SLAUGHTER AND MAY

Our club, our rules: the European Commission cracks down on foreign subsidies

18 June 2020

On 17 June 2020, the European Commission published a proposal for significant new powers to deal with distortions caused by foreign subsidies in the EU Single Market. This briefing outlines the headlines from the Commission's proposal and what we can expect next.

EU Commissioners Margrethe Vestager and Thierry Breton yesterday announced a White Paper on foreign subsidies in the Single Market. The White Paper outlines three new tools that would be available to the European Commission and national competition authorities to tackle distortive foreign subsidies within the EU.

Vestager explained that these new tools are aimed at filling the "regulatory gap" left by the existing State aid, public procurement, merger control, trade defence instruments and foreign direct investment (FDI) regulations. In particular, while State aid control ensures that public support granted by EU Member States does not lead to competitive distortions in the Single Market, there is currently no international or EU instrument that sufficiently addresses similar distortions caused by foreign subsidies. The proposed new instrument is intended to complement existing tools and fill that perceived gap.

The White Paper is the latest move by the EU to combat increasing anxiety in recent years about the role of some foreign players in EU markets. It follows the adoption of the FDI screening regulation in 2019 (discussed in this briefing), and more recently the Commission's call for Member States to strengthen their existing FDI screening regimes, or put new regimes in place where they do not already exist, in order to protect businesses important to the EU's response to the COVID-19 pandemic from predatory foreign takeover (see discussion in this briefing).

> *"The Single Market is the key to European prosperity, but it only works if there is a level playing field…"*
>
> Commissioner Vestager

Tool 1: General instrument to capture distortive effects of foreign subsidies

The Commission is seeking views on a new tool that would allow it and Member States to examine the distorting effects of some foreign subsidies on competition in the EU.

Using this general market scrutiny tool, the national regulatory authority or the Commission could act upon any indication that a company in the EU benefits from a foreign subsidy (with subsidies up to a threshold – the White Paper suggests EUR 200,000 granted over three consecutive years – benefiting from a safe harbour) by carrying out a preliminary investigation. If the preliminary investigation raises concerns, the authority could then launch an in-depth investigation to assess whether the foreign subsidy is likely to give rise to a distortion. The White Paper explains that certain categories of foreign subsidies would be

most likely to cause distortions (export financing aid, debt forgiveness absent a parallel restructuring plan, unlimited state-guarantees, tax reliefs, and funding specifically facilitating an acquisition) although it would remain open to the beneficiary to show that the subsidy in question is not in fact capable of distorting the market. Other subsidies would be assessed on a case by case basis using indicators such as the relative size of the subsidy, the size of the beneficiary and market dynamics (with the White Paper recognising that the lack of transparency around foreign subsidies, and commercial complexity, may make it difficult to assess the market impact of foreign subsidies).

> *"If you ran a club, and you wanted to make sure that there was no trouble, you could check people at the door before they came in. You could also have checks inside the club to make sure that everyone followed the rules once they were in. And it's the same with foreign subsidies: you can check for them in advance or you can fix the problems as they arise. Or you could do both."*
>
> Commissioner Vestager

If the supervisory authority considers that the foreign subsidy is capable of distorting the Single Market, it must then also consider any positive impacts – such as the creation of jobs, protecting the environment, digital transformation, and public safety – which might outweigh the distorting effect (a balancing test referred to in the White Paper as the "EU Interest Test"). If the subsidy fails this test, the White Paper suggests a range of "redressive measures", such as ordering the divestment of particular assets or getting the company to share the benefits facilitated by the subsidy (for example by giving other companies access to research results or infrastructure).

The White Paper notes that this tool has a broad scope, potentially encompassing the review of both acquisitions facilitated by foreign subsidies (the remit of the second tool), and market behaviour by a subsidised bidder in public procurement (the remit of the third tool). Affording the Commission or Member States such comprehensive powers for review without clear delineation between the tools could lead to significant uncertainty for businesses.

