

ANTITRUST CLIENT BRIEFING

EU proposal to regulate foreign subsidies that distort the internal market

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At a glance

The European Commission (EC) has published a proposal (Proposal) for a regulation on foreign subsidies that distort the internal market. The Proposal aims to address the perception that foreign subsidies have created an uneven playing field for competition.

Key Points:

- The Proposal lays down rules and procedures for the EC to investigate foreign subsidies that distort the internal market and for redressing such distortions. It addresses the detrimental effects of distortive foreign subsidies in the cases of concentrations and public procurement *ex ante*, and allows *ex post* investigations in other market situations, including in smaller concentrations and public procurement procedures.
- The scope of a foreign subsidy as defined in the Proposal is very broad and akin to that of State aid in EU law: all kind of financial or in-nature contributions or foregoing of revenues from any public authority or State-owned enterprises can be subject to foreign subsidy scrutiny. *Ex post* investigations can look back to financial support received in the past ten years and *ex ante* investigations into the past three calendar years. This could include also the huge amounts of public funds invested in almost every economic sector to mitigate the effects of the COVID-19 pandemic. The only safe harbour is foreign subsidies of less than €5 million over the last three years that are deemed unlikely to distort the internal market.
- The Proposal increases both the regulatory burden for parties and the risk of parallel investigations. For example, third country companies could be subject to multiple actions for a single instance of conduct, including: (i) an *ex post* investigation into an alleged distortive subsidy; (ii) an Article 102 TFEU investigation procedure relative to a suspected abuse of dominance; and (iii) an anti-subsidy trade defence investigation. In an M&A scenario, an acquirer may need to deal simultaneously with (i) an *ex ante* notification requirement for acquisitions that could be facilitated by foreign subsidies; (ii) merger control filings; and (iii) Foreign Direct Investment filings. The timing and possibility of diverging outcomes will be challenging to resolve.
- In relation to public procurement procedures, an overly extensive or complex self-assessment for bidding entities could discourage companies from presenting offers if they might have received a subsidy, which would reduce competition in the tenders. Whether the measures in question constitute a foreign subsidy that requires notification is not only a burdensome exercise, but also a complex one necessitating expert assessment.
- The proposal could have wide-ranging implications in terms of unilateralism. It is the first time that the European Union (EU) acts in an uncoordinated manner to tackle foreign subsidies. Given the importance of EU funding and State aid in the EU economy, it remains to be seen whether the new tools will have the desired effect to protect EU interests or if they could in practice disproportionately impact EU companies doing business abroad.

Background

The EC launched a public consultation during 2020-2021 to assess whether new instruments, as a complement to existing tools, were required to address distortions of competition caused by foreign subsidies.

The EC proposed three possible tools:

- A general instrument that would enable the EU or the Member States to challenge “distortive foreign subsidies” with rectification powers if distortions are found in the internal market
- A notification requirement for acquisitions facilitated by foreign subsidies, allowing the EU to impose remedies or to block the acquisition
- An instrument to exclude recipients of foreign subsidies from public procurement procedures if the foreign subsidy made the procurement procedure unfair

The public consultation showed strong support for intervention to tackle distortive foreign subsidies in the internal market. For that reason, the Proposal consolidates the three tools listed above into one single instrument.

Overview of the Proposal

A three-tiered investigative tool

The Proposal has two specific objectives:

- Identify the most distortive subsidies: this specific objective addresses the general lack of information about subsidies at the international level. The existing procedures to assess the potential distortion of the EU internal market caused by foreign subsidies are limited to harm caused by trade in goods.
- Remedy the distortions caused by foreign subsidies: this objective addresses the issue that the existing tools — in EU law or multilateral, regional and bilateral agreements — to remedy distortions caused by foreign subsidies once identified are not effective.

