RESPONSE OF THE CITY OF LONDON LAW SOCIETY COMPETITION LAW COMMITTEE TO THE EUROPEAN COMMISSION WHITE PAPER ON LEVELLING THE PLAYING FIELD AS REGARDS FOREIGN SUBSIDIES

1. Introduction

1.1 The City of London Law Society ("CLLS") represents City lawyers through individual and corporate memberships, including some of the largest international law firms in the world. The Competition Law Committee of the CLLS comprises leading solicitors specialising in UK and EU competition law in a number of law firms based in the City of London, who act for UK and international businesses, financial institutions, and regulatory and governmental bodies in relation to competition law matters.

1.2 We welcome the opportunity to respond to the White Paper by the European Commission (the "Commission") on levelling the playing field as regards foreign subsidies (the "White Paper" or "WP").[1] This response aims to provide comments on various aspects of the Commission's proposals and to answer the specific questions raised in the Commission's questionnaire.

2. General questions

1. <u>Do you think there is a need for new legal instruments to address distortions of the internal market arising from subsidies granted by non-EU authorities ('foreign subsidies')? Please explain and also add examples of past distortions arising from foreign subsidies.</u>

1.1 We understand, in principle, why the Commission is concerned about third country subsidies. The aim of the internal market, and in particular the State aid rules, is to restrict the ability of Member States to provide (selective) support to business and to secure a more level playing field between EU undertakings. However, because the same rules do not necessarily apply to non-EEA competitors, European companies can be disadvantaged by comparison to their global competitors who have greater access to State support and subsidy. In an increasingly globalised economy, the risk of foreign subsidies having a distorting effect on the internal market is increasing.

1.2 We therefore understand why the Commission is exploring the feasibility of introducing additional legal avenues. However, the new tools that are being proposed appear to be extremely far-reaching and could have a considerable impact on any non-EU company investing or operating in the EU or bidding for Member State procurements, including the EU's closest trading partners. The complexity of the proposed instruments would also raise compliance burdens for all businesses, and therefore the cost of doing business in Europe. Consequently, we are concerned that an overly complex and interventionist approach to tackle this issue could have unintended consequences in terms of increasing the burdens for all businesses (including EU businesses), and discouraging foreign

[1] The White Paper was published on 17 June 2020.

investment into Europe at a crucial time for Europe's recovery from the current COVID-19 crisis.

1.3 We are therefore concerned that, even if there is a legitimate rationale at the heart of these proposals, the strategies as they are currently being proposed could be disproportionate in terms of their impact on European businesses as a whole.

2. <u>Do you think the framework presented in the White Paper adequately addresses the distortions caused by foreign subsidies in the internal market? Please explain.</u>

2.1 The concept of addressing foreign subsidies is not new, and indeed is in line with the Commission's and President von der Leyen's vision of the EU New Industrial Strategy, demonstrating the EU's intention to become "less naïve" towards its trading partners.[2] It may also reflect the EU's interest in strengthening the WTO's subsidies rules as in the Trilateral Subsidies exercise by the U.S., EU, and Japan to draft proposals for strengthened WTO rules on, and remedies for, trade-distorting domestic industrial subsidies and improved transparency.

2.2 However, the framework that is presented in the White Paper leaves open some very significant questions about the exact scope of the new tools, in particular as to the potential overlap and interplay with existing EU competition and trade instruments (anti-subsidy, State aid, merger control, foreign direct investment screening), that would need to be resolved for the regime to be operational. There are also questions as to how it would be applied in practice, such as whether it would fall under the scope of DG-Competition or DG-Trade, or both. The proposals in some areas would also involve arrangements for shared competence with the Member States.

2.3 The proposed scope of the regime, in terms of the types of subsidies that will be targeted, appears to be very broad and in our view would benefit from being more specifically targeted on the types of subsidies that are most likely to raise concern in practice. In particular:

(i) The definition of "foreign subsidies" that has been proposed builds on the definition of subsidy set out in the EU Anti-Subsidy Regulation and in the EU Regulation on safeguarding competition in the air transport sector, which in turn rely on the subsidy definition set out in the WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). As we discuss further at paragraph 3.13 below, it is not clear to what extent this definition is intended to be equivalent to the concept of "aid" under the State aid rules, but on any approach the definition that is proposed appears very wide.

(ii) For the purpose of the White Paper, the Commission proposes that a *de minimis* threshold of EUR 200,000 granted to a company over a period of three years would be considered not to create distortions on the EU internal market, whilst foreign subsidies above that threshold would be subject to review. Whilst we recognise that this threshold would be consistent with the approach that is taken under the EU State aid rules, applying such a low threshold will mean that the

[2] COM (2020) 102 – A New Industrial Strategy for Europe, European Commission, 10 March 2020.

regime will cover an extremely wide array of foreign subsidies with minimal trade impacts.

(iii) There also does not currently appear to be any provision equivalent to the State aid GBER. The effect of this appears to be that relatively minor subsidy measures, directed at objectives that are broadly accepted as legitimate under the State aid rules (e.g. training, culture and heritage conservation, some environmental measures) would nonetheless in principle be open to individual scrutiny under these measures.

(iv) The Commission's illustrative list of the types of subsidies meriting heightened scrutiny appears to draw heavily from Article 6 of the SCM Agreement and DG-Trade's past experiences in countervailing duty investigations. These have tended to involve government support for bankrupt or failing steel companies and other situations involving excess global capacity. As a result, it would appear to overlook the proliferation of Chinese industrial subsidies designed to support the development of advanced technologies under "Made in China 2025," "indigenous innovation," the IC Fund, and other industrial policies.

(v) The Commission may also want to consider allowing a margin of appreciation in respect of subsidies issued by developing country governments. The SCM Agreement and the EU's anti-subsidy measures each establish preferential treatment for developing countries in anti-subsidy investigations, in recognition of the importance of subsidies in enabling such jurisdictions to transition to developed market economies. The same principle applies in respect of M&A activity: potential purchasers based in developing countries are more likely to require subsidies due to the nature of their domestic economies, and to effectively compete against potential purchasers based in developed market economies.

2.4 It will not be sufficient in practice (and would be inappropriate in principle) to rely on administrative discretion to narrow the range of cases that are in practice subject to review or investigation under these measures. Even if the prospect of investigation or an ultimate adverse finding is remote, businesses will incur significant compliance costs understanding and meeting the obligations under the proposed regime. Relying on administrative discretion also increases the risks of inconsistency and uncertainty as to the scope of the regime.

3. Module 1

1. Do you consider that Module 1 appropriately addresses distortions of the internal market through foreign subsidies when granted to undertakings in the EU?

3.1 The aim of Module 1 is to remedy distortions to the EU's internal market caused by foreign subsidies that are granted to undertakings in the EU. Whether, in practice, it will be able to do this successfully will largely depend on how the broad notions of "distortion" and "foreign subsidies" as currently set out in the White Paper are refined and how the module itself is applied in practice (including the approach to remedies). We are concerned that, without further clarity, there is a risk Module 1 could inadvertently capture transactions or subsidies that go beyond addressing the

regulatory gap identified by the Commission. Module 1 also risks leaving investing parties in significant doubt as to the application of its proposals, potentially stifling and/or unnecessarily delaying investments into the EU. Lastly, unless the scope of Module 1 is further narrowed, it may provoke unintended reactions by third countries e.g. trade retaliation, or the adoption of corresponding instruments that target authorised EU State aid or awards of EU funds.

3.2 Module 1 creates a hybrid enforcement tool that builds on and contains elements from the more established EU State aid, merger control, antitrust rules, WTO law and trade defence instruments (themselves based on WTO law). However, without well-defined building blocks, mixing and matching elements from regimes that are unique and, at times, diverging, could raise concerns about legal certainty and neutrality vis-à-vis non-EU players.

