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EU Anti-Subsidy Initiative: Notifications, Investigations – and a No-Deal Brexit Backstop?

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Adopting new tools to combat the effects of foreign subsidies is a top European Union (EU) priority for 2021; a no-deal Brexit would raise the stakes for this initiative significantly. The European Commission (EC) believes that non-European State-owned enterprises (SOEs) and other companies receive subsidies that can distort competition in the European single market. Trade defence rules offer no protection when non-EU subsidies distort investment decisions, market operations or pricing policies in beneficiaries' European operations, facilitate the acquisition of EU companies, or distort bidding in European public procurement.

The EC recently published comments on a June 2020 white paper on levelling the playing field as regards foreign subsidies (the White Paper), shedding new light on the forthcoming proposals. The EC is now working on draft legislation – expected for the second quarter of 2021 – to create an unprecedented legal framework empowering the EC and national authorities to take action against multinationals benefiting from foreign subsidies. The new legislation could apply not only to multinationals receiving foreign subsidies specifically targeting EU operations, but also companies benefiting from special tax or other regimes that arguably increase their profitability and thereby affect their competitive behavior in the EU. Examples could include the energy, food and agriculture and transport sectors, which benefit from special incentives and legal regimes in many jurisdictions.

The new EU legislation will reflect three so-called **"**Modules**"** outlined in the White Paper to address the distortive effects of foreign subsidies in the EU Single Market generally (Module 1), acquisitions of EU companies (Module 2) and EU public procurement procedures (Module 3). The EC received hundreds of submissions from Member States, non-EU stakeholders and governments, business and industry associations and individual companies and law firms, academic institutions, trade unions, NGOs, other public authorities and individual citizens. While non-EU respondents questioned the need for new legislation, almost all EU Member States – who will need to approve the new law along with the European Parliament — favoured the new tools. On the other hand, significant differences of opinion between the Member States commenting on the White Paper may prove difficult to reconcile.

Scope – Foreign subsidies and companies covered

The White Paper defined "foreign subsidies" broadly as financial contributions by a government or public body of a non-EU State conferring a benefit limited to an individual company, industry or group of companies or industries, insofar as they directly or indirectly cause distortions within the EU Single Market.

To determine whether a financial contribution confers a benefit, authorities would take into account private investors' usual investment practices, market rates for financing, and the adequate remuneration for a given good or service. If there are no directly comparable benchmarks, existing benchmarks can be adjusted or market conditions can be established based on generally accepted assessment methods. A *de minimis* threshold could be established for foreign subsidies presumed not to confer a benefit.

Member States generally agreed with the proposed scope, though some Member States considered that the concept of foreign subsidy definition should be broadened to cover more types of fiscal support or lower labour law or environmental protection standards.

<u>Module 1 — General instrument to capture distortive effects of foreign subsidies</u>

Module 1 would create a general "market scrutiny instrument" potentially covering any market situation in which foreign subsidies may cause distortions in the EU Single Market. This instrument could be used by national authorities or the EC under a shared system of review, perhaps modelled on the European Competition Network (ECN) for enforcement of EU competition law.

A case would start with a preliminary review to examine whether there is a foreign subsidy that may distort the internal market. If there is evidence tending to show that a foreign subsidy may distort the proper functioning of the internal market, an in-depth investigation would follow.

Once the existence of a foreign subsidy is established, the EC or a national authority would assess whether such subsidy causes a distortion in the internal market. Certain categories of foreign subsidies could be presumed to cause distortions, while others would require a more detailed assessment. In any event, the concerned companies could also show that the foreign subsidy in question is not capable of distorting the internal market in the specific circumstances of the case.

The White Paper proposed a non-exhaustive list of indicators to determine the impact of foreign subsidies: the relative size of the subsidy; the size and capacity utilization of the beneficiary; market structure (e.g., markets with structural excess capacity, concentrated markets and fast-growing markets are more likely to be subject to distortions); the market conduct in question (e.g., outbidding in acquisitions or distortive bidding in procurement procedures); and the beneficiaries' level of activity in the EU. Authorities would also consider whether the beneficiary has privileged access to its domestic market (through measures equivalent to special or exclusive rights) leading to an artificial competitive advantage that could be leveraged in the EU.

If the existence and distortive impact of a foreign subsidy are established, the EC or national authority would then impose measures to remedy the likely distortive impact, such as structural or behavioural remedies (assuming that repayment to the non-EU country is not suitable or feasible). Such measures could include the prohibition of a subsidized acquisition; mandated third party access, for example to mobility apps for providers of transportation services; mandatory licensing on fair, reasonable and non-discriminatory (FRAND) terms (e.g., if an undertaking receives subsidies and obtains telecom frequencies or provides access to networks using such frequencies); prohibition of specific market conduct linked to the foreign subsidy; or publication of R&D results so other companies can reproduce them.

