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Foreign subsidies: new rules to address competition distortions in the European single market

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On 5 May 2021, the European Commission (EC) published a legislative proposal for a new regulation on foreign subsidies distorting the internal market. The proposed regulation addresses potential distortive effects of foreign subsidies in the European Union (EU), introducing new rules and procedures for investigating financial contributions granted by public authorities of non-EU countries. A similar process already exists in EU countries under state aid rules.

The EC reports that in recent years foreign subsidies have had a distortive impact

on the EU's internal market, creating an uneven playing field for competition. Certain subsidies granted by non-EU countries have given their beneficiaries an unfair advantage in the acquisition of EU companies, influenced investment decisions, distorted trade in services and have influenced the behaviour of their beneficiaries in the EU market.

Considering this situation, the EC has proposed new tools to address those distortions. Once adopted, the proposed regulation will be directly applicable across the EU and will increase the regulatory obligations for companies operating or

investing in the EU benefitting from non-EU countries' subsidies.

The path to the proposed regulation – the need to close a regulatory gap

As part of the new industrial strategy for Europe, the EC has committed to explore the strengthening of the EU's anti-subsidy mechanisms.

In June 2020, the EC adopted a white paper on levelling the playing field regarding foreign subsidies and launched a consultation process with stakeholders. The white paper and the impact assessment report accompanying the proposed

regulation describe a legislative gap in EU competition, trade and public procurement rules, preventing the EU from taking action when foreign subsidies cause distortions in the internal market, including by financing concentrations or procurement bids.

The EC noted that in the EU there were no specific rules to address the distortive effects that foreign subsidies may have on the internal market, putting companies that engage in economic activities in the EU at a disadvantage compared to foreign subsidies beneficiaries.

In a recent report, the European Court of Auditors found that certain subsidies granted by the Chinese state would, if granted by an EU member state, constitute state aid and noted that this “difference in treatment can distort competition in the EU’s internal market”. The aim of this proposed regulation is thus to close this regulatory gap and to scrutinise foreign subsidies.

Foreign subsidy that ‘distorts the internal market’

In the context of the proposed regulation, ‘foreign subsidy’ refers to any financial contribution provided, directly or indirectly, by the government of a non-EU country that benefits a company engaging in an economic activity in the EU, and which is ‘selective’, in the sense of limited to an individual company or industry or to several companies or industries.

Foreign subsidies may take the form of zero-interest loans and other below-cost financing, unlimited guarantees, compensations, export financing, preferential tax treatment, tax credits or direct grants. Once the existence of a foreign subsidy is established, the EC will assess, on a case-by-case basis, whether the foreign subsidy ‘distorts the internal market’. However, the complexity of the commercial reality, and the lack of transparency concerning foreign subsidies, may make it challenging to identify or quantify the impact of a foreign subsidy on the internal market.

The proposed regulation provides that a distortion of the internal market shall be deemed to exist where a foreign subsidy is liable to improve the competitive position

of the company concerned in the internal market and where, in doing so, it actually or potentially negatively affects competition in the internal market.

The use of a non-exhaustive set of indicators is necessary to determine the distortion, including the amount and the nature of the subsidy, the situation of the company and the markets concerned, the level of economic activity of the company concerned in the internal market, as well as the purpose and conditions attached to the foreign subsidy or its use in the internal market.

According to the proposed regulation, a foreign subsidy is unlikely to distort the internal market if its total revenue is below €5m over any consecutive period of three fiscal years. In addition, several categories of foreign subsidies will most likely distort the internal market, such as unlimited guarantees, subsidies to an ailing company without a restructuring plan, subsidies directly facilitating a concentration or facilitating the submission of an unduly advantageous tender.

When the EC establishes that a foreign subsidy exists and that it is distortive, it should, where warranted, consider the possible positive effects of the subsidy on the development of the relevant economic activity, and balance these positive effects with its negative effects. When the negative effects outweigh the positive, the EC would have the power to impose redress measures or accept commitments from the companies concerned that remedy the distortion.

A three-tiered investigative tool

The proposed regulation establishes three new tools for the EC to investigate foreign subsidies, including an ‘ex officio’ market investigation tool and two notification-based tools.

‘Ex officio’ review of foreign subsidies. The proposed regulation creates a new power for the EC to conduct ‘ex officio’ market investigation regarding alleged distortive foreign subsidies. These investigations are not limited in scope and can concern different types of market situations, such as greenfield investments or concentrations and procurements below the

thresholds that would require notification under the proposed regulation.

The EC has extensive powers like those used in competition investigations, such as requests for information, dawn raids, fines and periodic penalty payments.

The proposed regulation gives the EC the power to examine on its own initiative information from any source regarding alleged distortive foreign subsidies. The investigation is divided into two phases: a preliminary review and in-depth investigation. If, once the preliminary review is concluded, the EC believes that there are sufficient indications that a company has been granted a foreign subsidy that distorts the internal market it can open an in-depth investigation.

At the end of the in-depth investigation, the EC may adopt a decision imposing redressive measures or a decision declaring binding commitments offered by the undertaking under investigation. If the preliminary assessment is not confirmed or the distortion is outweighed by pro-competitive effects, the EC can also adopt a no-objection decision.

Notification-based tool for concentrations. The proposed regulation creates an ex-ante notification system like the EU merger notification procedure, which gives the EC the power to investigate concentrations involving a financial contribution by a non-EU government.

The definition of concentration is the same as the one provided under the EU Merger Regulation. A ‘notifiable concentration’ will arise where, in a concentration involving a financial contribution by a non-EU government, the acquired company, or at least one of the merging companies, is established in the EU and generates an aggregate EU turnover of at least €500m and the company concerned received from third countries an aggregate financial contribution in the three calendar years prior to notification of more than €50m. Only foreign subsidies granted in the three years prior to the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest will be considered in the assessment.

Like the EU Merger Regulation, notifiable concentrations will be notified by the merging parties to the EC prior to their implementation.

If the EC deems that the merger has been facilitated by foreign subsidies and distorts the single market, it may either accept commitments by the parties that effectively remedy the distortion or prohibit the acquisition. The EC may impose fines and periodic penalty payments totalling up to 1 percent of aggregate turnover for supplying incorrect or misleading information, and up to 10 percent of aggregate turnover for failure to notify.

Notification-based tool for public procurement bids. The proposed regulation introduces an ex-ante notification system, which gives the EC the power to investigate whether foreign subsidies cause or risk causing a distortion in an EU public procurement procedure. The EC will assess

whether those subsidies enable companies to submit unduly advantageous tenders.

A notifiable financial contribution by a non-EU government in an EU public procurement procedure shall be deemed to arise where the estimated value of that public procurement is equal to or greater than €250m.

A company, when participating in a public procurement procedure, should notify the contracting authority regarding all foreign financial contributions received, or declare that it has not received any foreign financial contributions in the three years prior to the notification. Companies that do not submit this information cannot be awarded the contract.

The contracting authority will transfer the notification to the EC. If, after an in-depth investigation, the EC finds that a company benefits from a foreign subsidy which distorts the internal market, it can adopt

a decision with commitments to remove the distortion fully and effectively on the internal market. In the cases in which the EC does not offer commitments or does not consider the commitments appropriate or sufficient, the EC can adopt a decision prohibiting the award of the contract. ■

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