

Legal Update

European Commission Unveils Proposal to Tackle Foreign Subsidies Distorting Internal Market

On May 5, 2021, the European Commission ("Commission") published its proposal for a regulation on foreign subsidies distorting the internal market ("Proposal").¹ The Proposal is intended to tackle the distortive effects of foreign subsidies granted to undertakings engaging in economic activities in the European Union ("EU" or "Union"), including those that (i) facilitate concentrations or (ii) influence the awarding of public contracts in the EU.

The Proposal therefore complements existing EU tools, such as the State aid rules (which deal with distortions caused by Member State subsidies) and trade defense instruments (which deal with imports of subsidized goods), with a view to ensuring a level playing field. In relation to the treatment of concentrations that might be facilitated by subsidies, the Proposal draws heavily on the existing EU merger control regime. It also introduces a potentially significant new market investigation regime.

Overall, the proposed new regulation will constitute an important and novel legislative instrument in the Commission's armory.

1. Background

The Proposal is part of the EU's new industrial strategy for Europe, in which the Commission committed to explore how best to strengthen the EU's anti-subsidy mechanisms and tools,² and follows a white paper "*on levelling the playing field as regards foreign subsidies*," published on June 17, 2020 ("White Paper").³

The White Paper notably described a regulatory gap in the existing EU rules on competition, trade and public procurement, which effectively prevented the EU from taking action when foreign subsidies cause distortions in the internal market including by financing concentrations or procurement bids. The Proposal aims at filling this regulatory gap to ensure a level playing field in the internal market.⁴

2. Foreign subsidies covered by the Proposal

The Proposal would entitle the Commission to investigate and impose remedies in relation to foreign subsidies granted to an undertaking engaging in an economic activity in the EU internal market, to the extent such subsidies are liable to create distortions on the internal market.

The scope of the subsidies covered by the Proposal is therefore two-fold.

First, there must be a “foreign subsidy,” which is defined as a financial contribution which confers a benefit and is limited, in law or in fact, to an individual undertaking or industry or to several undertakings or industries.⁵

This definition is modelled on existing international and EU rules in relation to subsidies and covers a number of different situations:

- A financial contribution that takes the form of a transfer of funds or liabilities, the foregoing of revenue that is otherwise due, the provision of goods or services or the purchase of goods or services.
- A financial contribution that is provided by a third country either through the central government and government authorities at all other levels or through foreign public entities or through any private entity whose actions can be attributed to the third country.
- The existence of a benefit is to be determined by comparison with benchmarks reflecting market conditions.⁶
- The reference to the subsidy being granted to one or several undertaking(s) or industry(ies) is reminiscent of the concept of “specificity.”

A foreign subsidy only exists if it benefits an undertaking engaging in an economic activity in the Union. As clarified in the recitals to the Proposal, *“a financial contribution that benefits an entity engaging in non-economic activities does not constitute a foreign subsidy.”*⁷ Although there is no express definition of what constitutes an “economic activity”, guidance can be drawn from EU State aid law where exactly the same principle applies to EU subsidies.⁸

Second, the foreign subsidy must be liable to create a distortion on the internal market, which means it is liable to improve the competitive position of the undertaking(s) concerned in the internal market and, in doing so, it actually or potentially negatively affects competition on the internal market.

Whether this is the case would have to be assessed, on a case-by-case basis, by reference to a non-exhaustive list of indicators relating to the subsidy at stake, the recipient undertaking and the market on which it operates.⁹ However:

- A foreign subsidy the total amount of which is below EUR 5 million over any consecutive period of three fiscal years is considered unlikely to distort the internal market.
- In contrast, the Proposal sets out a list of categories of subsidies that are considered *“most likely to distort the internal market,”* such as foreign subsidies to firms in difficulty, unlimited guarantees, foreign subsidies that directly facilitate a concentration and foreign subsidies that enable an advantageous tender.¹⁰

3. A three-pronged approach to tackling foreign subsidies

The Proposal foresees three ways for the Commission to investigate foreign subsidies:

- **An ex-officio review of foreign subsidies**,¹¹ where, on its own initiative, the Commission can examine information from any source regarding alleged distortive foreign subsidies in any sector of the economy.

These reviews are not limited in scope and could, theoretically, target any instance where foreign subsidies are granted to an undertaking engaging in an economic activity in the internal market. As explained in the press release accompanying the Proposal, this concerns, for instance, “*greenfield investments or concentrations and procurements below the thresholds*”.