3.3 More specifically, Module 1 creates friction with WTO law in two respects. First, it risks discriminating against imported goods and services used by the targeted companies and, in addition, against foreign service suppliers located in the EU. Second, while the White Paper takes the view that "foreign subsidies" are not regulated by WTO law, this is a grey area in WTO law. It is arguable that WTO law does limit the granting of "foreign subsidies", both under the SCM Agreement and under the WTO General Agreement on Trade in Services (the "**GATS**"). If that is the case, then the EU would not be able to act unilaterally against "foreign subsidies" as envisaged, but would only be able to act via WTO procedures. This is specified in Article 32.1 of the SCM Agreement, which limits the ability of WTO members to take any action against "a subsidy", except as provided in the SCM Agreement and other WTO/General Agreement on Tariffs and Trade ("**GATT**") law.

2. <u>Do you agree with the procedural set-up presented in the White Paper, i.e. 2-step investigation procedure, the fact-finding tools of the competent authority, etc.? (See section 4.1.5. of the White Paper)</u>

2-step investigation procedure

3.4 Under Module 1, investigations would cover two stages. The first stage would involve a preliminary review of an existing foreign subsidy and the possible distortions of competition caused in the EU. The second stage would involve an in-depth investigation. Beneficiaries would be encouraged to cooperate, or, failing that, could face fines and periodic penalty payments. An in-depth investigation would be closed with no action, or, alternatively, subject to remedies proposed by the beneficiary or imposed by the competent authority.

3.5 We are concerned that under this approach proceedings could be very long lasting and, depending on the ultimate scope of Module 1, could also overlap with other processes such as merger control or foreign investment reviews. It is currently unclear what proportion of cases would be likely to proceed to a detailed investigation, and the criteria by which these cases would be selected and resolved are only very lightly specified.

3.6 Furthermore, while the Commission envisages that the competent supervisory authority would have a discretion rather than an obligation to investigate, the White Paper does not clearly set out the degree of such discretion (for example, in comparison to parallel antitrust or trade investigations), and does not clarify the specific status and rights of complainants, beneficiaries and foreign investors.

3.7 To avoid discouraging legitimate foreign investment, particularly where such investment is structural in nature and therefore hard to unwind at a later date, it will be important that there is a mechanism that can be used by companies to obtain positive reassurance as to the status of their arrangements at the outset.

3.8 The White Paper does not address rights of appeal. To the extent that this regime would involve empowering authorities to impose sanctions on individual undertakings it will be important to the legitimacy of the regime that those decisions can be subject to an appropriate level of challenge and judicial scrutiny.

Fact-finding tools of the competent authority

3.9 The competent authority, whether the Commission or a national authority is likely to encounter a number of enforcement challenges in relation to Module 1, in particular with respect to evidence gathering.

3.10 The effectiveness of several of the EU's existing legal instruments (e.g. its State aid regime) is closely linked with the Commission's powers to request information from Member States and alleged aid beneficiaries. The Commission's ability to request such information from non-EU Member States and non-EU based beneficiaries is likely to be much more limited. Indeed, some jurisdictions could actively prevent beneficiaries from sharing any information with the Commission, particularly in relation to undertakings that are active in strategically sensitive sectors.

3.11 In practice, this may lead to beneficiaries having to weigh-up whether to comply with an EU information request, or with confidentiality demands from the subsidising non-EU State. One could see how a cost-benefit analysis, which involves weighing up the risk of fines for failure to supply the information requested or even the risk of facing remedies under Module 1 in the EU, against the risk of antagonising its own subsidising State for what may be subsidisation of worldwide operations, would not always lead to investigative cooperation and disclosure.

3.12 The White Paper proposes to overcome such challenges by reliance on "facts available", a technique brought in from EU trade remedy investigations. This technique replaces missing or unreliable information, and the replacement may include information "*stem[ming] from market operators or Member States*". We are concerned with the use of this technique, especially in cases where governments or companies supply information which is subsequently disregarded by the Commission. If such a technique is to be used, it is important that procedural safeguards are put in place, to allow for a fair assessment of the facts and grounds leading to the supplied information being disregarded and made subject to the "facts available". The source of the "facts available" and the replacement information should also be part of the file available for inspection.

3. <u>Do you agree with the substantive assessment criteria (section 4.1.3) and the list of redressive measures (Section 4.1.6) presented in the White Paper?</u>

Substantive assessment criteria and scope

3.13 The notion of a “foreign subsidy” under the White Paper appears to be very broad. As set out at paragraph 2.3 above, it appears to be largely derived from the EU Anti-subsidy and Airline Sector Regulations (which, in turn, rely on WTO rules). The White Paper identifies several categories of foreign subsidies that it considers are likely to cause distortive effects. These include subsidies that are export-contingent; those directed at “ailing” firms (for instance, debt forgiveness without parallel restructuring); unlimited government guarantees; tax reliefs; or those directly aimed at facilitating takeovers. Other categories of subsidies would be examined in more detail to assess whether they could be distortive. However, it remains unclear to what extent the concept of subsidy is intended to be the same, or different, to the concept of "aid" under the EU State aid rules.

3.14 The concept of a “distortion” to the EU’s internal market also needs to be further developed. The White Paper lists categories of subsidies that are likely to have distortive effects but no such list can be exhaustive. The proposed list of distortive subsidies in the White Paper draws on the experiences of the concept of “prohibited subsidies” in the SCM Agreement, but expands and modifies it further, reinforcing the impression of a hybrid approach. If the intention is to model the approach that is applied under the State aid rules then the threshold to establish a "distortion" will be low. The effect of this (in the absence of any block exemption regime, as discussed at paragraph 3.1 above) will be that a swathe of subsidies would in principle be susceptible to enforcement action.

3.15 Clarification regarding the notions of “foreign subsidy” and “distortion”, and the extent to which they are intended to track, or differ from, equivalent concepts under EU State aid law, is therefore needed. This is all the more important as the White Paper envisages that, under Module 1, the Commission will have concurrent enforcement powers with national authorities. The risk of conflicting interpretations and ultimately diverging outcomes is particularly acute for national authorities, a number of which have limited experience in trade disputes, which have, to date, remained within exclusive jurisdiction of the EU.

3.16 The White Paper envisages that Module 1 would apply to companies established in the EU (whether or not they are the direct recipients of the subsidy). However, it goes on to add that consideration should be given to whether the measures should also apply to any company active in the EU that benefits from foreign subsidies, regardless of where it is established (e.g. such as when an undertaking established outside of the EU seeks to acquire an EU target). This second concept is very broad and essentially brings into scope all undertakings benefiting from foreign subsidies regardless of where they are located, provided there is some form of impact within the EU. If the intention is truly to level the playing field then an approach based on effects within the EU, rather than establishment within the EU, would seem to be the more appropriate basis (as is the case for the antitrust rules). However, as noted at paragraph 3.18 it is

not clear how the remedies proposals that are envisaged could be applied in the context of companies without any form of establishment within the EU.

List of redressive measures

3.17 Remedies would aim to neutralise the distortion to the internal market that has been identified. This includes "redressive payments", either to the granting authority or potentially to the EU or to Member States. This appears to be intended in principle to be a form of reimbursement of the subsidy but to the extent that such payments are made to an entity other than the granting authority they appear to be more akin to a penalty.

3.18 The White Paper also identifies a variety of alternative measures, including prohibition of investments, divestment of assets, access rights, conduct remedies or prohibition of certain conduct. It is, however, currently unclear how such measures would be enforced in relation to non-EU established companies. The White Paper appears to envisage, but does not state explicitly, that such remedies would continue to be redressive in nature i.e. the objective of such measures would be to counteract the benefit that has been received rather than to penalise the undertaking(s) in question.

3.19 We note that these remedies proposals, if introduced, would go considerably beyond the provisions that apply to EU Member States under the State aid rules. They also reflect a different conceptual approach, that could perhaps be articulated more fully, in that remedies would be applied to the undertakings that have benefitted from the subsidies, whereas under the State aid rules the obligation to comply rests in the first instance with the Member State.

