. This means that the FSR is applicable to foreign subsidies relating to trade in services in the EU. For trade in goods, the issue of the geographic location of the beneficiary of non-EU subsidies has been addressed above: given that the rationale of the FSR creation was largely based on the EU perception that the SCM Agreement does not cover subsidies where the granting authority and the beneficiary are not in the same territory, we can safely assume that the EC will apply the FSR on concentrations, public procurement bids or other investments (under the catch-all *ex officio* tool) wh ich involve undertakings that have benefited from goods subsidies by third (non-EU) countries.

By way of example, if we look at the IRA specifically, the question remains as to whether the EC will be able to review the financial contributions granted under it, in application of the FSR. The IRA is arguably a textbook case of a subsidy that is prohibited under Article 3 of SCM Agreement, seeing as its granting is "*contingent [...] upon the use of domestic over imported goods*" (Article 3(1)(b) SCM Agreement). It is also most likely in breach of the United States' national treatment obligation under Article III:4 of the General Agreement on Tariffs and Trade, as it accords to domestically assembled EVs treatment more favorable than that accorded to 'like' imported EVs.

On March 23, 2023, the EU Competition Commissioner answered a question from a Member of the European Parliament regarding the potential applicability of (and the EC's intention to apply) the FSR to the IRA by highlighting three key points: first, the IRA's *prima facie* scope of application is confined to "*companies engaging in an economic activity in the US*" and would therefore be assessed on a case-by-case basis in the context of the FSR. Second, the SCM Agreement is still applicable to "*the manufacture, production or export of goods granted by non-EU countries*," and it remains an option "*to launch a dispute settlement procedure at the World Trade Organization.*" Third, the EC retains the option to impose countervailing duties under the EU's anti-subsidy Regulation[20] if it finds that "*an EU industry is harmed by imports of a product that are subsidised coming from a non-EU country.*"[21]

For trade in goods, it therefore seems that while companies have a disclosure obligation, if the measures fall under the SCM Agreement, the EC will only be able to impose countervailing measures in the form of duties. The question in the IRA context then becomes: would the application of the FSR to the provision of services that may have *indirectly* benefited from the IRA's subsidies – which in principle target goods – be considered a "*specific action against a subsidy*" in the meaning of Articles 44(9) of the FSR and 32(1) of the SCM Agreement, so as to render such application WTO-incompatible? An indicative example, in the context of the EV subsidies, could be the provision of aftermarket services for such EVs in the EU. Would such services be captured by the FSR, even though the "original" subsidy for the assembly of the EV will fall under the SCM Agreement and will thus likely be excluded from the FSR's scope by virtue of Article 44(9) of the FSR?

WTO case law would likely argue against such an interpretation. The WTO Appellate Body has made clear that Article 32(1) of the SCM Agreement refers to actions against a subsidy as such, not against the imported products in particular.[22] So an application of the FSR against

19 In accordance with Article 32.1 of the SCM Agreement.

20 *Regulation 2016/1037 on protection against subsidized imports from countries not members of the European Union*, OJ L 176/55.

21 Answer given by Executive Vice-President Vestager on behalf of the European Commission (Mar. 23, 2023), https://www.europarl.europa.eu/doceo/document/P-9-2023-000441-ASW_EN.html.

22 Appellate Body Report, *United States – Continued Dumping and Subsidy Offset Act of 2000 (US-Offset Act (Byrd Amendment)),* WT/DS217/AB/R; WT/DS234/AB/R (Jan. 16, 2003), at para. 251.

the provision of ancillary services of a producer who has benefited from the IRA subsidies, would likely be considered a *"specific action against a subsidy."*

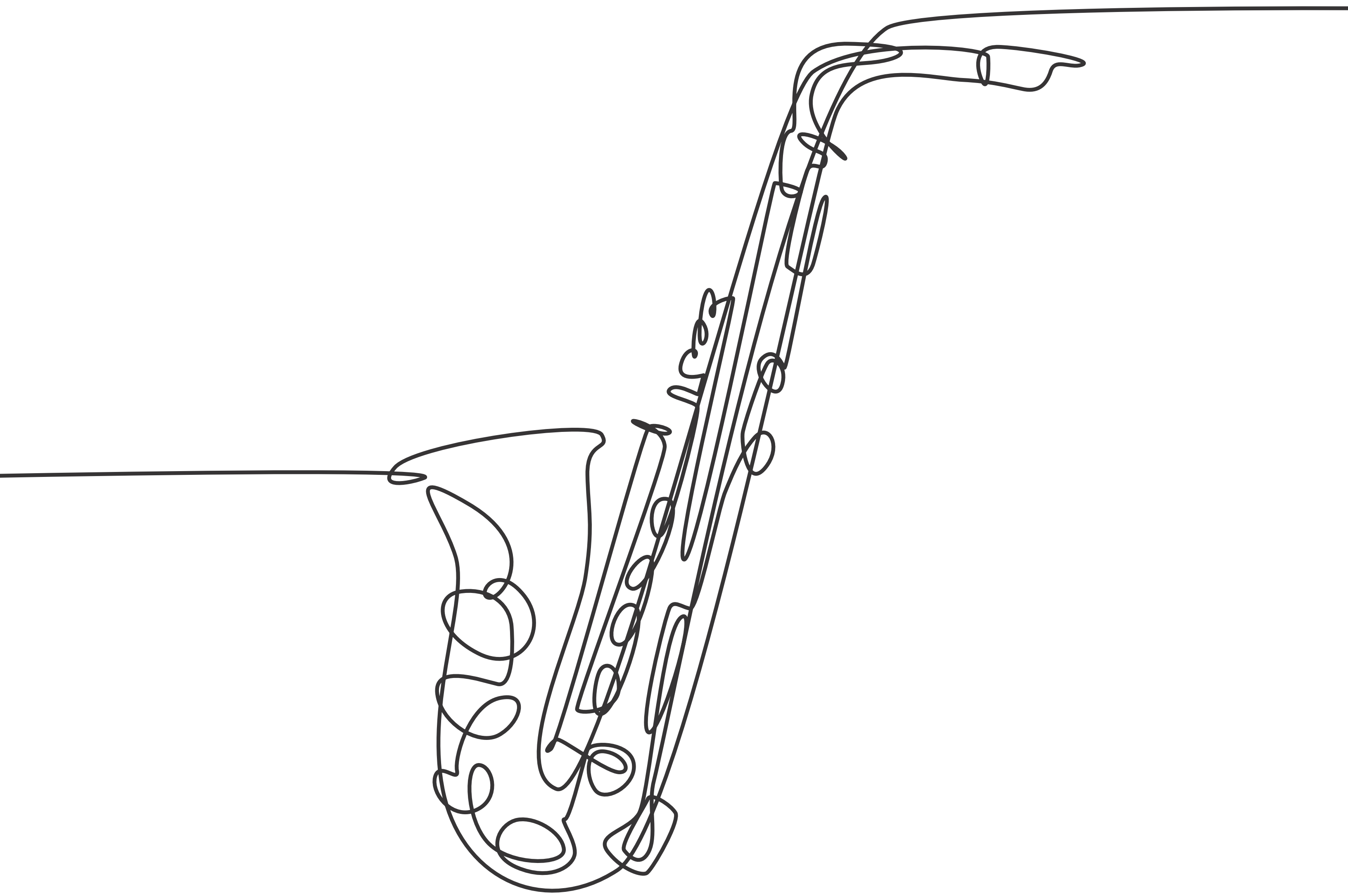
In view of the above, a company benefiting from the IRA's EV tax credit subsidy may find some relief in Article 44(9) of the FSR, since the SCM Agreement takes precedence over the FSR in terms of applicability to the IRA's subsidies. Thus, the only recourse against these subsidies is likely to be the WTO dispute settlement system, which functions at the State-to-State level. Such a dispute may or may not end up before a WTO panel depending on political considerations. For example, it is unclear what role the U.S-.EU Task Force on the IRA,[23] which was established in October 2022 as a discussion forum for the U.S. and the EU to deal with various contentious IRA-related issues arising in their bilateral relation, would have on the prospects of the EU bringing a WTO complaint against the U.S. on the basis of the IRA EV tax credit policy's incompatibility with the SCM Agreement. Even if such a dispute would eventually end up being adjudicated at the WTO, these processes take relatively long to complete, and this unavoidably creates significant legal uncertainty for the affected companies.

