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ALERT MEMORANDUM

The European Commission Launches a Public Consultation on a Proposed New Instrument To Address Distortive Effects of Foreign Subsidies in the Internal Market

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On June 17, 2020, in response to calls from the European Council[1] and certain Member States,[2] the European Commission published a White Paper setting out its proposals for a comprehensive set of new tools to tackle the potentially competition-distorting effects of foreign subsidies on the level playing field of the EU internal market. These tools also aim to address existing gaps in EU competition, public procurement, and trade defence rules regarding foreign subsidies.

1. **Rationale of the Commission's Initiative**

The rationale of the Commission's initiative is twofold:

— First, the White Paper seeks to address the undue competitive advantage that certain companies may obtain from subsidies granted by third-country governments. By leveraging their privileged

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[1] See Conclusions of the meeting of March 21-22, 2019.

[2] See the joint letter by France, Germany, Italy and Poland to Competition Commissioner Margrethe Vestager of February 4, 2020 (available at https://g8fip1kplyr33r3krz5b97d1-wpengine.netdna-ssl.com/wp-content/uploads/2020/02/Letter-to-Vestager.pdf), and the Netherlands' *Non-paper - Strengthening the level playing field on the internal market* (available at https://www.permanentrepresentations.nl/documents/publications/2019/12/09/non-paper-on-level-playing-field).

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position, the beneficiary undertakings may unfairly alter the balance of the playing field, either when they operate in the EU market or when they seek to enter it. This concern is especially pronounced in certain sectors: the White Paper mentions aluminium production and semiconductors as possible examples. The Commission is also concerned that, in their domestic legal systems, non-EU State-owned or State-backed companies may be subject to less stringent competition rules and may not be faced with the extensive monitoring and reporting obligations that bind their EU counterparts. Above all, foreign businesses may be allowed access to State subsidies in their jurisdictions without any form of control or limitation. Competition in the internal market may also be distorted by the fact that, due to EU State aid rules, European investors may have to finance their acquisitions with less readily available or more expensive private resources. The Commission's concerns are more pronounced in the current context of the COVID-19 health crisis where strategic EU companies are particularly vulnerable due to volatility or undervaluation on the stock markets.

— Second, the Commission aims to fill perceived gaps in the EU's regulatory arsenal concerning foreign subsidies under State aid, merger control, antitrust, trade defence and public procurement rules. Indeed, EU State aid rules only apply to public support granted by EU Member States, not to subsidies granted by non-EU authorities, even where such foreign subsidies distort competition in the internal market. Moreover, in a growing number of instances, foreign subsidies appear to have facilitated the acquisition of EU companies, distorted the investment decisions, market operations, or pricing policies of their beneficiaries, or distorted bidding in public procurement, to the detriment of non-subsidized companies. Current EU merger and antitrust rules do not allow the Commission to intervene on the ground that an economic operator has benefitted from foreign subsidies. Likewise, existing trade defence rules only relate to exports of goods (as opposed to services) from third countries,[3] while the existing tool for control of foreign direct investment ("FDI")[4] allows the Commission to address some, but by no means all, distortions caused by foreign subsidies.

2. Notion of "Foreign Subsidy" and the *De Minimis* Rule

The White Paper defines a "foreign subsidy" as "a financial contribution by a government or any public body of a non-EU State, which confers a benefit to a recipient in the EU and which is limited, in law or in fact, to an individual undertaking or industry or to a group of undertakings or industries."[5] This definition covers any form of foreign subsidy,[6] irrespective of

[3] See Regulation (EU) 2016/1037 of the European Parliament and of the Council on protection against subsidised imports from countries not members of the European Union (*i.e.*, the anti-subsidy regulation, allowing the EU to react to unfair competition where products have been manufactured with the support of non-EU funding).

[4] See Regulation (EU) 2019/452 of the European Parliament and of the Council of March 19, 2019, establishing a framework for the screening of foreign direct investments into the Union (the "FDI Screening Regulation"). The Regulation encourages Member States to set up FDI screening systems and coordinate their review, and empowers the Commission to issue non-binding opinions on individual cases; See https://www.clearytradewatch.com/2020/04/european-commission-urges-member-States-to-protect-suppliers-of-essential-products-from-foreign-takeovers/m and https://www.clearytradewatch.com/2019/02/new-eu-wide-foreign-direct-investment-screening-system-approved/

[5] The definition of "foreign subsidy" provided in Annex 1 of the White Paper is modelled on the definition of "subsidy" in the EU anti-subsidy regulation (see footnote 3) and in the EU Regulation on safeguarding competition in the air transport sector (Regulation 2019/712 of the European Parliament and of the Council of April 17, 2019).

