EU PROPOSAL TO ADDRESS FOREIGN SUBSIDIES

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Legal Briefings

On 5 May 2021, the European Commission issued its much anticipated proposed regulation on foreign subsidies distorting the EU market, which we summarised in our earlier blog post.

If adopted in its current form, the proposed regulation could have a transformative impact and significantly increase the regulatory risk and burdens for foreign companies operating or investing in the EU. Companies that are in receipt of foreign subsidies could be subject to wide-ranging investigative action affecting the way they conduct their business, while in the M&A area, there would be yet a further regulatory process that would need to be navigated in parallel to existing competition merger control and foreign direct investment screening processes. Bids in public procurement tenders would also be subject to scrutiny and could potentially be disqualified. While the proposed regulation appears to be aimed primarily at Chinese and Russian State-linked companies, any company in receipt of support from non-EU governments could be affected, including the USA as well as potentially the UK.

In this post, we set out further detail in relation to the key elements of the proposal, highlighting issues that could give rise to substantial risks and practical difficulties that would either require further clarification or amendment to the proposal. Companies now have the opportunity to submit comments on the proposed regulation here, which will be presented to the EU legislature as it considers the proposal.

THREE TOOLS

The proposed regulation provides for three different regimes to address foreign subsidies:

- A **general *ex-officio* tool for the Commission to investigate allegedly distortive foreign subsidies**. This tool is wide-ranging and covers all and any foreign subsidies granted during a prior ten year period, including those falling below the notification thresholds for the two notification-based tools in relation to concentrations and public procurements (below). Subsidies of less than €5 million over any consecutive period of three fiscal years however, are considered as "unlikely" to be distortive, effectively providing a limited "safe harbour".

- A **notification-based tool in relation to potentially subsidised mergers and acquisitions (so-called concentrations), with suspensory effect**. Concentrations would need to be notified to the Commission where: (i) the undertaking to be acquired, or at least one of the merging undertakings, is established in the EU and has aggregate EU turnover of €500 million or more; and (ii) the aggregate amount of the foreign financial contribution received by the undertakings concerned is more than €50 million over the three years prior to notification. Similar thresholds would also apply in relation to the formation of full-function joint ventures. The Commission however, would also be able to require notification of concentrations not meeting these thresholds where it suspects that the undertakings concerned may have benefitted from foreign subsidies during the past three years.

  The procedural aspects under this tool, including the way the thresholds are to be applied and the timelines for the investigation, are consistent with principles under the EU merger regulation and reviews under both instruments may run in parallel.

- A **notification-based tool in relation to potentially subsidised public procurement bids, with suspensory effect.** Bidders would need to notify to the contracting authority all foreign financial contributions where the estimated value of the public procurement at issue is €250 million or more. However, as with the notification tool for concentrations, the Commission would also be able to require notification where it suspects that the bidder may have benefitted from foreign subsidies during the past three years.

While each of these three tools have different areas of application, the substantive components that the Commission will be examining are the same, namely: (a) the existence of a "foreign subsidy"; (b) whether the subsidy causes a "distortion" in the EU market; (c) whether the negative effects in the EU market may be balanced by any positive effects of the subsidy; and (d) the redressive measures or commitments required to address the distortions. Essentially the same Commission investigative processes and powers also apply under the three tools. We address each of these aspects below.

"FOREIGN SUBSIDY" AND "FINANCIAL CONTRIBUTION"

A "foreign subsidy" for these purposes will exist where three cumulative conditions are met:

- there is a "**financial contribution**" provided, directly or indirectly, by the public authorities of a third country (i.e. a non-EU country) – this may also include financial contributions granted by public and private entities whose actions may be attributed to the public authorities, e.g. because they are under State control;

- such financial contribution confers a "**benefit**" to an undertaking engaging in an economic activity in the EU internal market; and

- that benefit is limited to an individual undertaking or industry or to several undertakings or industries (i.e. it is "**selective**"), in law or fact.

