

June 7, 2022

EC REGULATION ON FOREIGN SUBSIDIES DISTORTING THE INTERNAL MARKET

To Our Clients and Friends:

On 5 May 2021, the European Commission (*EC*) proposed a new Regulation on the grant of subsidies from foreign Governments outside the European Union (*foreign subsidy*) to companies active within the European Union (*EU*) which are considered to distort competition in the EU (the *Proposed Regulation*).

The Proposed Regulation is extremely far reaching.

First, it gives the EC the power to, on its own motion, require companies operating in the EU, which have received a foreign subsidy that is considered to distort EU competition, to take measures in order to eliminate the distortive effect of the subsidy. To this end the EC may demand the recipient company to reduce its EU activities, refrain from investments, divest assets or grant access to infrastructure. Given that it is up to the EC to determine in which circumstances a foreign subsidy may be considered to distort EU competition, the EC may apply its powers irrespectively of the amount of the subsidy granted and irrespectively of the level of the company's turnover within the EU. In other words, the EC may, on its own motion, require foreign companies that sell goods or services into the EU to undertake various rather invasive measures in order to mitigate alleged distortive effect of a foreign subsidy irrespectively of whether the amount of the foreign subsidy is minimal and whether the recipient has a relatively small turnover in the EU. Given the fact the Regulation provides that the statute of limitation for ex officio cases is 10 years, the Regulation is extremely far reaching.

Second, the Proposed Regulation also gives the EC the power to prohibit a concentration (*i.e.*, an acquisition, a merger or a joint venture) that has been notified to the EC pursuant to the Regulation. In particular, the Regulation requires companies to notify concentrations to the EC (a) where one of the parties to the concentration active in the EU has received a foreign subsidy of at least EUR 50 million within the last three calendar years; and (b) where at least one of the merging undertakings, or in the case of an acquisition, the acquiring party, or in the case of a joint venture, the joint venture or one of its parents, is established in the EU and has an aggregate turnover exceeding EUR 500 million. The statute of limitation for concentrations is three years.

Third, the Proposed Regulation requires a bidder participating in a public tender conducted by the national authorities in an EU Member State to notify the receipt of a foreign subsidy of EUR 50 million (or more) to the national authorities if the value of the contract to be awarded exceeds EUR 250 million. If the national authorities receive such a notification it must notify the EC and, if the EC considers that the subsidy distorts competition within the EU, it may decide that the national authorities may not award the contract to the bidder. The statute of limitation for public procurement awards is three years.

While it is possible for companies targeted by the EC in any of the above scenarios to offer remedies in order to remedy the distortive effect of foreign subsidy, the Proposed Regulation makes it clear that if the EC does not consider such remedies to satisfactorily eliminate the distortive effect of the foreign subsidy, the EC may impose remedies on the company.

Amendments to the Proposed Regulation in the Trialogue Procedure

The EC's adoption of a proposal on the new Regulation kick-started the triologue procedure between the EC, the Council of the European Union (the **Council**) and the European Parliament (**EP**), during which the Council and EP propose and discuss their amendments with the EC as an observer. Recently, on 4 May 2022 both the EP and the Council adopted their proposed amendments to the Regulation and started discussions in order to agree on the final text of the Regulation. Once an agreement has been reached, the Regulation will be formally adopted at a plenary session of the EP. It is expected that the Regulation will be adopted by the end of this year or early next year and enter into force in 2023.

1. The definition of a foreign subsidy

The EC proposed that a foreign subsidy includes (a) the transfer of funds or liabilities by a foreign State (such as capital injections, grants, loans, loan guarantees); (b) the foregoing of revenue otherwise due to a foreign State; and (c) the provision of goods or services or the purchase of goods and services by a foreign State. Both the Council and the EP have proposed to widen the definition of a foreign subsidy to include the grant of exclusive or special rights (for example the right to exploit State owned resources such as gas reserves, forests or mines) without the payment of adequate (market based) remuneration.

Comment

This proposed widening of the definition of a foreign subsidy is entirely in line with the EU State aid rules, which also provide that the grant of exclusive rights without adequate remuneration constitutes State aid.

2. New notification thresholds

With their proposed amendments, the Council and the EP have proposed new thresholds for the notification of both concentrations and public procurement contracts. While the Council desires more transaction to be notifiable to the EC by proposing to **increase the notification thresholds** for concentrations (from a turnover of EUR 500 million to EUR 600 million) and for public procurement contracts (from a contract value of EUR 250 million to EUR 300 million), the EP seeks to limit the amount of notifications by proposing to **reduce the notification thresholds** for concentrations (from a turnover of EUR 500 million to EUR 400 million) and for public procurement contracts (from contract value of EUR 250 million to EUR 200 million).

