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The European Commission Publishes White Paper on Foreign Subsidies – Political Power Meets Legal Ambiguity

Client Alert | June 18, 2020

On June 17, 2020, the European Commission (the ***Commission***) issued a White Paper asking for views on its plans for tackling foreign State subsidies that affect EU markets. If adopted, the reform will have far-reaching consequences on how non-EU owned businesses are run in the EU and how foreign entities can invest in Europe.

The White Paper is premised on the idea that subsidies provided by non-EU States are liable to distort competition within the EU, either through foreign States' financing of acquisitions of EU targets or through their subsidization of companies that are already active in the EU, thereby providing them with an unfair competitive advantage against their peers. The new tools are designed to address a regulatory gap and will complement existing legal instruments, such as merger control, foreign investment control in strategic sectors and anti-subsidy investigations.

The White Paper also reflects a move to shield EU merger control from a potential reform that would include public interest considerations being taken into account in the merger review process. Those calls have come from a number of Member States which have expressed their preference for the creation of "European champions" that would be better equipped to compete with their foreign rivals, and have called for the possibility that in the EU merger review process public interest considerations would outweigh competition concerns.

The Commission has proposed three new legal instruments: **Module I**, aims to address the distortions caused by foreign subsidies provided to an economic operator active in the EU market. **Module II**, is designed to address the issues around foreign State-subsidised acquisitions of EU target companies, as well as the potentially distortive effect of foreign subsidies in the context of acquisitions of EU targets. **Module III** envisages the introduction of a compulsory notification system for foreign subsidies in the context of individual public tender procedures.

Module I – Sweeping ex post foreign subsidy control

This instrument is the basis upon which the negative effects of foreign subsidies that are provided by non-EU states to companies established or active in the EU can be captured. As such, Module I is meant to close an existing regulatory gap, given that EU State aid control only covers subsidies provided by EU Member States, while the WTO anti-subsidy instrument only covers the import of subsidised goods to the EU and neither covers services nor production within the EU that has been subsidized by non-EU States.

In addition, Module I would provide for the Commission (or the relevant authorities of the EU Member States) to review ex post acquisitions of EU targets that have been facilitated by foreign subsidies. The review under Module I would likely take place once the acquisition has been completed.

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- The White Paper proposes a **broad definition of foreign subsidies** that could be covered under Module I. Specifically, there would be two large categories of subsidies covered:
    - Foreign subsidies that are presumed to cause per se a distortion in the internal market (a presumption that in principle cannot be rebutted), such as subsidies in the form of export financing (unless the export financing is provided in line with the OECD Arrangement on officially supported export credits), government guarantees of debts or liabilities of certain undertakings without any limitation as to the amount or duration, subsidies (such as debt forgiveness) to ailing undertakings, subsidies directly facilitating the acquisition of an EU target, and operating subsidies in the form of tax reliefs.
    - Any other foreign subsidy that does not fall under the category of inherently distortive foreign subsidies **could still be found to cause distortions in the internal market of the EU.** For this category of subsidies, the Commission would carry out a case by case assessment based on the following indicators in order to determine their precise impact:
        - the relative size of the subsidy in question;
        - the situation of the beneficiary (*e.g.,* the larger a beneficiary, the more likely that the subsidy would be distortive);
        - the situation on the market concerned (*e.g.,* subsidies to beneficiaries active in markets with structural excess capacity are more likely to be distortive);
        - the market conduct in question (*e.g.,* outbidding efficient bidders in acquisitions); and
        - the level of activity of the beneficiary in the internal market (*e.g.,* subsidies granted to undertakings with limited activity in the internal market are less likely to be distortive).
- Foreign subsidies below a certain mandatory threshold would be deemed not to generate distortive effects. The Commission proposes to set this threshold at EUR 200,000 over a period of three consecutive years, in line with the *de minimis* threshold that applies to subsidies (State aid) granted by EU Member States.[1]
- Ultimately, both categories of subsidies would be assessed on the basis of an **EU interest test**, whereby the distortion would be weighed up against its possible positive impact. When determining whether or not there is a positive impact in the EU, public policy objectives such as job creation, achieving climate neutrality and protecting the environment, digital transformation, or public safety, would be taken into account.
- Under Module I, the competent supervisory authorities (the Commission and the relevant Member State authorities) would be able **to act *ex officio*** upon any information concerning the grant of a foreign subsidy to a beneficiary active in the EU. The Commission and the Member States authorities will have vast **investigation powers** similar to what we know from State Aid or other competition investigations.
    - Similar to a situation in a State aid investigation, any investigation of foreign subsidies would consist of a **preliminary review**, followed by an **in-depth investigation**.
    - If it is confirmed by **an in-depth investigation** that the internal market has been distorted through a foreign subsidy, the Commission or the competent authorities of the Member States can decide (at their discretion) to impose **measures to redress those distortions**, such as the elimination of the

financial benefit of a foreign subsidy through payments to the third country in order to restore the level playing field. The competent supervisory authority may be given the power to impose a variety of alternative redressive measures, ranging from structural remedies over behavioral measures to redressive payments to the EU and the Member States (*e.g.,* divestment of assets, prohibition of certain investments, third party access, licensing on FRAND terms, etc.). The undertaking concerned may offer commitments to mitigate the distortion.