- **A prior notification requirement for concentrations involving foreign subsidies**, where mergers, acquisitions of control and the creation of joint ventures would become “notifiable” based on two thresholds:¹²
 - (i) the acquired undertaking or at least one of the merging undertakings is established in the EU and generates an aggregate turnover in the EU of at least EUR 500 million.¹³
 - (ii) The undertakings concerned received from third countries an aggregate financial contribution in the three calendar years prior to notification of more than EUR 50 million.¹⁴

There is specific guidance for joint ventures, although the thresholds are the same.¹⁵

In addition, the Commission would be entitled to request the prior notification of any concentration that does not satisfy these thresholds at any time prior to its implementation if it suspects that the undertakings concerned may have benefitted from foreign subsidies in the three years prior to the concentration.

In principle, and subject to potential derogations, a notifiable concentration must not be implemented before its notification and clearance.¹⁶

To avoid circumvention, if undertakings fail to meet their obligation to notify, the Commission would also be entitled to request the notification of the concentration and impose remedies, where appropriate.

- **A prior notification requirement when participating in public procurement procedures**, in cases where foreign subsidies cause or risk causing a distortion in a public procurement procedure, meaning that they enable an undertaking to submit—in certain public procurement procedures with an estimated value equal to or above EUR 250 million¹⁷—a tender that is unduly advantageous in relation to the works, supplies or services concerned.¹⁸

When submitting a tender or a request to participate in a public procurement procedure, undertakings would be required to notify to the contracting authority or the contracting entity all foreign financial contributions received in the three years preceding that notification or confirm in a declaration that they did not receive any foreign financial contributions.¹⁹

The notifications would then be transferred to the Commission to be reviewed. A review can also be initiated in cases where an undertaking fails to notify a foreign financial contribution, where a notification is not transferred to the Commission or where a foreign financial contribution is not notifiable but the Commission suspects that an undertaking may have benefitted from foreign subsidies in the three years prior to the submission of the tender or the request to participate in the public procurement procedure.²⁰

During the Commission's review, the evaluation of tenders may continue, but the contract may—in principle—not be awarded to a notifying party.²¹

Of note, the prior notification requirements for concentrations and participation in public procurement procedures do not concern "foreign subsidies" but "financial contributions." Thus, notification requirements may apply even if the financial contribution eventually does not qualify as a "foreign subsidy" or does not distort the internal market.

Finally, the three types of investigations foreseen by the Proposal are complementary. Indeed, the Proposal notes that, while "*a concentration or public procurement tender notified and assessed under the respective procedures cannot be reviewed again by the Commission on its own initiative,*" the information on financial contribution obtained through the notification procedures could also be relevant when "*assessed outside the concentration or procurement procedure.*"²²

Furthermore, the Proposal clarifies that "[t]he Commission should also have the possibility to carry out a review on its own initiative of already implemented concentrations or awarded public contracts."²³ As mentioned above, concentrations and public procurement procedures for which the prior notification requirements were not applicable could still be subject to scrutiny under the **ex-officio review of foreign subsidies**.²⁴

4. Investigative process and powers of the Commission

The Proposal provides for a general investigative process, which applies to all investigations into foreign subsidies carried out by the Commission, with certain adjustments necessary for investigations into concentrations and public procurement procedures.

The investigative process has two steps:²⁵

- First, a preliminary review would be initiated by the Commission in order to assess, on a preliminary basis, the existence of a foreign subsidy distorting the internal market.
- Second, an in-depth investigation could be initiated if the preliminary investigation reveals sufficient indications that an undertaking has been granted a foreign subsidy that distorts the internal market.
- This in-depth investigation may be terminated without remedies, in cases where the preliminary assessment is not confirmed or the positive effects of the foreign subsidy outweigh its negative effects.²⁶

For concentrations and public procurement procedures, specific timelines would apply:

- **With regard to concentrations**, the Commission would be required to (i) make a decision on whether or not to initiate an in-depth investigation within 25 days from the receipt of a complete notification and (ii) conclude an in-depth investigation within 90 working days from its initiation, extended by 15 working days in cases where commitments are offered and possibly extended by up to 20 working days if requested by the notifying undertaking or by the Commission.²⁷
- **With regard to public procurement procedures**, the Commission would be required to (i) complete its preliminary review within 60 days after receipt of a complete notification and (ii) conclude an in-depth investigation within 200 days after receipt of the notification, subject

to extensions “*in exceptional circumstances*,” after consultation with the concerned contracting authority.²⁸