4. <u>Do you consider it useful to include an EU interest test for public policy objectives (section 4.1.4) and what should, in your view, be included as criteria in this test?</u>

3.20 If the legal notions of "foreign subsidy" and "distortion" are to be interpreted broadly, as appears to be the case under the White Paper, then assessment under an "EU interest test" for public policy objectives will be critical. This approach would also mirror the approach under the EU State aid rules where it is recognised that State aid is in some circumstances an appropriate – and permitted - policy response to market failures of different kinds.

3.21 The challenge for the EU will be that the introduction of a subjective "public interest" test, however defined, is likely to increase the politicisation of the assessment. How the Commission (and indeed Member States' authorities) carry out this assessment would therefore be subject to intense scrutiny. Any indications of a more lenient treatment of State aid recipients as compared to the recipients of equivalent support from non-EU Member States could lead to a flare up of political concerns, with retaliation as a very concrete possibility. Again, with multiple concurrent enforcers, as envisaged in the White Paper, a robust system to ensure consistency and legal certainty will need to be established.

5. Do you think that Module 1 should also cover subsidised acquisitions (e.g. the ones below the threshold set under Module 2)? (section 4.1.2)

3.22 The White Paper notes that Module 1 also includes the possibility to review acquisitions facilitated by foreign subsidies and/or market behaviour by a subsidised bidder in a public procurement process. At this stage, it is unclear how the different modules proposed by the Commission are due to interact with each other and whether they will operate on a standalone basis, or alternatively will be combined into a single mechanism. However, in principle we consider that there should be one set of rules that apply in any given scenario. Mergers that are subject to Module 2 should therefore not be exposed to further, or subsequent, scrutiny under Module 1.

3.23 We also consider that for reasons of legal certainty mergers that fall below the thresholds should not be exposed to subsequent review under Module 1 (and that the thresholds should be set on this basis). In principle we would apply the same approach to procurement although for the reasons explained below we are not convinced that there is a need for bespoke rules for public procurement processes.

6. Do you think there should be a minimum (*de minimis*) threshold for the investigation of foreign subsidies under Module 1 and if so, do you agree with the way it is presented in the White Paper (section 4.1.3)?

3.24 The White Paper envisages that foreign subsidies that fall below a *de minimis* threshold would be beyond the scope of Module 1: a threshold of EUR 200,000, granted over a period of three years has currently been included. This aligns with the general *de minimis* threshold laid down in the EU State aid rules, but clarity would be needed on how this would be calculated for aid other than in the form of grants (i.e whether the detailed provisions set out in the *de minimis* notice would also apply in this context).

3.25 This would be a very low threshold, particularly in circumstances where the entity that is active within the EU may not be the direct beneficiary of the support and where it is not clear that other exemptions applicable under the State aid rules (e.g. under the GBER) would be available. Even if it is unlikely that low value subsidies would be the subject of enquiry there is the potential for these measures to impose a significant compliance burden on businesses in identifying and assessing such measures. We can therefore see a case for applying a higher threshold than would apply under the State aid rules.

7. Do you agree that the enforcement responsibility under Module 1 should be shared between the Commission and Member States (section 4.1.7)?

3.26 According to the White Paper, the Commission and Member States' authorities would be given concurrent powers to act on the basis of confidential complaints as well as to conduct own-initiative investigations. The Commission would have the ultimate say on whether a subsidy would be investigated by: (i) a single national authority; (ii) several national authorities acting in parallel; or (iii) the Commission.

3.27 From an enforcement and public resource perspective, we can see the potential benefit of having shared enforcement responsibility between the Commission and Member States. However, if the Commission and Member States' authorities are to have joint enforcement responsibility under Module 1, it will be essential to clarify how such shared responsibility will operate in practice in order to avoid potential parallel proceedings, uncertainty over which authority has jurisdiction, and to provide a clear case allocation and transfer framework (where applicable). Ultimately, any competence-sharing among agencies should avoid overlapping proceedings and ensure harmonisation.

3.28 We also note that, since responsibility for assessing whether State aid is compatible with EU law is not devolved, there is limited expertise amongst national authorities in the application of subsidies rules from the perspective of the enforcer. For a shared competence model to operate effectively it would be necessary to ensure that the relevant national authorities were appropriately skilled and supported.

4. Module 2

4.1 We acknowledge the Commission's position outlined in the White Paper that the EU State aid system does not apply to foreign subsidies that facilitate the acquisition of EU undertakings and therefore there is currently a "regulatory gap". The CLLS recognises the existence of this regulatory gap and also recognises that a Commission led "before the fact" notification system based on thresholds (quantitative or qualitative criteria), as set out in Module 2 of the White Paper, may be an appropriate way of seeking to address this gap.

4.2 However, we have significant reservations about the practical implementation of Module 2. The current draft Module 2 is broad in scope and lacks legal clarity in several respects. In particular, the notification system should provide sufficient certainty to non-EU undertakings on the scope of application, procedure and timing. Equally, the notification system should be manageable for the Commission and not impose undue pressure on the Commission's time and resources. With this in mind, we set out below some general comments on Module 2 and some practical suggestions to facilitate the efficient operation of Module 2. We then provide responses to each of the questions in the White Paper consultation.

4.3 The CLLS has concerns that the current proposals in Module 2 are potentially too complex and that there is much uncertainty in the practical implementation and interpretation of the proposals. The lack of clarity and ambiguities (detailed below) could lead to precautionary notification of a large volume of transactions that do not fall with the intended ambit of Module 2, generating unnecessary delay and regulatory burden. To avoid such precautionary notifications, greater clarity on the scope of Module 2 is required.

4.4 Further, whilst we understand that the Commission is seeking to address a regulatory gap, the CLLS is also mindful of the need for the EU to continue to attract investment, particularly from third countries that are close allies and key trading partners. CLLS is concerned that, as currently drafted, Module 2 may dis-incentivise investment in the EU by placing too large a regulatory burden on businesses. This is of particular

concern in the current financial environment as the EU continues to seek to recover from the financial impacts of COVID-19 on the EU economy.

4.5 In particular, Module 2 will introduce an additional regulatory burden and complexity to M&A transactions involving undertakings that receive foreign subsidies, and potentially create an additional barrier to entry and expansion of undertakings belonging to corporate groups with ownership links to non-EU states.[3] This is in addition to the current twin regulatory burdens of merger control notification (whether to the Commission of Member States) and / or foreign investment review notification (EU FDI Regulation and Member State FIR regimes). Module 2 would add a third, parallel notification system, with non-EU undertakings potentially needing to file three separate regulatory applications in the EU to facilitate an M&A transaction. This will result in a significantly more complex landscape for M&A. It would be helpful to consider the timelines and procedures of each of these three notification procedures; information required in each notification; and remedies.[4] To minimise the burden and expense on merger parties the Commission should ensure that the three parallel notification regimes are as coordinated as possible including as regards review periods and the nature and format of the information and data that will be required in order to ensure an efficient process, so far as possible.

4.6 We note that the White Paper explains that a "*new instrument on foreign subsidies would not affect the current rules on antitrust and mergers. In the case of parallel procedures under the FDI Screening Regulation, Merger rules and/or any new legal instrument, those instruments will include a mechanism to address any overlap and ensure that procedures are efficient*."[5] We are nevertheless concerned that there may be an overlap in practice in certain sectors (and transactions in those sectors) where both Module 2 and the EU FDI Regulation and / or EU Merger Control apply. This could result in overlapping procedures, inefficiency and potentially divergent outcomes. We would suggest that the Commission further consider mechanisms for managing the overlaps between Module 2 and merger control / foreign investment regimes. These should be proposed at an early stage to ensure the effectiveness and efficiency of Module 2.

