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## *Expanding the Geostrategic Toolbox: The EU White Paper on Foreign Subsidies*

June 24, 2020

Summary: On 17 June 2020, the European Commission ('EC') issued a White Paper proposing three new regulatory tools to tackle distortive effects that may be caused by foreign subsidies in the EU Single Market (the 'White Paper').<sup>1</sup>

The White Paper is the latest in a series of EU responses to rapidly growing concerns – in the EU and elsewhere – about increased geo-strategic and geo-economic competition between the world's major economic powers – through government ownership, subsidization, or other forms of government control or involvement, or simply through active and often discriminatory industrial policy measures in sectors and industries that are considered to be of strategic interest. The White Paper also comes, at least in part, as a response to an increased sense – in the EU and elsewhere – that the World Trade Organization (WTO) and other multilateral institutions may no longer be able to provide sufficient insulation against or a sufficiently strong legal and policy tool to address such concerns.

For the next three months, until 23 September 2020, a public consultation on the proposals in the White Paper will take place<sup>2</sup> and companies and trade associations should actively consider getting involved – directly or indirectly – to shape the future form of these likely new EU tools. We anticipate the European Parliament, by and large, to support the new initiatives<sup>3</sup>, although many MEPs may have their own views as to the specific form certain measures should take and the

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<sup>1</sup> European Commission, White Paper on levelling the playing field as regards foreign subsidies of 17 June 2020, COM(2020) 253 final.

<sup>2</sup> The questionnaire is available at <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12452-White-Paper-on-Foreign-Subsidies/public-consultation>.

<sup>3</sup> See Report on competition policy – Annual Report 2019 (2019/2131(INI)) Committee on Economic and Monetary Affairs, available at [https://www.europarl.europa.eu/doceo/document/A-9-2020-0022\\_EN.html](https://www.europarl.europa.eu/doceo/document/A-9-2020-0022_EN.html)

concerns that must be addressed.<sup>4</sup> The same will be true of EU Member States. Either way, it seems likely that the White Paper will lead to the adoption of far-reaching new legislation in the EU and potentially far-reaching new powers for the European Commission (EC) and/or certain EU Member State authorities, that can be invoked to block investment and shape competition in the EU Single Market.

Below, we provide some general background on the context in which these measures have been adopted first (Section I), followed by a discussion of the key new tools (or “Modules”) that the White Paper proposes (Section II), and a brief conclusion (Section III).

## **I. General Background**

### **A. Foreign Subsidies and Geostrategic Competition**

Concerns about geo-strategic and geo-economic competition have increased rapidly over the past several years. China and Russia are among the key countries that EU and EU Member State policymakers and observers are typically focused on (e.g., in terms of Chinese government investments in key strategic infrastructure or technologies). Other examples include recent developments in the context of the Coronavirus pandemic (e.g., reported attempts by the Trump Administration to acquire German vaccine developer Cure-Vac, and export and other trade restrictions in the pharmaceutical and life sciences sector). There is also uncertainty as to whether a post-Brexit UK will agree to what the EU sees as a level playing field in return for access to the EU’s Single Market. We have previously reported on developments in relation to EU and EU Member State measures on Foreign Direct Investment (“FDI”) [here](#), as well as some of the various trade-related restrictions imposed by the U.S. and the EU in the context of COVID-19 [here](#).

In the White Paper, the EC notes that the European Union (‘EU’) is very much open to trade and foreign investment. However, the EC views subsidies granted by non-EU governments as a potential challenge to ensuring a level competitive playing field in the EU’s Single Market. More specifically, the EC notes that foreign subsidies can distort competition in the EU internal market by allowing less efficient market operators to grow at the expense of more efficient ones, or by encouraging subsidy races. As regards acquisitions, there are also concerns about the overvaluation of EU assets and consequent inability of EU-based companies to compete in making strategic acquisitions because of a subsidised acquirer’s willingness to pay a higher than market price. Finally, the EC is concerned that price dumping by subsidised companies will squeeze EU companies out of public procurement and other tenders, as they will not be able to compete on price.

