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European Commission's White Paper on Foreign Subsidies: Closing a regulatory gap?

The Commission opens a public consultation on a new tool to protect the EU from international competition.

The European Commission (the Commission) is consulting the market on a proposal to add a new tool to the EU protective gear against international competition. The White Paper addresses the potential distortive effects of foreign subsidies on the EU single market. The various models proposed could have a significant impact on companies that have received non-EU subsidies and some types of inbound M&A. The consultation is open until 23 September 2020.

Key Points:

- The Commission has launched a public consultation to assess whether new instruments, as a complement to existing tools, are required to address distortions of competition caused by foreign subsidies.
- The Commission proposes three possible "Modules":
  - A general instrument that would enable the EU or the Member States to challenge "distortive foreign subsidies" with rectification powers if distortions are found in the internal market
  - A notification requirement for acquisitions facilitated by foreign subsidies, allowing the EU to impose remedies or to block the acquisition
  - An instrument to exclude recipients of foreign subsidies from public procurement procedures if the foreign subsidy made the procurement procedure unfair
- The Commission seeks views and input from all stakeholders on the three Modules. The public consultation is open for comment until 23 September 2020, with the aim of proposing a new legal instrument in 2021.
- The proposed regulatory tools could significantly alter the EU's regulatory landscape with significant effects for some types of inbound M&A and more generally on the way business is done in the EU.

Background

On 17 June 2020, the Commission published a "White Paper on an Instrument on Foreign Subsidies" which forms part of the policy objective "A new industrial strategy for Europe" included in the Adjusted Commission Work Programme 2020. The Commission's "gap analysis", on which the proposals are based, concluded that none of the regulatory instruments currently in force can adequately address foreign subsidies, which, in the Commission's view, cause distortions of the EU's internal market. Anti-

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subsidy investigations under World Trade Organization (WTO) rules only capture subsidized imports of goods from third countries. EU State aid rules aim to ensure a level playing field with regard to subsidies provided by EU Member States, but the rules do not address subsidies granted by non-EU governments. EU merger control aims to prevent any significant impediment to effective competition. The focus of the merger control analysis is on the structure of competition in a given market, but does not take into account the existence or effects of foreign subsidies as such. The EU Regulation "establishing a framework for the screening of foreign direct investments into the Union" (Regulation (EU) 2019/452, "FDI Screening Regulation"), applies to any foreign direct investment into the EU with a likely effect on security or public order. The legal instruments proposed in the White Paper would complement the FDI Screening Regulation and allow the assessment of potential distortions in the internal market in addition to threats to security and public order.

The proposed legal framework

The White Paper proposes three instruments, one for each Module, that could be applied alternatively on a stand-alone basis or in combination, while the Commission recommends a combination as "the most appropriate course of action".

The focus of the suggested instruments is the concept of "foreign subsidy", defined in Annex 1 of the White Paper as "a financial contribution by a government or any public body of a non-EU State, which confers a benefit to an economic operator active in the EU […]". This can consist in the (i) transfer of funds or liabilities (*e.g.*, capital injections, grants, loans), (ii) foregone or not collected public revenue (*e.g.*, preferential tax treatment or fiscal incentives), or (iii) the provision or purchase of goods and services. The three modules address subsidies from third countries regardless of the beneficiary's nationality.

Module 1 – New market scrutiny instrument to assess distortions in the internal market

The first instrument focuses on a legal framework that would allow the Commission and the National Competition Authorities (NCAs) to initiate a preliminary *ex officio* review based on information indicating that a foreign subsidy has been granted to a beneficiary active in the EU. The White Paper does not foresee a formal notification mechanism. If the preliminary review gives rise to concerns that (i) a foreign subsidy was granted that may (ii) lead to distortion in the internal market, the competent authority could launch an in-depth investigation. The White Paper lists certain categories of foreign subsidies likely to create distortions. These categories are:

- Subsidies in the form of export financing, unless the export financing is provided in line with the OECD Arrangement on officially supported export credits

- Subsidies that are (in law or in fact) contingent upon the use of goods or services of the subsidizing country over the use of EU goods (so called national content rule)

- Subsidies to ailing undertakings (*e.g.*, debt forgiveness) unless there is a restructuring plan leading to the long-term viability of the beneficiary (in light of the current COVID-19 crisis, this category does not apply to subsidies granted to remedy a serious national or global disturbance of the economy, if they are limited in time and proportionate)

- Subsidies whereby a government guarantees debts or liabilities of certain undertakings without any limitations as to the amount and the duration

- Operating subsidies in the form of tax reliefs, outside general measures

- Subsidies directly facilitating an acquisition

For all other types of subsidies not included in the above categories, the Commission has set out a non-exhaustive list of indicators that may be used for determining a distortive effect. This includes the size of the subsidy, the situation of the beneficiary, the situation on the market concerned, the market conduct in question, and the beneficiary's level of activity in the internal market.

