The Commission adopts White Paper on the Distortive Effects of Foreign Subsidies on the Internal Market

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On 17 June 2020, the Commission adopted a so-called White Paper on the distortive effects of foreign subsidies on the internal market. The White Paper is not a concrete legislative proposal but is rather an overview of identified problems and possible solutions. The proposals in the White Paper aim to improve competition and address distortive effects on the internal market caused by foreign subsidies, i.e. from third countries outside the EU, especially with a view to China but the proposal covers all third countries. To summarize, the very far-reaching proposals include requirements for redressive payments in certain state-aid-like situations, proposals for notification obligations and opportunities to prohibit certain acquisitions that have elements of subsidies from public bodies outside the EU and a possibility to exclude companies that receive such subsidies from public procurements. The White Paper is now subject to a public consultation which will be open until 23 September 2020 and is expected to raise a number of opinions for and against the far-reaching proposals.

Introduction

The Commission states in the White Paper that although the EU should remain open to global trade and investment, it is important to ensure fair competition and equal conditions for all economic operators in the EU internal market. The Commission considers, among other things, that it is important to prevent foreign subsidies from distorting competition within the EU.

The background is that the European Council, in its conclusions at the meeting on 21 and 22 March 2019, decided that the Commission should identify new tools to deal with the distorting effects of foreign subsidies on the internal market.

According to the Commission, there are gaps in the existing regulations for situations where foreign subsidies facilitate the acquisition of companies in the EU, directly support the operation of a company in the EU or distort the tender process in a public procurement, to the detriment of companies that have not received any support.

Within the EU, there are rules on **state aid** which include aid from Member States. However, subsidies granted by public bodies in non-EU countries to companies in the EU do not fall under the EU's state aid control.

Furthermore, the existing EU rules on **trade defense measures** such as anti-dumping rules only applies to the import of goods from third countries into the EU and therefore do not allow the possibility of remedying all distortions caused by foreign subsidies from outside the EU.

Although the **competition rules** deal with all types of anti-competitive behavior in the market, the rules do not consider whether the action is related to subsidies granted by a Member State or by a public body outside the EU.

Nor does the existing EU **public procurement rules** contain specific rules regarding distortions of public procurements caused by tenderers benefiting from foreign subsidies.

The regulation establishing a **framework for examining foreign direct investment in the Union** (also known as the FDI Regulation) enables the assessment of threats to security and public order but does not regulate the distortions of the internal market caused by third country investments. In addition, the FDI Regulation does not cover foreign subsidies that may not be linked to an investment.

The Commission's White Paper aims to address the gaps in the legislation described above. According to the Commission, it is becoming increasingly common that foreign companies appear to facilitate the acquisition of EU companies or distort the recipients' investment decisions, market transactions or pricing, or distort the tender process in public procurements, to the detriment of companies that have not received financial support.

The definition of "foreign subsidy"

The Commission's White Paper states that the definition of a foreign subsidy is: "*a financial contribution by a government or any public body of a non-EU State, which confers a benefit to a recipient and which is limited, in law or in fact, to an individual undertaking or industry or to a group of undertakings or industries.*" For a complete definition, see Annex 1 to the White Paper.

The definition of a foreign subsidy includes:

- foreign subsidies granted directly to undertakings established in the EU;
- foreign subsidies granted to an undertaking established in a third country where such subsidy is used by a related party established in the EU; and
- foreign subsidies granted to an undertaking established in a third country where such a subsidy is used to facilitate an acquisition of an EU undertaking or participate in public procurement procedures.

Furthermore, a foreign subsidy should only be covered by the White Paper's proposed regulation in situations where the subsidy directly or indirectly results in a distortion of the internal market.

The proposal in brief

As mentioned above, the Commission considers that there are gaps in the current regulatory framework. The Commission has therefore proposed several solutions to address this regulatory gap.

The first three options (referred to as modules) are aimed at dealing with the distorting effects of foreign subsidies:

i) in the internal market in general (Module 1);

ii) in acquisitions of companies in the EU (Module 2);

iii) in EU public procurement procedures (Module 3).

These modules can complement each other rather than being alternatives.

In addition to the above modules, the White Paper contains a fourth proposal for a general instrument to capture foreign subsidies in connection with EU funding.

Details of the proposed regulations

Module 1: General instrument for capturing distortive effects caused by foreign subsidies – with far-reaching corrective measures in the case of distortions

Overview of the proposal

In Module 1, the Commission suggests that a general instrument is established to capture all possible market situations where foreign subsidies may give rise to distortions in the internal market which would, inter alia, complement the existing state aid regulatory framework. Under this proposal, regulatory authorities (a national authority or the Commission) should be able to intervene if there is evidence or information that a company in the EU is benefiting from a foreign subsidy. The Commission

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and national authorities are proposed to have shared competence.