In any event, with considerable uncertainty lingering as to the precise delineation between subsidies that fall under the SCM Agreement and those that do not, the arguably most prudent approach for companies benefiting under the IRA's subsidies and are planning concentrations or public procurement bids in the EU would be to engage in some informal pre-notification discussions with the EC. The Draft IR provides for (and encourages companies to make use of) voluntary pre-notification contacts with the EC, to help determine whether a foreign subsidy assessment is involved in the context of a concentration.

The question remains as to how the *ex officio* tool (the third pillar of the FSR alongside the concentrations and public procurement tools) could interact with the IRA subsidies. Even if there is no concentration or public procurement bid on the horizon, if an IRA EV subsidy beneficiary has significant economic activities in the EU (e.g. large EV export volumes), they should be prepared for potential requests for information from the EC.

23 Press Release, EC, Launch of the EU-U.S. Task Force on the Inflation Reduction Act (Oct. 26, 2022), https://ec.europa.eu/commission/presscorner/detail/en/statement_22_6402.

THE FOREIGN SUBSIDIES REGULATION: AN AMBITIOUS INSTRUMENT THAT RAISES SIGNIFICANT CHALLENGES



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I. INTRODUCTION

The control of State aid as part of the competition law provisions has traditionally been a "European peculiarity,"[2] a "unique system inextricably linked to the European Union ("EU") integration process."[3] The Treaty system of State aid control is based on a general rule of incompatibility of aids, included in today's Article 107(1) TFEU, coupled with a number of exemptions, enshrined mainly in Articles 107(2) and 107(3) TFEU, and an *ex ante* control by the European Commission, that must be notified by the Member States of any planned aid. As the Court of Justice of the EU has underlined "The aim of that system of prior control is therefore that only compatible aid may be implemented."[4]The control of State aid has contributed to the maintenance of a level playing field in the European Union internal market, reducing distortions of competition, and avoiding subsidy races, even in times of serious crises, as those experienced in recent years.

At the same time, since the introduction of the EU State aid rules in the 1950s, not only the EU but also international markets have significantly evolved. In the current globalized economy, EU companies compete worldwide, and there are claims that EU undertakings are at a disadvantage vis a vis their competitors from other jurisdictions, as the latter may receive public financial support from their national authorities that in the EU is forbidden under the State aid rules. These complaints were aired by the 2019 Franco-German *Manifesto for a European industrial policy fit for the 21st Century* in the following terms: "Despite our best efforts, which we must pursue, there is no regulatory global level playing field. And there won't be one any time soon. This puts European companies at a massive disadvantage. When some countries heavily subsidize their own companies, how can companies operating mainly in Europe compete fairly?."[5] Not only Chinese state-owned firms, but also US, Russian or Middle Eastern companies have been referred to as beneficiaries of large subsidies in this context.[6] More recently, the adoption of the Inflation Reduction ACT ("IRA") by the United States has again ignited the debate in Europe about the granting of distortive foreign subsidies by non-EU countries with a detrimental effect in the internal market.[7]

In relation to the foregoing, the development of "international rules and cooperation on competition policies to ensure European firms do not suffer in third countries from unreasonable subsidization of local companies or anti-competitive practices" has been an EU "strategic interest" since 2016.[8] The European Union has indeed promoted State aid control frameworks worldwide.[9] In addition, the European Union has also included subsidy control provisions with a competition perspective in the new generation trade agreements signed with third countries.[10]

Similarly, the European Union is committed to the multilateral control of subsidies at the World Trade Organization and has proposed its reinforcement. Indeed, the European Commission has proposed modernizing the WTO rules by "Establishing new rules to avoid competitive distortions due to state intervention in the economy - competitive neutrality."[11] In particular, the EU proposes the adoption of new rules on industrial subsidies to counter the negative effects of heavy subsidization on international trade, as well as new rules on the behavior of SOEs in their commercial activities. In addition, as the Commission holds "Apart from industrial subsidies and SOE disciplines, there is a need to reflect on what other elements could be part of new WTO rules aiming at ensuring the principle of "competitive neutrality" and promoting a level playing field. […] The overall aim should be that any state intervention in the economy is done in full transparency and does not distort competition to favour certain

2 Kellin Bacon, *European Union Law of State Aid* (3rd edn, OUP 2017) 4.

3 Tembinkosi Bonakele, "The Case for a BRICS Competition Agenda" in Tembinkosi Bonakele *et al* (eds), *Competition Policy for the New Era: Insights from the BRICS Countries* (OUP 2017) 41.

4 C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2020:139, para 19

5 A Franco-German Manifesto for a European industrial policy fit for the 21st Century, available at https://www.bmwk.de/Redaktion/DE/Downloads/F/franco-german-manifesto-for-a-european-industrial-policy.pdf%3F__blob%3DpublicationFile%26v%3D2.

6 See in this regard, e.g. the reference in POLITICO, available at https://www.politico.eu/article/five-industrie-need-watch-foreign-subsidies-rules/.

7 See e.g. the references of President Von der Leyen to the IRA in a speech at the College of Europe in Bruges, available at https://ec.europa.eu/commission/presscorner/detail/en/speech_22_7487.