A finding of distortive effects could be weighed against evidence of possible positive impacts that the supported economic activity or investment might have within the EU or on public policy interests recognized by the EU, such as creating jobs, achieving climate neutrality and protecting the environment, digital transformation, security, public order and public safety and resilience. If on balance, the positive impact of the supported economic activity or investment sufficiently mitigates any distortion on the internal market, no redressive measures would be required (the EU Interest Test).

Member States generally agreed on the proposed approach to Module 1, though some raised practical concerns such as the difficulty of obtaining information on non-EU subsidies, the time required for investigations and the ability to enforce redressive measures. Some Member States considered that Module 1 would be broad enough to eliminate the need for Modules 2 and 3. In relation to enforcement responsibilities, some Member States argued for shared responsibilities between the Member States and the EC, while others supported giving the EC exclusive authority. Most non-governmental contributors considered that the EC should be exclusively responsible for enforcing Module 1.

Several Member States agreed with the proposed €200,000 de minimis threshold, while others argued for a higher threshold to avoid discouraging foreign direct investment and to focus enforcement on the most distortive subsidies. Views of non-governmental commentators on the necessity of a de minimis threshold were mixed, with some respondents arguing there here should be no threshold at all and others arguing that the threshold should be lower or sector-based.

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

Module 2 would specifically address distortions caused by foreign subsidies facilitating the acquisition of EU companies by creating a mandatory ex-ante notification system analogous to that created by the EU Merger Regulation. For this purpose, an "acquisition" would be defined as the acquisition – directly or indirectly – of control of an undertaking, a specific percentage of the shares or voting rights or a "material influence" in an undertaking. Module 2 would thus be broader than the EU Merger Regulation, which is triggered by a change in control.

Companies benefitting from non-EU subsidies would need to notify their acquisitions of EU companies, above a given threshold, to the competent supervisory authority. The actual thresholds would depend in particular on the options chosen regarding the EU target, the trigger for notification and the appropriate competent supervisory authorities. Thresholds could be based on turnover (e.g., €100 million), assets likely to generate a significant EU turnover and/or transaction value.

The notification requirement could also be limited to acquisitions facilitated by a certain volume of financial contribution from non-EU authorities. Potentially subsidized acquisitions would be defined as acquisitions of EU targets, where a party has received a financial subsidy in the last three calendar years prior to the notification or up to one year following the closing of the acquisition. This approach would require a degree of self-assessment by the companies involved, creating a risk of error or circumvention, but the EC notes that the identification of a financial contribution should be more objective than the identification of a financial subsidy, which requires an assessment of the competitive benefit of the financial contribution in the EU.

In a first step, acquirers would be obliged to file a short information notice containing basic information needed for the competent supervisory authority to identify possibly problematic operations involving foreign subsidies. This could include legal information such as ownership and governance; information on financing; turnover information; description of the business; financing of the transaction; main sources of the overall financing of the acquirer; financial contributions from non-EU authorities for purposes of the transaction or otherwise for the past three years; and information on alternative prospective acquirers of the target, including any bid that has been received as part of the sale process.

Transactions could not be closed while the review is pending. Should the supervisory authority find that the acquisition is facilitated by the foreign subsidy and distorts the Single Market, it could either accept commitments by the notifying party that effectively remedy the distortion or prohibit the acquisition. As in Module 1, the reviewing authority could allow a transaction that would otherwise be prohibited based on the EU Interest Test.

While the White Paper leaves open the possibility that reviewing authority under Module 2 could be exercised at the Member State level, there was a strong preference for the EC being the competent supervisory authority. This approach would provide a one-stop-shop control across the EU for acquisitions above the thresholds and avoid the need for several Member State authorities to review a single transaction in parallel. Member States would be involved through an information mechanism at the start and during the EC procedure and would be consulted on final decisions, following in-depth investigations. If Module 2 is combined with Module 1, moreover, Member States could, in any case, examine acquisitions ex officio, even below the thresholds set up in Module 2.

Most Member States commenting on the White Paper supported Module 2, but some raised practical concerns, for instance regarding the administrative burden and risk of delay, while others opposed the introduction of a new notification requirement for fear of creating overlaps with merger control and foreign direct investment screening. Similarly, some Member States proposed using the EU Merger Regulation definition of acquisition for acquisitions caught by Module 2. Several Member States favoured sharing enforcement powers for Module 2, instead of giving sole jurisdiction to the EC.

As concerns the notification requirement, Member States proposed a variety of criteria. Several Member States proposed that only subsidized acquisitions should be notified, and some argued for limiting notifiable transactions based on quantitative criteria, to certain sectors or only when a trade defence instrument notification is compulsory. On the other hand, some Member States questioned the need for turnover thresholds or recommended using lower thresholds. Otherwise, very few transactions involving innovative start-ups and scale-ups would be covered. Another option would be for the EC to have the power to launch investigations into specific investments and acquisitions on its own initiative rather than requiring ex-ante notification. This approach could reduce administrative burdens on companies and supervisory authorities but result in less legal certainty.