In any investigation under the Proposal, the Commission would have far-reaching powers to:

- Impose interim measures, where there are indications of (i) a foreign subsidy distorting the internal market and (ii) a serious risk of substantial and irreparable damage to competition on the internal market.²⁹
- In the context of concentrations, interim measures could also be imposed in cases where a concentration is implemented in breach of the standstill obligation or in breach of the commitments accepted by the Commission.³⁰
- Request information from the undertaking(s) concerned, other undertakings, associations of undertakings, Member States or third countries.³¹
- Carry out inspections within the EU, with the assistance of the authorities of the Member States, but also outside the European Union, with the consent of the undertaking(s) concerned and of the government of the relevant third country.³²

In addition, the Commission would be entitled to conduct far-reaching “market investigations” into a particular sector, for a particular type of economic activity or based on a particular subsidy instrument if it suspects that foreign subsidies distort the internal market. The resulting reports could then be used in the framework of investigations under the Proposal.³³

In order to ensure the effectiveness of these investigative tools, the Proposal foresees that:

- In cases of non-cooperation, either by an undertaking concerned or by a third country, findings may be made on the basis of “facts available,” with the result that the outcome of the procedure may be less favorable to the undertaking(s) concerned than if it (they) had cooperated.³⁴
- Fines and periodic penalty payments could be imposed in cases where an undertaking intentionally or negligently fails to comply with requests for information or inspections within the Union.³⁵

These fines and periodic penalty payments would have to be set in light of the nature, gravity and duration of the infringement, taking due account of the principles of proportionality and appropriateness, but may not exceed:

- (i) For fines, 1% of the aggregate turnover of the undertaking or association of undertakings concerned in the preceding business year.
- (ii) For periodic penalty payments, 5% of the average daily aggregate turnover of the undertaking or association of undertakings concerned in the preceding business year for each working day of delay.

Finally, the Proposal also provides for certain common procedural provisions in relation to (i) limitation periods, (ii) the publication of decisions, (iii) the addressees of decisions and the possibility of requesting that certain information be treated as confidential, (iv) respect of the rights of defense and (v) professional secrecy.³⁶

5. Remedies foreseen by the Proposal

The Proposal provides for significant remedies in order to address the distortive impact of foreign subsidies:

- **For the general review of foreign subsidies distorting competition on the internal market**, the Commission could impose redressive measures or accept binding commitments from the undertaking(s) concerned, with a view to fully and effectively remedying the distortion identified.
- **For concentrations**, the Commission would be entitled to approve a concentration, make it subject to commitments offered by the undertaking(s) concerned or prohibit it.³⁷

If a concentration has already been implemented but found to distort the internal market or if it has been implemented in breach of commitments, the Commission would be entitled to:³⁸

- Require the undertakings concerned to dissolve the concentration or to restore the situation prevailing prior to the implementation of the concentration; and
- Take any other appropriate measure to ensure the undertakings concerned dissolve the concentration or take other restorative measures as required.

In addition, the Proposal provides for specific fines, as follows:

- Fines of up to 1% of the aggregate turnover in the preceding business year in cases where an undertaking, intentionally or negligently, supplies incorrect or misleading information in a concentration notification.
 - Fines of up to 10% of the aggregate turnover in the preceding business year in cases where a notifiable concentration has not been notified, where a concentration has been implemented during the standstill period or where a prohibited concentration has been implemented.
- **For public procurement procedures**, the Commission would only be entitled to prohibit the award of a contract to the undertaking(s) concerned, make it subject to commitments offered by the undertaking(s) concerned or adopt a no-objection decision.³⁹

In addition, the Proposal provides for specific fines, as follows:⁴⁰

- Fines of up to 1% of the aggregate turnover in the preceding business year in cases where an undertaking, intentionally or negligently, supplies incorrect or misleading information in a notification of financial contributions in the context of public procurement procedures.
- Fines of up to 10% of the aggregate turnover in the preceding business year in cases where an undertaking, intentionally or negligently, fails to notify a subsidy in the context of public procurement procedures.

