

## CLIENT ALERT

### European Commission Proposal on Foreign Subsidies: Towards a Globalization of EU State Aid Control?

May 18, 2021

On May 5, 2021, the European Commission unveiled a proposal for a [Regulation “on foreign subsidies distorting the internal market.”](#) This legislative initiative is aimed at remedying potential distortions of competition in the EU caused by companies receiving subsidies from non-EU governments. The proposal provides for three new regulatory tools, i.e., a mandatory filing obligation for certain mergers backed by foreign subsidies, a requirement to notify foreign financial contributions when submitting bids for public contracts over a certain value, and a general market investigation tool. The proposed scrutiny of foreign subsidies would complement existing State aid rules, which only apply to subsidies granted by EU Member States, with the aim of ensuring a level playing field for all market players within the EU. However, the proposal would add considerable complexity to an already complex regulatory landscape for international businesses in the EU.

## Main takeaways

- The European Commission adopted a **proposal for a Regulation** that would give it new powers to investigate alleged distortions of competition in the EU caused by companies receiving subsidies (broadly defined) from non-EU governments.
- Borrowing elements from existing State aid, merger control, antitrust and public procurement rules, the proposal would create **three new regulatory “tools”, two notification-based and one general investigative tool**.
- First, a **notification-based tool for M&A activity fueled by foreign subsidies** would apply to transactions where the target is established in the EU and generates a turnover in the EU of at least **€ 500 million** and the undertakings concerned received an aggregate financial contribution from non-EU governments of more than **€ 50 million** in the last three years;
- Second, a **notification-based tool to investigate whether foreign subsidies enable undertakings to submit “unduly advantageous” tenders in EU public procurement procedures** would apply to bids for public contracts in the EU with an estimated contract value of at least **€ 250 million**;
- Third, a **general investigative tool** would enable the Commission to investigate alleged distortive effects of foreign subsidies in any market situation, including concentrations and government contracts below the above-mentioned thresholds.
- The Commission would have **extensive investigative** powers similar to those in antitrust investigations and could adopt **commitments decisions** or impose **redressive measures**; it could also **block** concentrations or public contract awards.

## Regulatory gap

The new proposal aims to close a perceived gap in the existing EU regulatory arsenal, and, in particular, to address the following:

- **EU antitrust and merger control rules** do not enable the Commission to take into account the potential distortive effects of foreign subsidies;
- **EU State aid rules** only apply to financial support granted by EU Member States and not to financial support granted by third countries (even if that support affects competition in EU markets);
- the **WTO Agreement on Subsidies and Countervailing Measures (ASCM)** and the **EU anti-subsidy trade defense instrument** apply only to the import of subsidized goods, but not to services, nor do they apply when foreign subsidies support investments, acquisitions or bids in public procurement procedures;
- existing **EU public procurement rules** do not specifically address distortions to EU procurement markets caused by foreign subsidies; and, furthermore,
- national **foreign direct investment screening** regimes (the EU has sought to harmonize these through the [FDI Screening Regulation](#), which entered fully into force in October 2020) aim to address threats posed by foreign takeovers and investments to national security and public order, not market distortions.

## Scope – the concept of “foreign subsidy”

The concept of “foreign subsidy,” and, by extension, the scope of the proposed Regulation, is broad. It covers **not only direct financial contributions** (subsidies in the narrow sense) but **all kinds of transfers of funds or liabilities** (including capital injections, loans, loan guarantees, fiscal incentives, debt forgiveness, debt to equity swaps, etc.). It also covers **the forgoing of revenue** that is otherwise due (e.g., tax exemptions) and **the provision of goods and services or the purchase of goods or services**. In short, like the concept of “aid” in EU State aid control, the notion of “subsidy” would encompass any economic advantage that the beneficiary would not be able to obtain under normal market conditions, and the recitals of the draft Regulation suggest that a “private investor test” may be used to determine whether this is the case. The similarities with the notion of State aid do not stop there, as the advantage must also be selective (granted only to individual undertakings or industries), (directly or indirectly) attributable to the State (i.e., the public authorities of the third country) and liable to distort competition in the internal market.

The Regulation would **apply to any undertaking that engages in economic activity in EU markets** and benefits from foreign subsidies that are liable to distort competition in those markets. Note that the Regulation would therefore not only apply to non-EU companies that receive State support in their “home” countries, but potentially also to EU-based companies or EU-headquartered groups that benefit from third-country subsidies.