8 Commission communication "Global Europe: competing in the world," COM (2006) 567, 4 Oct. 2006, p. 7.

9 See also in this regard, Juan Jorge Piernas López, "State aid law beyond the EU," in Leigh Hancher, & Juan Jorge Piernas López, *Research handbook on European State aid law* (2nd edition), E. Elgar, 2021, pp. 297-313.

10 Leonardo S. Borlini, "Subsidies Regulation Beyond the WTO Substance, Procedure and Policy Space in the 'New Generation' EU Trade Agreements" in Giulina Ziccardi Capaldo (ed), *The Global Community: Yearbook of International Law and Jurisprudence* 2016 (OUP 2017).

11 Annex to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Trade Policy Review - An Open, Sustainable and Assertive Trade Policy Brussels, 18.2.2021 COM(2021) 66 final ANNEX, at pp. 9-10.

firms."[12] These recent statements are in line with the EU's policy of developing transnational or regional solutions to remove distortive subsidies and increase transparency. Indeed, the EU has pursued this policy "bilaterally and regionally building support within the WTO for its own regulatory positions,"[13] and it already advanced in its 2019 Global Strategy its intention to continue this policy, "notably to strengthen rules on subsidies."[14]

In this context, the adoption of the Foreign Subsidies Regulation ("FSR") can be seen as a complementary step towards the limitation of distortive subsidies granted by non-EU countries in line with previous initiatives. In particular, the FSR aims to address a gap in EU Law, which the previously-described measures do not fully solve, namely the distortive effects in the EU internal market of subsidies granted by non-EU countries.

II. THE ADOPTION AND MAIN CONTENT OF THE FSR

A few weeks after the publication of the above-referred Franco-German manifesto, which *inter alia* suggested to examine the possibility of considering "whether a right of appeal of the Council which could ultimately override Commission decisions could be appropriate in well-defined cases, subject to strict conditions,"[15] the European Council, i.e. the Heads of State or Government of the EU Member States, noted that the European Commission "intends to identify before the end of the year how to fill gaps in EU law in order to address fully the distortive effects of foreign state ownership and state-aid financing in the Single Market."[16]

On June 17, 2020, the European Commission issued a White Paper on levelling the playing field as regards foreign subsidies, a day after the publication of the road map for Trade policy review, including WTO reform initiative.[17] Subsequently, the Commission proposed the FSR on May 5, 2021 under internal market and common commercial policy legal bases, namely Articles 114 TFEU and 207 TFEU. Following the ordinary legislative procedure, the FSR was agreed by the Parliament and the Council in June 2022 (on the last day of the French Presidency of the Council), and the final text of the Regulation was adopted on November 10, 2022 by the Parliament and on November 28, 2022 by the Council, which is a remarkably fast legislative procedure that shows the broad support of the EU legislators to the Commission´s initiative. The FSR entered into force on January 12, 2023.

The FSR aims, as established in its Article 1, "to contribute to the proper functioning of the internal market by establishing a harmonized framework to address distortions caused, directly or indirectly, by foreign subsidies, with a view to ensuring a level playing field."[18] Under the FSR, as the Commission has summarized, "the Commission will have the power to investigate financial contributions granted by non-EU governments to companies active in the EU. If the Commission finds that such financial contributions constitute distortive subsidies, it can impose measures to redress their distortive effects. [The FSR introduces] three new tools:

- A notification-based tool to investigate concentrations involving a financial contribution by a non-EU government, where the acquired company, one of the merging parties or the joint venture generates an EU turnover of at least €500 million and the transaction involves a foreign financial contribution of more than €50 million;
- A notification-based tool to investigate bids in public procurements involving a financial contribution by a non-EU government, where the estimated contract value is at least €250 million and the bid involves a foreign financial contribution of at least €4 million per third country; and
- A general tool to investigate all other market situations, where the Commission can start a review on its own initiative (ex-officio) or it request an ad-hoc notification for smaller concentrations and public procurement procedures."[19]

The FSR will start to apply on July 12, 2023, when the Commission will be able to start *ex officio* investigations. A few months later, on October 12, 2023, the notification obligation for concentrations and public procurement above certain thresholds will start to apply. For these

12 *Id.* at p. 10.

13 Marise Cremona, "The Single Market as a Global Export Brand: Exporting the Single Market," European Business Law Review, 21, 5, 663-680, at p. 670.

14 "The EU Global Strategy in Practice - Three years on, looking forward," p.20, available at https://eeas.europa.eu/sites/eeas/files/eu_global_strategy_2019.pdf.

15 A Franco-German Manifesto for a European industrial policy fit for the 21st Century, available at https://www.bmwk.de/Redaktion/DE/Downloads/F/franco-german-manifesto-for-a-european-industrial-policy.pdf%3F__blob%3DpublicationFile%26v%3D2.

16 European Council meeting (21 and 22 March 2019), Conclusions, available at https://data.consilium.europa.eu/doc/document/ST-1-2019-INIT/en/pdf.

17 Available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12451-EU-trade-investment-policy-review_en.

18 Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market, DO L 330 de 23.12.2022, p. 1/45, at Article 1.1.

19 Information available at https://competition-policy.ec.europa.eu/foreign-subsidies-regulation_en.

purposes, the Commission published on February 6, 2023 a draft Implementing Regulation and invited interested parties to submit their comments.

Under the regulation, several successive steps must be taken before the Commission can adopt redressive measures or accept commitments in relation to foreign subsidies. In particular, (i) the Commission must establish the existence of a foreign subsidy, (ii) the Commission will then assess whether the subsidy causes a distortion, if so, (iii) the Commission will balance the positive and negative effects of the subsidy, and (iv) if the negative effects outweigh the positive ones the Commission may adopt redressive measures, such as the divestment of assets, or accept commitments. Some issues can be identified for each of the steps. We will focus on these steps.

Regarding the existence of a foreign subsidy, Article 3.1 FSR provides that "a foreign subsidy shall be deemed to exist where a third country provides, directly or indirectly, a financial contribution which confers a benefit on an undertaking engaging in an economic activity in the internal market and which is limited, in law or in fact, to one or more undertakings or industries."[20] Article 3.2 FSR provides clarifications on the notion of financial contribution, a very broad notion that encompasses many measures that would amount to State aid under Article 107(1) TFEU, save for the requirements of distortion of competition and effect on trade.

The terminology used by Article 3 is however closer to that employed in the WTO context, in particular in the Agreement on Subsidies and Countervailing Measures (e.g. benefit instead of advantage), that contains a definition of subsidy that is similar but not identical in scope to the notion of State aid under Article 107(1) TFEU. In this regard, it remains to be seen how the EU Courts will interpret these provisions, also in light of their traditional reluctance to use WTO concepts in the context of the application of the EU State aid rules.