To achieve these objectives, the Proposal establishes a three-tiered investigative tool with the following components:



Component 1 - Merger control

- A notification-based investigative tool for concentrations in which the turnover of the EU target exceeds €500 million and the foreign financial contributions exceed €50 million



Component 2 - Public procurement procedures

- A notification-based investigative tool for bids in public tenders with a contract value greater than €250 million



Component 3 - All other foreign subsidies

- An *ex officio* investigative tool for all other market situations and for concentrations and public procurement procedures for values below the thresholds for components 1 and 2

The Proposal involves enforcing all components at the EU level, with a view to ensuring a consistent application of the rules throughout the EU.

Broad scope for EC intervention

The Proposal focuses on the concept of a "distortive foreign subsidy", understood as an intervention that meets all four cumulative conditions below:

- There should be a 'financial contribution' provided by the public authorities of a third country, including public authorities at central or local level. Financial contributions can be provided directly or indirectly by the third country. The contributions may be granted through public or private entities. A 'financial contribution' is interpreted loosely. It can for example be a transfer of funds or liabilities (e.g. capital injections, grants, loans, etc.) or the foregoing of revenue that is otherwise due;
- Such a financial contribution should confer a benefit to a company engaging in an economic activity in the internal market. A financial contribution that benefits an entity engaging in non-economic activities does not constitute a foreign subsidy;
- The benefit should be limited, in law or in fact, only to an individual company or industry or to several companies or industries; and
- The foreign subsidy distorts the internal market in that it improves the competitive position of the beneficiary.

For State aid practitioners, these criteria are not unfamiliar as they mirror closely the definition of aid under Article 107(1) TFEU.

There is a presumption that a subsidy of less than €5 million over three consecutive years will not distort the EU internal market. Whether the subsidy distorts the internal market will be a question of facts. The EC will analyse the impact of the subsidy, taking into account, *inter alia*, the nature of the subsidy, the situation of the beneficiary and the markets concerned, and the beneficiary's level of economic activity in the internal market.

The Proposal sets out categories of foreign subsidies most likely to distort the internal market, in particular:

- A subsidy granted to an ailing company (unless there is a genuine restructuring plan)
- A subsidy in the form of unlimited guarantee for debts or liabilities
- A subsidy directly facilitating a concentration
- A subsidy enabling the beneficiary to submit an unduly advantageous tender

The definition of a foreign subsidy is so broad that many beneficiaries may be subject to EC scrutiny.

EC's extensive investigative and decisional powers

Under the Proposal, the EC would be granted extensive powers to investigate all foreign subsidies. The EC may do so *ex officio*, i.e. on its own initiative examining information coming from any source. While the Proposal is silent as to the possibility of complaints, the broad language used appears to imply that — unlike in State aid control — the EC is left free to consider them or not. The Proposal is also silent on how procedural rights of third parties when there is no in-depth investigation..

Similarly to the powers that the EC has in State aid and antitrust matters, the EC can request any information it deems necessary, and conduct inspections in the EU and outside the EU (in the latter case, the company(ies) under investigation must consent to the inspection and the government of the

third country(ies) must be officially notified and agree to the inspection). When carrying an inspection, the EC can enter any premises and land, examine books/business records and take copies, ask representatives of the company for explanations, and seal any business premises, books, or records. Similarly to State aid control, if the beneficiary and the third country do not cooperate in the investigation, the EC can adopt a decision based on facts available. The existing EU case law on antitrust dawn raids regarding the powers and limits of the EC is also likely to apply *mutatis mutandis* to foreign subsidies.

The EC can impose fines and periodic penalty payments if incorrect, incomplete, or misleading information is provided or if the company under investigation refuses to submit to or obstructs the inspections (broken seals, etc.). Fines shall not exceed 1% of the worldwide turnover of the company concerned and the periodic penalty shall not exceed 5% of the company's average daily turnover.

After a preliminary assessment, the EC can either initiate an in-depth investigation or, if there are no sufficient grounds to do so, close the preliminary review and inform the company. When opening an in-depth investigation, the EC will publish a notice summarising its preliminary assessment and inviting views from interested parties, Member States and the third country concerned.