4.7 An alternative to a new notification system as set out in Module 2, is that the EU FDI Regulation and foreign investment regimes in Member States are adapted to specifically include consideration and assessment of foreign subsidies that facilitate the acquisition of EU undertakings. We note that there is already a trend towards increased foreign investment control in Europe.[6] Arguably, a simpler alternative could

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[3] Module 2 may also place potential acquirers who may have received financial contributions, particularly State-invested/owned investors, at a competitive disadvantage in auction processes thereby dis-incentivising much needed EU investment in certain sectors and EU jurisdictions.

[4] We note that at the same time as the Commission is considering introducing a third notification regime there are also increasing calls to streamline the EU merger control process so that it is more efficient, simplified and shorted and reducing the burden of unnecessary RFIs. Introducing a third foreign subsidy notification procedure appears anathema to such demands for a leaner merger control regime.

[5] WP, footnote 12.

[6] We note that several Member States, for example, the UK, Italy, Spain, France and Germany are strengthening their foreign investment control tools or introducing new rules. Other countries, for example, Denmark, Finland, the

be to expand the current FDI Regulation rather than creating a third layer of notification.

(i) For example, the EU's new FDI Screening Regulation already explicitly considers whether an investor benefited from significant funding, including subsidies, by the government of a "third" country. [7]

(ii) Further many foreign investment regimes in Member States are arguably sufficiently wide in scope to enable consideration of influence by non-EU third countries. For example, German foreign investment filings require the disclosure of influence by foreign states through means other than equity participation (including by way of financial support). Germany also has residual jurisdiction to investigate foreign investment in all sectors of the economy. Member States have also introduced rules allowing intervention in sectors that are not likely to be objectively considered critical from a national security perspective but are regarded as critical by the respective Member State (e.g. from an industrial policy or domestic economy perspective).

(iii) Currently the substantive tests are different: under FDI rules, where the test of whether foreign investment is acceptable is a question of "national security and public order", whereas the proposed White Paper focuses on foreign subsidies facilitating an acquisition and distorting the internal market. However, the substantive tests under FDI regimes could be broadened to encapsulate the enforcement gap highlighted in the White Paper and specifically set out in Module 2.

4.8 Whilst, in the CLLS' view, the most appropriate approach would be to modify the FDI Screening Regulation and Member State FDI rules as suggested above, an alternative approach would be to amend the EU merger control regime. The White Paper acknowledges that in principle whether an economic operator has benefited from foreign subsidies could form part of the assessment under EU merger control regulations.[8] We invite the Commission to contemplate modifying the existing merger control rules to include new grounds for prohibition in line with the need to ensure that foreign subsidies do not distort competition in the internal market in the context of acquisitions of EU targets. Alternatively, the substantive assessment could be further broadened in scope to explicitly take greater account of non-price effects on competition, including foreign subsidies.[9]

Netherlands and Sweden have also announced plans to introduce or amend existing foreign investment control legislation.

[7] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, para 9, 10, 13, 23, Article 4 (2) (a).

[8] WP, 3.1.

[9] Such an approach would allow greater flexibility and arguably be in line with other Commission policy objectives. For example, it could also allow greater consideration of sustainability effects of a transaction.

4.9 A further alternative to the current proposals in Module 2 would be to introduce a voluntary notification system[10] or to limit the scope of Module 2 to certain "key" foreign investment sectors and / or target critical infrastructure (i.e. in effect exempting sectors where investment is encouraged or required).

4.10 Lastly we have a number of more discrete observations on the proposals, namely:

(i) We understand the proposals apply equally to all financial subsidies granted by non-EU entities to acquire undertakings established in the EU. To what extent does the proposed Module 2 take account of and consider equivalent "state aid" regimes in non-EU states and any previous assessment of such potential foreign subsidies?

(ii) Module 2 incorporates elements of EU trade and competition law. It would be helpful to understand further which Commission DG will have primary responsibility for review of notifications under Module 2 and how coordination between DG Trade and DG Comp will operate in regard to:

(a) Module 2; and

(b) coordination of potential parallel reviews under the FDI Regulation and EU Merger Control notifications for the same transaction.

4.11 It would also be critical to ensure that the Commission has sufficient resources to effectively implement Module 2. The EU must remain an attractive region for M&A transactions and investment. There is a danger that without sufficient resources, the review process in Module 2 would become inefficient and a barrier to investing in the EU.

1. <u>Do you consider that Module 2 appropriately addresses distortions of the internal market through foreign subsidies that facilitate the acquisition of undertakings established in the EU (EU targets)?</u>

4.12 As explained below a number of concepts in Module 2 require clarification by the Commission. Without such clarification, the scope of Module 2 is too wide and places too high a regulatory burden on acquirers', thereby dis-incentivising investment in the EU.

2. <u>Do you agree with the procedural set-up for Module 2, i.e. ex ante obligatory notification system, 2-step investigation procedure, the fact-finding tools of the competent authority, etc. (See section 4.2.5 of the White Paper)</u>

4.13 We understand the envisaged procedure involves a two-step mandatory ex ante notification system, namely:

[10] As under the UK merger control regime the Commission could retain jurisdiction to 'call in' completed transactions which in their view raise potential foreign subsidy concerns. We note that whether such a voluntary notification system would be workable depends on the Commission having sufficient resources and powers of investigation to examine potentially non-notified transactions.

(i) notification based on thresholds / qualitative criteria - preliminary review ("**Phase I**"); and

(ii) in-depth investigation if concerns are confirmed ("**Phase II**").

4.14 Whilst this mechanism is understood in principle there is a lack of clarity as to how it will operate in practice.

Notification

4.15 We understand that Parties are required to self-assess and submit a notification if the relevant acquirer has received a financial contribution from a third party country that satisfies certain quantitative and / or qualitative thresholds.[11] We comment below in response to Question 3 on the practical and legal difficulties of the proposed thresholds and self-assessment notification procedure.

4.16 In addition, we consider that given the novelty of Module 2 and the difficulties of self-assessing whether the relevant acquirer has received a financial contribution from a third party country, it would not be appropriate to open administrative proceedings (including the potential imposition of gun-jumping fines) for failure to notify a transaction. Without clarity on what constitutes a "*financial contribution*" and how to allocate value to such a financial contribution, the imposition of penalties for non-notification would be disproportionate. The Commission should also provide detailed guidance on notifiability.

4.17 We are also doubtful that it will be possible, in practice, for the Commission to investigate potentially non-notified transactions under Module 2 on any kind of consistent basis. In particular, it is not clear how the Commission would determine: (i) whether financial subsidies have been granted; and (ii) the value of any such financial subsidies granted by non-EU entities to private companies based outside the EU?

Phase I

4.18 At Phase 1 the Commission will consider if a "foreign subsidy" has been received by the relevant acquirer. As discussed at 2.3 above, "foreign subsidy" is very widely defined in Annex 1 of the White Paper as:

> "*a financial contribution by a government or any public body of a non-EU State, which confers a benefit to a recipient and which is limited, in law or in fact, to an individual undertaking or industry or to a group of undertakings or industries*."

4.19 The White Paper states that a short notification is required at Phase I. There is limited detail given on what information will be required in such a notification and the scope of such a notification. By way of example, under the EU Merger Regulation parties must either submit a "Form CO" or a reduced length "Short Form CO". The latter is a (relatively) simplified notification procedure that is available for concentrations which meet the turnover thresholds but do not give rise to competition concerns in the EU. We would encourage the Commission to consider whether it should similarly have two

[11] WP, 4.2.2.2.2.

forms of notification under the subsidies regime, distinguishing between those foreign contributions which whilst prima facie satisfying the qualitative / quantitative target and financial contribution thresholds:

(i) may give rise to (i) a foreign subsidy facilitating an acquisition and / or (ii) distortive effects on the internal market;

(ii) whilst satisfying the thresholds may not give rise to distortive effects on the internal market; and / or may result in positive impacts / public policy interests.

4.20 Approval within a short time period would be anticipated for category (ii). Category (i) would be subject to more robust investigation at Phase 1 and potential Phase II in-depth investigation. The CLLS submits that the review period and timelines should accord with the timelines under EU merger control so as not to cause unnecessary delay to transactions.

