CLIENT ALERT

European Commission Proposes New Tools to Scrutinize Foreign Subsidies: Additional Red Tape for Companies Doing Business in the EU

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Companies doing deals and business in the European Union ("**EU**") may soon see more 'red tape' added to the already complex set of regulations on merger control, EU State aid, foreign direct investments, and public procurement. Following an initiative from the European Council and the European Parliament, and a White Paper published in June 2020,[1] on 5 May 2021, the European Commission ("**Commission**") issued a Regulation proposal[2] for scrutinizing foreign (non-EU) subsidies ("**Foreign Subsidies Regulation**"). We understand that the Commission expects to review between 30 and 50 cases per year.

Companies doing business in the EU supported by foreign (non-EU) public measures should monitor these developments closely and keep track of all foreign subsidies received. Special attention should be directed to M&A activities with implications in the EU as an additional pre-closing authorization may soon be required from the Commission in certain circumstances.

[1] https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf

[2] https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf

Context: Foreign (non-EU) Subsidies go largely unchecked today

Pursuant to Article 107 of the Treaty on the Functioning of the European Union ("**TFEU**"), it is illegal for EU Member States to grant aid that favors selected companies in a way that it would distort or threaten to distort competition in the EU internal market, unless approved under strictly defined grounds by the Commission. The EU State aid regime is designed to ensure a level playing field among Member States.

However, currently no regulation tackles the issue of the distortion of competition resulting from financial contributions granted by a non-EU state, which confers a benefit to a company engaging in an economic activity in the EU and is limited, in law or in fact, to an individual undertaking or industry or to several undertakings or industries ("**Foreign Subsidy**"). The many foreign direct investment screening regimes that have been adopted by Member States in recent years implement review mechanisms based on national security considerations but not on fairness of competition. WTO subsidy rules and EU trade defense instruments apply to imported goods that may have benefitted from certain subsidies, but do not apply when foreign subsidies support non-imported goods, or if services are concerned.[3]

With the Foreign Subsidies Regulation, the Commission "*aims at closing the regulatory gap in the Single Market, whereby subsidies granted by non-EU governments currently go largely unchecked, while subsidies granted by Member States are subject to close scrutiny.*"[4] The Impact Assessment Report,[5] published by the Commission on the same day as the regulation proposal, recalls that the EU is the world's largest trading block and the world's leading destination of foreign direct investment with an amount of approximately EUR 7 trillion in 2019. Executive Vice-President Margrethe Vestager confirmed that openness is the Single Market's biggest asset, but insisted that "*openness requires fairness.*" [6]

The three new review tools proposed by the Commission

Under the Foreign Subsidies Regulation, the Commission would have three new tools at its disposal to investigate Foreign Subsidies, namely:

- ***Additional merger control tool***. Mergers, acquisitions of single or joint control, or the creation of joint ventures involving financial contributions by a non-EU country, where the EU turnover of the target is EUR 500 million or more and the aggregate foreign financial contribution is at least EUR 50 million in the three calendar years prior to notification, would need to be notified to the Commission and cleared before implementation. The procedure

[3] https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_1984

[4] European Commission, press release of 5 May 2021 (IP/21/1982).

[5] https://ec.europa.eu/competition/international/overview/impact_assessment_report.pdf

[6] European Commission, press release of 5 May 2021 (IP/21/1982).

would largely monitor what is currently applicable under the EU Merger Regulation[7] (25 working days in phase 1, 90 working days in phase 2, stand-still obligation, etc.).

- ***Public procurement tool***. Bids in public procurement procedures involving Foreign Subsidies, where the estimated value of the procurement is EUR 250 million or more, would also need to be notified to the Commission and the respective bidder would not be allowed to be awarded the contract until cleared by the Commission. The applicable time limits would be 60 days in phase 1 and 200 days in phase 2 (we understand these to be calendar days).

- ***Catch-all review tool***. On its own initiative, the Commission would be entitled to investigate any other market situation for distortions of competition resulting from Foreign Subsidies, and may request ad-hoc notifications to that effect. Setting a "safe harbor", the Commission indicates that foreign subsidies below EUR 5 million over any consecutive period of three fiscal years would be unlikely to be distortive of competition. Interim measures may be imposed during the notification process.

For the first two tools, "gun-jumping" fines shall be imposed if the concentration is implemented or the contract awarded *before* the Commission has approved the transaction (up to 10% of the company's worldwide turnover). In all instances, on-site inspections, so-called dawn raids, may be conducted to investigate any suspected failures to make the required notifications.

Should the Commission find that, on balance, the foreign subsidy has negative effects on the EU internal market – this balancing test being largely undefined at this stage,[8] and may thus include not only fairness of competition considerations, but also broader economic or other employment considerations – it would have the power to impose so-called "redressive measures" or accept commitments to remedy the distortion. These may include the repayment of the foreign subsidy, the divestment of certain assets or other reduction in market presence, giving access to a certain infrastructure under fair and non-discriminatory conditions, or other structural or behavioral remedies usually encountered in a merger control context.

Next steps and recommendations

The European Parliament and the Member States will now discuss the proposal, alongside an eight-week public consultation. Once and if adopted, the Foreign Subsidies Regulation would be directly applicable across the EU.

The self-assessment exercise imposed on companies because of this new instrument would be particularly intricate, notably in light of the very broad definition of foreign subsidies, which can take the form not only of direct grants, but also

[7] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (OJEU L 24, 29.01.2004, p. 1-22).

[8] Foreign Subsidies Regulation, Article 5 (1): "The Commission shall, where warranted, balance the negative effects of a foreign subsidy in terms of distortion on the internal market with positive effects on the development of the relevant economic activity."

zero-interest loans, and other below-cost financing, unlimited State guarantees, zero-tax agreements, etc. Importantly, the Foreign Subsidies Regulation would have a retroactive effect in the sense that it would cover foreign subsidies granted 3 years (for the merger and public procurement tools) and 10 years (for the catch-all tool) prior to the entry into force of the Foreign Subsidies Regulation.

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