[6] The relevant financial contribution may consist of: a transfer of funds not made at market conditions (capital injections, grants, loans, loan guarantees, setting off of operating losses, compensation for financial burdens imposed by public authorities); foregone or uncollected public revenue, such as debt forgiveness or rescheduling, preferential tax treatment or fiscal incentives such as tax credits; or the supply or purchase of goods or services at

whether it is granted to: (i) an undertaking established in the EU; (ii) an undertaking established in a third country, where the subsidy is used by a related party established in the EU; or (iii) an undertaking established in a third country, where the subsidy is used to facilitate the acquisition of an EU undertaking or to participate in public procurement procedures.

Under the White Paper's proposed *de minimis* threshold, foreign subsidies below €200,000 provided to a single undertaking over a period of three years are presumed to be unable to cause distortions in the EU internal market.[7]

3. **Three Suggested Options ("Modules") for Addressing the Distortive Effects of Foreign Subsidies**

The White Paper proposes three options ("Modules") to address the distortive effects of foreign subsidies. These may be complementary to one other and are as follows:

i. a general market scrutiny instrument, aimed at capturing all relevant market situations affecting the operation of companies established or active in the internal market (Module 1);

ii. an *ex-ante* approval procedure regarding acquisitions of EU companies (Module 2); and/or

iii. tenderer exclusion in EU public procurement procedures (Module 3).[8]

The Commission also sets out a general approach to foreign subsidies in the context of EU funding.

3.1 Module 1 (General Instrument to Capture Foreign Subsidies to Undertakings Established or Otherwise Active in the EU)

Module 1 addresses the concern that foreign subsidies may create an uneven playing field in which less efficient, subsidized operators increase their market share at the expense of more efficient, unsubsidized competitors. Under the proposed general instrument, the competent supervisory authority ("CSA") – *i.e.*, the Commission and the relevant Member State authorities, which will exercise their respective enforcement powers under a shared review system to avoid duplication – may take action upon receiving information from, *e.g.*, market players or Member States, on foreign subsidies available to undertakings established or otherwise active in the EU.

Under the system of shared enforcement, each national supervisory authority will be empowered to enforce Module 1 in its jurisdiction, defined as the territory of the respective Member State. The Commission will be competent where an undertaking in the EU was entitled to receive a foreign subsidy, irrespective of whether it concerned the territory of one or more Member States.9 The Commission and the Member States will retain discretion in deciding whether to investigate individual cases.

The investigation will begin with a preliminary review phase. Where evidence suggests a foreign subsidy may distort the proper functioning of the internal market, the investigating authority can launch an in-depth investigation.[10] Certain subsidies (such as export financing that is not compliant with OECD

preferential terms.

[7] The White Paper's de minimis threshold is thus aligned with the one under EU State aid rules (see Commission Regulation (EU) No 1407/2013 of December 18, 2013).

[8] If Module 2 is combined with Module 1, Member States could in any case examine acquisitions ex officio, even if these were below the thresholds established in Module 2 (see infra), ensuring an effective system of control with modest public enforcement costs.

[9] Therefore, a foreign subsidy could be investigated by a single national supervisory authority, several national authorities acting in parallel, or the Commission. Future legislation on this matter should contemplate effective cooperation mechanisms among the multiple enforcers, such as those currently in force for cooperation in antitrust matters under Regulation 1/2003 and the 2004 Commission Notice on cooperation within the Network of Competition Authorities.

[10] For a foreign subsidy to fall within the scope of the review under Module 1, it is enough for the beneficiary to be entitled to receive it, whereas actual payment of the subsidy is not a requirement.

standards, subsidies to ailing companies, unlimited guarantees, operating subsidies in the form of tax relief, or subsidies directly facilitating an acquisition) could be presumed to be distortive. For other subsidies, the distortive effect would depend on a number of factors, including the size of the subsidy and the beneficiary, market structure (markets overcapacity and tech markets are particularly targeted), and the beneficiary's market conduct and level of activity in the EU.

Where distortive effects are established, the White Paper envisages a balancing test (the so-called "EU Interest Test") against the positive impact, if any, that the foreign subsidy may have in the EU in terms, e.g., of jobs, environmental protection, digital transformation, security, or public safety. The Commission will have exclusive jurisdiction to apply the EU Interest Test, while Member States may provide input at the Commission's request or at their own initiative.

