Mind the gap: European Commission publishes White Paper on Foreign Subsidies

July 13, 2020

In response to calls from a number of member states, the European Commission has launched a public consultation on a set of tools to tackle subsidies granted by foreign governments where these can distort competition within the European internal market. If implemented, the proposed measures will surely impact the way state-supported foreign companies can conduct their business in the EU. They are also certain to increase the already complex regulatory hurdles for foreign subsidised players that want to be active in the EU, including in inbound M&A transactions. The Commission welcomes any comments to its proposals until 23 September 2020.

Why now?
The White Paper on Foreign Subsidies forms part of the latest efforts by the Commission to ensure a level playing field in the EU across all types of sectors. Its application ranges from foreign-subsidised M&A transactions to foreign-subsidised companies that either operate in the EU, participate in public procurement procedures or access EU funds. This white paper has been a while in the making, following the Commission’s prohibition of the Siemens/Alstom merger last year, where the German and French governments argued that combining the two companies was necessary to counter unfair competition from China’s CRRC, the largest rail manufacturer in the world (see our analysis here). Some of the white paper’s proposals follow a policy paper published by the Dutch government last year, calling on the Commission to ensure a level playing field between EU and non-EU companies, preventing unfair competition by state-owned companies or by companies established in third countries but benefiting from “home state” benefits.

The white paper seeks to fulfil a regulatory gap. According to the Commission, the scope of its already existing EU and international regulatory tools – such as those regarding state aid, foreign direct investment, trade defence protections, merger control, antitrust and public procurement – have fallen short of successfully tackling competition distortions produced by foreign government subsidies. In practice, the Commission has found that foreign subsidies have increasingly facilitated the acquisition of EU targets, influenced investment decisions and commercial policies, and modified the playing field under which companies compete in the EU (including public tenders and access to EU funding), to the detriment of non-subsidised companies.

First things first: notion of “foreign subsidy”
The white paper contains a broad definition of foreign subsidy: “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 (…) to an individual undertaking or industry or to a group of undertakings or industries.” This definition covers foreign subsidies granted to undertakings established either in: (i) the EU, (ii) a third country where that foreign subsidy is used by a related party established in the EU, and (iii) a third country where that foreign subsidy is used to facilitate the acquisition of an EU target or to participate in an EU public procurement procedure.

The Commission proposed a de minimis threshold: foreign subsidies below EUR 200,000 provided to a single undertaking over a period of three years are presumed incapable of producing distortions of competition within the EU single market. These criteria would, in principle, be consistent with the existing de minimis rule under EU State Aid rules. Additional criteria may also be considered by the Commission, including the size of the subsidy, the situation of the beneficiary, and the conditions governing the market concerned.

Having identified a potentially harmful foreign subsidy is a first step. The Commission will then assess whether the potentially distortive effect of that subsidy is outweighed by its positive impact within the EU (also known as the “EU Interest Test”). There are a number of situations that could help companies meet this test, such as creating jobs, achieving climate neutrality and protecting the environment, digital transformation, and enhancing security. These reasons would generally be consistent with existing EU State Aid rules, which consider these reasons grounds for compatibility of state aid.

A three-pronged approach
The white paper proposes three different instruments — each identified as a “module” — for tackling distortive effects of foreign subsidies, which can be either applied alternatively, on a stand-alone basis, or jointly:

- a catch-all instrument to address foreign subsidies that cause distortions in the internal market and are provided to a beneficiary established or, in some instances, simply active in the EU (Module 1);
- an ex-ante procedure to assess the acquisition of EU companies (Module 2); and
- an exclusion ground from EU public procurement procedures against recipients of distortive foreign subsidies (Module 3).

In addition, the white paper contains measures aiming to regulate foreign access to EU funding.

Module 1: the catch-all for possible market distortions
Under this option, the Commission or the relevant member state authorities would launch ex officio proceedings to investigate possible distortions of the competitive conditions within the internal market caused by foreign subsidies to a beneficiary recipient that is established or, in some instances, merely active in the EU.

The structure of Module 1 is twofold. It would initiate a preliminary investigation to examine whether a foreign subsidy may have the
potential of distorting the internal market. If the review suggests that a foreign subsidy could produce distortive effects, an in-depth investigation would follow. If distortive effects are ultimately confirmed and do not meet the EU Interest Test, measures may be imposed to tackle those distortions in the internal market.

The white paper outlines a wide array of remedial measures that range from repayment orders to structural remedies and behavioural measures. The white paper also expands on additional measures that could be implemented: (i) divestment of assets, (ii) prohibiting certain investments, (iii) prohibiting subsidised acquisitions, (iv) granting third-party access to critical infrastructure or facilities, (v) licensing on fair, reasonable and non-discriminatory (FRAND) terms, (vi) behavioural remedies, and (vii) publishing certain R&D results allowing third-parties to reproduce them.