Module II – Prior notification of acquisition of EU targets

Module II has a somewhat narrower scope than Module I, as it is intended to specifically address distortions caused by foreign subsidies which facilitate the acquisition of EU targets,[2] either: (1) directly, by explicitly linking a subsidy to a given acquisition or (2) indirectly, by *de facto* increasing the financial strength of the acquirer, which would in turn facilitate the acquisition.

The competent supervisory authority (in all likelihood the Commission) would ***ex ante*** review acquisitions involving possible foreign subsidies under a compulsory notification mechanism. The Commission would also have the right to conduct an *ex officio* review of the acquisition which should have been notified by the acquirer, including after it has been completed. The review could ultimately result in the prohibition of the acquisition or, if it has been already completed, in its unwinding.

- The scope of notifiable acquisitions will be wider than under EU merger control. In addition to the **acquisition of control**, it will also include the **acquisition of at least a certain percentage of shares or voting rights** (which, in an earlier version of the White Paper, was set at 35%) or the **acquisition of material influence** over the target company.
- Potentially subsidised acquisitions would be defined as acquisitions of an EU target where a party has received a financial contribution by any third country government in the past three years or expects such contribution in the coming year.
- The framework described above might include **thresholds** to better target the potentially problematic cases of subsidised acquisitions. The actual value of such thresholds will likely depend on the options chosen regarding the notion of “EU target”, the trigger for notification and the appropriate competent supervisory authorities.
    - An “EU target” triggering a filing requirement could be defined by reference to various thresholds to ensure that all acquisitions of interest are caught. In particular, the White Paper suggests a **qualitative threshold** referring to all assets likely to generate a significant EU turnover in the future and a **quantitative threshold**. A quantitative threshold based on turnover could be set at, for example, EUR 100 million, but other values, thresholds or alternative approaches could also be envisaged.
    - The trigger of potentially subsidised acquisitions could be limited to acquisitions facilitated by a **certain volume of financial contributions** from third country authorities. This could, for instance, be the case where the total amount of financial contribution received by the acquiring undertaking in the three calendar years prior to the notification is in excess of a certain amount or a given percentage of the acquisition price.
    - The value of each of these thresholds will most likely also depend on the supervisory authority entrusted with the implementation of Module II (whether the Commission or authorities at the national level).
- The notification would entail **a stand-still obligation** throughout the Commission’s

review. If, after having reviewed the notification, it is not concluded that there is sufficient indication that the acquirer benefitted from foreign subsidies facilitating the acquisition, the Commission may decide to open an ***in-depth investigation***, upon which, the Commission may decide not to oppose the acquisition, to clear the acquisition subject to certain conditions or to prohibit the acquisition.

- In order to block a subsidised acquisition, the Commission will need to demonstrate that the acquisition was **facilitated by a foreign subsidy** and that it would result in a **distortion of the internal market**, based on the following proposed non-exhaustive indicators, namely:
  - the size of the subsidy in question (*e.g.,* the greater the subsidy in relative terms, the more likely it is to have a negative impact on the internal market);
  - the situation of the beneficiary (*e.g.,* the larger the EU target or the acquirer, the more likely that the subsidised acquisition is distortive);
  - the situation on the relevant markets (*e.g.,* subsidised acquisitions where the EU target is active in markets with structural excess capacity are more likely to cause distortions than others); and
  - the level of activity in the internal market of the parties concerned (*e.g.,* subsidised acquisitions where the parties, notably the target company, have limited activities in the internal market in comparison with their global activities are less likely to distort the internal market).

Module III – Review mechanisms to monitor foreign subsidies in the context of public tenders in the EU

Under Module III, economic operators participating in public procurement procedures would be obliged to notify to the contracting authority when submitting their bid whether they (or any of their consortium members or subcontractors and suppliers) have received a financial contribution within the past three years preceding the participation in the procedure, and whether such a financial contribution is expected to be received during the period of execution of the contract.

