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Proposed Foreign Subsidy Regulation Has Political Overtones

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The European Commission proposed a new regulation, the Foreign Subsidies Regulation, on the grant of distortive subsidies from foreign governments outside the EU to companies active within the EU.

On June 30, the Council of the European Union and the European Parliament reached a provisional political agreement on the final text of the regulation, which is expected to be formally adopted by the council within the next few months.

First, the regulation gives the commission the power, on its own motion, to require companies operating in the EU that have received a foreign subsidy considered to distort competition in the EU to take measures in order to eliminate the distortive effect of the subsidy.

To this end, the commission may demand the recipient company to reduce its EU activities, refrain from investments, divest assets, grant access to infrastructure, or alternatively require the recipient to repay the foreign subsidy to the foreign state.

Given that it is up to the commission to determine in which circumstances a foreign subsidy may be considered to distort EU competition, the commission may apply its powers irrespective of the amount of the subsidy and the level of the company's turnover within the EU.

In other words, the commission may require foreign companies that sell goods or services to the EU to undertake various rather invasive measures to mitigate the alleged distortive effect of a foreign subsidy, regardless of the amount of the subsidy and whether the recipient has a relatively small turnover in the EU.

Second, the regulation also gives the commission the power to prohibit a concentration, i.e., an acquisition, a merger or a joint venture, that has been notified to the commission pursuant to the regulation.

In particular, the regulation requires companies to notify concentrations to the commission where:

- The parties to the concentration active in the EU have received a foreign subsidy of at least €50 million ($49.6 million) within the last three calendar years; and

- At least one of the merging undertakings, or, in the case of an acquisition, the acquiring party, or in the case of a joint venture, the joint venture or one of its parents, is established in the EU and has an aggregate EU turnover exceeding €500 million ($496 million).

Third, the regulation requires a bidder participating in a public tender conducted by the national authorities in an EU member state to notify the national authorities of the receipt of a foreign subsidy:

- For a value equal to or greater than €50 million, if the estimated value of the procurement contract to be awarded is equal to or exceeds €250 million ($248 million), excluding Value Added Tax;[1] and

- If the bidder receives one or more foreign subsidies for an aggregate value equal to or exceeding €4 million ($3.9 million).[2]

Upon receipt of such a notification the national authorities must notify the commission, which may decide that the contract may not be awarded to the bidder because the foreign subsidy distorts competition within the EU.

While it is possible for companies targeted by commission investigations in the context of the notification of a concentration or public bid to offer remedies in order to remedy the distortive effect of foreign subsidy, the commission may reject them and itself impose remedies that, if not accepted, may lead to the prohibition of the concentration or the grant of the award, or to a requirement to repay the foreign subsidy to the foreign government.

Even if the regulation does not explicitly provide that it is to be interpreted in line with the state aid rules, the commission will be heavily inspired by its own decision-making practice and the case law of the EU courts in the field of state aid.

Definition of a Foreign Subsidy

According to Article 2 of the proposed regulation, a foreign subsidy includes:

- The transfer of funds or liabilities by a foreign state, e.g., capital injections, grants, loans, loan guarantees;

- The forgoing of revenue otherwise due to a foreign state, e.g., taxes and levies owed to the state; and

- The provision of goods or services or the purchase of goods and services by a foreign state.

Given that the concept of foreign subsidy is nonexhaustive, the regulation's definition of a foreign subsidy is likely to be applied in line with standard EU state aid practice.

Concentrations With a Strong EU Presence

The thresholds that must be fulfilled for notifying a concentration under the regulation focus on companies with a relatively high turnover within the EU. The EU-based parties generally need to have an aggregate EU turnover exceeding €500 million.

By contrast, notifiable concentrations under the EU Merger Regulation, or EUMR, are those where the parties have a high worldwide turnover, while the turnover thresholds within the EU are relatively lower. In other words, the regulation targets companies with a strong EU presence irrespective of their worldwide presence.

Thus, it would appear that relatively few of those concentrations that would be notifiable under the regulation would already be notifiable under the EUMR.

This is no coincidence, because without the strong EU presence it is difficult to rely on the grant of foreign subsidies in order to take rather invasive measures vis-à-vis foreign companies.[3]

Lack of Guidance to Determine Distortive Effect

The regulation provides that the commission must assess how distortive a foreign subsidy is in the EU by balancing the negative effects of the foreign subsidy against its positive effects. This is referred to as the balancing exercise.

If the negative effects outweigh its positive effects, the commission may either accept remedies imposed by the parties or accept those proposed by the company that received the foreign subsidy.

If the commission considers that the negative effects cannot be repaired through remedies, it may:

- Prohibit or require the dissolution of the concentration, i.e., the merger, acquisition or joint venture;
- Prevent the recipient company from being awarded a public procurement contract; or
- Require the foreign subsidy to be repaid to the foreign state.