Tool 2: Foreign subsidies facilitating the acquisition of EU companies

The second tool is intended to ensure that foreign subsidies do not give an unfair advantage to their beneficiaries when acquiring (stakes in) EU targets. If the first tool is the security guard on the club floor, then, as Vestager explained, the second tool is the bouncer on the door, checking companies as they come in and thereby assisting and complementing the work of the security guard inside. If a company has received certain financial contributions from a non-EU government in the past three years or expects such a contribution in the coming year (with the trigger amounts up for discussion), it would be obliged to notify the Commission where it plans to acquire control of, or material influence in, an EU company. The proposal to require notifications in cases of material influence is interesting given that the EU merger control rules apply only to acquisitions of control.

The White Paper proposes various thresholds to target potentially problematic cases, such as a qualitative threshold referring to all assets "*likely to generate a significant EU turnover in the future*" (to catch so-called "killer acquisitions") or a target turnover test of EUR 100 million. Transactions requiring notification could not be closed whilst the Commission's review is pending (the "standstill" obligation).

Upon notification, the Commission would conduct a preliminary review, followed by an in-depth investigation if a market distortion is suspected. The length of both these reviews is currently unspecified. The investigation would consider whether the acquisition was facilitated by a foreign subsidy, and whether as a result the market would be distorted; as with tool 1, the Commission would apply the EU Interest Test in its assessment. Foreign subsidies that *directly* facilitate acquisitions would normally be held to distort the market. If the Commission concludes that the subsidised acquisition is likely to harm the level playing field, it would seek to secure commitments from the acquiring company, which would be similar to those redressive measures proposed for tool 1 (though the White Paper notes that the focus of commitments in tool 2 is more likely to be structural remedies). As a last resort, the Commission will also have the power to block a harmful merger altogether.

Tool 3: Foreign subsidies in public procurement procedures

The final tool deals with the threats that foreign subsidies can pose to the fairness of EU public procurement procedures. The Commission envisages a compulsory notification mechanism whereby bidders would have to inform the procurer of financial contributions received by bidders or any of their consortium members, subcontractors or suppliers, from non-EU countries within the last three years – as well as whether such a financial contribution is expected during the duration of the contract. A designated authority at Member State level would then undertake a preliminary review and in-depth investigation where necessary, to assess whether there is a foreign subsidy conferring an unfair advantage in the procurement process.

If the supervisory authority found the bidder to have received a foreign subsidy that distorted the process, the bidder would be excluded from that specific procurement procedure, and possibly from future procedures, for a maximum of three years. The procurer would be prevented from awarding the contract to the subsidy beneficiary while the authority's review was ongoing. Recognising the disruption to public procurement procedures this may entail, the White Paper notes that strict time limits would be introduced for the authority's review – suggesting 15 working days for the preliminary review and three months for an in-depth review (subject to the possibility of extension where the Commission disagrees with the national authority's assessment).

Foreign subsidies in the context of access to EU funding

Finally, and separate from the three core tools, the White Paper flags the risk that foreign subsidies may distort the application process for EU funding by giving an unfair advantage to beneficiaries in public tenders for EU grants. The Commission suggests that the approach to this issue should mirror the procedure for public procurement.

Response and next steps

During the Q&A session that followed the press conference, Vestager recognised that the novel proposal put forward by the White Paper was "*not uncontroversial*"; however, she emphasised that "*when it comes to foreign subsidies we have absolutely no control and no transparency*", and that this had to change.

Trade Commissioner Phil Hogan welcomed the announcement, explaining that the EU's openness was "*increasingly being challenged through foreign trade practices, including subsidies that distort the level playing field for companies in the EU*". The Commission has a difficult road ahead of it to develop these

initial proposals, especially against the backdrop of the COVID-19 pandemic. To recover from the crisis, the EU must carefully walk the tightrope of maintaining openness to foreign investment and avoiding undue burdens on businesses, whilst also ensuring that the EU remains a level playing field during this volatile period.

The publication of the White Paper has launched a 14-week public consultation period, which will close on Wednesday 23 September 2020. It remains to be seen how the market and indeed Member States will react to these bold proposals, and whether foreign countries might make moves to retaliate. Informed by the input received, and following "*careful discussion*", the Commission will next put forward an initial impact assessment, ahead of presenting a draft legislative proposal in 2021.

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