If the EU Interest Test shows that the positive impact of the subsidized activity or investment does not outweigh the distortions, and repayment of the foreign subsidy to the third country is neither suitable nor feasible, the CSA may impose measures of redress or seek commitments that range from structural and behavioral remedies to monetary payments to the EU or Member States concerned. Possible measures of redress include: (i) divestment of certain assets; (ii) prohibition of certain investments; (iii) prohibition of a subsidized acquisition; (iv) third-party access to a subsidized infrastructure or facility; (v) licensing on fair, reasonable, and non-discriminatory ("FRAND") terms; (vi) the prohibition of a specific market conduct (such as distortive pricing practices) linked to the foreign subsidy; and/or (vii) publication of certain R&D results that allow other undertakings to reproduce them.[11]

3.2 Module 2 (Foreign Subsidies Facilitating the Acquisition of EU Undertakings)

Module 2 is specifically intended to address distortions caused by foreign subsidies facilitating the acquisition of EU undertakings by ensuring that no unfair benefit is conferred as a result on the subsidies' recipients, either directly by linking a subsidy to a given acquisition, or indirectly by de facto increasing the financial strength of the acquirer. The Commission's concern is that the foreign subsidy may enable the subsidized investor to pay a higher price for the assets in question than it would otherwise have paid, thus distorting the valuation of EU assets and preventing non-subsidized would-be acquirers from achieving efficiency gains or accessing key technologies.

Unlike under Module 1, the Commission would be the only CSA, to ensure "one-stop-shop" control across the EU for acquisitions above certain thresholds.[12] It may conduct an *ex ante* review, under a compulsory notification mechanism, of any planned acquisition of EU targets[13] involving foreign subsidies. The scope of this review would be very broad, since it would encompass both the acquisition of control and of non-controlling rights granting "*material influence*" over the target. To ensure effective implementation, the CSA would also have the right to *ex officio* review an acquisition which should have been notified by the acquirer but was not, including after its completion.

The notification obligation would cover only potentially subsidized acquisitions exceeding given thresholds (see footnote 13), in which the notifying

[11] Moreover, under the White Paper, the CSA should have the power of imposing severe sanctions to incentivise undertakings to provide information concerning the foreign subsidy as of the preliminary stages of the review and/or to comply with the measures imposed or the commitments offered.

[12] The White Paper suggests the adoption of a centralized review system at EU level, which in the Commission's view may lead to lower overall enforcement costs, also for the companies involved, and increased legal certainty.

[13] "EU targets" are defined as any undertakings established in the EU that meets certain thresholds. These thresholds may refer to the value of the transaction or the turnover generated, and/or to other qualitative criteria, such as assets likely to generate significant EU turnover in the future in order to capture ("killer") acquisitions of potentially relevant firms currently achieving modest turnover in the EU. The White Paper suggests a relatively modest turnover threshold of €100 million.

party has received a "financial contribution" from any third-country authority in the past three years or expects such a contribution in the coming year. The parties may not complete the transaction for a certain period (to be determined) after notification or (if the CSA considers there is sufficient evidence of the distortive effect of the subsidy on the acquisition) after the opening of an in-depth review.

As under Module 1, if it is established that a foreign subsidy distorts the internal market through the facilitation of an acquisition, the transaction will be subject to the EU Interest Test, i.e., the Commission will balance the established distortion against the positive impact of the foreign subsidy in the EU or on public policy interests recognized by the EU.

If, at the end of the in-depth investigation, the CSA finds that the acquisition under review is facilitated by foreign subsidies and distorts the internal market, it may accept commitments by the notifying party which effectively remedy the distortion. As a last resort, if no suitable commitment is acceptable to the acquirer, it may prohibit the acquisition.

3.3. Module 3 (Foreign Subsidies in Public Procurement)

Module 3 addresses the concern that subsidized companies may be able to make more advantageous bids in the context of public procurement procedures, e.g., by submitting bids below market price or even below cost.

Businesses participating in public procurement procedures would be required to notify the contracting authority of whether they have received a financial contribution from a third country within the last three years preceding participation in the procedure or are expected to receive such a contribution during execution of the contract.[14]

The contracting authority will then transmit all complete notifications to the CSA (either the Commission or the relevant national supervisory authorities within a system of shared competences),[15] which will have jurisdiction to investigate and assess the existence of a foreign subsidy.[16] Where the CSA confirms that that candidate has indeed received distortive foreign subsidies, the undertaking in question will be excluded from participating in that procedure. Where certain conditions are met, such exclusion may be ordered for subsequent procurement procedures for up to three years.[17] The investigation may cause significant delays in completion of the tender procedure since the contracting authority would be barred from awarding the contract to the allegedly subsidized candidate and, consequently, would have to suspend adjudication until the investigation was complete.

4. **Foreign Subsidies and EU Funding**

Lastly, the White Paper discusses the issues raised by foreign subsidies in the case of applications for EU financial support. While all economic operators should compete on an equal footing, foreign subsidies may distort the process of access to EU funding, which is typically based on public tenders, by putting their beneficiaries in a better position to apply.

The White Paper suggests a number of measures to prevent such unfair advantages. In particular, where EU funding is distributed through public tenders or calls for projects, a similar procedure would apply as the one envisaged for EU public procurement procedures. Moreover, the Commission emphasizes the importance of ensuring that international financial

[14] Under the White Paper, CSAs should be empowered to fine companies that fail to comply with the notification obligation. To focus the instrument only on those foreign subsidies that may cause distortions of the procurement procedure, and to limit the administrative burden for contracting authorities and the CSAs, higher notification thresholds and additional conditions may be introduced.