A "financial contribution" in turn is defined widely to include any transfer of funds or liabilities (e.g. capital injections, loans or guarantees), the foregoing of revenue that is otherwise due (e.g. tax incentives) and the provision of goods or services or the purchase of goods and services.

The qualification of a "foreign subsidy" appears to be based on definitional elements from EU State aid and international trade law and it may be expected that the Commission will borrow from existing practice and precedent in these areas.

It should also be noted that while the purpose of the proposed regulation is to address foreign subsidies, the triggers for the notification tools in relation to concentrations and public procurement bids are based on the receipt of "financial contributions" rather than "subsidies", giving them a much broader scope.

DISTORTION ON THE EU INTERNAL MARKET

A foreign subsidy would only be considered as problematic, if it results in a distortion on the EU internal market. A "distortion" for these purposes would exist if the foreign subsidy is liable to improve the competitive position of the undertaking concerned (i.e. the recipient undertaking) and thereby actually, or potentially negatively affect competition in the EU internal market. This assessment is to be carried out on the basis of a non-exhaustive series of indicators that are set out in the proposed regulation, as follows:

- the amount of the subsidy;

- the nature of the subsidy;

- the situation of the undertaking and the markets concerned;

- the level of economic activity of the undertaking concerned on the EU internal market; and

- the purpose and conditions attached to the subsidy as well as its use on the EU internal market.

The proposed regulation also sets out a number of specific types of foreign subsidies that may effectively be considered as distortive by nature, namely: subsidies granted to an undertaking that would otherwise go out of business (unless there is an appropriate restructuring programme); unlimited guarantees for debts or liabilities; a subsidy directly facilitating a concentration; and a subsidy enabling a bidder to submit an unduly advantageous tender in a public procurement tender. For these types of subsidies a detailed assessment based on the indicators would not be required.

Insofar as the notification tools in relation to concentrations and public procurements are concerned, the assessment of whether there is a distortion is to be limited to the concentration / public procurement procedure at stake.

The framework for assessing distortions under the proposed regulation appears to be based on experience under EU State aid law, although it remains to be seen how the Commission would go about making its assessment in practice and in particular, the extent of the economic analysis that would inform its assessment.

BALANCING NEGATIVE AND POSITIVE EFFECTS

If the Commission concludes that the foreign subsidy in question results in a distortion, it would then assess any positive effects of the foreign subsidy on the development of the relevant subsidised activity and weigh these positive effects against the negative effects of the distortion. This balancing assessment must be taken into account by the Commission when deciding upon possible redressive measures and may even lead to the conclusion that no redressive measures should be imposed.

The balancing assessment again seems to be inspired by the Commission's practice under EU State aid law, under which the Commission also undertakes a balancing exercise as part of its assessment of whether State aid can be considered as "compatible with the internal market".

REDRESSIVE MEASURES AND COMMITMENTS

The Commission would have the power to impose redressive measures or accept commitments to remedy the distortion caused by the foreign subsidy. The possible redressive measures and commitments set out under the proposed regulation are based on the measures applied under EU State aid control to mitigate against the distortive effects of State aid and comprise both behavioural and structural remedies, including:

- providing access to subsidised infrastructure or licencing of subsidised assets on fair, reasonable and non-discriminatory terms;

- reducing capacity or market presence and divestment of certain assets;
- refraining from certain investments; and
- publication of results of subsidised research and development.

The Commission may also accept the repayment of the foreign subsidy (including an appropriate interest rate) by the recipient undertaking, provided the Commission can ascertain that the repayment is transparent and effective.

Under the notification tools for concentrations and public procurements, if the undertakings concerned do not offer commitments that are satisfactory to the Commission, the Commission will issue a decision prohibiting the concentration / award of the public contract to the undertaking in question.

INVESTIGATION PROCEDURES AND POWERS

Commission investigations under the three tools would have two phases: a "preliminary review"; and – if the Commission considers based on the preliminary review that there are sufficient indications of a distortive foreign subsidy – a subsequent "in-depth investigation".