Indeed, the General Court has held that "The reference to the concept of 'subsidy' within the meaning of the WTO Agreement on Subsidies and Countervailing Measures has, as the Commission submits, no relevance whatsoever to the classification of the measure in question as State aid within the meaning of Community law."[21] Similarly, the Court of Justice has held that "the fact that the contested aid would not be considered to be a "specific subsidy" under the Agreement on Subsidies cannot reduce the scope of the definition of aid under Article 92(1) of the Treaty."[22]

In this context, it might also be worth recalling the well-settled *Polydor* case-law, according to which "the interpretation given to the provisions of European Union law, including Treaty provisions, concerning the internal market cannot be automatically applied by analogy to the interpretation of an agreement concluded by the European Union with a non-Member State, unless there are express provisions to that effect laid down by the agreement itself."[23] Finally, the preamble of the FSR states that the Regulation should be applied and interpreted in light of the relevant Union legislation, "including that relating to State aid," which could hint to an interpretation of the relevant provision closer to the notion of State aid under Article 107(1)TFEU.[24]

Regarding the existence of a distortion caused by the foreign subsidy, Article 4 FSR explains that "A distortion in the internal market shall be deemed to exist where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market and where, in doing so, that foreign subsidy actually or potentially negatively affects competition in the internal market."[25] This presumption is in line with that applicable under EU State aid law in relation to the criterion of distortion of competition. As the European Commission has summarized, "for all practical purposes, a distortion of competition within the meaning of Article 107(1) of the Treaty is generally found to exist when the State grants a financial advantage to an undertaking in a liberalized sector where there is, or could be, competition."[26] Similarly, Union Courts have consistently held that "where State financial aid strengthens the position of an undertaking as compared with other undertakings competing in intra-[Union] trade, the latter must be regarded as affected by the aid."[27] Public support can therefore be usually considered as capable of having an effect on trade between Member States.

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20 Regulation (EU) 2022/2560, cit., at Article 3.1.

21 T-55/99, *CETM v. Commission*, ECLI:EU:T:2000:223, paragraph 50.

22 C-409/00, *Spain v. Commission*, EU:C:2003:92, paragraph 56.

23 See for a recent Grand Chamber reference to this case-law C-221/11, *Demirkan*, EU:C:2013:583, paragraph 44 and case-law cited.

24 Regulation (EU) 2022/2560, *cit.*, at Preamble, paragraph 9.

25 *Id.* Article 4.1

26 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, C/2016/2946, OJ C 262, 19.7.2016, p. 1–50, at page 41.

27 C-518/13, *Eventech v. The Parking Adjudicator*, ECLI:EU:C:2015:9, paragraph 66.

However, Article 4.1 FSR clarifies that "A distortion in the internal market shall be determined on the basis of indicators, which can include, in particular, the following: (a) the amount of the foreign subsidy; (b) the nature of the foreign subsidy; (c) the situation of the undertaking, including its size and the markets or sectors concerned; (d) the level and evolution of economic activity of the undertaking on the internal market; and (e) the purpose and conditions attached to the foreign subsidy as well as its use on the internal market."[28]

These requirements appear to be *prima facie* more demanding than those applicable under EU State aid law, where the abovementioned presumptions have not been qualified in this way. However, it should be noted that Article 4.2 FSR adds that where the total amount of a foreign subsidy to an undertaking does not exceed EUR 4 million over any consecutive period of three years, that foreign subsidy shall be considered unlikely to distort the internal market, a presumption that does not apply in the State aid field. In addition, Article 5 FSR defines a number of categories of foreign subsidies most likely to distort the internal market, some of which could already be found in recent trade agreements signed by the EU, in particular foreign subsidies granted to an ailing undertaking, or in the form of an unlimited guarantee for the debts or liabilities of the undertaking.[29]

Regarding the third step, the balancing test, Article 6 FSR provides that "the Commission may, on the basis of information received, balance the negative effects of a foreign subsidy in terms of distortion in the internal market, according to Articles 4 and 5 against the positive effects on the development of the relevant subsidized economic activity on the internal market, while considering other positive effects of the foreign subsidy such as the broader positive effects in relation to the relevant policy objectives, in particular those of the Union."[30]

In relation to this examination, while the negative effects must be felt in the internal market under Article 6 FSR, the regulation acknowledges that in the assessment of the positive and negative effects of a foreign subsidy, positive effects other than those that take place in the internal market (e.g. environmental protection carried out abroad) "should be taken into account, where appropriate, in order to avoid that the balancing gives rise to unjustified discrimination."[31] In this regard, it is submitted that the EU State aid regulations, in particular the so-called GBER,[32] and soft law instruments concerning the compatibility of State aid measures with the internal market, such as the Guidelines on State aid for climate, environmental protection and energy,[33] will be a relevant benchmark against which to carry out, *mutatis mutandis*, the balancing test under the FSR in order to avoid unjustified discrimination when compared to State aid given by Member States to companies operating in the internal market. To this extent, as explained in the FSR's preamble, "The Commission should also examine broader positive effects in relation to the relevant policy objectives, in particular those of the Union. Those policy objectives can include, in particular, a high level of environmental protection and social standards, and the promotion of research and development."[34]

Finally, concerning the adoption of redressive measures or the acceptance of commitments, Article 7 FSR allows the Commission to adopt redressive measures in order to remedy the distortion in the internal market actually or potentially caused by a foreign subsidy, unless it has accepted commitments offered by the undertaking under investigation, where such commitments fully and effectively remedy the distortion in the internal market.[35] The FSR mentions some remedies as examples, such as reducing capacity or market presence, including by means of a temporary restriction on commercial activity, refraining from certain investments, requiring the undertakings to dissolve the concentration concerned, or the repayment of the foreign subsidy, including appropriate interest.[36]

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28 Regulation (EU) 2022/2560, cit., Article 4.1.

29 Agreement between the European Union and Japan for an Economic Partnership, [2018] OJ L 330, at article 12.7, which defines as prohibited subsidies: "(a) legal or other arrangements whereby a government or a public body is responsible for guaranteeing debts or liabilities of an enterprise, without any limitation as to the amount and duration of such guarantee; and (b) subsidies for restructuring an ailing or insolvent enterprise without the enterprise having prepared a credible restructuring plan. Such a restructuring plan shall be prepared within a reasonable time period after such enterprise having received temporary liquidity support. The restructuring plan shall be based on realistic assumptions with a view to ensuring the return to long-term viability of the ailing or insolvent enterprise within a reasonable time period. The enterprise itself or its owners shall contribute significant funds or assets to the costs of restructuring."

30 Regulation (EU) 2022/2560, cit., Article 6.1.

31 *Id.* preamble at paragraph 21. See also in relation to the WTO non-discrimination requirements and the application of the FSR, Morris Schonberg, "The EU Foreign Subsidies Regulation: Substantive Assessment Issues and Open Questions," EStAL 2|2022, at pages 146 and 151.

32 Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, DO L 187 de 26.6.2014, p. 1/78.