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<sup>4</sup> The European Parliament played an active role, for example, in amending and further expanding the scope of the recent EU Foreign Direct Investment Review regulation that will come into full force in October of this year.

In the current global economic environment, foreign subsidies may also serve geostrategic objectives and the predatory establishment of a strong presence in the EU. Competition with China is one example, with the EU attempting to address issues such as concerns with the safety and security of its basic infrastructure (e.g., 5G networks). The coronavirus crisis has also significantly weakened EU companies, and there is a concern that their acquisition by subsidised market operators could lead to the transfer of competitively important technologies outside the EU. In the same vein, caught in a trade war between the US and China and in light of concerns about the future strength of the WTO and the multilateral system in general, the EU appears to believe it needs additional tools or “defensive mechanisms” to deal with the rapidly expanding range of global geo-economic threats that it perceives to exist.

The expansion of the EU’s regulatory toolbox may also offer a fallback position for the EU in the context of Brexit. In other words, if the currently sought trade agreement between the EU and the United Kingdom (‘UK’) does not incorporate what the EU sees as adequate rules on State aid, as sought by the EU as part of its level competitive playing field, then the tools proposed in the White Paper would still give the EU the ability to maintain scrutiny for subsidies granted by the UK.

## **B. The Regulatory Gap**

The White Paper explains that, although the EU has developed elaborate rules to tackle distortions within the EU internal market, the existing regulatory instruments are insufficient to address the issues described above.

**EU merger control** allows the EC to intervene where concentrations impede effective competition. However, these rules do not take into account whether an economic operator may have benefitted from foreign subsidies, and the EC cannot intervene solely on this basis. Notably, in view of the EC’s prohibition of the *Siemens/Alstom* deal,<sup>5</sup> German and French authorities have pointed out that a deal would have created a company that would be better able to compete with subsidised Chinese high-speed train builders, both in the EU and worldwide.

**The EU’s State aid rules** discipline financial support granted by EU governments to their economic operators. However they do not cover financial support granted by non-EU governments to undertakings in the EU, either directly or through their third-country parent companies.

**The EU Public Procurement framework** does not contain specific rules regarding the participation of beneficiaries of foreign subsidies in procurement. Contracting authorities are not legally required, nor equipped to investigate such concerns, although the procurement rules contain enough flexibility for them to do so. Similarly, EU financial regulations are meant to reduce the

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<sup>5</sup> See the EC’s press release at [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_19\\_881](https://ec.europa.eu/commission/presscorner/detail/en/IP_19_881).

impact of abnormally low bids, but there are no specific rules for examining whether foreign subsidies allow companies to access EU funding.

As regards **trade policy**, there are several multilateral, bilateral and unilateral measures in place that allow the EU to react to unfair practices, usually in the form of extra import duties. However, the EC notes that the scope of these instruments is limited. For instance, the *WTO Agreement on Subsidies and Countervailing Measures* ('SCM Agreement') covers subsidised imports of goods from third countries, but does not address subsidies related to trade in services.

Last year, the EU adopted a framework for the **screening of foreign direct investments** that target critical assets of the EU or its Member States (the 'FDI Screening Regulation'). While this allows screening of the impact of foreign direct investment on the grounds of security or public order, it does not address broader concerns with foreign direct investment that may pose geostrategic competitive risk.<sup>6</sup>

## **II. Modules 1-3: Key Tools Proposed by the White Paper to Address Foreign Subsidy Concerns**

### **A. Module 1: General Instrument to Capture Distortive Effects of Foreign Subsidies**

The White Paper proposes the creation of a number of new regulatory instruments to address the deficiencies noted above.