In-depth investigations would be launched by way of an "initiating decision" which sets out the Commission's preliminary assessment and on which interested parties, including the undertaking concerned, can respond and submit comments. It also appears that prior to taking any *final negative decision*, the Commission will issue a statement of objections-type document, to which the undertaking concerned can respond.

Specific timeframes for the two investigative phases would apply under the notification tools for concentrations and public procurements.

- Under the concentrations tool, preliminary reviews are to be completed within **25 working days** and in-depth investigations normally within **90 working days**. These are the same basic time periods for the Phase 1 and Phase 2 review of transactions under the EU Merger Regulation.
- Under the public procurement tool, preliminary reviews are to be completed within **60 days** and in-depth investigations normally within **200 days** of the notification being received by the Commission.

As part of its investigation, the Commission may request "all necessary information" from both the undertaking concerned as well as other operators, EU Member States and third countries. The Commission would also be able to conduct on-site inspections, i.e. dawn raids, within the EU. Inspections could also be carried out outside the EU, provided the undertaking concerned and the relevant third country government both consent.

Where there is non-cooperation by the undertaking concerned or relevant third country, the Commission would be able to take its decision on the basis of the "facts available", which would tend to be unfavourable. Similarly, where an undertaking concerned fails to provide the necessary information to determine whether a "financial contribution" confers a "benefit" to it and therefore a "subsidy", the Commission may assume that this is the case.

The Commission would also be able to levy fines and periodic penalty payments in the event of negligent or intentional procedural breaches, e.g. where an undertaking supplies incorrect, incomplete or misleading information, and for non-compliance with Commission decisions imposing redressive measures or binding commitments. Fines of up to 10% aggregate turnover could also be imposed where the undertakings concerned fail to comply with their notification obligations under the notification tools for concentrations and public procurements and where a concentration is implemented in breach of the suspensory obligation (or indeed, any prohibition decision).

PRACTICAL DIFFICULTIES AND AREAS THAT REQUIRE FURTHER CLARIFICATION

The proposed regulation is evidently very far-reaching and if passed in its current form, has the potential to significantly increase the regulatory risk and burdens for foreign companies operating or investing in the EU. It also remains to be seen how the proposed tools would operate in practice as the provisions of the regulation give rise to a number of difficulties and uncertainties that will require further clarification. In particular:

- As explained above, the notification tools for concentrations and public procurements are not triggered by the receipt of foreign "subsidies" but rather foreign "financial contributions". The notion of a "financial contribution" is much wider than that of a "subsidy", and essentially includes any transfer or use of financial resources that is directed by the foreign State, including remuneration by the foreign State for goods and services provided. This would mean, for example, that the notification obligations could be triggered where the undertaking concerned simply carries out public contracts awarded by a foreign State, even where these contracts are concluded on market terms and therefore should not be considered as a "subsidy", with the result that the notification obligations may prove very onerous in practice.

- The Commission's decision to base the notification triggers on "financial contributions" rather than "subsidies" appears to be motivated by the aim of providing bright-line requirements, as the question of whether a financial contribution gives rise to a subsidy may not always be straight-forward. There will however, be many instances where this will not be the case and it should be reasonably clear that there is no "subsidy". For example, where a public contract is awarded pursuant to a competitive tender process this normally means that the contract may be assumed to be on market terms and therefore that there is no "benefit". Similarly, where a fiscal incentive is made available to all companies in practice, it should not normally be considered as "selective". There appears therefore significant scope to carve-out certain categories of financial contribution from the notification obligations, which would then help to streamline and focus the regime.