Non-governmental respondents from the EU were supportive of Module 2, though some cautioned against applying it too broadly, e.g. in relation to the concept of de facto facilitation or certain types of investments (e.g., portfolio or passive financial investments). Some respondents noted ambiguities in terms of procedure, assessment criteria and definitions and called for alignment of Module 2 with the EU Merger Regulation. Most respondents agreed with the use of quantitative thresholds, but without consensus on the right threshold, in some cases with parallel qualitative standards for smaller transactions of a strategic nature. As mentioned, most non-EU contributions argued that no new regulation is needed, or that any new notification obligation should be limited to SOEs or previously distortive companies.

Module 3 — Foreign subsidies in EU public procurement procedures

Module 3 is intended to address the potential harmful effects of foreign subsidies in EU public procurement procedures. Foreign subsidies may enable bidders to gain an unfair advantage, for example by submitting bids below market price or even below cost, allowing them to obtain public procurement contracts that they would otherwise not have obtained. The White Paper proposes a mechanism whereby bidders would have to notify the contracting authority of financial contributions received from non-EU countries. The competent contracting and supervisory authorities would then assess whether there is a foreign subsidy and whether it made the procurement procedure unfair. In this case, the bidder would be excluded from the procurement procedure.

The majority of Member States who commented on Module 3 agreed with the need for action on public procurement but not necessarily with the proposed framework. Several Member States challenged the need for a dedicated legal instrument to tackle the distortive effects of foreign subsidies in public procurement. Some disagreed with the premise that foreign subsidies have a negative effect on public procurement, while others suggested addressing the issue under existing rules on abnormally low tenders.

A majority of Member States expressed concern about the proposal to share responsibilities between contracting authorities and supervisory authorities. Member States broadly agreed that contracting authorities should not be responsible for assessing whether a foreign subsidy distorts the public procurement procedure and that this task should instead be incumbent on the national supervisory authority or the EC. Some Member States argued that the EC should have exclusive jurisdiction in the interest of consistency and legal certainty.

Key Takeaways

The anti-subsidy tools proposed in the White Paper are an important part of the von der Leyen Commission’s industrial strategy. If the EU and UK fail to reach a Brexit deal requiring the UK to observe EU-style State aid rules, these new tools will become even more important. Member State comments on the White Paper revealed substantial support for the introduction of new powers to combat the distortive effect of non-EU subsidies, but also significant differences of opinion that may stand in the way of rapid adoption.

Some of the differences in Member States’ views are quite fundamental – for example, whether a notification obligation for subsidized acquisitions (Module 2) is needed if the general investigation power (Module 1) will cover potentially distortive acquisitions. A number of Member States challenge the need for new legislation on public procurement (Module 3). A number of Member States also resist conferring exclusive jurisdiction on the EC, even to investigate potentially subsidized acquisitions under Module 2.

Can the EC reconcile these differences of opinion, and if so how? A possible compromise on Module 2 could involve a narrowly defined obligation to notify potentially subsidized acquisitions of control to the EC. Acquisitions of control and other investments not subject to mandatory notification could remain subject to investigation by the EC and national authorities under Module 1. Module 3, on public procurement procedures, may be dropped in view of the lukewarm Member State support and existence of a well-developed EU legal framework for public procurement.

Regardless of the proposed approach on Modules 1, 2 and 3, clearer guidance on the foreign subsidies that will trigger the application of the new framework will be critical, especially for multinationals that must determine whether transactions trigger a notification requirement. The definition of non-EU financial contributions will likely be based on the broad EU concept of State aid. But there is currently no precedent for determining when such non-EU contributions are likely to distort markets, or proposed acquisitions, in the EU.

EC officials stress that the new framework would target only clear distortions and should not create excessive burdens for multinationals or supervisory authorities. In the case of Module 1, the burden of identifying and proving distortive non-EU subsidies will fall on the EC and national authorities. This burden of proof, and limited resources, may ensure that relatively few companies are impacted. On the other hand, the burden of identifying acquisitions that may trigger mandatory notification under Module 2 will fall on the private sector. Clear guidelines, and potentially safe harbours, will be essential to avoid the imposition of significant burdens that may deter needed investment into the EU.

Despite significant differences of opinion, political support for some form of protection against unfair competition fueled by non-EU subsidies will create significant pressure to find a compromise. This pressure would increase significantly if a no-deal Brexit leaves the UK free to subsidise its companies' EU activities. It would be ironic if the primary target of the new tools – originally envisaged as protection in particular against Chinese SOEs – turned out to be an ex-Member State.

This entry was posted on Monday, December 14th, 2020 at 11:45 am and is filed under European Union, Foreign subsidies, White Paper
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