4.21 The filing should also provide the acquirer with an opportunity to explain: (i) why the financial contribution is not a foreign subsidy; (ii) why any given foreign subsidy would not facilitate the acquisition; (iii) why there is no distortion of the internal market; and / or (iv) why the investment will result in positive impacts/ public policy interests.

Phase II

4.22 Module 2 states that the Commission will "*open an in-depth investigation, if it had sufficient evidence tending to show that the acquiring company could have benefitted from foreign subsidies facilitating the acquisition*".[12] Greater clarity is required on the precise legal test for the Commission to open a Phase II investigation, the degree of evidence that is considered sufficient and the magnitude of any benefit that would be required to trigger a Phase II investigation.

Due Process and Rights of Defence

4.23 Given the potential redressive measures and sanctions envisaged in Module 2, the procedure outlined should also clearly articulate parties rights of due process, such as, access to file and rights of defence.

3. Do you agree with the scope of Module 2 (section 4.2.2) in terms of

- **definition of acquisition**
- **definition and thresholds of the EU target (4.2.2.3)**
- **definition of potentially subsidised acquisition**

As regards thresholds, please provide your views on appropriate thresholds.

Definition of Acquisition in section 4.2.2.1

4.24 We understand Module 2 is designed not only to cover the acquisition of control, but also acquisitions "*of at least [a specific percentage] % of the shares or voting rights or*

[12] WP, 4.2.5.

otherwise of "material influence" in an undertaking".[13] The scope of acquisitions captured in Module 2 is therefore very wide - possibly, wider than intended and required. The CLLS submits Module 2 should be limited to acquisitions of control only.

Non-Controlling Shareholding/ Voting Rights

4.25 If the Commission were to require the ability to review non-controlling minority shareholding acquisitions in Module 2, the burden for companies would likely be excessive. If the Commission were to adopt this proposal then the CLLS submits that acquisitions of non-controlling minority voting rights or shareholdings would need to be "*significant*".[14] The CLLS suggests that the Commission should consult further on the specific percentage threshold.

Material Influence

4.26 The definition of "material influence" has not yet been determined and there is considerable ambiguity as to the meaning of this term. The White Paper acknowledges that "*material influence*" would have to be properly defined in order to avoid "*confusion*" and unnecessary filings.[15] Not only is a definition required it would also be helpful to provide examples of "material influence". Guidance is needed on (i) the elements that constitute "*material influence*" and (ii) what types of corporate governance rights would confer such influence. For example, will this be based on an analysis of rights acquired under the draft transaction agreement? Will the test be similar to that used by the CMA, where an acquirer is considered to have material influence if it can influence decisions at the shareholder or board level through a range of diverse factors, such as, industry expertise, or having a "strong and persuasive personality"? Or would the Commission follow the approach of the German Bundeskartellampt and adopt a "competitively significant influence test"?

4.27 The CLLS also notes that in jurisdictions that have adopted a material influence test, such as the UK and Germany, this has led to a degree of uncertainty in application of the test (and we note that the UK test operates in the context of a regime that does not have a mandatory pre-notification obligation). Given the novelty of Module 2 it is imperative to reduce any further scope for uncertainty.

4.28 In this connection, it is highly relevant to ask whether it is helpful and appropriate to introduce a "material influence" test at all. Module 2 is based on an apparent wish for the Commission to be able to review any potential transaction by making the jurisdictional and intervention thresholds very low. Whilst this may be understandable from an "abundance of caution" perspective, it creates significant legal uncertainty and the CLLS would suggest that, as a starting point, a better approach would be for the Commission to provide an explanation of the relevance of minority acquisitions in the context of foreign-subsidised acquisitions.

[13] WP, 4.2.2.1.

[14] WP, 4.2.2.1.

[15] WP, 4.2.2.1, footnote 37.

Divergence from EU Merger Control

4.29 For both acquisitions of: (i) a specific percentage of a non-controlling shareholding together with voting and presumably contractual veto rights; and (ii) "material influence", there is a risk of potential divergence from the position under the EU merger control rules. For example, will the percentage threshold of shareholder / voting rights align with minority shareholder financial protection rights in the Jurisdictional Notice, which do not confer decisive influence and therefore an obligation to file?[16] There is a risk of inconsistency and conflicting outcomes with EU merger control - non-controlling minority acquisitions of EU companies would not require notification under the merger control regime but may require notification under Module 2.

Definition and thresholds of the EU target under section 4.2.2.3.

4.30 It is critical that "EU target" is clearly defined. The White Paper refers to "*any undertaking established in the EU"* which satisfies certain thresholds. The current drafting is too wide and leaves to much room for interpretation and therefore creates uncertainty. For example, to name but a few, does this refer to: (i) a legal entity which is incorporated in the EU; (ii) a legal entity which has a significant presence or activities in the EU; (iii) the ultimate top parent company only, or could the indirect acquisition of an EU subsidiary of a larger corporate group also fall within this definition?

4.31 The CLLS submits that it is important the relevant thresholds are easily understandable and simple to apply and self-assess. The EU merger control thresholds function well as they generally offer clear bright lines (other than perhaps in relation to full functionality) on whether a transaction requires an EU notification.

(i) The CLLS submits that the thresholds set out in Module 2 with regard to the EU Target, in particular, quantitative thresholds with reference to the value of the transaction or based on turnover, would function well.[17] Such thresholds would allow an acquirer and the Commission to notify and review transactions without having first to undertake a detailed analysis of the value of any financial contribution (see below). With regard to turnover thresholds, the Commission could rely on established turnover principles set out in the Jurisdictional Notice to the extent possible. With regard to value of transaction thresholds, clear guidance is required.[18]

Further, the threshold amounts must be sufficiently high in order to limit the application of Module 2 to those foreign subsidies that will likely lead to a distortion of the internal market. Indeed, the White Paper itself recognises that it is important that the threshold is not set too low as this will only result in "*a higher number of small, potentially less relevant acquisitions*" requiring notification.

[16] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings ("Jurisdictional Notice").

[17] WP, 4.2.2.3.

[18] Germany and Austria have recently introduced transaction value based thresholds in the area of merger control. This experience highlights the need for clear guidance and practical difficulties, which arise in applying a transaction value threshold.

Therefore, the CLLS submits that a sensible approach, in line with the first limb of the EU merger control thresholds, could be a quantitative target threshold turnover of EUR 250 million.

(ii) The CLLS submits that further clarification is required with regard to a threshold based on "*volume of financial contribution from third-country authorities*". The example is given "*where the total amount of financial contribution received by the acquiring undertaking in the three calendar years prior to the notification is in excess of a certain amount or of a given percentage of the acquisition price*". Such a threshold would effectively require an acquirer always to self-assess whether a financial contribution has been received from a third-country authority in circumstances where the Commission plans to interpret the concept of financial contribution very broadly, as in EU State aid law (for example, complex tax rulings). The relevant acquirer may not be aware of and / or recognise any previous interaction with third-country authorities as financial contributions. Secondly, a quantitative threshold also requires the relevant acquirer to self-assess and attach a monetary value to any such potential "financial contribution". Experience from anti-subsidy or state aid investigations shows that establishing the value of any financial contribution is extremely difficult, time consuming and complicated. The CLLS submits that such an assessment places too high a burden on acquiring entities; leaves too much ambiguity as to what constitutes a "financial contribution"; and leaves too much uncertainty on how to allocate value to any such financial contribution. In short, legal uncertainty is increased by requiring an acquirer to self-assess financial contributions. Therefore, such a threshold is not appropriate.

Definition of potentially subsidised acquisition

4.32 The White Paper suggests defining potentially subsidised acquisitions "*as planned acquisitions of an EU target where a party has received a financial contribution by any third country government".*[19] The CLLS submits that the current definition of foreign subsidy and examples of the forms a financial contribution can take in Annex 1 are overly expansive. This could result in Module 2 occasioning a large number of notifications (particularly if combined with low thresholds). Further, we note that the current definition includes "*foreign subsidies granted directly to undertakings established in the EU*". A consequence of this is that companies established in the EU, including European group companies, may conceivably be caught by Module 2 if they or their subsidiaries receive subsidies abroad (*e.g.*, tax credits). Again, further clarification on scope is required to allow companies to identify and manage risk.

