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THE EUROPEAN COMMISSION PROPOSES A REGULATION ON FOREIGN SUBSIDIES

On 5 May 2021, and as announced in March 2020, the European Commission proposed a Regulation on foreign subsidies. The proposal includes a three-fold mechanism to address the potential distortive effects of foreign subsidies granted to companies operating in the European Union. The proposal is available on this **link**.

1. BACKGROUND

In March 2020, the European Commission ("**Commission**") declared that it intended to propose the adoption of an instrument to enable it to supervise the granting of foreign subsidies. The Commission stated that this was necessary because of the existing asymmetries between controlling State aid granted by Member States and controlling foreign subsidies. While the former are subject to significant regulatory limitations, the latter generally eluded the European Union's control, which, according to the Commission, undermined the internal market's level playing field.

In June 2020, the Commission published a White Paper in which it proposed three control instruments: (i) a general one to control foreign subsidies; (ii) a specific one to control company acquisitions supported by foreign subsidies; and (iii) another specific one to control foreign subsidies that give their recipient an advantage in public tenders within the European Union. These three instruments are still in the Proposal for a Regulation on foreign subsidies distorting the internal market ("**Proposal"**), but the Proposal clarifies some matters regarding their design and application that the White Paper left open.

2. PRACTICAL IMPLICATIONS

The future approval of the Regulation would have a significant impact on foreign companies that operate in the European Union. Specifically, State-funded companies from countries such as China whose presence in the European Union is growing, could be significantly affected. In fact, although the proposed instruments do not target any country specifically, the Proposal itself does specifically refer to the impact of subsidies from China.

Likewise, the instruments add to the red tape of companies that fall within the scope of the Regulation, such formalities having already been increased with the entry into force of foreign direct investment screening mechanisms in certain essential sectors.

Nevertheless, the Commission has opted for the middle ground by deciding to limit its control over especially important subsidies, probably in an attempt to find the right balance between pursuing the Proposal's objectives and discouraging foreign investment into the European Union. In addition, despite early concerns regarding how the powers to implement the mechanisms are to be allocated between the Commission and the Member States, the Proposal fully empowers the Commission to apply these rules. This will not only guarantee that future rules will be applied uniformly, but will also avoid companies having to deal with several national authorities, as is the case with foreign direct investment screening.

3. PROPOSED MECHANISMS

In general, the three instruments will give the Commission control over any type of foreign subsidy (e.g. direct grants, access to low interest financing, tax incentives or debt write-offs) to companies operating in the European Union.

Once the existence of a foreign subsidy is detected, the Commission will assess whether it distorts the internal market because of its amount, nature, the circumstances of the company receiving it or the market's characteristics. The Commission would also need to consider whether the subsidy's positive effects, if any, outweigh its negative effects. The Proposal does not explain how the Commission is to do this, while the White Paper linked the positive effects to the objectives of European Union's public policies such as creating employment, climate neutrality or digital transformation. If the Commission concludes that the subsidy distorts the internal market, it will impose corrective measures. These measures can be structural (e.g. divestment of certain assets) or behavioural (e.g. the publication of R&D results or the obligation to offer access to certain infrastructure), and may also include returning the subsidy. Failing to comply with these measures can result in fines of up to 10% of the relevant company's turnover in the preceding business year, as well as periodic penalties of up to 5% of the daily turnover for each day the company fails to comply with the measures. The Commission may also take interim measures in the event of serious risk of irreparable damage.

3.1 GENERAL INSTRUMENT

The first mechanism is a general one to identify foreign subsidies. While the White Paper, in line with State-aid rules, established that this instrument would apply to control subsidies exceeding EUR 200,000 granted in the course of three consecutive years, this threshold seems to have been increased to EUR 5 million. That said, companies are not required to notify subsidies exceeding this amount (except as explained below). It is thus an *ex post* instrument that enables the Commission to act when it becomes aware that a foreign subsidy of that amount has been granted.

The Proposal includes mechanisms that aim to reduce the difficulties that the Commission is expected to face when having to collect information on these subsidies (which also apply to the specific instruments for merger and public procurement control). In particular, the Proposal includes mechanisms that the

Commission generally uses in antitrust cases, such as requests for information and conducting inspections. Likewise, companies that provide incorrect information or refuse to undergo an inspection, can be fined up to 1% of their turnover in the preceding business year. The Commission can also impose periodic penalties of up to 5% of the daily turnover for each day the company fails to comply with the measure.

3.2 MERGER CONTROL INSTRUMENT

The second instrument controls concentrations that receive foreign subsidies and does so by implementing a compulsory notification system that suspends the execution of the transaction until it is authorised. The proposed system is very similar to the rules governing European merger control under Regulation 139/2004, which will make it easier to detect notifiable transactions and enable both procedures to be processed at the same time. In particular, the 25 and 90 working day periods proposed to initially assess and further examine a transaction, respectively, are in line with those provided to assess Phase I and II concentrations. Similarly, a 15 working day extension is established if the parties offer commitments.

The Commission has proposed quantitative thresholds based on the acquired company's turnover and the amount of the subsidy. In particular, the transaction must be notified in the following cases:

- The acquired company, at least one of the merging companies, the joint venture itself or one of its parent companies (depending on how the transaction is structured) is established in the European Union and generates a turnover of at least EUR 500 million within that geographical area; and
- The undertakings concerned received from a third country a total financial contribution of at least EUR 500 million in the preceding three calendar years.

Nevertheless, the Commission may also require the notification of concentrations that do not meet the abovementioned thresholds if it suspects that the companies involved may have benefitted from foreign subsidies during that period. Furthermore, the Commission reserves the right to examine, under the first mechanism, subsidised concentrations even after they have been implemented, which includes transactions in which the companies involved have received subsidies exceeding EUR 5 million.

3.3 PUBLIC PROCUREMENT CONTROL INSTRUMENT

The third instrument controls subsidies that give recipients of foreign subsidies in the last three years an unfair advantage in public tenders when the value of the contracts is EUR 250 million or more. The Commission has also introduced a quantitative threshold for notification and analysis purposes, yet can require notification even if this threshold is not met, as well as assess transactions *ex post* under the general instrument.

The obligation to notify foreign subsidies extends not only to direct bidders and their groups, but also to their main subcontractors and suppliers. Main subcontractors or suppliers are those whose involvement is key to perform the contract or where the economic share of their contribution exceeds 30% of the estimated value of the contract.

The Proposal establishes that the tender process is to be suspended while the Commission is examining the transaction, except where the contract is awarded based on the most economically advantageous tender criterion. In this case, the contract can be awarded to the notifying party notwithstanding the fact that, if the Commission subsequently prohibits its involvement, the contract will be awarded to the next best tender. This can cause delays in procedures, especially those that involve technical criteria to award the contract, since the Commission's assessment can take up to 260 days, or more if the procedure is extended.

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