33 Communication from the Commission – Guidelines on State aid for climate, environmental protection and energy 2022, DO C 80 de 18.2.2022, p. 1/89.

34 Regulation (EU) 2022/2560, preamble at paragraph 21.

35 Regulation (EU) 2022/2560, article 7.1 and 7.2.

36 *Id.* article 7.4.

Interestingly, in relation to the latter, the EU legislators appear to be well-aware of the difficulties that the European Commission might face to verify compliance with this commitment, and the ensuing risk of circumvention that exists in the absence of enforcement and monitoring tools.[37]In this regard, the regulation clarifies that "where the undertaking under investigation proposes to repay the foreign subsidy including an appropriate interest rate, the Commission shall accept such repayment as commitment only where it can ascertain that the repayment is transparent, verifiable and effective, while taking into account the risk of circumvention."[38]

III. SOME CONCLUSIONS

The FSR addresses a gap in European Union Law related to distortions caused by subsidies granted by non-EU countries, therefore outside the scope of the State aid rules, that cause distortions in the internal market. This legal gap has been identified for a long time, so one could wonder what has triggered the adoption of the FSR at this particular moment. The paralysis of the multilateral trading system in recent years, the withdrawal of the United Kingdom from the EU, becoming a non-EU jurisdiction also for the purposes of the FSR, the global geopolitical context, pointing towards a multipolar world, or the EU´s more assertive and independent stand in international relations after the adoption of the Open Strategic Autonomy might have been some of the elements taken into account when considering this proposal, as well as the increasing complaints of industry and some Member States, exemplified by the Franco-German Manifesto. To this extent, the preamble of the FSR states that "The proper application and enforcement of this Regulation are to contribute to the resilience of the internal market against distortions caused by foreign subsidies and thereby contribute to the Union's open strategic autonomy."[39] This notwithstanding, the regulation also makes clear that the Union intends to honor its international obligations and particularly those made under WTO Law.[40] In addition, the FSR foresees the possibility of abrogating the Regulation, "if the Commission considers that multilateral rules to address foreign subsidies distorting the internal market have rendered this Regulation fully redundant."[41]

The FSR has a very far-reaching scope, which poses challenges for legal certainty. The definition of financial contribution is significantly broad, and there is notable uncertainty as to how the Commission will apply the criteria for distortion or the balancing test. In this regard, the regulation tasks the European Commission to "publish and regularly update guidelines regarding the criteria for determining the existence of a distortion caused by a foreign subsidy on the internal market, the application of the balancing test, the application of its power to request a prior notification of any concentration or foreign financial contributions received by an economic operator in a public procurement procedure, and the assessment of a distortion in a public procurement procedure. When issuing such guidelines, the Commission should conduct appropriate consultations with stakeholders and Member States. In order to facilitate the implementation of this Regulation in the early stages of its application, the Commission should endeavor to make public clarifications on the application of those provisions before the publication of the guidelines."[42]These clarifications will certainly be welcomed, and the EU Courts will probably be called upon to further refine the different tests.

The reporting obligations are also very exacting. To this extent, several stakeholders that have participated in the consultation of the FSR Draft Implementing Regulation have criticized the notification requirements under the FSR. For instance, the German Federal Government has held that "the goal of the Regulation is to have a stringent tool to act in cases of foreign subsidies distorting the internal market, but not to make unnecessary red tape, useless data piles and create asymmetric bureaucratic costs for European industry. The drafts foresee an extensive notification system which creates enormous burden for undertakings as well as the Commission."[43] The enforcement of the new instrument will therefore be exigent.

Finally, the implementation of the new instrument in future years will also be key to assess whether the FSR will trigger a global reaction, and particularly a risk of retaliation by other international trade partners that could set up similar schemes to the detriment of the multilateral control of subsidies. The reaction might also be positive, as stakeholders around the world might become more aware of the often distortive and wasteful character of many subsidies, for instance to ailing firms, and their negative effect on competition and public finances.

37 See also on this point Morris Schonberg, "The EU Foreign Subsidies Regulation: Substantive Assessment Issues and Open Questions," EStAL 2|2022, at page 151.

38 Regulation (EU) 2022/2560, article 7.6.

39 Regulation (EU) 2022/2560, preamble at paragraph 7.

40 *Id.* article 44.9. See also the preamble, at paragraph 69.

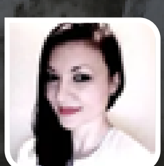
41 *Id.* Article 52.3(e).

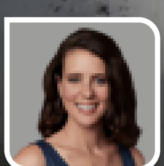
42 *Id.* Preamble, paragraph 73.

43 Statement by the Federal Government on the Implementing Regulation pursuant to the Regulation on foreign subsidies distorting the internal market, available at https://www.bmwk.de/Redaktion/EN/Downloads/I/implementing-regulation-pursuant-to-the-regulation-on-foreign-subsidies-distorting-the-internal-market.pdf?__blob=publicationFile&v=2.

TRANSNATIONAL SUBSIDIES: ACHILLES' HEEL FOR FOREIGN INVESTMENT, TRADE, AND COMPETITION

BY GEORGIANA POP & ANA AMADOR[1]





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Since the global financial crisis of 2008, subsidies became the most significant form of government intervention in the global trade arena, having surpassed tariffs and non-tariff measures.[2] More than half of global trade in goods occurs in products and markets in which at least one subsidized firm operates, according to recent estimates.[3] Globally, subsidies target agriculture, manufacturing, including motor vehicles, machinery, ships, and electronics as well as R&D and energy.[4] Grants represent more than half of subsidy programs, followed by tax incentives, and loans.[5] The European Union ("EU"), the United States ("U.S."), and China accounted for 75 percent of measures in place across a wide range of countries.[6] Subsidies by these large economies that are also significant global trade players can have large cross-border effects in many economies around the globe.

Because subsidies grant recipient firms a comparative advantage over their non-recipient competitors in the international and domestic markets that is not necessarily associated with efficiency, subsidies are generally controlled to safeguard effective international trade, competition, and the efficient management of fiscal resources. Rules governing the granting of subsidies to limit their unintended consequences can be introduced, either as part of the competition rules or as pro-competitive regulation aimed at avoiding discriminatory treatment in favor of certain market players.[7] The literature noted few takeaways on the impact of subsidies on trade and competition. Besley & Seabright (1999) found that aid is less likely to distort competition if the aid is granted to a few firms with no significant market power.[8] Aghion, Cai, Dewatripont, Du, Harrison & Legros (2015) found that aid provided to many firms in a sector with low degree of concentration would enhance innovation and productivity growth.[9]

I. WHAT IS A TRANSNATIONAL SUBSIDY?

Scholars define a transnational subsidy as "a subsidy granted to a benefit recipient manufacturing the product at issue outside the country of the granting government."[10] The notion of transnational or foreign subsidy is broad and covers direct grants, loans, guarantees, tax measures, preferential procurement conditions and government ownership or control.