4.33 Additionally, the CLLS notes that the definition of "*foreign subsidy*" in Annex 1 is intended to follow the definition in the WTO SCM Agreement and the EU's trade defence legislation. These instruments are designed to prohibit and counter subsidies in relation to exports of specific goods, and not to regulate inbound investment and M&A activity. Subsidies in the area of international trade can be traced more easily to specific goods; for example, a tax credit to incentivise "green" production methods, or incentives to locate manufacturing in a particular region of the exporting country. For

[19] WP, 4.2.2.1.

this reason and those set out above, it is far less straightforward to assess whether a subsidy is specifically used to facilitate an acquisition, or is simply a benefit to the business at large (and so could not reasonably be said to have subsidised the acquisition). In particular, many businesses (including those in the EU) will seek subsidies of some description, particularly tax credits and reliefs, in order to increase their profits or to reinvest (including, but not exclusively, by engaging in M&A activity). The blanket approach set out in Annex 1 could potentially capture any subsidy granted to any part of an acquirer's business, even if that subsidy does not genuinely impact upon the acquisition. The CLLS suggests that the Commission include a narrower definition of "foreign subsidy" for the purpose of Module 2, by tying the subsidy more clearly to the acquisition (e.g., only requiring screening where a subsidy is granted for the specific purpose of the acquisition, or where grant of the subsidy is conditional upon the acquisition taking place).

4.34 Module 2 further suggests the relevant period is "*the last [three] calendar years prior to the notification and financial contributions granted after notification and up until one year following the closing of the acquisition*"[20]. The CLLS suggests shortening the relevant time period to one year prior to notification. Furthermore, given this is intended to function as an *ex ante* mandatory notification system it is unclear to the CLLS how financial contributions post-closing can be captured. For example, a future financial contribution may not be known to an acquirer at the time of signing and closing a transaction.

4. <u>Do you consider that Module 2 should include a notification obligation for all acquisitions of EU targets or only for potentially subsidised acquisitions (section 4.2.2.2)?</u>

4.35 The CLLS submits that Module 2 should only include a notification obligation for potentially subsidised acquisitions. Were the Commission to consider all acquisitions of EU targets the scope is simply too wide. The Commission would receive a large number of notified transactions which are unproblematic and do not require notification, and would inappropriately encroach on an undertakings commercial freedom and privacy of information. Moreover, ultimately the notification system would become unworkable for the Commission to manage and review given the anticipated large number of notifications. The CLLS acknowledges that the Commission will therefore need to consider carefully the appropriate thresholds, given the comments above in connection with the impracticability of parties self-assessing whether they have received a final contribution from third-country authorities.

5. <u>Do you agree with the substantive assessment criteria under Module 2 (section 4.2.3) and the list of redressive measures (section 4.2.6) presented in the White Paper?</u>

Substantive Criteria

4.36 We understand that the Commission is seeking to remedy two potential distortions namely:

[20] WP, 4.2.2.1.

(i) acquisitions facilitated by a foreign subsidy; and

(ii) resulting distortions of the internal market (i.e. Target related).[21]

4.37 We understand these tests are cumulative. However, there is a lack of clarity as to how the distortion assessment would be applied, the precise criteria for each type of distortion, and the related standard of proof.

Acquisitions facilitated by a foreign subsidy

4.38 Module 2 states that it "*aims to ensure that foreign subsidies do not give an unfair advantage to their recipients when acquiring (stakes in) other undertakings*"[22] and that "*subsidised acquisitions may distort the level playing field with regard to investment opportunities in the internal market*". [23] Module 2 provides as an example the "possibility" for a subsidised acquirer to outbid competitors for the acquisition of an undertaking - "*such outbidding distorts the allocation of capital and undermines the possible benefits of the acquisition for example in terms of efficiency gains*".[24]

4.39 The CLLS notes that a higher purchase price is not the only, or even key, success criteria in a competitive auction process. When assessing potential buyers a seller will consider, for example, timing, deal certainty, synergies and cultural fit amongst other criteria. We would therefore query whether outbidding can be assumed to result in a distortion or unfair advantage.

4.40 Module 2 also notes that direct foreign subsidies that facilitate an acquisition are "*normally*" seen as harmful and therefore distortive of the internal market. It would be helpful to understand if this is envisaged to be a legal presumption and, if so, whether and how it can be rebutted.

4.41 Module 2 also notes that if a foreign subsidy de facto facilitates an acquisition then the Commission will consider whether the subsidy has a distortive effect. However, the list of "indicators" focuses on the activities of the Target and not the actual subsidy / impact on the financial strength of the acquirer.[25] Limited guidance is provided on how the distortive effect of the de facto facilitated acquisition would be assessed. Whilst it may be possible to identify a link between the acquirer and a potential foreign subsidy, the CLLS submits that assessing the impact of such an alleged foreign subsidy on the acquisition is more challenging. When considering a de facto facilitation, the assessment, for example, of whether a non-EU undertaking has acted on commercial terms or as a result of indirect financial support from a non-EU state, will be highly fact specific and vary on a case-by-case basis. The Commission should also consider

[21] WP, 4.2.3.

[22] WP, 4.2.1.

[23] WP, 4.2.3.

[24] WP, 4.2.3.

[25] WP, 4.2.3.

exempting certain categories of financial subsidies altogether, e.g. contributions that have to be used for a certain purpose (for instance for R&D) that cannot be acquisition related.

Distortions on the Internal Market

4.42 Limited guidance is provided on the "theory of harm" resulting from distortions on the internal target markets. We note the list of "indicators" but more clarity on the precise requirements for establishing such harm would be welcome. In particular it would be helpful to understand:

(i) Whether the Commission's distinction and presumption regarding whether foreign subsidies directly or de facto facilitate an acquisition also apply to the assessment of distortions on the internal market.

(ii) The evidential standard the Commission must meet to establish that the subsidised acquisition will result in distortions on the internal market. The CLLS submits that a minimum requirement should be a direct and significant link. Clarity would be welcome on how the Commission can establish such a direct link. Do the list of "indicators" equally apply to both actual and potential distortions of competition and to both direct and de facto subsidies facilitating an acquisition?

Redressive Measures

4.43 Broadly we understand the following types of redressive measures are envisaged:

(i) redressive payments if effective; and

(ii) structural or behavioural remedies.

4.44 With regard to option (i), we note the Commission states that "*redressive payments and transparency obligations may in practice be less likely to be effective redressive measures under Module 2*".[26] It would helpful for the Commission to clarify the basis for this statement. Is this because, for example, the Commission has concerns in regard to enforcement and ensuring the distortive subsidy is repaid? Further, it would be helpful to give further guidance on different potential scenarios. For example, what if the redressive payment results in financial difficulties for the undertaking?

4.45 The Commission also states that "*the focus of commitments is likely to be on structural remedies*". With regard to option (ii) - structural or behavioural remedies - these must be targeted to address the specific harm identified, namely a distortive subsidy. It would be helpful to understand further how the design of structural and / or behavioural remedies are envisaged to remedy the harm identified. Further guidance and practical examples or the types of commitments envisaged would be welcome. The CLLS also notes that, depending on the sector, behavioural remedies may be more appropriate. Structural and behavioural remedies are also potential outcomes of the EU Merger Regulation notification procedure. Merger and foreign subsidy remedies will arguably need to be closely coordinated to ensure there is no overlap and they do not conflict

[26] WP, 4.2.6.

(e.g. a merger remedy does not impede the implementation of a foreign subsidy remedy). The Commission should provide additional guidance on this.

4.46 Lastly, for all redressive measures and Commission decisions, the Commission should clearly stipulate the envisaged appeals procedure and timetable.