If the EC finds that a foreign subsidy distorts the internal market, the EC may impose redressive measures. A company under investigation can also submit commitments to remedy a distortion in the internal market and the EC can make those commitments binding. Commitments or redressive measures may consist of the following (among others):

- Offering access under fair and non-discriminatory conditions to any infrastructure that was acquired or supported by the distortive subsidy or licensing on fair, reasonable, and non-discriminatory terms of assets acquired or developed with the help of the distortive subsidy
- Reducing capacity or market presence
- Refraining from certain investments
- Divestment of certain assets
- Dissolving the concentration
- Repaying the foreign subsidy (including interest rate)

The EC shall balance the negative and positive effects of the subsidy when deciding whether to impose redressive measures or to accept commitments.

If the investigation concludes there was no distortive foreign subsidy or the positive effects outweigh the negative ones, the EC will adopt a no objection decision.

While investigating the foreign subsidy, the EC may also take interim measures if there are (i) indications that a financial contribution constitutes a distortive foreign subsidy and (ii) there is a serious risk of substantial and irreparable damage to competition in the internal market.

Not complying with a decision with commitments, a decision ordering interim measures, or a decision imposing redressive measures may lead to a fine of up to 10% of the company's global turnover and a periodic penalty payment not exceeding 5% of the company's average daily turnover.

If the EC has a reasonable suspicion that foreign subsidies are awarded in a specific sector, it can conduct a sector inquiry.

Impact of the Proposal on M&A activity

Foreign subsidies in the M&A context can distort the internal market and undermine the level playing field for various economic activities in the EU. This effect could be particularly notable in the context of

concentrations leading to a change of control over unionised or union-controlled companies, if such concentrations are fully or partially financed through foreign subsidies. The Proposal lays out the conditions under which a foreign subsidy in a concentration is considered to distort the internal market. The EC will analyse whether foreign subsidies granted in the three calendar years prior to the transaction distort the internal market.

Which transactions may be scrutinised?

A concentration will be analysed by the EC if all of the following apply:

- There is a change of control on a lasting basis (e.g. a merger or acquisition of control) or the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity (full-function joint venture). “Control” means the possibility of exercising decisive influence.
- The target, one of the merging undertakings, the joint venture, or one of its parent companies (depending on the nature of the transaction) is established in the EU and generates an aggregate turnover in the EU of at least €500 million (turnover shall be calculated in accordance to the principles set out in the EU merger jurisdictional notice).
- The undertakings concerned (or the joint venture and its parent companies) received from third countries an aggregate financial contribution in the three calendar years prior to notification of more than €50 million.

The regime is pre-closing and suspensory, meaning that the parties to the transaction shall notify the transaction to the EC before closing and shall not implement the transaction before clearance (with a limited exception for public bids). Derogations from the suspension obligation (outside public bids) may be granted only exceptionally.

The Proposal also gives the EC authority to call in and review any transaction that has not yet closed even if it falls below the thresholds if the EC suspects that the parties to the transaction may have benefited from foreign subsidies. Such review prevents the closing of the transaction.

How long will the EC take to review transactions involving foreign subsidies?

The timeline is the same as under the EU Merger Regulation. Phase 1 starts from complete notification and lasts 25 working days. The Proposal does not determine what type of information the merging parties shall supply. An implementing Regulation will likely be adopted to provide a standard form and detail what type of information parties will need to provide to the EC.

If, at the end of Phase 1, the EC decides to open an in-depth investigation (Phase 2), it will have an additional 90 working days to review the transaction. That period can be extended by 15 working days if the parties offer commitments. The Proposal does not seem to allow the merging parties to offer commitments in Phase 1.

The EC may stop the clock if the parties to the transactions have not supplied the complete information which the EC has requested.

Parties may notify their transaction to the EC once they can demonstrate a good faith intention to concluded an agreement or, in the case of a public bid, when they have publicly announced their intention to make such a bid.

What investigative and decisional powers does the EC have?