II. AN INTERNATIONAL LEGAL FRAMEWORK THAT GENERATES DEBATE ON THE TREATMENT OF TRANSNATIONAL SUBSIDIES

Subsidies are regulated under the World Trade Organization ("WTO") Subsidies and Countervailing Measures ("SCM") Agreement. The definition contains three basic elements: (i) a financial contribution (ii) by a government or any public body *within the territory* of a Member (iii) which confers a benefit. All three elements must be satisfied for a subsidy to exist. It is unclear whether the term "*within the territory*" refer to the granting body - i.e. any public institution, sub-national governments, and state-owned entities - or the location of the recipient of the financial contribution.[11] The WTO acknowledged this gap back in 2004, when it addressed the applicability of the subsidy discipline to international assistance by multilateral institutions.[12]

2 IMF, OECD, World Bank, and WTO (2022) "Subsidies, Trade, and International Cooperation."

3 *Ibid.*

4 *Ibid.*

5 *Ibid.*

6 World Bank (2022), "Unfair Advantage: Distortive Subsidies and Their Effects on Global Trade."

7 See, for example, the Code of Conduct agreed between provinces and territories of Canada and the legislation introduced in Australia to prevent internal relocation of firms motivated by subsidies (Interstate Investment Cooperation Act). For an analysis of both instruments see Kenneth P. Thomas, *Investment Incentives and the Global Competition for Capital*, Palgrave Macmillan 2011, pp. 155-162.

8 Besley T. & Seabright P. (1999), "State aids Making EU policy properly reflect geography and subsidiarity," *Economic Policy*, 14:28.

9 Aghion, P., Cai, J. Dewatripont M., Du, L., Harrison, A. & Legros, P. (2015), "Industrial Policy and Competition," *American Economic Journal: Macroeconomics*, 7:4, October.

10 Marc Benitah, The Wto Law of Subsidies, a Comprehensive Approach, 605 (Wolters Kluwer, 2019).

11 The Appellate Body in US – *Countervailing Measures (China)*, para. 4.42 defined the notion of "government" as encompassing "*both the government in the 'narrow sense' and 'any public body within the territory of a Member.'*" Thus, the Appellate Body referred to the financing authority in interpreting "within the territory." Yet, the Appellate Body has not gone as far as to confirm that transnational subsidies fall under the scope of the SCM Agreement.

12 See WTO, Note by the Secretariat, WT/WGTDF/W/22 (March 16, 2004) at para. 21.

There is a lively debate and limited consensus as to whether the WTO SCM Agreement apply to transnational subsidies and, if it does, to which extent. While some scholars consider transnational subsidies can be assimilated to international assistance to multilateral institutions, thus falling outside the scope of the SCM Agreement, others interpret "within the territory" as referring to the granting authority, with no territorial limitation as to the recipient. In the middle, some commentators consider that transnational subsidies should be subject to the WTO SCM Agreement only if the constitute "prohibited subsidies"[13] (i.e. financing is contingent in law or in fact on export performance), but not when they constitute "actionable subsidies"[14] (i.e. subsidies that are not prohibited, but can be challenged either through dispute settlement or countervailing measures due to their negative impact on trade).[15] Because most of the subsidies fall under the category of "actionable subsidies" (e.g. production subsidies), this interpretation would leave outside the scope of the WTO SCM Agreement most of transnational subsidies, unless the petitioner provides evidence that the measure is *de facto* tied to export (although not stated in law as an eligibility criteria).

Some countries including the U.S. and the EU economies have taken advantage of this regulatory gap to develop legislative initiatives and enforcement actions tackling the distortions generated by transnational subsidies.

III. BOTH SIDES OF THE ATLANTIC ACTED, BUT HOW CAN THE NEW RULES AIMING TO DISCIPLINE TRANSNATIONAL SUBSIDIES IMPACT LOW- AND MIDDLE-INCOME ECONOMIES?

A. United States

Since the 1980s, the U.S. has traditionally excluded transnational subsidies from countervailing regulations. Under 19 Code of Federal Regulations (C.F.R.) § 351.527 a subsidy does not exist if the Secretary of Commerce determines that the program is funded "by the government of a country other than the country in which the recipient firm is located."

This situation, however, is shifting following the introduction of two proposed bills in June and December 2021.[16] The draft bills (S.1187 - Eliminating Global Market Distortions To Protect American Jobs Act of 2021 and H.R.6121 - Eliminating Global Market Distortions to Protect American Jobs Act of 2021) propose empowering U.S. Commerce Department to countervail subsidies offered to producers and exporters in the country under investigation granted by a government located elsewhere.[17] The subsidies would be accumulated with those offered by the country targeted under investigation in instances where the country "*facilitates*" the provision of subsidy.[18]

In addition, the draft America Creating Opportunities for Manufacturing, Pre-Eminence in Technology, and Economic Strength ("COMPETES") Act of 2022, also proposes allowing Commerce to investigate cross-border subsidies and strengthening circumvention investigations.

None of these bills have been enacted into law.[19] In the meantime, the U.S. is using enforcement actions including anti-circumvention instruments (i.e., trade measures targeting practices consisting in completing or assembling products in a country different to the one targeted by an anti-dumping ("AD") or countervailing duty ("CVD") order). Specifically, anti-circumvention instruments are being used to target: (i) foreign manufacturers that process Chinese subsidized inputs,[20] and (ii) subsidiaries of Chinese firms established abroad. The circumvention instrument

13 Article 3 SCM.

14 Article 5 SCM

15 See William Alan Reinsch & Sparsha Janardhan, Center for Strategic and International Studies ("CSIS"), Crossing the Line, International subsidies (January 14, 2022), (with references to Gary Horlick, Gustavo Hernandez, and Crochet & Hegde, https://www.csis.org/analysis/crossing-line-transnational-subsidy.

16 The draft bills proposed to amend Section 771 of the Tariff Act of 1930 (19 U.S.C. 1677) (adopting the SCM Agreement definition of "subsidy") to encompass "transnational subsidies." S.1187 - Eliminating Global Market Distortions To Protect American Jobs Act of 2021 §301.

17 H.R.6121 - Eliminating Global Market Distortions to Protect American Jobs Act of 2021 §201.

18 Although the bills are not specifically targeted against China, the summary of the bill by the Congressional Research Services mentions that the initiative "would allow Commerce to ensure that the countervailing duty laws apply to China's Belt and Road Initiative subsidies, which benefit China-based or China-operated firms operating in countries outside of China." https://www.brown.senate.gov/imo/media/doc/eliminating_global_market_distortions_to_protect_americans_jobs_act_section-by-section.pdf.