6. Do you consider it useful to include an EU interest test for public policy objectives (section 4.2.4) and what should, in your view, be included as criteria in this test?

4.47 Broadly we agree that it is helpful to include an EU interest test. The Commission may determine that a foreign subsidy has facilitated an acquisition and distorted the internal market. However, this would need to be balanced against any positive impact (the EU interest).

4.48 First, is such an EU interest test also available in Phase 1? For example, the Commission could consider an exemption list of certain EU public policy interests allowing transactions to be approved in Phase 1.

4.49 With regard to a Phase II review, this needs to remain predictable for companies and advisers. The Commission should therefore provide guidance on the list of public policy objectives that will be considered and how the different public policy considerations would be weighed or balanced against one another (as well as practical examples). For example, does this depend on the magnitude of the distortion to the internal market and / or do certain EU interests carry more "weight" to counteract any potential negative effects of distortions. Detailed guidance on relevant benchmarks and evidential thresholds would be helpful. This should include, for example, clarity on whether the burden of proof is on the notifying parties or on the Commission. If the former, then guidance on how can parties can demonstrate *"positive impact that the investment might have within the EU or on public policy interests recognised by the EU*" is required. Without such clarity on application of an EU interest test, transactions will face considerable legal uncertainty and an increased regulatory burden, thus dis-incentivising investment in the EU.

7. Do you agree that the enforcement responsibility under Module 2 should be for the Commission (section 4.2.7)?

4.50 The CLLS supports the proposition that Module 2 should be the exclusive competence of the Commission.

(i) A parallel notification system to Member States and the Commission would place too high a regulatory burden on non-EU undertaking, lead to an unacceptable degree of uncertainty, and, lastly, potential diversion in approach between the Commission and Member States.[27]

[27] We do note that the Commission's approach to centralised jurisdiction in relation to Module 2 contrast with the position under the EU Screening Regulation, where Member States have retained autonomy over the scope/nature of their rules and associated enforcement. However, we consider such exclusive competence necessary to mitigate the efficiency and procedural burden concerns outlined in this response.

(ii) Shared competence between the Commission and Member States would be at odds with the one-stop-shop principle that applies in merger control.

(iii) The Commission currently has exclusively responsibility for EU competition policy and is also responsible for EU trade policy (including exclusive competence for trade defence measures, including anti-subsidy investigations). The Commission therefore has the necessary experience to operate Module 2.

(iv) By contrast, individual Member States are not responsible for conducting trade defence investigations. Therefore, they will in many cases lack the necessary knowledge and experience to effectively implement a foreign subsidy screening mechanism based upon the principles established in the trade defence space.[28] This could result in ineffective and inconsistent screening between different Member States, increasing the likelihood of distortion of the internal market.

(v) Member States may have conflicting investment incentives. If enforcement responsibility lies with the Commission arguably this will result in more equal application of Module 2.

(vi) Lastly, the CLLS submits that the EU interest test is best assessed by the Commission. On this basis, the Commission should therefore have exclusive enforcement responsibility for all of Module 2.

5. Module 3

1. Do you think there is a need to address specifically distortions caused by foreign subsidies in the specific context of public procurement procedures? Please explain.

5.1 The EU public procurement rules do not require the participating operator to be established or primarily based in the EU or the EEA.[29] This provides contracting authorities with a wider choice of possible contractors, and therefore increases competition in the procurement process. Increased competition has the advantage of reducing public spend, so ensuring the lowest price for the best quality products, works and services.

5.2 We recognise that the presence of foreign subsidies could, in principle, give rise to a distortion of overall competition in markets that use competitive procurement processes if it means that, over time, a highly subsidised contractor is able to undercut its competitors by submitting bids that would, without the subsidy, be economically less sustainable. If this allows subsidised contractors to consistently outbid competitors for contracts, then in the long term it could have the effect of driving

[28] On this point, we note that the UK has found it necessary to rapidly create its own trade remedies authority in the context of its departure from the European Union, illustrating the potential challenges that Member States may encounter in the event that they had to establish their own foreign subsidy screening mechanisms and authorities.

[29] As the White Paper explains (see paragraph 3.3), under the Public Procurement Directives the EU is obliged to grant secured access to its public procurement market to third countries who are signatories of various international agreements. Public buyers may decide to exclude bidders from other third countries from their procurement procedures.

competitors out of the market which would lead to less choice for contracting authorities.

5.3 It is less clear to us that the presence of subsidies is likely (outside of the type of scenario that is already covered by the rules on abnormally low bids) to lead to distortions of an individual competitive process in the sense that the contracting authority is not receiving the best value for money for the goods or services that are the subject of the competition tender. This is particularly the case where the subsidies that are of concern are general subsidies to a particular industry or business, as opposed to more targeted contract-specific subsidies.

5.4 In our view, therefore, the public procurement process may not be the most appropriate mechanism to address the concerns that have been identified on a holistic basis. Such an approach potentially places a conflict at the heart of the procurement process in that it would require contracting authorities simultaneously to act to incentivise bidders to provide their best prices for goods and services whilst also policing the manner in which they do this. It also has the potential to send a mixed message to bidders as to the behaviour that is expected of them when determining the prices that they offer.

5.5 It may be appropriate to consider ways to strengthen existing mechanisms, such as the provisions on abnormally low bids, in order to address situations where the effect of a subsidy is distorting competition within the framework of a specific competition. It may also be appropriate to reinforce compliance with any additional general legal obligations that are introduced in relation to subsidies, through the use of provisions that require contracting authorities to exclude bidders that have been found to be in breach. In these cases however, the provisions should only be triggered where there is a pre-existing finding of breach, such that the contacting authority is not itself required to make an assessment as to whether or not a bidder is in compliance with the law. Further, to the extent that the Commission's concern is that contracting authorities may select lower quality, subsidised bids, this can be resolved by the quality/standard being specified in the relevant procurement contract.

2. <u>Do you think the framework proposed for public procurement in the White Paper appropriately addresses the distortions caused by foreign subsidies in public procurement procedures? Please explain.</u>

5.6 We are concerned that the proposed instrument will increase the costs, complexity of process, and timing of public procurement procedures. We see some risk that the White Paper's proposals may have the unintended consequence of reducing the choice of tenderers available to contracting authorities, therefore driving up the costs of public contracts and undermining the objective of obtaining the best value for money for public contracts.

5.7 Under the proposal, public authorities would need to consider – above and beyond the procurement considerations that already exist – whether a foreign subsidy concern arises. For these purposes it is necessary to consider not only the bidder itself, but its

subcontractors and suppliers.[30] As noted in the White Paper, the economic operator *itself* may not be aware of the existence of a financial contribution.[31] Against that background it would be burdensome and resource intensive for contracting authorities to identify foreign subsidies (or even to determine if a notification is complete before referring it to the supervisory authority), especially where the contracting authority is relatively small or regional.

5.8 There is considerable scope for these proposals to introduce additional delays into what can already be a lengthy process. The potential three month in-depth review period, coupled with the standstill obligation, would represent a substantial delay to the procurement timeline for all parties (including other tenderers that are not being investigated). This delay could cause significant difficulties for public authorities especially where urgent contracts are involved (for example, in the response to COVID-19).

5.9 The proposals would also place an increased burden on economic operators who participate in tenders subject to the rules. Tenderers would have to incur additional time, cost and resource by complying with the notification requirement, even if they have not received foreign subsidies. Carrying out the due diligence to comply with the notification requirement would be particularly onerous for contractors with numerous consortium members, subcontractors, suppliers or those with business activities in different countries. This could deter potentially suitable tenderers from participating in EU based public procurements. Additionally, it is unclear how the Commission intends to deal with cases where economic operators fail to comply with the notification obligation.