Module 1 would be an *ex post* market scrutiny tool with a very broad substantive scope that could capture all market situations in which foreign subsidies may have a distortive effect (subsidies for exports of goods and agricultural products into the EU would continue to be covered by the EU trade defense instrument, and so would not fall within the scope of Module 1). Module 1 would include the competence to conduct *ex post* FDI reviews in situations where foreign subsidies for an acquisition might lead to distortions of the Single Market. This means that provided that foreign subsidies are in play, Module 1 would significantly broaden potential *ex post* FDI reviews, both at European Commission and national levels (including new authority for those EU Member States that do not currently have national FDI screening mechanisms in place). Module 1 would be enforced *ex officio* by the EC, national supervisory authorities or jointly, based on a cooperation and coordination system.

The EC describes a two-step process for Module 1. During a preliminary investigation, the competent supervisory authorities would examine whether a foreign subsidy was granted to an undertaking established or active in the EU that may distort the internal market. If this is suspected, the authorities would begin an in-depth investigation.

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<sup>6</sup> See <http://trade.ec.europa.eu/doclib/press/index.cfm?id=2008>.

Where the in-depth investigation confirms a foreign subsidy that creates distortions, a decision with commitments or other redressive measures can be adopted (e.g., divestment of certain assets; third-party access obligations; licensing on FRAND terms; redressive payments to the EU or to Member States). Reporting and transparency obligations would also apply, with any non-compliance sanctioned by financial penalties imposed on the undertaking concerned.

Notably, the White Paper proposes a number of substantive assessment criteria for whether a subsidy creates distortions:

- Certain categories of foreign subsidies, such as subsidies in the form of export financing or subsidies to undertakings that are unable to obtain independent commercial financing, would be regarded as more likely to create distortions in the internal market, as would unlimited government debt guarantees, operating subsidies through tax relief, and foreign subsidies that directly facilitate an acquisition.
- Other foreign subsidies would be assessed against a non-exhaustive list of indicators, such as the relative size of the subsidy, the beneficiary's competitive situation, or structural excess capacity on the market at issue.
- In addition, a *de minimis* rule would provide a safe harbour for subsidies that do not exceed EUR 200,000 granted over period of three years.

Finally, even if a distortion is established, a balancing exercise, the so-called 'EU Interest Test', would take place to weigh the foreign subsidy's possible positive impact on EU public policy objectives (e.g. sustainability, digital transformation, security and public safety) against its potential distortive effects. The European Commission would have exclusive competence to apply the EU Interest Test, on referral from a national authority where a Module 1 procedure takes place at national level. The EC proposes to apply a limitations period of ten years on the ability of authorities to require redressive measures under Module 1.

## **B. Module 2: Foreign subsidies facilitating the acquisition of EU targets**

Module 2 is intended to ensure that foreign subsidies do not give an unfair advantage to their recipients in (complete or partial) acquisitions of EU targets. Subsidies at issue would include a direct subsidy explicitly linked to the acquisition as well as an indirect subsidy, resulting in a *de facto* increase in the financial strength of the acquirer.

The EC envisages a *compulsory notification mechanism* that would allow *ex ante* review of a planned acquisition by a competent authority. This would be possible where foreign subsidies have been granted to the acquirer up to three years before notification of the transaction.

The *procedure would also be suspensory in effect*: the acquirer could not complete the acquisition until a two-step preliminary and, if required, in-depth investigation is concluded. Acquirers that fail to notify would risk significant fines and the obligation to unwind the transaction.

Module 2 would extend to any ‘financial contribution’ by third-country authorities. The EC views this as more objective and less controversial than having to find that the contribution constituted a “subsidy.”

Module 2 would cover the acquisition of control; the acquisition of shares or voting rights above certain thresholds (yet to be determined); and the acquisition of any “material influence” over an undertaking. Contrary to current EU merger control, this could extend to significant non-controlling minority rights or shareholdings.

Various thresholds are proposed for Module 2 to ensure that acquisitions of interest are caught:

- A qualitative threshold based on all assets likely to generate significant EU sales (turnover) in the future and/or a quantitative threshold set with reference to the value of the transaction; and
- A quantitative threshold based on sales, which could be set at EUR 100 million or higher. Alternative approaches could also be envisaged. The level of the threshold would also depend on the size of the market that the relevant supervisory authority is competent for.