## Three tools

The proposal comprises three new regulatory “tools,” i.e., a general “ex officio” investigative tool and two notification-based tools. The Commission proposes that it be the sole authority competent to wield these tools to ensure consistency in the application of the Regulation.

### *General investigation tool*

First, the proposal would give the Commission a **general power to examine on its own initiative information from any source regarding alleged distortive foreign subsidies**. If, on the basis of its preliminary review, the Commission concludes that there are sufficient indications that an undertaking has been granted distortive foreign subsidies, it can open an in-depth investigation. Such investigation may be concluded by a no-objection decision (if the preliminary assessment is not confirmed or the distortion is outweighed by pro-competitive effects), a decision imposing redressive measures or a decision declaring binding commitments offered by the undertaking under investigation.

The general “ex officio” investigative tool would apply to any market situation within the EU, potentially including concentrations or public procurements below the thresholds set for the two notification-based tools discussed below.

For the purposes of its investigation, the Commission would have **extensive investigatory powers** similar to those in antitrust investigations, including the power to issue RFIs and to conduct on-site facility inspections (“dawn raids”). This may include inspections in third countries, provided, however, that the third country agrees to the inspection.

The Commission would also have the power to impose **interim measures** where there is prima facie evidence of distortive subsidies and a serious risk of irreparable harm to competition.

### ***Notification-based tool for concentrations***

Second, the proposal provides for a **notification-based tool to scrutinize M&A activity allegedly fueled by foreign subsidies**. It applies to “concentrations” (a notion defined in the same way as in the EU Merger Regulation (EUMR), which encompasses acquisitions, mergers and the creation of full-function joint ventures).

Procedurally, there are also many similarities with the EUMR. The proposal provides for a **mandatory, suspensory pre-closing notification** of concentrations meeting the following thresholds:

- The **target** (i.e., the acquired undertaking or at least one of the merging parties) **is established in the EU** and generates an aggregate **turnover in the EU of at least € 500 million** (in the case of joint ventures: the joint venture itself or one if its parent undertakings is established in the EU and generates an aggregate EU-wide turnover of at least € 500 million) and
- the undertakings concerned received from third countries an **aggregate financial contribution in the three calendar years prior to the notification of more than € 50 million**.

However, the Commission can “**call in non-notifiable deals**, i.e., request prior notification of any concentration falling below the above thresholds, at any time before its implementation, where it suspects that it has been financed with foreign subsidies (in which case the same procedure is followed as for a notifiable concentration).

The notification entails a standstill obligation, although some derogations are possible. The Commission has **25 working days** from notification to carry out a **preliminary assessment**. If it then decides to open an **in-depth investigation**, the standstill period is extended by an additional **90 working days** (which can be extended by 15 working days if the parties offer commitments). As under the EUMR, there are several ways to extend these time limits further.

After the in-depth investigation, the Commission can adopt (i) a no-objection decision; (ii) a decision with commitments; or (iii) a prohibition decision. The Commission can also impose fines for “jumping the gun” or supplying incorrect information.

### ***Notification-based tool for bids in public procurements***

Finally, the proposal provides for a **notification-based tool to investigate whether foreign subsidies enable undertakings to submit “unduly advantageous” tenders in EU public procurement procedures**. Undertakings wishing to participate in bids for public contracts in the EU with an estimated value of **at least € 250 million** would have to notify all foreign financial contributions received in the previous three years from a non-EU government (or confirm in a declaration that they did not receive any such contributions). Failure to do so would result in exclusion.

The Commission would have **60 days** from receipt of the notification to carry out a **preliminary assessment**, and **200 days** from the date of notification to conduct an **in-depth investigation**. The evaluation of the tenders by the contracting authority would continue during these review periods, but the award of the contract would have to be suspended. For the purposes of its investigation, the Commission would have the same extensive investigative powers as noted above.

After its in-depth investigation the Commission can issue (i) a no-objection decision, (ii) a decision with commitments or (iii) a decision prohibiting the award of the contract. The procedure can also be closed simply by the expiration of the review periods.

Here too, the Commission can require undertakings bidding for public contracts below the notification threshold to submit an *ad hoc* notification, where the Commission suspects that they may have benefited from foreign subsidies liable to distort the level playing field between the bidders.