[15] The contracting authority may also alert the national supervisory authority in situations where it has sufficiently plausible indications that a tenderer received a foreign subsidy and failed to notify it.

[16] For transparency reasons, notifications would be published.

[17] During that period, however, the excluded tenderer will be allowed to demonstrate that it no longer benefits from a distortive foreign subsidy when participating in a public procurement procedure, in which case the exclusion will cease.

institutions that implement projects supported by the EU budget, such as the European Investment Bank or the European Bank for Reconstruction and Development, mirror this approach to foreign subsidies.

5. **Interplay with EU and International Instruments**

At this stage, the White Paper does not discuss the possible legal basis of any proposal for a new legal instrument on foreign subsidies, which would in any event be subject to full compliance with the EU Treaties. But the Commission articulates the possible interplay of this instrument with other regulatory tools at the EU's disposal:

EU Merger Regulation ("EUMR"). The White Paper foresees that merger control rules and foreign subsidy rules will be enforced in parallel, but separately. If a given acquisition has to be notified under both the possible new instrument on foreign subsidies and the EUMR, the undertakings concerned will be required to file separate notifications.

EU antitrust rules. The White Paper expects the new instrument to complement current EU antitrust rules.

EU State aid rules. The new instrument would operate separately from EU State aid rules as it will only apply if financial support takes the form of a subsidy granted by non-EU countries.

EU public procurement. The new instrument is intended to complement the existing EU public procurement framework, which does not contain specific rules regarding the participation of economic operators benefitting from foreign subsidies.

EU anti-subsidy regulation. The White Paper foresees that the new instrument will complement the EU anti-subsidy regulation, which allows the EU to act against subsidized imports of goods from a third country but not against subsidies related to trade in services or to the acquisition of companies.

FDI rules. Existing FDI rules tackle threats to security and public order, but not to the level playing field in the broader sense. The new instrument, which the Commission would be given direct powers to enforce, would have a broader scope than the FDI Screening Regulation, as it would not focus only on critical or strategic assets or be limited to an FDI scenario. Should a procedural overlap exist (e.g., where an FDI constitutes an acquisition that is facilitated by a foreign subsidy and raises concerns with regard to security and public order), the White Paper envisages the application of both instruments in parallel.

WTO Agreement on Subsidies and Countervailing Measures. Since the agreement in question covers only subsidized imports of goods from third countries, the new instrument will be complementary.

6. **Conclusion**

The White Paper confirms a general trend in the EU to combine openness to foreign investment with rules aimed at protecting European companies from distortive subsidies and the maintenance of a "level playing field"' through the EU's own State aid rules. The possible scope of the instruments contemplated is very large, notably in light of the EU's expansive notion of State subsidy and the thresholds envisaged for the Module 2 instrument.

The Commission is inviting the other EU institutions, Member States, and all other stakeholders to submit comments on the 45-page document by September 23, 2020. The results of the consultation will then feed into a formal proposal for future legislation in 2021. Although the purpose of a White Paper is only to launch a debate on this matter, a number of open questions can already be identified:

— On procedure, while for Module 1 the Commission clarifies that it and the CSAs would have discretion to investigate, the White Paper does not clearly set out the degree of such prosecutorial discretion (in comparison, for instance, to antitrust or trade defence investigations), nor the status and rights of complainants, beneficiaries, or foreign investors. Under EU State aid rules, this status (and corresponding due process rights, such as access to information) is traditionally limited because the EU Member State granting the aid is the main defending party and is bound by a duty to cooperate with the EU institutions. This might not be possible here, even in cases where the beneficiary faces sanctions in the form of fines or a prohibition to acquire a company.

— On the scope of potential beneficiaries, the White Paper clearly considers that the relevant criterion is not the nationality of the company, but that of the country granting subsidies. As a result, even companies established in the EU (including European group companies) may conceivably be caught by the new instruments if they or their subsidiaries receive subsidies abroad (*e.g.*, tax credits), which may be used in the internal market. It remains to be seen how companies will identify and manage this risk.

— On coordination with other trade instruments or agreements, while the White Paper emphasizes complementarity with existing disciplines (mostly related to trade in goods), there is still a risk of overlap. For instance, the Commission is silent on whether the same subsidy (with respect to a company manufacturing goods) might be caught both by anti-subsidy duties and by measures of redress under Modules 1 or 2. On trade agreements, the White Paper interestingly contemplates the possibility of suspending actions under the new legal instruments if it appears "*more appropriate*" to use the relevant agreement's dispute settlement provision to tackle the foreign subsidy. It remains to be seen how the EU will attempt to implement these principles while complying with its international commitments.

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