In addition, a Module 2 review could be limited to financial contributions by third-country authorities that exceed a given minimum amount.

Similar to Module 1, the effects of the subsidy could be balanced against the overall positive impact of the transaction or recognised EU public policy interests. If the overall conclusion is that the financial contribution is distortive, then either (i) the acquirer would have to accept commitments that effectively remedy the distortion or (ii) the acquisition would be prohibited.

Given that Module 2 would work through an *ex ante* notification process that should be coordinated with merger control regimes, the European Commission suggests that it should have exclusive responsibility for enforcing Module 2. The EC notes that EU Member States could still apply Module 1 *ex post* to review foreign-subsidised acquisitions.

### **C. Module 3: Foreign subsidies in public procurement**

Module 3 would be a requirement for purchasers subject to EU public procurement rules to exclude from procurements those bidders who have received distortive foreign subsidies. This new ground for exclusion would apply both to the procurement procedure at issue, but could also lead to exclusion from subsequent procurement procedures, under certain conditions.

A bidder would have to notify information regarding the receipt of foreign subsidies, including the main sources of overall financing of the tender, total amount of foreign financial contributions received in the past three years, and foreign financial contributions received to participate in the

tender and expected during execution of the contract to a contracting authority. This would be provided to the competent supervisory authority.

A policing mechanism would also provide that third parties and competitors would be entitled to inform the contracting authority that a notification should have been made. Failure to notify would be sanctioned by significant fines and possible exclusion from the procurement or even termination of an ongoing contract.

Similar to Module 1, Module 3 would be administered by both the EC and national authorities, with coordination among them. Because public procurement procedures should be delayed as little as possible, strict time limits would apply, such as 15 working days for a preliminary review by the national supervisory authority and no more than three months for an in-depth review.

The substantive standard of assessment is the same as for Module 1, adapted to the procurement context. The supervisory authority would assess whether the subsidy has distorted the procurement procedure and, if so, whether it is nevertheless justified by the EU interest test.<sup>7</sup>

### **III. Conclusion**

The White Paper and the various proposals it contains raise a broad range of issues that companies and industries both within the EU and abroad should consider carefully. As the White Paper itself acknowledges, the proposed measures and tools would both overlap with, be complimentary to, and potentially raise key issues under a range of other existing regimes both within the EU (e.g., Merger control, government procurement rules, State aid rules, etc.), and beyond (e.g., in terms of their relation to the WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement), the Agreement on Government Procurement (GPA), and even the General Agreement on Tariffs and Trade (GATT) and General Agreement on Trade in Services (GATS).

The White Paper and its proposals are also unlikely to be the last word on this topic – both within the EU, and beyond. We anticipate the European Commission, the European Parliament, and the EU Member States, as well as a broad range of other governments around the world to continue focusing on these issues and to consider and, in many cases, put in place further, more active industrial policy and trade-related measures.

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<sup>7</sup> A final point worth mentioning are the White Paper's proposals concerning foreign subsidies to NGOs, public or quasi-public authorities, or basic research and development activities that, at the same time, may be requesting or relying on grants provided by the EU. In grant award procedures, the EU targets funding to projects that implement EU public policy objectives. EU contributions are intended to partially reimburse costs incurred by entities active in non-market or pre-market activities, but there may be concerns in some instances about the extent to which foreign government contributions or involvement could impact the views or advocacy of the entities requesting funding, or the use of or focus of R&D or other activities that such entities are engaged in. The White Paper suggests that such concerns could be addressed through a notification obligation and the possibility to exclude the applicant if the foreign subsidy distorts or is likely to distort the grant procedure, applying the same criteria to this test as provided for procurement under Module 3.

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Consultations on the White Paper are open until 23 September 2020. Interested parties and stakeholders should consider actively contributing to the debate. WilmerHale would be pleased to assist in developing comments for the consultation and in representing stakeholders in the legislative process. If you have queries, please contact those listed below.

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