Kluwer Competition Law Blog

The Commission's White Paper on Foreign Subsidies

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1. Overview

On 17 June 2020, the European Commission ("EC") issued a White Paper consulting on "Levelling the Playing Field as regards Foreign Subsidies". These are major new proposals to protect EU companies against perceived unfair advantage from companies benefitting from subsidies from non-EU States.

Countries such as China and Russia have already reacted to the White Paper, urging the EU to guard itself against protectionism. In a recent joint statement, the German and French economy ministers emphasised that their countries want to have a more level playing field to be in a situation to compete with China and the US.[1] Others within the EU believe the EC proposals are not far-reaching enough: for instance, the centre-right European People's Party (EPP) in the EU Parliament has called for a temporary ban on Chinese takeovers of European companies made vulnerable by COVID-19.[2]

The rationale of the White Paper is that Member States of the EU are subject to controls under EU State aid rules, to ensure that selective State support for businesses does not give rise to market-distorting advantages within the EU. These controls do not, however, apply to support given by non-EU States to beneficiaries outside the EU. Where those beneficiaries are also active in the EU, the effect of the support could therefore be distortive to market conditions within the EU.

The White Paper acknowledges that there are some protections under EU trade policy, but sees significant limitations. The proposals in the White Paper aim to close the perceived legislative gap.

2. Proposals

The White Paper sets out three "Modules":

- Module 1 – distortions caused by foreign subsidies affecting general market operations;

- Module 2 – distortions caused by foreign subsidies facilitating the acquisition of EU undertakings;
- Module 3 – distortions caused by foreign subsidies in the context of procurement procedures.

The White Paper also deals with proposals in relation to access to EU funding.

3. General instrument to capture foreign subsidies (Module 1)

Module 1 of the White Paper proposes a general market scrutiny instrument to capture all possible market situations in which foreign subsidies may cause distortions of the EU internal market.

Process[3]

The White Paper proposes that a competent authority (either the EC or Member State authorities) could initiate a review to examine whether there is a foreign subsidy that might distort the internal market. Following a preliminary review, the authority could close the case or proceed to an in-depth review, with powers to impose redressive measures at the end of the review. The authority would also have powers to obtain information and conduct site visits, including powers to impose penalties for failure to comply.

Substantive review[4]

A foreign subsidy would be a financial contribution by a non-EU state or state body, conferring a benefit on an individual entity, industry or to a specific group of entities or industries. A financial contribution could take many forms, such as capital injections, grants, loans, guarantees, set-off, debt forgiveness, fiscal measures, and also provision or purchase of goods or services. The subsidy would be to an entity established in the EU or otherwise active in the EU (e.g. seeking to acquire an EU business).

There would be a safe haven for foreign subsidies below a set threshold (possibly €200,000 over three years, in line with existing State aid *de minimis* amounts).

Module 1 proposes delineating certain categories of subsidies that would be considered likely to create distortions, such as:

- export financing,
- subsidies contingent upon use of goods/services of the subsidising country,
- debt forgiveness to ailing undertakings,
- unlimited guarantees (by amount or duration),
- operating subsidies in the form of tax relief which are not general measures, and
- subsidies directly facilitating an acquisition.

Subsidies that fall outside these categories would require a case-by-case analysis of their impact on the internal market. As lack of transparency may make it difficult to assess the impact on the internal market, the White Paper proposes using indicators such as: size of subsidy, situation of beneficiary, market situation, market conduct, and level of activity across the EU. If the beneficiary has privileged access to its domestic market resulting in an artificial competitive advantage that could be leveraged within the EU, this would be another relevant factor in the assessment.

If the authority were to find an actual or potential distortion arose as a result of the subsidy, it

would apply an "EU interest" test – balancing that distortion against the positive impact the foreign subsidy might have within EU (taking into account the EU public policy objectives such as job creation, climate/environmental benefits, digital transformation, security, public order/safety and resilience), thereby allowing political considerations to be relevant for the assessment.

If, ultimately, the authority concluded that a foreign subsidy created a distortion and the EU interest test was not satisfied, the authority could obtain commitments or impose redressive measures, such as:

- re-payment of the subsidy back to the third country – however the White Paper recognises the difficulty of implementing this measure and suggests it is only a possibility if there is an independent authority in the third country that could monitor this;
- structural measures such as: divestment; prohibition of certain investments; prohibition of subsidised acquisitions or unwinding in case of a completed acquisition;
- behavioural measures such as: third party access; FRAND licensing; prohibition of specified market conduct; publication of R&D results; redressive payments to the EU or a Member State.