19 The COMPETES Act of 2022 was substituted by United States Innovation and Competition Act of 2021.

20 The use of the circumvention authority has been expanded, as it targeted initially slight modifications or assembly of parts in third countries. *See*: Victor Crochet, International Economic Law and Policy Blog, Guest Post: The Imitation Game: Recent Developments on Transnational Subsidies and Anticircumvention in Europe and the United States. (Mar. 16, 2022),: https://ielp.worldtradelaw.net/2022/03/guest-post-the-imitation-game-recent-developments-on-transnational-subsidies-and-anticircumvention-i.html.

was amended in September 2021.[21] It requires simplified investigation compared to AD, CVD, and permits extending non-market economy treatment to trade originating in market economy countries.[22]

This has implications for other high-income and low- and middle-income economies. For example, in December 2021, the U.S. Department of Commerce ("USDOC") found that imports of welded oil country tubular goods ("OCTG") completed in Brunei or the Philippines using inputs manufactured in China are circumventing the antidumping and countervailing duty orders on OCTG from China.[23] The circumvention case on solar modules and cells produced in Cambodia, Malaysia, Thailand, and/or Vietnam with input "minimally processed"[24] from China has been in the spotlight, after the U.S. Department of Labor finding relating raw material (polysilicon) to forced labor.[25] [26]

In addition, in ***mergers*** involving foreign government subsidies, the U.S. Federal Trade Commission and the U.S. Department of Justice may determine whether the acquisition, if consummated will violate antitrust rules. Specifically, on December 29, 2022, President Biden signed into law the "Consolidated Appropriations Act, 2023," which includes the Merger Filing Fee Modernization Act of 2022. As such, any person submitting a filing that received a subsidy from a "foreign entity of concern" must disclose information about those subsidies during the notification process. Thus, there is still reliance on instruments from traditional antitrust regulation addressing the cross-border subsidies in the context of M&A, although the notion of "person of concern" brings-up elements of national security.[27]

B. The European Union

The EU has targeted transnational subsidies in countervailing investigations initiated against the recipient country ***in the context of international trade policy.*** For example, the EU has instituted countervailing measures on imports of certain woven and/or stitched glass fiber fabrics originating in Egypt in 2020.[28] The merchandise was manufactured by Jushi Egypt and Hengshi Egypt, two Egyptian subsidiaries of the China National Building Materials Group, a Chinese SOE. Jushi and Hengshi manufactured the merchandise in the Suez Economic and Trade Cooperation Zone ("SETC Zone"), a special economic zone which was jointly established by the Government of China ("GOC") and the Government of Egypt ("GOE"). The European Commission found that the GOE agreed to support the zone not only through tax breaks, but also agreed to the GOC providing financial assistance.[29]

More recently, the EU imposed countervailing duties on imports of stainless-steel cold-rolled flat products originating in India and Indonesia (March 15, 2022).[30] The European Commission assessed cooperation between Indonesia and China for the development of the Morowali Industrial Park run by the China's Shanghai Decent Investment (Group), the holding company of Tsingshan Group. The European Commission concluded that China provided preferential financing to Indonesia for production, and that the pooling of resources by China and Indonesia provided a specific benefit to the firms operating in the Morowali Industrial Park.[31]

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21 19 Fed. Reg. 52300.

22 *Ibid.*

23 Oil Country Tubular Goods From the People's Republic of China: Final Affirmative Determinations of Circumvention, (Nov. 26, 2021), (86 Fed. Reg. 67443).

24 USDOC press release, Department of Commerce Issues Preliminary Determination of Circumvention Inquiries of Solar Cells and Modules Produced in China (Dec. 27, 2022), https://www.commerce.gov/news/press-releases/2022/12/department-commerce-issues-preliminary-determination-circumvention.

25 U.S. Department of Labor press release, US Department of Labor adds polysilicon from China to "List of Goods produced by Child labor or forced labor." (Jun 24, 2021), https://www.dol.gov/newsroom/releases/ILAB/ILAB20210624.

26 See Senator Brown comments on proposed bill Eliminating Global Market Distortions to Protect American Jobs Act, ("This bipartisan bill will strengthen our antidumping and countervailing duty laws to challenge China's unfair trade practices and protect American jobs in sectors that are important to Ohio."), https://www.brown.senate.gov/newsroom/press/release/brown-legislation-strengthen-trade-laws-protect-american-workers.

27 The notion of "entities of concern" includes (i) entities owned or controlled by a person subject to the jurisdiction or direction of China, Russia, Iran, or North Korea; (ii) foreign terrorist organizations; (iii) persons targeted with asset freezes by OFAC ("SDNs"); (iv) entities involved under the Espionage Act; Export Control Act, Atomic Energy Act found to have been involved in an activity detrimental to national security.

28 Commission Implementing Regulation (EU) 2020/776, OJEU, (Jun 15, 2020), L 189/1; Commission Implementing Regulation (EU) 2020/870, OJEU, (Jun. 24, 2020), L201/10.

29 See commentary by Congressional Research Service, Trade Remedies, Countervailing duties (Aug. 23, 2021), https://crsreports.congress.gov/product/pdf/R/R46882#:~:-text=Countervailing%20duty%20(CVD)%20laws%20provide,produced%20in%20the%20United%20States.

30 Commission implementing Regulation (EU) 2022/433, OJEU (Mar.16, 2022), L 88/24.

31 In both cases, the European Commission rejected the Government of China contention that by countervailing Chinese support, the EU was in contravention of the SCM Agreement. The European Commission argued that the terms "by a government" need to be interpreted inter alia in light of Article 11 of the ILC Articles on State Responsibility for Internationally Wrongful Acts ('ILC Articles'), according to which "conduct can be attributed to a State 'if and to the extent that the State acknowledges and adopts the conduct in question as its own.'"

In both cases, the European Commission examined whether the conduct of a foreign government should be attributed to the exporting country as providing those subsidies indirectly via the foreign government, as agreed by both governments. When a demonstrable, explicit link is established between the exporting country and the foreign government granting the subsidy, the exporting country is considered accountable for having actively sought, acknowledged, and adopted as its own such subsidies for the benefit of products produced in the exporting country. While both cases have been appealed to the General Court,[32] one of them has been appealed to the WTO. The latter might bring the first opportunity for a panel to interpret the applicability of WTO SCM to transnational subsidies.[33]

The EU has also designed ***initiatives aiming to safeguarding EU internal market***. The EU initiative is the first of this kind in the world. Specifically, in 2022, it adopted the Foreign Subsidies Regulation ("FSR") addressing the negative impact for the EU internal market of financial contributions granted by non-EU governments to firms active in the EU.[34] The FSR entered into force on January 12, 2023,[35] and introduces three main tools for disciplining foreign subsidies:

· *Control of mergers and acquisitions*: Compulsory *ex ante* notification of mergers and acquisitions involving a financial contribution by a non-EU government, where the acquired company, one of the merging parties or the joint venture generates an EU turnover of at least €500 million and the transaction involves a foreign financial contribution of more than €50 million.

