CLEARY GOTTLIEB

The Draft Foreign Subsidies Regulation

Relationship with other Instruments

Some Thoughts on Multilevel Enforcement and Duplication of Efforts

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Background

The draft Foreign Subsidies Regulation is the result of concerns that **foreign subsidies distort competition** in the internal market. The **perceived mismatch** between the control of State aid granted by Member States and that over foreign subsidies led to a ***gap analysis***:

- The Commission found that the Union's competition instruments, trade and FDI policy, as well as public procurement rules do not adequately address distortions that foreign subsidies cause in the internal market. Merger Control deals with competitive effects of concentrations, FDI screening focuses on security concerns, not subsidies, and public procurement rules do not specifically address subsidization either.
- The same is said of international agreements: the WTO/countervailing duty focus is too narrow and not working properly (measures vis-à-vis **imported *goods* only**; it's not relevant for services and capital flows (foreign direct investment). The official texts are almost silent with respect to Free Trade Agreements. Privately it is argued that they do not lead to sufficiently effective scrutiny.
- The proposed new rules will nevertheless be part of a complex set of existing rules. I'd like to take you through some of the resulting issues of "peaceful coexistence".

Relationship of the Draft Regulation to Other Instruments

Relationship with Other Instruments - Overview

PRINCIPLES

Relationship of the Draft Regulation with other instruments is addressed in some detail in Art. 40:

— No Investigations and no measures under the Draft Regulation if that "would be contrary to the Union's obligations" under international agreements (Art. 40 (7). Specifically mentioned: no "specific action against a subsidy within the meaning of Art. 32.1 ASCM" (WTO).

— There are more detailed rules with respect to EU autonomous legislation :

CONCURRENT APPLICATION OF EU LEGISLATION ("WITHOUT PREJUDICE")

The competition rules:

— Art. 101, 102, 106, 107, 108 TFEU.

— Reg. 1/2003 and the Merger Regulation (139/2004).

— Countervailing Duty Regulation (2016/1037).

— FDI Screening Regulation (2019/452).

— Regulation on safeguarding competition in air transport (2019/712).

DRAFT REGULATION TAKES PRECEDENT

Regulation on protection against injurious pricing of vessels (2016/1035) (until full entry into force).

Regulation on unfair pricing practices in maritime transport (4057/86).

Relationship of the Draft Regulation to Other Internal, Autonomous Rules

Relationship with Autonomous, Internal Rules (1)

The Draft Regulation provides in Art. 40, for the most part, that it will apply concurrently with other internal rules ("this Regulation is without prejudice to …"). The underlying reasoning is that most other internal rules, while applicable to a particular situation, do not address the specific issue of third country subsidization.

- The Draft Regulation will apply concurrently with the **competition rules applicable to undertakings**, i.e. Art. 101, 102, 106 TFEU and secondary legislation (e.g. Regulation 1/2003), including the Merger Regulation (Reg. 139/2004) (Art. 40(1) Draft Regulation). This will lead to significant duplication of efforts, as regards Merger Control rules, where two separate notifications of the same concentration will have to be filed to and be decided upon by the Commission, in case the concentration has Community dimension. Complexities of at least similar magnitude will arise in larger procurement cases.

Relationship with Autonomous, Internal Rules (2)

- The Draft Regulation will apply concurrently to certain "specialized" competition rules, such as, for example, the Regulation on safeguarding competition in air transport (Reg. 2019/712). The Draft Regulation would require "concentrations" and procurement proceedings involving air carriers to be analyzed under the Draft Regulation (Art. 40(6) of the Draft Regulation).
- The Draft Regulation will also apply concurrently with the **State aid rules** (Art. 107, 108 TFEU) and, although secondary implementing legislation in the field of State aid is not specifically mentioned in Art. 40(1), it must be inferred that such implementing legislation also applies concurrently (as the State aid rules in the Treaty do not properly work without such implementing rules). The reason is that the subject matter of both sets of rules is different: the State aid rules deal with State aid granted by Member States; the third country subsidy rules deal with subsidies granted by third countries.
- The Draft Regulation also will apply concurrently with the **rules under the framework for the screening of foreign direct investment**, i.e. Regulation 2019/452, in light of the different legislative objectives (public security concerns).

Relationship with Autonomous, Internal Rules (3)

- At first sight, more surprising is that the Draft Regulation will apply concurrently with the **Countervailing Duty Regulation** (Reg. 2016/1037) (Art. 40(2)). Both sets of rules deal with third country subsidies. The explanation can be found in Art. 40(7) of the Draft Regulation and Art. 32.2 of the WTO SCM Agreement. The later requires that *"[n]o specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994*", and Art. 40(7) mandates that the Draft Regulation must not be applied where Art. 32.2 ASCM is applicable. Hence:
  - Third country subsidies covered by the GATT rules, and specifically the ASCM, (subsidies affecting trade in goods) fall within the scope of the Countervailing Duty Regulation, which implements the specific requirements of the WTO and the ASCM; they do not fall within the scope of the Draft Regulation.
  - All subsidies not covered by the GATT rules (subsidies for services, subsidies for the creation of intellectual property) fall within the scope of the Draft Regulation.

Relationship with Autonomous, Internal Rules (4)

- Application should be mutually exclusive but there will be more complex cases, in which foreign subsidies support both goods and services (and/or the underlying IP). (Example: a subsidy for production know-how that is build into production facilities for goods). The Draft Regulation does not address these more complex cases.