Non-compliance with the measures would be punishable by the imposition of fines.

4. Foreign subsidies facilitating the acquisition of EU targets (Module 2)

Module 2 complements Module 1 and intends to specifically address distortions caused by foreign subsidies that facilitate the acquisition of EU firms.

Process[5]

Module 2 also envisages a two-step process, administered by the EC (rather than the EC and Member States).

The first step would involve a mandatory requirement to file a short information notice, followed by a standstill period (although the parties could request a waiver from the standstill obligation). The fact of notification would be made public, to allow for third party comments.

Upon expiry of the standstill period, if the authority did not open an in-depth investigation, the parties would be free to close the transaction. If the authority proceeded to an in-depth investigation, the standstill obligation would continue to apply and, ultimately, redressive measures could be imposed.

Scope[6]

Module 2 proposes to cover acquisitions of control (applying the same concept as under EU merger control[7]) *and also* – below the level of control – acquisitions of a specified percentage (to be decided) or of "material influence". The White Paper recognises that the concept of "material influence" would have to be defined properly in order to avoid confusion about the need to notify and that there may be a number of "precautionary" notifications by firms seeking legal certainty.

The proposal targets "potentially subsidised acquisitions" – i.e. where the acquirer has received a financial contribution (meeting certain thresholds, to be determined) from a third country within a specified period (proposed as three years) prior to notification. Financial contributions expected to be granted within one year following closing of the deal would also be within scope.

The regime would apply to targets established in the EU which meet specified financial thresholds, set at a level to capture businesses with significant actual or future activities in the EU. The threshold could be quantitative (e.g. based on target turnover of €100 million) or, as an alternative, by reference to assets likely to generate a significant EU turnover in the future and/or by reference to the value of the transaction.

Under the proposal, where all these criteria are met, the mandatory notification obligation would arise (with sanctions for failure to comply, including fines and unwinding of the transaction).

Substantive review[8]

The authority would first assess whether the acquisition would be facilitated by a foreign subsidy and then would assess whether the subsidised acquisition might result in a distortion of the internal market.

Foreign subsidies might facilitate an acquisition either directly (where the link to the acquisition can be established) or *de facto* (where the foreign subsidy reinforces the financial strength of the acquirer). Foreign subsidies granted directly for the acquisition of EU targets would normally be considered to distort the internal market. For *de facto* facilitation, the actual or potential impact on the internal market would need to be assessed in more detail. Given the lack of transparency related to foreign subsidies, the authority could use a range of factors (as per Module 1) to assess whether there is a distortion.

If a distortion were found to arise, the authority would (as for Module 1) apply an "EU interest" test to balance the distortion against the positive impact of the foreign subsidy.

The in-depth investigation could result in case closure, a conditional clearance or prohibition of the acquisition. For a conditional clearance, the acquirer would offer legally binding commitments, in the form of the redressive measures suggested for Module 1 (although structural remedies would be likely to be the most appropriate measures here, in the same way as structural remedies are prioritised to solve competition concerns in merger control cases).

5. Procurement (Module 3)

Module 3 intends to ensure that foreign subsidies are addressed in public procurement procedures. EU public buyers would be required to exclude from public procurement procedures all companies that have received distortive foreign subsidies.

Process[9]

Firms participating in public procurement procedures would have to notify the contracting authority when submitting their bid whether they (or any of their consortium members or sub-contractors) have received relevant financial contributions within the last three years preceding the participation in the procedure (and whether such contributions are expected to be received during the procedure). In order to focus on the most relevant cases and to limit the administrative burden for public buyers thresholds and additional conditions could be introduced (e.g. notifications only required above a certain value or limitations of relevant time periods). The supervising authority at Member State level would investigate and assess the existence of a foreign subsidies based on the firm's notification.

As a prior notification obligation would require self assessment by company which, according to the White Paper, carries significant risk of error and circumvention, third parties and competitors could inform the contracting authority that a notification should have been made which will provide *prima facie* evidence for the necessity of notification (!) (but this will need to be substantiated).

