Filling the regulatory gap to address foreign subsidies: the EC’s search for a level playing field within the internal market

Abstract:
The paper starts from EU legal treatment of foreign subsidies and the anticipated conclusion of filling existent gaps in this area. In section 2, breaches in EU competition law are scrutinized, particularly in the light of the EU merger control regime and articles 101 and 102 of the TFEU. In section 3, the effects of foreign subsidies in the EU internal market are studied from the point of view of state aid rules. Finally, in sections 4 and 5 the new EU FDI-screening Regulation, the White Paper on levelling the playing field as regards foreign subsidies and the proposal of a new EU Regulation to address distortions caused by foreign subsidies in the Single Market are examined.

It is concluded that the EU is gradually becoming more proactive and equipped with legal instruments that welcome the effects theory and which will allow the EU to evaluate economic policies followed by third countries, especially related to investments in the EU when associated with foreign subsidies. Here, it remains to be seen how third countries will react to those EU instruments particularly considering the reciprocity principle and possible negative reaction from those countries.

Index: 1. Introduction; 2. Distortion of the functioning of the EU internal market caused by extra-territorial effects: 2.1. General overview; 2.2. Current gaps in EU competition law. The case of the merger control regime; 2.3. EU state aid rules; 3. The EU FDI-screening regulation; 4. The White Paper on levelling the playing field as regards foreign subsidies and the proposal of a new EU Regulation to address distortions caused by foreign subsidies in the Single Market; 5. Conclusions;
1. Introduction:

Due to the Covid-19 situation, the world faces disrupting challenges that can only be compared with the ones that were tackled after the World War II. The biggest world crises since 1945 stands in front of us and it can only be overcome if world leaders work together. Fear and populism has brought back the assumption, in several countries, of neo-protectionist measures, as opposed to a multilateral approach to world trade that was historically followed by most of worldwide countries and recognized in the work of different international organizations such as the WTO or the WHO.

This different political approach to world trade has become clearer in recent years, especially considering the slow but consistent return of protectionist measures since the 2008 financial crisis\(^1\) and the paralysis of the Doha Round of WTO trade negotiations.\(^2\)

Up until recently, the EU has been reluctant to adopt trade reciprocity policies which could address the negative effects associated with the use of “beggar-thy-neighbour” policies.\(^3\) Furthermore, the EU has traditionally been an open economy and an advocate of free trade which means a low degree of protectionism.

Yet a change can be perceived in the external trade policy of the EU, particularly by assuring that reciprocity is used when faced with protectionist measures taken by third countries.

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\(^1\) See the data collected by the Global Trade Alert available at [https://www.globaltradealert.org/global_dynamics](https://www.globaltradealert.org/global_dynamics) (last accessed in October 2020).


\(^3\) This idea is aligned with international economic theories that start from game theory. According to those theories, the main reason why states have kept commitments, even those that have produced a lower level of returns than expected, was because they fear that any evidence of unreliability would damage their cooperative relationships and, if that happens, lead other states to reduce their willingness to enter future agreements. In the past, those economic theories arguing that reputational concerns helped to ensure states maintained their agreements were questioned because (1) states have different levels of reliability about different agreements, and (2) there is considerable evidence that states possess multiple or segmented reputations.

The perception of this change is clear if one follows EU reports in recent years on international trade; the several communications and proposals for regulations that have appeared; claims submitted by the EU to the WTO and public statements issued by the European Commission. Moreover, following the 2020 New Industrial Strategy for Europe, the EC has recently explained that, in order to reap the full benefits of global trade, Europe will pursue a model of open strategic autonomy, shaping the new system of global economic governance and developing mutually beneficial bilateral relations, "while protecting ourselves from unfair and abusive practices." As was stated by the EC, "openness to trade and investment is part of the economy’s resilience, but it must go hand in hand with fairness and predictable rules." It is also noteworthy that changes caused by the pandemic situation will also impact the way global trade will be perceived by the EU.

Following the new approach to external trade policy, the EU has signed different bilateral and regional agreements (Preferential Trade Agreements – PTAs) which have tried to push itself as a key player in the international trading system. By doing so it also aims to relaunch a multilateral approach to world trade.