Applicability

Module 1 should be applicable to companies that are established in the EU and that benefit from foreign subsidies. Furthermore, the Commission states that it could be considered whether Module 1 also should cover certain companies that are otherwise active in the EU that benefit from foreign subsidies. It is suggested that a rule corresponding to the de minimis rule for state aid would apply, i.e. aid of less than EUR 200,000 over a period of three years will not be investigated.

Categories of foreign subsidies that are likely to create distortions

Once it has been established that a foreign subsidy exists, the supervisory authority shall assess whether the subsidy actually or potentially distort the level playing field in the internal market. Certain categories of foreign subsidies are likely to create distortions in the internal market. These are listed below:

- 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 (such as debt forgiveness) to ailing undertakings, i.e. undertakings unable to obtain long-term financing or investment from independent commercial sources, unless there is a restructuring plan leading to the long-term viability of the beneficiary and including a significant own contribution by the beneficiary. Subsidies granted to remedy a serious national or global disturbance of the economy do not fall in this category, if they are limited in time and proportionate to remedy the respective disturbance.
- Subsidies whereby a government guarantees debts or liabilities of certain undertakings without any limitation as to the amount of those debts and liabilities or the duration of such guarantee.
- Operating subsidies in the form of tax reliefs, outside general measures.
- Foreign subsidies directly facilitating an acquisition.

All other foreign subsidies require a more detailed evaluation in accordance with criteria that help determine whether a foreign subsidy actually or potentially causes a distortion of the functioning of the internal market. Such criteria may be e.g. the relative size of the subsidy in question, the recipient's situation (for example, the risk is greater if it is a large company), the situation in the relevant market (for example, the risk is greater if the market is concentrated) and the extent of the activities of the companies concerned in the EU market.

Assessment of Distortion

It is suggested that the procedure in Module 1 should consist of a two-step system in which the first stage consists of a preliminary examination of a possible distortion in the internal market as a result of a foreign subsidy. If suspicions remain after the preliminary examination, the supervisory authority should be able to initiate an in-depth investigation.

No notification of foreign subsidies is suggested. However, investigations may be made on the basis of complaints or through the initiation of an ex officio investigation by the Commission or a national authority. However, the Commission proposes that mechanisms should be put in place to ensure that the supervisory authority can gather the necessary information. For example, the supervisory authority shall be able to use penalties such as fines for failure to provide requested information and be able to carry out dawn raids to search for evidence.

The supervisory authority may find that the subsidized business or investment has a positive impact that outweighs the distortion. If the supervisory authority finds this to be the case, it can choose not to proceed with the investigation (the so-called test of whether there is an EU interest).

Sanctions

If the supervisory authority finds that there is a foreign subsidy which distorts competition, the supervisory authority must be able to oblige the beneficiary to remedy the distorting effects. Such remediation can be done, for example, through redressive payments. Alternative recommended measures include structural and behavioral corrective measures, such as divestment of certain assets, prohibition of specific behavior, prohibition of certain investments or providing third party access.

Module 2: Foreign subsidies that facilitate the acquisition of companies within the EU–- the obligation to notify and in some cases prohibit distortive acquisitions

Overview of the proposal

Module 2 is intended to deal specifically with distortions caused by foreign subsidies that facilitate the acquisition of certain companies in the EU. In short, module 2 aims to ensure that foreign subsidies do not give an unfair advantage to their recipients when they acquire other companies. Module 2 is thus narrower in scope than module 1 and is suggested to apply in parallel with the existing rules on merger control.

The Commission states that foreign subsidies can distort the internal market by facilitating the acquisition of a company within the EU. This can be done either (1) directly by providing a company with a subsidy explicitly linked to a specific acquisition or (2) indirectly by increasing the financial strength of the acquirer, which in turn facilitates an acquisition.

Certain acquisitions must be notified to the Commission

Under Module 2, companies receiving a financial subsidy from a non-EU state will need to notify their acquisitions of EU companies to the Commission (proposed to be the supervisory authority). This proposal is so far much more far-reaching than the rules on merger control, since it covers not only changes in control but also minority acquisitions. When the notification is supposed to take place is not clear, but the Commission has opened up for a variety of alternatives. One suggestion is that certain turnover thresholds shall be applied. An example of a threshold is the acquisition of companies whose turnover exceeds EUR 100 million, but other thresholds may also be considered. It is suggested that the duty to register shall be limited to cases where subsidies have been received during the three preceding years before registration or up to one year after closing.

The White Paper also discusses that the duty to register must only be required for foreign subsidies that exceed a certain (not yet stated) amount or a certain percentage of the acquisition price.

Assessment of distortion

In order to take action, the Commission would have to show that an acquisition would be facilitated by a foreign subsidy and that it would distort the internal market.