5.10 We are therefore doubtful whether the public procurement regime is the appropriate medium to pursue the objectives set out in the White Paper. This is particularly the case if Module 1 is pursued in some form, enabling an independent review and assessment of particular arrangements. If the Commission is minded to pursue this approach we would consider it essential that:

(i) A threshold for review is included, as proposed in the White Paper, in order to address "*only those foreign subsidies in public procurement that might cause distortions of the procurement procedure*", and to "*limit the administrative burden for public buyers and the competent supervisory authorities*".[32] This threshold should not be set by the size of the foreign subsidy, but rather by the size of the procurement contract involved. If the regime applied based on the size of the foreign subsidy, then this may risk blocking the entire public procurement system, and causing significant delays even in small and routine contract bids. If, on the other hand, the threshold is set in relation to the size of the procurement contract (e.g. to catch the top 10% of contracts by value), then large, strategic contracts that are more vulnerable to the distorting effects of foreign subsidies could be

[30] WP, 4.3.3.1.

[31] WP, 4.3.3.1.

[32] WP, 4.3.3.1.

thoroughly screened, and any subsidised bids evaluated in full, whilst smaller procurement processes, which the Commission would presumably not intend to capture, could proceed as normal. We would recommend that the Commission establishes a high value threshold for review. This is because it is unlikely that low or medium value public contracts are distorted to the same extent by foreign subsidies, and in these instances the administrative burden on the public buyer to evaluate, and potentially reject an otherwise attractive bidder would outweigh the potential benefit.

(ii) The application of these provisions be confined to a limited and predetermined sub-set of procurements involving the highest value contracts in strategically sensitive markets, where the potential benefits of such a regime are more likely to be proportionate to the disbenefits. Contracting authorities need to be able to definitively determine at the outset of a procurement whether these obligations apply.

(iii) There is either an option for the review timeline to be expedited, or for the standstill obligation to be lifted to avoid undue delay to the completion of the procurement process (particularly in urgent cases).

(iv) The regime should allow for a "pre-clearance" option, allowing recipient companies to approach the supervisory authority and obtain an advance foreign subsidy decision. This would streamline the procurement process considerably, as the timeline would not need to be paused to obtain a decision from the supervisory authority (instead, the procurement authority could "leapfrog" referral and move on to evaluate the distorting effect of the subsidy on the specific procurement process). For bidders that frequently participate in public procurement contracts, a blanket approval would avoid the need to duplicate assessment across different tenders. For smaller bidders, or those that are new to the procurement space, the pre-clearance option would minimise the risk of them being disincentivised by the prospect of facing the supervisory authority hurdle in every procurement bid they enter. We would also recommend that where a company operates in various Member States, it should be possible to approach the EU supervisory authority for blanket approval under a "one-stop-shop" principle.

5.11 To assist public procurement authorities in their assessment, we welcome the Commission's suggestion that it will provide a "uniform methodology" by which the contracting authority will assess whether the subsidy has distorted the public procurement procedure.[33] We recommend that the Commission clearly sets out the substantive test for distortion to ensure legal certainty, thereby excluding the wide and burdensome discretion of contracting authorities and ensuring a consistent approach between authorities. In addition, the level of technical and economic data that is required to assess the level of distortion needs to be proportionate to the size of the contract and the ability of contracting authorities of all sizes and levels of resource to manage.

[33] WP, 4.3.3.3.

3. Do you consider the foreseen interplay between the contracting authorities and the supervisory authorities adequate e.g. as regard determination of whether the foreign subsidy distorts the relevant public procurement procedure?

5.12 The interplay between the contracting authorities and the supervisory authorities may give rise to a number of challenges.

5.13 There are multiple layers of referral involved: notification from the contracting authority to the supervisory authority to assess whether a foreign subsidy exists, and then back from the supervisory authority to the contracting authority to assess whether the subsidy has distorted the public procurement procedure in question. The layers of referral significantly delay the public procurement procedure, since the contracting authority may not award the contract to the investigated economic operator until the supervisory authority investigation is closed. As set out at 5.8 above, this can further delay the already lengthy public procurement process, which is particularly a concern in relation to time-sensitive contracts.

5.14 Further, the margin of discretion that would be afforded to the contracting authority in determining whether a foreign subsidy has a distorting effect in the context of a specific procurement procedure raises issues around legal certainty. We appreciate that the contracting authority is well placed to make such an assessment, since it is uniquely familiar with the requirements of the contract and the background on the other bidders in the process. However, the fact that contracting authorities could effectively overturn the finding of a national authority, by deeming that the presence of a large foreign subsidy does not have a distorting effect in their specific procurement process, is problematic in terms of legal certainty and introduces additional scope for challenge in what can already be a complex process for contracting authorities to navigate. Moreover, it may be in the interests of the public authority to decide that there is no distorting effect in a particular case, for example because the subsidised bidder is offering a particularly low price, or a bid that is attractive for other reasons, but to decide that a foreign subsidy in similar circumstances is distortive, thus leading to inconsistency and uncertainty for bidders.

4. Do you think other issues should be addressed in the context of public procurement and foreign subsidies than those contained in this White Paper?

5.15 We are concerned that Module 3 is already over-specified, and may give rise to unintended consequences in its current form. Therefore we advocate the paring back of the scope of this Module, and do not think it should cover further issues.

5.16 To the extent that this module is designed to address a concern that contracting authorities do not use the powers already available to them to target foreign subsidies, there may be a case for the Commission or Member States to issue guidance to contracting authorities on their approach to procurement policies more generally.

5.17 If however, the fundamental objective is that contracting authorities moderate their overall approach to procurement so that they take into account not only their own short term position but the impact of their procurement practices on the competitiveness of the overall market, then in our view this cannot appropriately be addressed either through guidance or a “bolt on” subsidy regime which introduces conflicting objectives.

Rather, this should be tackled through a review and adjustment to the obligations on contracting authorities that are specified in the public procurement regime.

6. Interplay between Modules 1, 2 and 3

1. Do you consider that

a. Module 1 should operate as stand-alone module;

b. Module 2 should operate as stand-alone module;

c. Module 3 should operate as stand-alone module;

d. Modules 1, 2 and 3 should be combined and operate together?

6.1 For the reasons set out above, we consider that there would be a case for defining more tightly the scope of the measures that are being proposed, in order to focus on the situations that are most likely to raise substantive concerns, and reduce the negative impact on situations that are either neutral or beneficial to the EU. We would therefore like to see the scope of all three Modules reduced, even when viewed on a standalone basis.

6.2 We also consider that there is considerable overlap between Module 1, which is a very broad general measures, and Modules 2 and 3. We would therefore like to see further consideration given as to whether the Commission's key objectives could be achieved by pursuing either Module 1 alone or by dropping Module 1 and pursuing the more specific measures in Module 2 and 3.[34]

6.3 Whatever approach is ultimately adopted it will be important that the measures operate on an integrated overall basis. We would therefore see it as important that the regime is designed and operates on an integrated basis rather than being introduced as individual measures.

7. Questions relating to foreign subsidies in the context of EU funding

1. Do you think there is a need for any additional measures to address potential distortions of the internal market arising from subsidies granted by non-EU authorities in the specific context of EU funding? Please explain.

2. Do you think the framework for EU funding presented in the White Paper appropriately addresses the potential distortions caused by foreign subsidies in this context? Please explain.

[34] In particular, the issues that are highlighted in Module 3 do not necessarily need to be addressed by a standalone measure. Rather, they could be covered as a natural extension to the Module 1 screening tool. For example, the outcome of any review of a foreign subsidy in Module 1 could be carried across into any procurement processes in which the beneficiary of the subsidy participates.

7.1 In our view, EU funding arrangements raise similar issues to those considered in relation to Module 3 above. We are concerned that addressing subsidies through the mechanism of a competitive process introduces inherent conflicts of interest and that the methodologies proposed by the White Paper have the potential to impose disproportionate burdens on both contracting authorities and bidders. We would therefore suggest that concerns around subsidies should be addressed through a standalone measure and that a single measure of the type discussed in Module 1 would be more appropriate for this purpose.

CLLS Competition Law Committee
23 September 2020