- The notification thresholds for concentrations give rise to various ambiguities that require further clarification. In particular, in the case of acquisitions, it is not fully clear whether the €500 million EU turnover threshold applies only to the target group or also for the acquirer and whether only financial contributions and therefore subsidies received by the acquirer are relevant, or whether financial contributions received by the target group also need to be taken into account. In addition, the criterion of being "established in the EU" which is part of the trigger, is not defined anywhere in the proposed regulation. While definitions of this concept exist in other EU law areas (in particular, EU customs law), in the interests of legal certainty, it would be better for this to be spelled out in the proposed regulation.

- The proposed regulation would leave the Commission with significant investigative discretion. No real indications are provided as to how the Commission will use the *ex officio* tool and decide when to open investigations into foreign subsidies. In addition, in the case of the notification tools for concentrations and public procurements as explained above, the Commission could require notification even where the notification thresholds are not met where it suspects that one of the undertakings may have benefitted from foreign subsidies in the past three years. The Commission would also retain the ability to investigate concentrations and public procurements not meeting the thresholds under its ex *officio tool*.

- This open-ended discretion could give rise to significant legal uncertainty for foreign companies operating and investing in the EU. To alleviate these concerns, the Commission could provide further specifics as to how it would exercise these powers, potentially in the form of "enforcement priorities", as it has done in other areas.

- The substantive concepts and assessment standards under the proposed regulation are set out in relatively high-level terms and it remains to be seen how the Commission would go about applying them in practice. By way of comparison, under EU State aid law, the Commission has clarified its practice by issuing detailed aid measure and sector-specific guidelines, setting out how it qualifies "State aid" and considers distortions and the balancing of positive and negative effects. But under the proposed regulation, this is currently something of a blank canvas.

- To provide further clarity, the Commission could issue guidelines specific to the proposed regulation that would flesh out its approach. Alternatively, the Commission could confirm that it would be following an approach that is in line with that under EU State aid law, and the provisions of the detailed guidelines that it has already adopted in this area. This would represent a common-sense approach, as many of the substantive concepts and assessment standards under the proposed regulation appear to be based on EU State aid law, with which the Commission's DG Competition that would be responsible for enforcing the regulation, obviously has significant experience. It would also make sense for the Commission to follow EU State aid law practice in assessing foreign subsidies in order to avoid possible arguments that it is discriminating against third countries.

- It is not fully clear how the Commission would take into account existing subsidy control commitments agreed with other third countries at the international level. While the proposal provides that the Commission will not take measures that would be contrary to the EU's international obligations, it remains to be seen how this will be applied in practice and how far this would restrict the Commission's freedom of action. On the one hand, the proposal specifically recognises that action cannot be taken against foreign subsidies in relation to goods within the scope of the WTO Agreement on Subsidies and Countervailing Measures, which excludes any action that goes beyond its provisions. But the proposal does not address any of the other subsidy control commitments agreed with various third countries under the EU's international trade agreements.

- This is relevant, in particular, to the UK. Under the UK-EU Trade and Cooperation Agreement, the UK is required to operate a subsidy control regime that is essentially substantively equivalent to EU State aid law, and under which it is required to take into account effects on trade and investment with the EU. Yet on the basis of the current proposal, it seems possible that companies in receipt of financial contributions from UK authorities could still be subject to its provisions and may be required to notify these financial contributions even though they would already have been subject to the disciplines of a rigorous subsidy control regime.

NEXT STEPS

The Commission's proposal will now be passed on to the EU's legislature, the EU Council and the EU Parliament, which will have to agree upon a joint text if the regulation is to pass. This may take some time and it is possible that these Institutions may require material changes to the proposed tools.

Companies now also have the opportunity to submit comments on the proposed regulation here until 21 July 2021. The public feedback received will be presented to the EU legislature as it considers the proposals.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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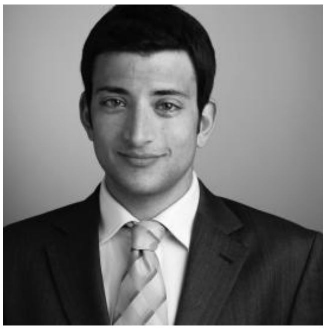

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