Module 2: additional regulatory hurdles
The Commission observes that foreign subsidies may distort the internal market by facilitating the acquisition of EU targets either: (i) directly, by providing a subsidy explicitly linked to a given acquisition, or (ii) indirectly, by de facto increasing the financial strength of the acquirer. Accordingly, the white paper, while subsidies directly facilitating acquisitions are deemed to distort the internal market due to the serious risks they pose to the level playing field for investments, de facto facilitations have to be examined in detail to assess whether they actually or potentially do so.

The rationale behind Module 2 is to prevent foreign subsidies from facilitating an unfair advantage for the recipient when acquiring EU targets or stakes in these targets. Like the existing EU state aid system, the Commission proposes a one-stop-shop. According to the white paper, this type of centralised system at the EU level would lead to lower overall enforcement costs, both for public authorities and companies, and increased legal certainty.

The scope of application of Module 2 is broad and covers both direct and indirect acquisitions of controlling and non-controlling interests (the latter provided that the interest grants a "material influence" over the EU target). The notification requirement would cover only potentially "subsidised acquisitions"; where a notifying party has received a financial contribution by any third-country authority in the past three years or expects this contribution in the coming year. As mentioned above, the requirement covers any foreign subsidy that either directly or indirectly (de facto) facilitates the relevant transaction, thus capturing subsidies that are even unrelated to the relevant transaction.

The white paper includes several possible thresholds outlining the tool’s scope of application, including a EUR 100 million turnover threshold, as well as a qualitative test applying to assets "likely to generate a significant EU turnover in the future".

Following the structure of Module 1, the mechanism proposed under Module 2 encompasses a twofold process which must also meet the EU Interest Test. If the outcome of the Commission’s investigation shows that the transaction is facilitated by foreign subsidies that distort competition within the internal market, the Commission may: (i) accept commitments by the relevant party aiming to remedy the competition distortion, (ii) prohibit the transaction, or (iii) unwind the acquisition, if already completed.

In practice, Module 2 would mean implementing a separate mandatory review mechanism running in parallel to merger control and FDI screening procedures and also creating separate thresholds that could be either qualitative, quantitative or a combination of the two.

Module 3: excluding bidders from EU public procurement procedures
The Commission observes in the white paper that foreign subsidies may also distort public procurement procedures, either directly by explicitly making a link between the subsidy and a given procurement project, or indirectly by de facto increasing the financial strength of the recipient (for example, bidding significantly below market price or below cost). As a result, Module 3 corresponds to a new ground for excluding subsidised companies participating in EU public procurement procedures, ensuring that the playing field remains even. The white paper provides the possibility of establishing deterrent tools, such as fines, if bidders fail to comply with the notification obligation or where they submit incorrect information.

In practice, Module 3 requires bidders participating in public procurement processes to declare to the contracting authority: (a) whether they have received a financial contribution by a foreign government within the last three years preceding the participation in the process, and (b) whether the financial contribution is expected to be received during the execution of the contract. Accordingly, the relevant contracting authority would communicate this information to the competent supervisory authority (in this case, either the Commission or the relevant national authority), which would in turn launch an investigation to assess the declared foreign subsidies. This investigation procedure would also be two pronged in nature. If the outcome confirms the existence of a subsidy that distorted the public procurement process, the relevant bidder would be excluded from the process. The white paper includes the possibility of excluding the subsidised bidder from participating in public procurement processes for a maximum of three years.

What next?
The Commission will outline next steps on the basis of feedback received from all interested stakeholders by 23 September 2020 (link available here). The results of the Commission’s consultation will be used to draw up a formal legislative proposal that will form part of the EU legislative process in 2021. Normally, this process can take time but, based on public statements, the Commission has indicated that it is giving the proposal priority (also in view of the COVID-19 crisis). Executive Vice-President Vestager has already stated that the new tools should be operational “a few months” after the consultation ends (see here).

The Commission’s proposal sends a strong political message: although the EU will remain an open market for non-EU investors, they need to play by European rules. It also resonates with EU member states and European champions – all voicing concerns in
recent years about the negative effects of globalisation and unfair competition from state-backed foreign companies.

At the same time, the proposal increases the regulatory hurdles for companies active in the EU and receiving foreign subsidies. As the Commission is casting a wide net, the impact will not be limited to state-owned companies, but will affect any company receiving subsidies from non-EU governments (including European companies with activities abroad). Additionally, the new rules may affect the influx of inbound M&A, as they may make some foreign bidders less attractive in a competitive auction process.

It will also be crucial to keep an eye on the current negotiations between the EU and the UK. By implementing the white paper, the Commission may secure the upper hand if the UK decides to establish less rigorous foreign subsidy rules in favour of UK companies, which may then transfer those competitive advantages into the EU internal market. As such, the new rules may close a real or perceived regulatory gap by creating a level playing field in the EU when it comes to subsidies, either granted by EU member states or third countries.