- Only in a few cases will the Draft Regulation take precedence over other EU legislation, in particular over the following specific sectorial rules of limited application:
  - Regulation 2016/1035 on protection against injurious pricing of vessels, which is not yet effectively applicable, because the underlying OECD 1994 Shipbuilding Agreement is not yet applicable (see Art. 18(2) of Reg. 2016/1035). Once Reg. 2016/1035 becomes fully applicable, it will take precedence over the Draft Regulation, except for the treatment of concentrations and procurement questions (Art. 40 (4) Draft Regulation).
  - Regulation 4057/86 on unfair pricing practices in maritime transport.

Relationship of the Draft Regulation to International Agreements

Relationship with International Agreements (1)

Article 40 (7) of the Draft Regulation addresses the issue:

"(*7) An investigation pursuant to this Regulation shall not be carried out and measures shall not be imposed or maintained where such investigation or measures would be contrary to the Union's obligations emanating from any relevant international agreement it has entered into*."

Article 40 (7) then distinguishes between the WTO Agreement and other Agreements under international law.

- For subsidies covered by the WTO Agreement, it provides specifically that "*no action shall be taken under this Regulation which would amount to a specific action against a subsidy within the meaning of Article 32.1 [ASCM]*", so that all third country subsidies related to goods will have to be dealt with under the Countervailing Duty Regulation (as discussed above). The scope of application of the Draft Regulation is therefore limited to subsidies not regulated under WTO rules.

Relationship with International Agreements (2)

- There is no similarly precise rule as regards other international Agreements. Hence, the Draft Regulation should not be applied if the three conditions of Art. 40 (7) first sentence are cumulatively met, i.e. where investigations or measures under the Draft Regulation would (i) be *contrary to the Union's obligations* emanating from (ii) *any relevant international agreement* it (iii) *has entered into*.
  - There must be, **first**, an **international agreement** that deals with the issue of third country subsidization. A number of international agreements do, with varying degrees of detail and precision.
  - Such an agreement must, **second**, provide for an **obligation** for the Union not to unilaterally regulate certain subsidies covered by such agreement. Such an obligation can be inferred, where the agreement provides that a particular institution or a particular party to an agreement shall have primary responsibility to determine whether a subsidy is permissible and consistent with the obligations under an agreement.

Relationship with International Agreements (3)

- Some Agreements prohibit subsidies in principle and provide for precise substantive criteria for their possible approval, cross referencing EU State aid rules. They identify who is responsible for granting approvals and provide for the procedure for such approval. The **EEA Agreement** probably provides the best example for such a comprehensive agreement. In that case, (only) the EFTA Surveillance Authority is responsible for approving State aid (subsidies) granted by the EFTA States. By pretending to have enforcement powers over the same subsidies, the Union would breach its commitments under public International law.
- Other Agreements regulate the substantive requirements for subsidy approval (sometimes cross referencing EU State aid rules) and provide for a rule that an independent authority in the contractual party granting the subsidy should review the subsidy but without regulating the procedure in detail or by reference to EU law. The **Stabilization and Association Agreements** with the EU Membership candidates fall within that category. Given that the Agreements provide for enforcement through an independent authority in the accession country, the Union would likely breach its commitments under public international law if it assumed conflicting unilateral enforcement powers.

Relationship with International Agreements (4)

- Other examples of agreements allocating primary enforcement powers to national authorities are some sectoral agreements between the Union and certain third countries (again, in particular the accession countries), which provide for State aid rules and independent national enforcement, such as the Energy Community Treaty, the Transport Community Treaty, and the Agreement on a European Common Aviation Area. This comes on top of special internal rules in these sectors.
- Yet other Agreements, like general free trade agreements, only contain much less detailed general commitments to avoid distortive subsidies, which lack precision and enforcement mechanisms. In the absence of a particular attribution of competences for the implementation and enforcement of these rules, it is unlikely that the exercise of unilateral enforcement mechanisms by the Union would breach those agreements or other rules of public international law.

- The Agreement must, **third**, have been entered into by the Union.
  - The third requirement may exceptionally raise issues. There are some instances, where the Union requires candidate countries to enter into, or join, international agreements, which provide for detailed substantive and procedural State aid rules (CEFTA).

Conclusions

Conclusions (1)

- The Draft Regulation provides for a broad new instrument, with wide ranging powers and effects on economic operators and other policy areas alike.
- The new instrument will place a significant administrative burden on both the Commission (three new units are envisaged in DG COMP) and on economic operators. It will not just be Chinese or third country undertakings that will be subject to proceedings but EU entities as well, if they benefit from third country subsidies.
- The rules on the relationship with other internal policy instruments show that a significant level of overlap (and duplication) is deliberate (as it is the necessary consequence of concurrent application of, say, the merger regulation and the Draft Regulation). The Commission's justification rests on differing policy objectives.
- In the transport and energy sectors, there are both special internal rules and specific international agreements – very complex set of rules for third county subsidies.

Conclusions (2)

- The rules on the relationship to international agreements also show a tendency for concurrent application, except were the use of the Draft Regulation infringes an „obligation“ under an international agreement.
  - There is a lot of scope for argument as to what exactly „obligation“ means, for example, under the SAA’s with candidate countries.
  - Notable exception: the WTO rules, the ASCM, and the countervailing duty regulation (intended to be mutually exclusive vis-á-vis the Draft Regulation). That, however, leads to a complex relationship, with diverging rules, depending on whether the subsidy benefits goods, services, or intellectual property and know-how.

Conclusions (3)

In sum:

- The mainly concurrent application of the Draft Regulation with several existing policy instruments will lead to potentially significant overlaps and administrative burden for undertakings and the Commission but is consistent with the objective of broadly expanding control over third country subsidies.
- To the extend the Draft Regulation provides for mutually exclusive application, much of the details of how that will work in practice are uncertain and will likely be points of significant contention.
- Please continue to watch this space!
- Many thanks for your attention!