The Proposal lists a number of potential commitments and redressive measures, which are either behavioral or structural in nature. These can go from fair, reasonable and non-discriminatory licensing or assets divestment requirements to the requirement to dissolve a concentration or repay the foreign subsidy including an appropriate interest rate.⁴¹

Of note, when deciding on commitments or redressive measures, the Commission would be required to undertake a balancing exercise so as to determine whether and to what extent the positive effects of a foreign subsidy on the development of the relevant economic activity outweigh the negative effects in terms of distortion on the internal market.⁴²

In the case of a breach of the redressive measures imposed, commitments accepted or interim measures,⁴³ fines and periodic penalty payments can be imposed and set in light of the nature, gravity and duration of the infringement, taking due account of the principles of proportionality and appropriateness, subject to the following ceilings:

- For fines, 10% of the aggregate turnover of the undertaking(s) concerned in the preceding business year.
- For period penalty payments, 5% of the average daily aggregate turnover of the undertaking(s) concerned in the preceding business year for each working day of delay.

A decision imposing redressive measures or accepting commitments can be revoked, in cases where the undertaking(s) concerned failed to comply with these measures or commitments or if the decision was based on incomplete, incorrect or misleading information.⁴⁴

6. Risks for foreign subsidies granted before the entry into force of the mechanisms foreseen under the Proposal

The Proposal foresees that subsidies granted before the entry into force of the mechanisms foreseen under the Proposal could still be subject to investigations in the following circumstances:⁴⁵

- **When carrying out an ex-officio review of foreign subsidies**, the Commission would be entitled to review foreign subsidies granted in the 10 years prior to the entry into force of the Proposal, in cases where such foreign subsidies distort the internal market after the start of application of the Proposal.
- **For notifications of concentrations or in the context of public procurement procedures**, all foreign financial contributions granted in the three years prior to that notification, including at a time when these notification requirements were not applicable, would have to be notified and would be subject to the relevant investigation mechanisms.

Nonetheless, the Proposal would not apply to concentrations that were concluded before the start of application of the notification requirement.

7. Next steps

To become law, the Proposal must now go through the EU's ordinary legislative procedure. This means that the Proposal must be reviewed and adopted by the European Parliament and the Council of the European Union, which may propose amendments to the text proposed by the Commission.

In parallel, the Commission has also opened an eight-week public consultation on the Proposal.⁴⁶

For more information about the topics raised in this Legal Update, please contact any of the following lawyers.

Julian Ellison

+32 2 502 551

jellison@mayerbrown.com

David M. Harrison

+44 20 3130 3050

dharrison@mayerbrown.com

Christian Horstkotte

+49 211 86224 0

chorstkotte@mayerbrown.com

Nathalie Jalabert Doury

+33 1 53 53 43 43

njalabertdoury@mayerbrown.com

Nikolay Mizulin

+32 2 551 5967

nmizulin@mayerbrown.com

Paulette Vander Schueren

+32 2 551 5950

pvanderschueren@mayerbrown.com

Edouard Gergondet

+32 2 551 5946

egergondet@mayerbrown.com

Dylan Geraets

+32 2 551 5948

dgeraets@mayerbrown.com

Endnotes

- ¹ Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, SWD(2021) 99 final, SWD(2021) 100 final, SEC(2021) 182 final, COM(2021) 223 final, 5.5.2021, available at: https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.
- The Commission has also published a press release, facts page, Q&A and impact assessment report which are available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1982.
- ² Commission Communication, *A new industrial strategy for Europe* (COM(202) 102 final).
- ³ This white paper was discussed in our Legal Update *European Commission Publishes White Paper on Foreign Subsidies Distorting the EU Internal Market*, available at: <https://www.mayerbrown.com/en/perspectives-events/publications/2020/06/european-commission-publishes-white-paper-on-foreign-subsidies-distorting-competition-in-the-eu>.
- ⁴ The Proposal also includes provisions, in Article 40, dealing with the relationship between the Proposal and other legislative instruments.
- ⁵ Proposal, Article 2.
- ⁶ Proposal, Recital (10).
- ⁷ Proposal, Recital (10).
- ⁸ Under EU state aid law, typical non-economic activities comprise activities which are the responsibility of the state and where no private economic market exists: for example, the fire brigade, police, customs, air traffic control, general road and rail infrastructure provision.
- ⁹ As per Article 3 of the Proposal, indicators to be considered would include (i) the amount of the subsidy, (ii) the nature of the subsidy, (iii) the situation of the undertaking and the markets concerned, (iv) the level of economic activity of the undertaking concerned on the internal market and (v) the purpose and conditions attached to the foreign subsidy as well as its use on the internal market.
- Further clarifications on how the Commission should undertake this process is also provided in Recitals (12)-(15) of the Proposal.