The Commission proposes in the White Paper that the assessment of whether a subsidized acquisition distorts competition in the market must be done according to a number of criteria. Examples of such criteria are the relative size of the subsidy in question, the beneficiary's situation (the risk is e.g. greater if it is a large company), the situation in the relevant market (the risk is e.g. greater if the market is concentrated) and the extent of the activities of the companies concerned in the EU market.

A transaction should not be closed as long as the Commission's review is ongoing (so-called standstill, which is also applied to ordinary merger control notifications).

Sanctions

If the Commission finds that the acquisition is facilitated by the foreign subsidy and that it results in a distortion of the internal market, it could either accept the commitments of the notifying party which effectively remedies the distortion or, as a last resort, prohibit the acquisition. In situations where the parties have failed to notify a notifiable acquisition, the Commission shall have the power to investigate notifiable acquisitions ex officio. Failure to notify may result in fines and demands for divestment.

This module also allows the Commission to apply a test of whether there is an EU interest.

Module 3: Foreign Subsidies in public procurement –- duty to notify and in some cases exclude tenders

The proposal in brief

Module 3 is specifically designed to address the distorting effects of foreign subsidies on public procurement and to ensure equal conditions between tenderers. It includes both a notification obligation and the possibility to exclude tenders.

Some foreign subsidies must be notified

This module proposes a mechanism whereby a tenderer must notify the contracting authority of financial subsidies that the tenderer, any consortium members, or subcontractors has received from outside the EU during the past three years, or if these operators are expected to receive such a contribution during the execution of the contract. This obligation to notify shall apply only when the value of the contract obtained, and the amount of the foreign subsidy exceeds certain thresholds, which have not yet been determined.

Assessment and penalties

The Commission states that through foreign subsidies, tenderers can gain an unfair advantage, e.g. by submitting tenders that are lower than the market price or even below the cost level, enabling them to obtain contracts that they would not otherwise have received in a public procurement.

The Commission proposes that it is up to the competent contracting authorities and the supervisory authorities to assess whether there is a foreign subsidy and whether it has made the procurement procedure unfair. In such a case, the tenderer would be excluded from the procurement procedure.

The White Paper also discusses the possibility of excluding such tenderers from future public procurement for a maximum period of three years. During that period, the tenderer must be able to demonstrate that it no longer benefits from a distorting foreign subsidy when participating in a public procurement. If this can be proven, the tenderer shall be allowed to participate in future procurements.

The current public procurement regulations do not contain a specific exclusion ground for recipients of state aid that is incompatible with EU rules. The Commission therefore notes that, to ensure non-discrimination and equal treatment, the possibility of applying such a ground of exclusion in respect of recipients of unlawful state aid under the current state aid rules must be considered.

General strategy for foreign subsidies in connection with EU funding – obligation to notify and in some cases exclusions of tenders / applications

The White Paper also outlines a general strategy for dealing with distortions created by foreign subsidies in connection with EU funding. In order to ensure that all actors have access to and compete for EU financial support on equal terms, and to ensure that the procurement procedures are not jeopardized by the unfair advantages given to subsidized economic operators, the White Paper suggests that a strategy similar to module 3 shall apply to EU procurement procedures and EU funding. The White Paper proposes a mandatory registration mechanism and exclusion of tenderers if the subsidy is deemed to distort the procurement / award process.

The White Paper also emphasizes the importance of ensuring that international financial institutions that implement projects supported by the EU budget, e.g. the EIB, or the EBRD, follows a similar strategy for foreign subsidies.

Next step

Public consultations – where various stakeholders such as companies, citizens, Member States, associations and academics can state their opinion – will continue until 23September 2020. There is a questionnaire that stakeholders can fill out: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12452-White-Paper-on-Foreign-Subsidies

The opinions will then be published on the Commission's website, but it is possible to request confidentiality for all or part of a response. The Commission states that, after analyzing the public consultations, it will return with further proposals as early as 2021. In the event that the Commission adopts a concrete legislative proposal, the legislative process within the EU, where the Commission, Parliament and Council must agree, takes a relatively long time. Delphi will be back with updates in the future.

Final comments

The White Paper entails very far-reaching proposals that can be expected to be the subject of many discussions and lobbying by parties that are for and against the proposal. If the proposals are implemented in actual legislation, they will affect many players in the EU who receive different types of financial subsidies from third countries. Although the legislative process often extends over time, it may be important to be aware that rules regarding foreign subsidies are on the way, to be able to plan ahead.

At this stage, the Commission's proposal leads to a number of questions regarding the closer scope of the regulations, procedural rules and how the proposed rules will relate to existing regulations. Different definitions in the new regulatory framework will be of great importance and the interpretation of these will ultimately be a matter for the EU courts. The question of proportionality will certainly be discussed both in the legislative process and in the application of the rules.

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