## Background

The European Commission touts the proposal as a “key element” of the EU’s updated Industrial Policy, which was presented on the same day as the proposed Regulation and which aims inter alia to make EU industry more competitive globally and to reduce supply dependencies for strategic products, services and technologies laid bare by the COVID-19 pandemic. As such, it seems to be part of a pivot by the EU towards a more hard-nosed approach to trade and investment relationships with the rest of the world.

The proposal follows a public consultation on the European Commission’s June 2020 White Paper on foreign subsidies. Its origins can be traced back to the Commission’s controversial 2019 decision to block the rail equipment merger between Siemens and Alstom, resisting pressure from Paris and Berlin to create a “European Champion” to compete against state-sponsored rivals from outside the EU. In a letter dated February 4, 2020, shortly after Margrethe Vestager’s re-appointment as Competition Commissioner, the governments of France, Germany, Italy and Poland urged her to reform the EU competition toolbox to make it “*more efficient and effective in tackling potential abusive behaviour in the single market of economic operators from outside the EU, including state-backed or subsidized countries,*” “*thus strengthening the competitiveness of EU industry,*” noting that “*the nature of global competition has changed.*” Around the same time, the Dutch government also came up with a proposal to add a new pillar to EU competition law, by giving the Commission additional powers to intervene if it found that state-backed companies from outside the EU were distorting markets, inter alia by blocking such companies from buying EU competitors on the basis of inflated valuations. As for the part of the Commission’s proposal concerning public procurement, it revives (in a modified form) a 2012 proposal by (the then Internal Market Commissioner) Michel Barnier to give the Commission the power to prevent non-EU companies from winning public procurement contracts in the EU if they were based in countries that did not offer similar access to European firms.

## Impact and wider context

If adopted, the proposal will potentially affect any companies that benefit from third-country support and engage in economic activity in the EU (in particular, M&A activity or bids for government contracts).

The proposal would effectively enable the Commission to apply scrutiny similar to that allowed under EU State aid rules to subsidies (broadly defined) granted by non-EU governments. This would add an additional layer of **complexity** to an already highly complex regulatory landscape for international businesses in the EU. For instance, one and the same M&A transaction may in the future be subject to up to three regulatory procedures – merger control, FDI screening and foreign subsidy control (leaving aside any other sector-specific controls) – each with its own filing requirements and timetables. Further complexity would be added by the European Commission’s right to “call in” M&A transactions below the thresholds (both under the proposed foreign subsidies Regulation and the new policy on below-threshold referrals – Article 22 EUMR).

It is interesting to note in this context that the European Commission has already found “creative” ways within the framework of existing regulations to tackle potential distortions of competition in the EU by foreign-backed companies.

For example, in 2016 the Commission established merger control jurisdiction over China General Nuclear's (CNG) acquisition of joint control over a number of subsidiaries of Electricité de France (EDF) (responsible for the construction of the Hinkley Point C nuclear power plant in the UK), by deciding that the EU turnover of all Chinese state-owned enterprises (SOEs) active in the energy sector should be aggregated for the purposes of determining whether the transaction had an EU dimension. This was based on a finding that these SOEs are all ultimately controlled by the same entity (i.e., the Chinese State, through Central SASAC). This set a precedent for later reviews of M&A activity by Chinese SOEs in the EU.

Another recent example is the Commission's (and in some international trade circles, somewhat controversial) Regulation of 15 June 2020, imposing countervailing duties on imports of certain glass fiber fabrics originating in China and in Egypt. In that Regulation, the Commission imposed countervailing duties on imports from Egypt, not only for subsidies received in Egypt but also for subsidies received in China to the benefit of the Egyptian exporter (a subsidiary of a Chinese exporter). That was a major shift of EU anti-subsidy policy, which now aims at expanding the EU's anti-subsidy scrutiny territorially to "catch" subsidies granted by countries other than the targeted one but having an effect on the business conduct and pricing of the exporter in the targeted country. This has made headlines as an interesting view on implementing the WTO ASCM. It remains to be seen if the WTO Dispute Settlement Body will be engaged in this case and whether this step by the EU will be condemned or will become the new norm in WTO Members' trade defense practice.

### **What's next?**

The Commission's legislative proposal is subject to the ordinary legislative procedure (formerly "co-decision"), meaning that it can only be adopted if the European Parliament and the Council agree on a common text. The negotiations between the two institutions can be expected to last at least one year and may result in a watered-down text, although there seems to be broad political support for the introduction of some form of foreign subsidies control. After its adoption, the Regulation will not become applicable for another six months.

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