Under the Proposal, the EC would have the same investigative powers as described above, i.e. the power to request information, to conduct inspections, to impose interim measures, etc.

After an in-depth investigation, the EC has the power to adopt the following decisions:

- No objection decision
- A decision with commitments
- A decision prohibiting a concentration

If the EC finds that the transaction has already been implemented and that it distorts the internal market, the EC can either require the parties to dissolve the concentration or order any other appropriate measure to ensure that the parties dissolve the transaction or take other restorative measures.

In addition, the EC can impose the following fines:

- 1% of the company's aggregate global turnover in the event of incorrect or misleading information
- 10% of the company's global turnover in case of failure to notify, implementation ahead of clearance, or implementation of a prohibited transaction

How will the Proposal interact with the general EU merger regime?

The Proposal simply states that the Regulation is without prejudice to the application of the EU Merger Regulation.

The EU Merger Regulation contains different thresholds, meaning that a concentration that is notifiable under the Proposal may not be notifiable under the EU Merger Regulation (and *vice versa*); in which case, there is only one review by the EC and no possible conflicting outcomes.

The Proposal is silent on how the EC will proceed if a concentration is notifiable under both the EU Merger Regulation and the Proposal. Will it be the same case-team reviewing the transaction? Will the transaction need to be notified at the same time under both instruments? Will the EC issue its decision on the same day for both instruments? What will be the redressive measures if the concentration does not significantly impede effective competition under the EU Merger Regulation but distorts the internal market under the Proposal? Only practice will tell, unless an implementing Regulation is adopted, clarifying the interaction between both instruments.

Impact of the Proposal on public procurement activities

The internal market can also be distorted if companies benefiting from foreign subsidies are awarded public contracts in the EU. The Proposal lays down the conditions under which a foreign subsidy in a public procurement procedure is considered to distort the internal market. The EC will analyse whether foreign subsidies granted in the three calendar years preceding the notification to the EC distort the internal market.

Which public procurement procedures may be scrutinised?

Public procurement procedures are defined by reference to other EU legal instruments (notably the EU Directive on public procurement and the EU Directive on the award of concession contracts).

The Proposal only targets EU public procurement procedures of an estimated value of €250 million or more.

Participants to a tender or public procurement procedures shall notify to the contracting authority all foreign financial contributions received in the three calendar years preceding that notification or confirm in a declaration that they did not receive any foreign financial contributions.

The Proposal does not set a minimum amount of foreign financing received: it refers to *all* foreign financial contributions. The contracting authority shall transfer the notification to the EC without delay. Companies that do not submit the required information or declaration shall not be awarded a public contract.

The Proposal also gives the EC authority to request the notification of the foreign financial contributions received by a company in any public procurement procedure that is not notifiable if the EC suspects that the participant to the tender/public procurement procedure may have benefited from foreign subsidies.

How long will the EC take to review public procurement procedures involving foreign subsidies?

The EC shall complete its preliminary review within 60 (calendar) days after it received the notification. If the EC opens an in-depth investigation, it shall be closed within 200 (calendar) days from notification.

The contract shall, in principle, not be awarded while the EC is carrying its investigation. The investigation by the EC may therefore significantly delay completion of the tender procedure. This possibility raises the question of whether an unfavourable situation for entities that have received a foreign subsidy would arise because the contracting authority might prefer to avoid the delays, and therefore directly discard entities which are under the scope of an investigation.

What investigative and decisional powers does the EC have?

Under the Proposal, the EC would have the same investigative powers as described above.

The EC has the power to adopt the following decisions:

- No objection decision
- A decision with commitments
- A decision prohibiting the award of the contract

In addition, the EC can impose the following fines:

- 1% of the company's aggregate global turnover in the event of incorrect or misleading information
- 10% of the company's global turnover in case of failure to notify a subsidy

Sources

[Proposal for a Regulation on foreign subsidies distorting the internal market](#)

[Latham & Watkins' *Client Alert* on the European Commission's White Paper on Foreign Subsidies: Closing a regulatory gap?](#)

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