Comment

While the notifiable transactions will undoubtedly play an important role for the EC's attempt to curb the grant of foreign subsidies to companies active in the EU, it overlooks that the real power given to the

EC for that purpose lies in the EC's powers to investigate, on its motion, and outside the scope of any merger or public procurement procedure, foreign subsidies granted for any amount to companies with small EU turnovers. Indeed, there is no doubt that if in the context of a notified merger or public procurement contract, the parties are not willing to offer the remedy required by the EC, the EC may, besides prohibiting the concentration in question, be able to pursue the company outside the scope of the notified procedure based on its ex officio powers. However, neither the Council nor the EP appear to have picked up on the significant effects that the EC's ex officio powers may have.

3. Member States' ability to inform the EC of suspected foreign subsidies

While the EC proposal envisaged that the EC will be informed of the subsidy through notifications or market information, the Council and the EP propose that Member States should also be able to report foreign subsidies to the EC. The EP even proposes that companies should be able to consult informally with the EC in order to determine whether a subsidy must be notified and that the EC may initiate a dialogue with foreign governments to discuss the grant of systemic distortive foreign subsidies.

Comment

These proposed amendments will strengthen the role that national authorities of EU Member States play viz a viz foreign Governments. Clearly when negotiating contracts with foreign Governments it is helpful for EU Governments to have the ability to rely on the possibility to inform the EC of any intentions of foreign Governments to assist their national companies.

4. Limitations in the EC's powers to investigate

While the Proposed Regulation entitles the EC to investigate any subsidy for any economic activity in the EU (irrespective of its economic value), it also provides that subsidies with a value below EUR 5 million should be considered unlikely to distort competition. The EP now proposes that this threshold should be reduced to EUR 4 million.

Also, while both the Council and the EP consider that the 10-year period during which the EC may retrospectively investigate subsidies granted before the entry into force of the Proposed Regulation should be reduced, the Council wants to reduce this period to 5 years, while the EP wants to reduce it to 7 years.

Both the Council and the EP propose to cut red tape by reducing the period during which the EC may conduct its preliminary investigation after the notification of the subsidy from 60 days to 20 working days (the Council) or to 40 days (the EP) and that the period for in-depth investigations should be reduced from 200 days to 110 working days (the Council) or 120 days (the EP).

5. Assessment of the distortive effects of the foreign subsidy – the balancing exercise

The Proposed Regulation provides that the EC must assess how distortive a foreign subsidy is by balancing the negative effects of the foreign subsidy against its positive effects. If the negative effects outweigh its positive effects, the EC may impose remedies or accept remedies proposed by the parties.

If the EC considers that the negative effects cannot be repaired through remedies it may prohibit (i) the concentration (*i.e.*, the merger, acquisition or joint venture); or (ii) prevent the recipient company from being awarded a public procurement contract.

The Council and the EP have proposed that the EC must issue guidance on how it will determine whether the subsidy distorts competition. Further the Council considers that if a company submits that the subsidy has positive effects relating to EU policies (such as the protection of the environment, R&D&I or social standards), the EC must be obliged to take them into account. The Council also considers that information submitted by Member States must be given considerable weight. The EP proposes various amendments that will guide the assessment of the distortive effect. To this end the EP considers that the EC must be obliged to consider that the subsidy is more likely to distort competition the larger the company is, the higher the value of the subsidy is and the more control a foreign Government has.

In cases of public procurement, the Council proposes that the EC must consider that if alternative sources of supply for the goods and services concerned are limited, the subsidy is less likely to be distortive.

Comments

The proposed Regulation fails to address the main flaw of the balancing exercise. For the purposes of subsidies granted by EU governments subject to the EU State aid rules, the starting point of the balancing exercise is that the aid has *positive* effects (e.g. environmental protection, R&D, infrastructure construction etc.). However, under the Regulation the starting point is that the subsidy has *negative* effects (namely that it will distort competition). In addition, while under the EU State aid Guidelines the identification of the positive effects depends on the objective of the specific Guideline (e.g. R&D, environmental protection, employment, regional cohesion etc.), under the Regulation the potential positive effects are limited to a vague reference to the “*effect on the development of the relevant economic activity*”.

This reverse presumption will make it more difficult to have a foreign subsidy authorised under the Regulation. This is all the more so given that in the context of the EU State aid Guidelines the EC’s counterpart is the Member State that granted the subsidy (which has more political leverage) while under the Regulation the EC’s counterpart is the company receiving the subsidy (which has less or no political influence). Thus, the EC should be required to consider whether the foreign subsidy has any of those positive effects that have been established in the numerous intra-EU State aid Guidelines and only if the negative effects are able to outweigh these positive effects should the EC be able to impose commitments or adopt a negative decision.

While the fact that both the Council and the EP intend to amend the EC’s proposal by requiring the EC to adopt guidance on how it will conduct the balancing exercise is a step on the way to align the foreign subsidy assessment with that under the EU State aid rules, the adoption of this guidance will not remedy the fact that the EC’s assessment starts with the presumption that the grant of the subsidy entails negative effects.



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