In order to focus the instrument on the most relevant cases, the White Paper envisages that **notification could be subject to certain conditions**, for example if the financial contribution is above a certain value and the value of the tendered contract exceeds the threshold of the EU Public Procurement Directives. In those cases of subsidised bidding in public procurement procedures that falls outside the scope of Module III, the possibility remains that this conduct can be addressed under Module I. Similar to Module II, this procedure also requires a degree of self-assessment by tender participants.

- The effect of any foreign subsidy would be assessed in relation to the specific procurement procedure that is applied. Following the notification, a relevant **foreign subsidy would be referred** to the relevant competent authority, which may start an investigation.
- This investigation would also consist of **two steps**. In the **preliminary review**, the competent national authority may either conclude that there is no foreign subsidy and close the investigation, or proceed to conduct an **in-depth investigation**. The White Paper envisages the adoption of strict time limits, which could be extended in certain circumstances (*e.g.,* 15 working days for the preliminary review and no more than three months for an in-depth review).
- Within the context of cooperation and coordination, the national supervisory authority in question is obliged to inform the Commission, the contracting authority and all the competent supervisory authorities of the Member States of these decisions and communicate its prior draft conclusions to the Commission. During the investigation, the relevant contracting authority **is prevented from awarding**

the contract to the economic operator that is under investigation.

- Following an investigation of the effects of the subsidy, the participant could, in certain circumstances under which the foreign subsidy is found to be distortive, be **excluded from the tender** as well as **future tenders** (for a period of maximum three years) or have any **existing contracts terminated**.

Finally, in an attempt to potentially further broaden the scope of Module III, the White Paper considers that the measures put in place to address foreign subsidies under the generally applicable public procurement rules should **apply equally to** prevent **EU funding** that has been deployed through procurement from contributing to distortions of the internal market.

Preliminary Observations

Module I is a far reaching instrument which bestows upon the EU and the Member States a wide arsenal of investigative and remedial powers. However, although it sets very concrete goals in terms of the results it wishes to achieve, the details of the concrete legislative proposal remain to be seen, as there is a number of questions that the White Paper leaves unanswered.

First, while it provides examples of the types of foreign subsidies that it intends to address, the White Paper **lacks a concrete definition** as to what will constitute a **foreign subsidy** that might warrant the Commission’s attention. Given the sweeping powers that the Commission and the relevant Member States authorities will have to investigate and address any distortions of the internal market caused by foreign subsidies, it will be crucial to ensure at least some level of legal certainty by adopting a precise definition of ‘foreign subsidy’.

The reference made in the White Paper to the notion of “aid” under State aid rules and to the notion of “subsidy” under the WTO SCM Agreement on subsidies are particularly unhelpful, as the two instruments are very distinct in terms of their respective scope.

Second, similarly to the notion of foreign subsidy, the notion of “distortion of the internal market” will also need to be defined. It is unlikely that the notion of “distortion of competition” could be directly transposed from State aid control rules, as that would result in virtually each and every foreign subsidy qualifying as being distortive and therefore can be redressed.

Third, the Commission’s proposals rely on the assumption that third countries will accept the extraterritorial application of the proposed law in much the same way as they do the EU merger rules. However, this ignores the fact that almost all countries with competition law regimes operate merger rules that apply to foreign entities. That is not the case as regards foreign subsidies; the proposed new tools are unprecedented and there are no similar instruments in the legislative arsenal of the EU’s major economic partners. More generally, the concept of controlling State subsidies, other than in the rather limited context of the WTO SCM Agreement, is unknown outside the EU (other than those who are engaged in bilateral agreements with the EU), which makes it even less likely that third countries would simply accept the EU’s new instruments and cooperate with a foreign subsidy investigation.

Fourth, the White Paper seems to grant an unusually **wide margin of discretion** to the Commission in its deliberations. Not only has the Commission (or the competent authorities of the Member States) absolute discretion into which cases it will conduct a preliminary review or open an in-depth investigation, but it can also simply decide to close an in-depth investigation on the grounds that it is no longer a priority.

According to the White Paper, an investigation by the Commission’s or by the competent authorities of the Member States’ investigation will rely on stakeholders’ contributions.

It remains to be seen, and will to a large extent depend on how the Commission will use its new powers, whether stakeholders will indeed make the effort and commit resources to support such investigations if they can be terminated at the Commission's sole discretion and without any obligation on the Commission to state the reasons for such a termination in proceedings (other than the investigation no longer being a priority). The possibility that the Commission might terminate an in-depth investigation on the ground that it is no longer a priority in effect insulates any desire to terminate proceedings from any effective judicial oversight, similar to the power enjoyed by the Commission under Article 106 TFEU.[3]

In the same vein, it is noticeable that investigations would only be initiated *ex officio* with the White Paper not providing for the possibility of complaints being submitted. Stakeholders will then be likely to have even more limited rights within the framework for foreign subsidy investigations that complainants currently do in relation to State aid investigations.