- ¹⁰ Proposal, Article 4.
- ¹¹ The Commission, in the press release accompanying the Proposal, refers to this mechanism as a “general market investigation tool”.
- ¹² Proposal, Article 18. A specific definition of “control” is provided in Proposal, Article 20.
- ¹³ Rules for the calculation of “turnover” are provided in Proposal, Article 21.
- ¹⁴ Rules on the aggregation of financial contributions are provided in Proposal, Article 22.
- ¹⁵ Proposal, Article 18(4).
- ¹⁶ Proposal, Article 23.
- ¹⁷ Proposal, Article 27. The Proposal refers to relevant EU Directives and excludes procurement procedures in the fields of defense and security.
- ¹⁸ Proposal, Article 26.
- Of note, the Commission would be required to assess both (i) whether there is a distortion on the internal market and (ii) whether a tender is unduly advantageous in relation to the works, supplies or services concerned.
- ¹⁹ Failing which, such undertakings shall not be awarded the contract. See Proposal, Article 28.
- ²⁰ Proposal, Article 28.
- ²¹ Proposal, Article 31.
- ²² Proposal, Recital (37) and Article 33.
- ²³ Proposal, Recital 31.
- ²⁴ This is also confirmed by DG Competition’s website, which refers to “[a] general tool to investigate **all other market situations**, and smaller concentrations and public procurement procedures, which the Commission can start on its own initiative (ex-officio) and may request ad-hoc notifications.” See: https://ec.europa.eu/competition/international/overview/foreign_subsidies.html.
- ²⁵ Proposal, Articles 8 and 9.
- ²⁶ Even if a decision is made to conclude the investigation without imposing redressive measures or accepting commitments, this decision may be revoked in cases where the decision was based on incomplete, incorrect or misleading information. See Proposal, Article 16.
- ²⁷ Proposal, Articles 23 and 24. In certain circumstances, these time limits can either be suspended or do not apply. See Proposal, Article 19(4) 23(5) and 23(6).
- ²⁸ Proposal, Article 29.
- ²⁹ Proposal, Article 10.
- ³⁰ Proposal, Article 24.
- ³¹ Proposal, Article 11.
- ³² Proposal, Articles 12-13.
- ³³ Proposal, Article 34.
- ³⁴ Proposal, Article 14.
- ³⁵ Proposal, Article 15.
- ³⁶ Proposal, Articles 35 to 39.
- ³⁷ No redressive measures are foreseen in the context of concentrations. Proposal, Article 24.
- ³⁸ Proposal, Article 24.
- ³⁹ No redressive measures are foreseen in the context of public procurement procedures. Proposal, Article 30.
- ⁴⁰ Proposal, Article 32.
- ⁴¹ Proposal, Article 6.
- ⁴² Proposal, Article 5.
- ⁴³ Proposal, Article 15(4).
- ⁴⁴ Proposal, Article 16.
- ⁴⁵ Proposal, Article 47.

⁴⁶ This consultation is available at: <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12621-Trade-investment-addressing-distortions-caused-by-foreign-subsidies/>.

Mayer Brown is a distinctively global law firm, uniquely positioned to advise the world's leading companies and financial institutions on their most complex deals and disputes. With extensive reach across four continents, we are the only integrated law firm in the world with approximately 200 lawyers in each of the world's three largest financial centers—New York, London and Hong Kong—the backbone of the global economy. We have deep experience in high-stakes litigation and complex transactions across industry sectors, including our signature strength, the global financial services industry. Our diverse teams of lawyers are recognized by our clients as strategic partners with deep commercial instincts and a commitment to creatively anticipating their needs and delivering excellence in everything we do. Our “one-firm” culture—seamless and integrated across all practices and regions—ensures that our clients receive the best of our knowledge and experience.

Please visit mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

Any tax advice expressed above by Mayer Brown LLP was not intended or written to be used, and cannot be used, by any taxpayer to avoid U.S. federal tax penalties. If such advice was written or used to support the promotion or marketing of the matter addressed above, then each offeree should seek advice from an independent tax advisor.

This Mayer Brown publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the “Mayer Brown Practices”) and non-legal service providers, which provide consultancy services (the “Mayer Brown Consultancies”). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website.

“Mayer Brown” and the Mayer Brown logo are the trademarks of Mayer Brown.

© 2021 Mayer Brown. All rights reserved.