Once it is established that a foreign subsidy distorts the internal market, the market distortion must be balanced against the positive impact the foreign subsidy might have within the EU regarding jobs, environmental considerations, digital transformation etc. (EU interest test). If the EU interest test shows that the positive impact mitigates the distortion in the internal market, the investigation ends without any measures imposed. In case of the opposite, the competent authority can impose measures to redress the distortions if the beneficiary does not offer adequate commitments. In alignment with EU State aid rules, foreign subsidies not exceeding the *de minimis* threshold of €200,000 granted over a consecutive period of three years are presumed not to cause any distortions in the internal market.

With this instrument the EU would enlarge the international trade notion of subsidy to encompass situations more similar to its State aid definition. The negotiations at the WTO and in the context of international trade agreements over the past 20 years have shown that this is far from simple, legally and practically, and risks attracting strong reactions from the EU's trading partners.

Module 2 – New suspensive notification requirement for acquisitions facilitated by foreign subsidies

Module 2 aims to address foreign subsidies facilitating the acquisition of EU target companies that may give rise to distortions in the internal market, either (i) directly by linking a subsidy to a given acquisition or (ii) indirectly by *de facto* increasing the financial strength of the acquirer, which in turn would be used for an acquisition. Companies benefitting from the financial support of a non-EU government would need to notify acquisitions of EU companies, above a given threshold. An acquisition would be defined as (i) the acquisition of direct or indirect control of an undertaking or (ii) the direct or indirect acquisition of voting rights of a yet-to-be-specified percentage of the shares or voting rights of an undertaking or otherwise material influence.

The White Paper proposes the Commission as the competent supervisory authority for such notifications. Transactions could not be closed whilst the Commission's review is pending. Following the notification, the Commission could scrutinize the proposed acquisition in a preliminary review (Phase I) and, if relevant, open an in-depth investigation (Phase II). Phase II would be launched based on sufficient evidence that the acquirer benefits from foreign subsidies facilitating the acquisition. In case of a failure to notify, the Commission would have the right to *ex officio* review acquisitions that should have been notified. As also contemplated by Module 1, the EU interest test would apply, balancing the established distortion against the positive impact the foreign subsidy might have. If the investigation reveals that an acquisition facilitated by foreign subsidies distorts the internal market and the positive impact does not outweigh this distortion, the authority can decide to take any of the following actions:

- Accept commitments by the notifying party which effectively remedy the distortion
- Prohibit the acquisition
- Unwind the acquisition in case the parties failed to notify the transaction prior to closing

The notification requirement would cover acquisitions in which the parties have received a financial contribution by a non-EU public authority in the past three years or expect such contribution in the coming year.

A similar requirement in merger clearance was set by the *RJB Mining* case law with regard to EU State aid control. The Commission, however, has not made extensive use of this possibility and, in *STX/Aker*, the court excluded that the *RJB Mining* case law could apply to foreign subsidies outside the EU State aid regime. But this could be about to change.

Module 3 – Possible exclusion of bidders from EU public procurement procedures

Module 3 addresses the potential harmful effect of foreign subsidies on the conduct of public procurement procedures in the EU. The White Paper proposes a mechanism by which bidders would be required to notify the contracting authority of financial contributions received from non-EU countries. The competent contracting and supervisory authorities would then assess whether such contributions constitute a foreign subsidy and whether the contributions rendered the procurement procedure unfair. In this case, the subsidized bidder would be excluded from the procurement procedure.

The interaction between public procurement and subsidization has proven to be complex in regard to State aid. Questions have been raised even about whether the requirements of the public procurement directives can truly eliminate any possible State aid in Europe. It remains to be seen how the Commission will propose to ascertain in a harmonized manner throughout the very diversified public authorities of the 27 Member States the effects of financial contributions received from non-EU countries.

Outlook

The public consultation on the White Paper is open for comment until 23 September 2020. Following this consultation period, the Commission will prepare legislative proposals and start the legislative process.

The proposed new instruments would constitute a significant alteration of the EU's regulatory landscape, for which compatibility with the EU's existing international obligations remains to be assessed.

Remaining complex issues include whether the proposed instruments will be compatible with the categorization of subsidies and remedies permitted under WTO rules, and whether application of the proposed regime could lead to third countries benefitting from compensation rights in sectors beyond those targeted by the new instruments. Similarly, the linkage between foreign subsidies and EU merger control law would significantly increase the complexity of foreign acquisitions, in particular if the foreign subsidy assessment goes beyond that in the *RJB Mining* case law, and, as suggested, involves a two-phase review. This linkage alone might suggest more second-phase reviews for non-EU acquisitions.

Together with the FDI Screening Regulation that was only introduced last year, the proposed new instruments would mark another step towards increased protection of the internal market against unfair international competition — whether real or perceived. The instruments would potentially affect any non-EU recipient of government funding that is operating or investing in the EU. This effect may lead to further barriers to trade, higher administrative burdens for inbound M&A transactions, and certain foreign investors dealing with merger control, FDI, and foreign subsidy filings in parallel.

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