· *Control of foreign public procurement*: Compulsory *ex ante* notification of bids in public procurement processes involving a financial contribution by a non-EU government when the estimated contract value is at least €250 million, and the bid involves a foreign financial contribution of at least €4 million per third country; and

· *Control on all other market situations*: The Commission can start a review on its own initiative or at the request of an interested party for smaller-sized concentrations or public procurement procedures.[36]

The implementation of the FSR[37] raises several questions. For instance, given the extensive notion of "financial contribution" it may be difficult for firms to map the exact financial support. Firms are also required to conduct a market economy test to check whether the financial contribution provided an advantage to the recipients. In addition, parties need to indicate any potential distortive effect in the internal market, and the benefit to the parties' business in the EU.[38] If a foreign subsidy is found to distort the single market, the European Commission has the power to impose structural and non-structural redressive measures, or accept commitments to remedy the distortions (e.g. divestment of certain assets or prohibition of a certain market conduct). Failure to notify[39] under the two *ex ante* mechanisms may result in a penalty amounting to 10 percent of the aggregate turnover, whereas the provision of incorrect, misleading, or incomplete information may lead to fines equaling 1 percent of the global turnover.

This EU initiative has been criticized for being considered too protectionist.[40]

32 The two European Commission decisions have been challenged before the General Court of the European Union ("GC"). The EU issued judgment in case in case T-480/20 - *Hengshi Egypt Fiberglass Fabrics and Jushi Egypt for Fiberglass Industry v. Commission*. The General Court sustained the Commission Regulation and concluded that the terms "within the territory of a country" under Article 1.1 SCM Agreement "do not preclude the possibility of concluding that the financial contributions may be attributed to the country of origin or export of the product concerned."

33 Request for consultation by Indonesia, Anti-dumping and countervailing duties on stainless steel product from Indonesia, (Jan 26, 2023), WT/DS616/1, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/DS/616-1.pdf&Open=True.

34 The European Commission further published a Draft Implementing Regulation, laying down the procedural rules related to the application of the FSR. See also Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market, OJ L 330, 23.12.2022, p. 1–45.

35 The FSR will start applying from July 12, 2023, and the notification requirement will enter into force on October 12, 2023.

36 The level of information that the parties will have to provide to the Commission is extensive, including a summary description of the deal or tender, information about the parties, detailed information about the financial contributions received in the past three years, information about the bidders, etc.

37 See https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13602-Distortive-foreign-subsidies-procedural-rules-for-assessing-them_en.

38 The Commission has large investigative powers that mirror the ones under merger control, including request for information to the parties (and to third countries contracting authorities), conducting interviews, inspections within and outside the territory of the Union, impose fines on entities failing to cooperate or provide the requested information.

39 The new notification requirement under the FSR will impact the timetable that parties may have initially projected for concluding a deal. In addition, the parties will need to deal with risk allocation as the application of FSR may result in the prohibition of concluding the deal.

40 Sherman & Sterling, EU takes another big protectionist step as new foreign subsidies regulation comes into force, (Jan 20, 2023), https://www.shearman.com/en/perspectives/2023/01/eu-takes-another-big-protectionist-step-as-new-foreign-subsidies-regulation-comes-into-force#:~:text=The%20EU%20Foreign%20Subsidies%20Regulation,granted%20by%20non%2DEU%20countries.

IV. WHERE DO WE GO FROM HERE AND ARE THERE RISKS TO BE AWARE OF?

Globally, there is still room for clarifying what transnational subsidies are, and how their distortive effects can be tackled from a policy and regulatory perspective.

First, at the WTO, there is an opportunity to clarify whether transnational subsidies are covered under the WTO SCM. This is offered by the recent case at the WTO regarding the anti-dumping and countervailing duties on stainless steel product from Indonesia.[41] However, the case might never reach the report stage.

Second, it is questionable whether every export subsidy can fall under the WTO SCM or only prohibited export subsidies. In addition, there is no practice as to what can amount to a transnational export subsidy. So far, the practice in the EU has targeted subsidies to Chinese subsidiaries established in free economic zones and oriented towards export. On the other hand, the increased investment (especially foreign investment) in a country can lead to the development of an industry and increased foreign trade. If transnational subsidies are associated with foreign investment, low- and middle-income countries might not even be aware of the perils of being targeted by transnational subsidies investigations. This is also because there is no tested evidence on what mechanisms can be put in place by a low- or middle-income country within the framework of bilateral investment negotiations to avoid the risks of being targeted by transnational subsidies investigations.

Third, there is a question as to the target of transnational subsidies enforcement: should it only address China countervailing practices? Should it be directed against projects in the Belt and Road Initiative ("BRI") as a mechanism through which China asserts global economic leadership and control of core technologies and supply chains? Should it target Non-Market Economy countries or other countries? The U.S. in its Filing Fee Modernization Act also targets entities in Russia, Iran or North Korea based on "national security" claims. Thus, there is a risk of political use of the enforcement against transnational subsidies, particularly in a context where the notion of national security combines military, political and economic policy considerations.

Fourth, it is important to reflect on the regulatory framework that can better address the distortive effects of transnational subsidies. The U.S. and EU regulatory initiatives and enforcement activities take elements from different areas of law, notably trade defense (countervailing and circumvention investigations), merger control, and foreign investment law. In this respect, there is a risk that regulators attempt to use existing instruments to address the potential distortive effects of transnational subsidies which cannot capture their complexities. As an example, the exercise of gathering information in a merger control review in the EU is relatively straight-forward. The same fact gathering exercise is more complex for firms in low- and middle-income economies, or subsidiaries participating in public procurement processes which might not have visibility on the subsidies received by the parent company. Further, firms might not associate M&A or participation in public procurement with the obligation to disclose subsidies from foreign governments. Similarly, remedies (structural, behavioral) that mirror the ones under merger control might not be as effective to tackle the potential distortionary effects of transnational subsidies.

Finally, there is also a risk that low- and middle-income economies receiving foreign investment are not always keeping pace with the regulatory changes and practice occurring in high-income economies, such as those in the U.S. or EU. These regulatory initiatives might have a decisive impact on exporting firms in low- and middle-income economies and their ability to connect to new markets and integrate into global value chains. Moreover, low- and middle-income countries might not contemplate the introduction of similar oversight mechanism on foreign investment, which if subsidized might distort domestic trade and competition.

In a context where unilateralism has gained momentum, low- and middle-income economies risk being excluded from the debate on transnational subsidies and their potential effects on their external trade. The international financial institutions, such as the World Bank can engage in dialogue with countries implementing initiatives that aim at tackling the distortive effects of transnational subsidies as well as with low- and middle-income economies receiving foreign investments. This is particularly important to seek avenues that can address low- and middle-income economies' foreign trade expansion and mitigate potential negative effects associated with increased protectionism.

41 WT/DS616.

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