KNOW-HOW

Gleiss Lutz

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STATE AID

EU COMMISSION PLANS NEW COMPETITION LAW TOOLS: WHITE PAPER ON FOREIGN SUBSIDIES

On 17 June 2020, the EU Commission presented its "White Paper on levelling the playing field as regards foreign subsidies", which had been announced some time ago, to the public.

The document is a first and could have a major impact on transaction practice. It is an interesting mix of familiar elements of competition law – State aid, abuse and merger control as well as public procurement law – and established instruments from trade law and investment control.

Background: Protection against foreign subsidies

The project, which increasingly blurs and merges the boundaries of different legal instruments, is therefore the responsibility of several Directorates-General within the Commission (notably the DG COMP and DG TRADE).

Even though it is not stated explicitly, the project first and foremost concerns China. The reason for this is the increasing penetration of state-supported companies from the People's Republic into the EU. Particularly in the coronavirus crisis, there is a concern that weakened EU companies could become easy prey for takeovers from China. Europeans want to protect themselves against state-backed companies from Asia going on a shopping spree and buying up the European silverware.

The practices to be combated have long been known and bemoaned by EU industry. The Commission is taking aim at the subsidy practices familiar to it for decades from EU State aid control procedures, such as export subsidies, grants, low-interest loans, State guarantees, debt relief and tax aid. EU subsidiaries of non-EU companies benefit from these and achieve considerable competitive advantages. As potentially affected sectors, the Paper names the usual suspects: aluminium, steel, semiconductors, shipbuilding and the automotive industry.

New forms of merger and abuse control

Ultimately, the proposal fills a legal vacuum: the strict State aid rules in Article 107 et seq. TFEU are only geared towards aid granted by EU Member States. Although the European anti-subsidy rules permit – based on the WTO rules – the imposition of countervailing duties, in practice, these have over the last 25 years not proved to be a particularly powerful weapon in the fight against unfair subsidisation by third countries, however. The White Paper suggests various possible modules:

- Firstly, this is a new form of **merger control**. The Commission is considering reviewing corporate acquisitions that are financed primarily through foreign subsidies. Specifically, the Commission wants to review participations that make it possible for the foreign investor to exert control over business decisions or that grant the foreign investor a stake conferring a certain influence. The rules would apply to targets with an annual turnover of at least EUR 100 million, but could also capture "potentially relevant firms with (currently) limited turnover in the EU". As is the case with current (antitrust) merger control, the companies involved would have to notify the acquisition to the Commission as soon as certain thresholds are met. According to the White Paper, this could be where the investor has in the past three years received subsidies in a certain (still to be defined) amount to finance the purchase price. The notification obligation goes hand in hand with a standstill obligation and the imposition of fines should this obligation be violated. If an investor does not

- notify a notifiable acquisition, the Commission may open an ex officio investigation.
- This is also to be accompanied by a form of **abuse control**. The Commission would, in cooperation with Member State authorities, examine whether the activities of state-backed companies from third countries, such as the provision of services, distort competition. The threshold for this is to be surprisingly low. The White Paper suggests the same "de minimis" threshold of EUR 200,000 in state subsidies granted over a period of three years as laid down in the EU State aid rules. A large number of companies would probably be subject to this system.
- Thirdly, companies would have to issue a declaration if they are bidding for large **public contracts**. The declaration must indicate whether they or their subcontractors have received aid from foreign governments within the last three years. If the authority issuing the invitation to tender has doubts about the accuracy of the information, it would have to contact the national supervisory authorities or the Commission, which may investigate the matter and, if necessary, impose a three-year ban on public contracts.

Substantive test and possible sanctions

In substantive terms, the main objective is to examine whether an acquisition or commercial practice is facilitated by subsidies and whether it will distort competition in the internal market. In this regard, the Commission wants to review the support measures on a case-by-case basis taking a "collection of indicators related to the subsidies and the relevant market situation" into account. These aspects include the amount of the subsidy, the size of the undertaking, the market share, the existence of structural excess capacity, the degree of concentration and the importance of the (technology) sector. In addition, the Commission also wants to take the "degree of openness" of the undertaking's domestic market into account, for – the Commission argues – where a subsidy recipient faces only limited competition in that market, it could leverage its privileged position in other markets.

When it comes to the envisaged sanctions, the proposal takes the usual harsh lines followed by Brussels' competition policy as a basis. Acquisitions are to be prohibited or divestment of certain assets ordered. Further options include reductions of capacity, investments and market presence. The undertakings are also to be obliged to grant access to key infrastructure or IP rights on fair, reasonable and non-discriminatory (FRAND) terms.

Prohibitions are to come into play if a state-supported undertaking from a third country pursues aggressive price strategies with the help of subsidies. Foreign subsidies are to be siphoned off (with payment being made to the EU or its Member States and not to the foreign subsidy provider). There are obviously sanctions for non-compliance with such orders. An addressee failing to comply therewith will have to contend with fines and periodic penalty payments.

Instruments still need to be tested in practice

The Commission is (obviously) proceeding on the basis that the proposed instruments comply with WTO rules. The 57-page document ends with an annex containing questions to be answered primarily by the Member States. Adoption is planned for 2021.

Subjecting financial aid by non-European governments to such a review by the EU is a new step. State support was previously only taken into account in passing as part of the competitive assessment in the context of merger control procedures.

There is no question that the new regulations will lead to more red tape. The notification and other thresholds proposed in the White Paper are (very) low, meaning that a large number of matters could be caught by these. The notification procedure for planned acquisitions will – and the document leaves little room for doubt in this regard – be very time-consuming and expensive. The new system is to run in parallel to the already existing competition instruments at EU and national level, such as the (numerous) merger control systems. The national rules of foreign trade law and investment control which aim to assess whether a planned participation by foreign investors poses a threat to national security or public order will obviously also have to be checked.

This means an increase in complexity. Although it does appear conceivable for State aid control and merger control as well as other regulatory systems to coexist in principle, this may however lead to efficiency losses and conflicts between the systems, for example if the different decision-makers issue different orders or demand conflicting commitments. Coordinating the various review and approval processes will most likely pose a challenge for M&A practitioners.

It will not be a simple matter for the Commission and the competent national authorities to implement the system in practice, either. As has become apparent in connection with the Anti-subsidy Regulation, it will most likely be difficult to prove that a subsidy actually exists. The financial contribution measures are (in many cases deliberately) very complex in order to conceal that they are subsidies, for example sophisticated capital injections and guarantee or financing structures, also involving private partners. The fact that the financial flows between the relevant state governments and companies (some of which are not even legally independent, but part of the State administration) are not very transparent may also render this a Herculean task.

The additional approval procedure may of course constitute an obstacle to investment. Nevertheless, the Commission's approach has its supporters among European industry. The advocates of the new system point out that there is simply no reason in an increasingly networked world for a strict subsidy regime pursuant to Article 107 et seq. TFEU to apply to EU undertakings only, while third countries are not subject to any limits of this kind.

Another interesting (political) question is how the third countries concerned will receive the new plans. The possibility that they will regard these as a declaration of war and retaliate by resorting to protectionist measures cannot be ruled out. The upcoming discussions will definitely be interesting.

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LAWYERS

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