While the outcome of the commission's assessment of whether the foreign subsidy distorts competition in the EU is key for determining whether it is necessary to implement remedies or repay the foreign subsidy, the regulation does not include much guidance on how the commission should undertake that assessment.

The regulation merely provides that besides taking account of the foreign subsidy's value, nature, purpose or use and conditions, as well as the size and activities of the recipient,[4] the positive effects of the foreign subsidy are the "effect on the development of the subsidized economic activity" and "broader positive effects in relation to the relevant policy objectives, in particular those of the Union."

Further, while the preamble of the regulation states that the commission should publish guidance for determining a foreign subsidy's distortive effect, the regulation does not make reference to any of the approximately 25 existing EU state aid guidelines already issued for the purposes of identifying the positive effects of a subsidy, e.g.the guidelines on state aid for climate, environmental protection and energy, adopted in January.

This is all the more a problem since, when the commission assesses aid under the state aid guidelines, if

the objective conditions have been met for the activity in question, the aid is automatically considered to have positive effects. This would be the case for an eligible renewable energy generation plant, for example, which serves to protect the environment.

The commission will not examine whether, despite the positive effects, the grant of the aid leads to undue distortion of competition that outweighs the positive effects.

However, since there are no guidelines for the purpose of assessing foreign subsidies, the starting point is that they have negative effects, i.e., that they will unduly distort competition. This reverse presumption will make it more difficult to have a foreign subsidy authorized under the regulation.

This is all the more so given that in the context of the EU state aid guidelines, the commission's counterpart is the member state that granted the subsidy, which has more political leverage, while under the regulation the commission's counterpart is the company receiving the subsidy, which has less or no political influence.

The approach outlined in the regulation may only be justified by a notion that somehow the grant of foreign subsidies is worse than granting EU subsidies.

If this cannot be done, and it seems difficult to do so, there is no reason that the starting point for foreign subsidies should not be that they also have those positive effects that have been established in the EU state aid guidelines.

Finally, while the regulation incorporates the state aid de minimis threshold, according to which a foreign subsidy that does not exceed €200,000 ($198,000) over three years will not be considered to distort competition, it expands that rule by providing that foreign subsidies not greater than €4 million over a period of three years are considered unlikely to distort competition.

This is probably the most helpful provision that the regulation contains in terms of determining the prospects of whether a foreign subsidy will be considered to distort EU competition.

Noncompliance and Fines

Recipients of foreign subsidies that provide incorrect, incomplete or misleading information, do not reply, reply too late, or refuse to submit to inspections may be subject to fines of up to 1% of the aggregate turnover in the preceding financial year, or periodic penalty payments of up to 5% of the average daily aggregate turnover in the preceding financial year, for each working day of delay.

Companies that do not comply with a commission decision imposing remedies to alleviate distortive effects of the subsidy, prohibiting the concentration or the award of a public procurement contract or requiring repayment of a foreign subsidy, may be subject to:

- Fines of up to 10% of the aggregate turnover in the preceding financial year; and/or
- Periodic penalty payments of up to 5% of the average daily aggregate turnover in the preceding financial year for each day of noncompliance.

Conclusion

The regulation is based on the commission's long history of receiving complaints stating that EU companies suffer from foreign companies having been granted subsidies in order to compete in the EU.

The regulation is therefore designed to prevent distortive subsidies from being granted to companies operating particularly in sectors where EU competition has already been restricted from such subsidies, such as the maritime and aviation sectors.

However, the political implications of this regulation cannot be overstated; it is especially directed against foreign governments that use companies to extend their economic and political influence in the EU.

That is, there is no doubt that the regulation is the EU's new tool to pursue certain political interests that cannot be handled through other channels.

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[1] The same applies if the overall procurement value is equal to or exceeds €250 million and the estimated value of a lot, or all the lots to which the tender applies, is equal to or exceeds 125 million (excluding VAT).

[2] A 'bidder' includes not only the company submitting a bid but also its subsidiaries that do not have commercial autonomy, holding companies and main subcontractors and suppliers involved in the same tender.

[3] While foreign established companies are the main targets, the regulation will obviously also apply to companies established in the EU that receive foreign subsidies.

[4] The regulation only provides more firm guidance in extreme situations by stating that the foreign subsidy is likely to distort EU competition where it (i) is granted companies that, absent the subsidy, would be likely to go out of business in the short or medium term without having a restructuring plan capable of bringing the company back to long term viability, (ii) consists of guarantees for unlimited time and/or amount, facilitates a concentration; or enables the recipient to submit an unduly advantageous bid in a tender.