The investigation will be in two steps with a preliminary review and in-depth investigation (similar to Module 2). During the review the contracting authority is barred from awarding the contract to the firm that is being investigated. If the supervisory authority concludes in Phase 1 that no foreign subsidy exists it informs the contracting agency. In Phase 2 the supervisory can decide that a foreign subsidy exists or that it does not. Either way it has to inform the EC of its intended decision before informing the contracting authority. The authority's review has to avoid delays in the public procurement procedure (max. of 15 working days for the preliminary review is proposed, and no more three months for the in-depth review, both mentioned in square brackets in the White Paper).

Redressive measures[10]

Where the review of the supervisory authority confirms that the firm received a foreign subsidy it would determine whether such subsidy is distortive. In case the foreign subsidy enables the recipient to submit an offer that would be economically less sustainable (in the case of bidding significantly below market price or below cost) a distortion may be presumed.

If a foreign subsidy is found to be distortive the firm will be excluded from the on-going procurement procedure and could additionally be excluded for several years from future procedures before the same contract authority. The White Paper mentions that an exclusion of undertakings having received illegal EU State aid will need to be considered as well for equal treatment reasons (as this is not contained in the current public procurement framework).

EU funding[11]

EU funding rules and agreements with third countries to govern access to EU funding for third country entities do not take into account the existence of foreign subsidies. The White Paper proposes that where a foreign subsidy is found to exist, e.g. in the context of a firm applying for an EU grant, it would be assessed whether the foreign subsidy distorts the award procedure, in which case the applicant would be excluded from the procedure.

6. Next steps for the White Paper

The White Paper kicks off an open public consultation closing on 23 September 2020. The EC hopes that the tools to assess foreign subsidies will be operational in a "few months", but taking the proposals in the White Paper successfully through the EU legislative procedure will take time. Therefore, although the EC wants to move quickly, it will need to build momentum across Member States, which as ever may prove more challenging than the rhetoric might suggest.

7. Outlook

If implemented, these proposals would introduce a potentially onerous new regime within the EU, covering both ongoing conduct and acquisitions. There are clearly challenges in terms of designing a workable regime, as well as political challenges in striking the balance between attracting investment and protecting European businesses. However, as protectionism has crept up the agenda

globally, the EU has inclined further this way. The COVID-19 crisis has also exacerbated concerns as to the vulnerability of the economy and businesses within the EU, giving more momentum to these proposals. That said, given the political and practical challenges, we need to wait to see whether, how and when these proposals materialise into legislation.

Although the proposed legislative regime is undoubtedly most inspired by concerns about the ever-growing influence of China on the EU economy, it could have significant repercussions for a wide range of non-EU investors in Europe. Indeed, given Brexit, this would also capture UK businesses benefiting from UK State support in future, once the transitional period is over and the EU State aid regime has ceased to be applicable in the UK. As a non-Member State, the UK will not have any say over the progress on these proposals.

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[1] See: https://www.bmwi.de/Redaktion/DE/Videos/2020/20200622-pressestatement-altmaier-le-maire.html.

[2] See: https://www.argusmedia.com/news/2115229-eu-mulls-tougher-stance-on-foreign-investments?amp=1.

[3] See section 4.1.5 of the White Paper.

[4] See sections 4.1.2 – 4.1.4 and section 4.1.6 of the White Paper.

[5] See section 4.2.5 of the White Paper.

[6] See section 4.2.2 of the White Paper.

[7] See for details on the notion of “control”: the Commission’s Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, OJ C 95, 16.4.2008, p. 1.

[8] See sections 4.2.3 – 4.2.4 of the White Paper.

[9] See section 4.3.3 of the White Paper.

[10] See section 4.3.3.3 of the White Paper.

[11] See section 5 of the White Paper.

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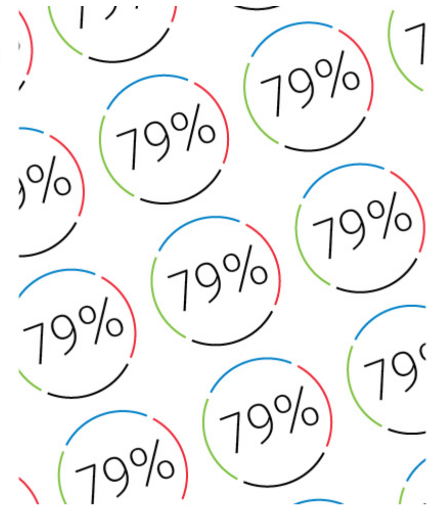

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