The unusually wide margin of discretion accorded to the Commission in foreign subsidy investigations, coupled with the lack of any legal standing for stakeholders, may render the new regime prone to being used as a political tool in the service of the political priorities of a particular Commissioner at a given point in time, thereby undermining the credibility of the new instruments.

The White Paper proposes to level the playing field by closing the regulatory gap that is not covered by EU State aid controls and trade defense instruments. However, **Module II** goes well beyond the closing of that gap, and has the potential to lead to discrimination against direct foreign investment in the EU. This might have far reaching consequences for Europe's economy.

First, EU State aid control is neutral as regards State or private ownership. State ownership and the participation of the State as an actor in the economy is not in and of itself an element that the Commission could or would regulate or over which it would require oversight powers. Nothing prevents Member States or publicly owned companies from investing in the economy, by, for example, acquiring undertakings established in the EU. As long as the publicly owned acquirer has paid the market price for the target company, the acquisition escapes EU State aid control. A typical, and according to the Commission's own guidelines, also the most desirable, way to determine whether the price paid for a certain asset represents the market price is to conduct a competitive bidding process.

However, it is exactly this type of bidding process that the White Paper considers might lead to an undesirable outcome where one of the bidders is backed by a foreign State subsidy, thereby allowing it to pay a higher price for the target company. This is in stark contrast with the situation where a bidder is backed by an EU Member State and can therefore outbid other potential acquirers. Whereas the latter situation falls outside the scope of the notion of "State aid" and thus escapes scrutiny, the former situation may be considered to cause distortion in the internal market.

If adopted, not only will Module II introduce a notification requirement for foreign State investments in the EU, but it may also end up treating such investments more strictly, ultimately **discouraging foreign direct investments**.

Second, while its exact details still need to be resolved, it may be a challenge to define the notion of "foreign subsidy" in such a way that is both practicable and does not undermine the principle of legal certainty. If the Commission decides to attach the notification obligation to acquisitions that have been directly subsidised by foreign States, it might not be overly burdensome for acquirers to circumvent the filing obligation by making arrangements to receive the subsidy via a different channel. The Commission's new powers to investigate such a circumvention of the rules would quickly reach their limits when the Commission would need to investigate, assess and opine upon whether a foreign State has deliberately structured its financial support to a company in such a way as to avoid the filing obligation. As mentioned in relation to Module I, it appears to be overly optimistic to expect any third country to willingly cooperate with the Commission in the context of these new types of instruments, not to mention that third countries, unlike EU Member States have no obligation of loyal cooperation with the Commission.

By contrast, adopting a broad definition of the concept of “foreign subsidies” that is liable to trigger a notification obligation could render the operation of the new regulatory regime impracticable and, may discourage direct foreign investment in the EU. Under a broad definition, any subsidy that the acquirer received in the past three years could lead to a notification obligation and, eventually, to an in-depth investigation. For example, an acquirer established in the United States that benefitted from subsidies to revamp its production facilities domestically and which would then go on to acquire an EU target could be considered to have been “subsidised” for the purposes of its acquisition in the EU, since the subsidies it received for its US facility freed up its financial resources for the acquisition.

The proposed regulatory framework presented in the present White Paper constitutes an undeniably ambitious project for the stronger regulatory oversight of the role that foreign subsidies play in the EU’s economy.

The details of both the substantive scope and the procedural rules of the proposed new instruments will ultimately determine how important and how effective these tools will be in the Commission’s regulatory arsenal. The reaction of the EU’s major economic partners will also be likely to influence how far the Commission will be seeking to push the boundaries of this new regulatory regime and how effectively it can implement it in practice.

While introducing new tools to level the playing field in the internal market may indeed be necessary and a welcome development, it will be important for the Commission and the Member States to not lose sight of the existence of established instruments and perhaps to rely more boldly on trade defense measures and other existing tools to achieve the same objectives.

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[1] Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid, OJ L 352, 24.12.2013, p. 1.

[2] There is still no concrete and definitive proposal for the definition of “EU Target” under Module II but the White Paper proposed the following: “*any undertaking established in the EU and meeting a certain turnover threshold in the EU*”, without excluding the consideration of other criteria.

[3] Article 106 TFEU prohibits Member States, with respect to public undertakings or (private) undertakings endowed with special rights, from enacting or maintaining in force any measure contrary to the rules contained in the Treaties, and in particular, Articles 101 and 102 TFEU.

Gibson Dunn’s lawyers are available to assist with any questions you may have regarding these developments. For additional information, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm’s Antitrust and Competition or International Trade practice groups, or the following authors:

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