Until 2006, bilateral agreements principally served non-economic purposes (neighbourhood and development objectives), while EU economic interests were served

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7 Data concerning cases launched by EU are available at https://trade.ec.europa.eu/wtdispute/search.cfm?code=1 (last accessed in October 2020).
8 In February 2020, the position of Chief Trade Enforcement Officer of the EU was created (“will ensure compliance with the provisions in the agreements concerning the environment, climate and workers’ rights.”). See EC press release IP/20/1409.
9 See Communication from the Commission - A New Industrial Strategy for Europe, Brussels, 10.3.2020, COM(2020) 102 final
by multilateral agreements. Since then, PTAs have largely been justified on the basis of economic interests.\(^{11}\)

Some of the PTAs – such as CETA (Comprehensive Economic and Trade Agreement) or JETA (EU-Japan Trade Agreement) – are considered to be deep rather than shallow agreements\(^{12}\), as they involve a wide range of issues beyond tariffs, including domestic regulations (or behind-the-border measures), such as services, investment, intellectual property protection, competition policy and public procurement rules.

At the same time, in many other third countries, more and more EU investors and companies face obstacles when investing, while non-EU companies enjoy the benefits of the liberal EU-market when dealing with foreign direct investment (FDI).

In fact, the EU is the world’s leading destination for FDI and, in 2017, accounted for more than one third (35\%) of the world’s inward investment positions.\(^{13}\)

In this regard, it is known that some non-EU companies and investors can benefit from the regulatory and financial support given by non-EU countries that can hardly be scrutinized according to existing EU rules.

That is the result, in many cases, of different approaches from non-EU jurisdictions to regimes such as merger control, public procurement and state aid. In some countries, those regimes are clearly protectionist and, in others, although they appear to

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\(^{12}\) On the distinction between “deep” and “shallow” agreements, see World Trade Organization, “World Trade Report: The WTO and preferential trade agreements: From co-existence to coherence”, 2011 available at https://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report11_e.pdf (last accessed in October 2020). Two distinct dimensions of deep integration are the “extensive” and the “intensive” margin. The extensive margin refers to an increase in the policy areas covered by an agreement, while the intensive margin refers to the institutional depth of the agreement. The extensive and intensive dimensions of deep agreements may be related, as an extension of the coverage of an agreement may require the creation of common institutions for its proper functioning.


be neutral towards national and non-national companies, are surrounded with additional regulations that carry out protectionist measures.\(^\text{14}\)

However, these non-EU companies and investors compete with EU companies inside the EU internal market according to the same rules.

Against this backdrop, this paper aims to analyse gaps in EU law, especially concerning the EU legal treatment of foreign subsidies, and how the EC is trying to fill those gaps seeking, at the same time, some degree of connection or link with the EU internal market. In doing so, the EC recognizes the importance of the effects theory in EU economic law.

Accordingly, in section 2, breaches in EU competition law are scrutinized, namely in the light of the EU merger control regime and articles 101 and 102 of the TFEU. In section 3, the effects of foreign subsidies in the internal market from the point of view of state aid rules will be studied. Finally, in section 4 and 5, the new EU FDI-screening Regulation, the White Paper on levelling the playing field as regards foreign subsidies and the subsequent proposal for an EU Regulation are examined.

2. Distortion of the functioning of the internal market caused by extraterritorial effects

2.1. General overview

Extraterritorial effects occurring outside the EU can distort or threaten to distort competition in the internal market. However, in the past, neither EU primary law nor ECJ jurisprudence recognized the possible application of the so-called “effects theory” in order to make EU law applicable to those situations.

One can say that this was due to the recognition of the territoriality principle in EU law as a general principle enshrined in public international law.\(^\text{15}\)

\(^{14}\) Nuno Cunha Rodrigues (2017).

\(^{15}\) This means that a State cannot take measures in the territory of another State, through the application of national laws, without the latter’s consent. This is, of course, the case of EU law, the application of which presupposes an adequate link with the territory of the Union, in order to respect that basic principle.
Nevertheless, according to public international law, States can exercise their jurisdiction extraterritorially, namely when considering special circumstances that may occur outside their respective territorial realm.\textsuperscript{16–17}

In any case, the possible extraterritorial application of EU law is achieved by seeking some degree of connection or link with the EU territory,\textsuperscript{18} or through the so-called “territorial extension” technique.\textsuperscript{19}

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\textsuperscript{16} This is the case, for example, when a particular action is committed in a State’s territory, even if part of that action has been carried out in another State (objective territoriality) (e.g. in cases resulting from the application of criminal law or commercial law); when jurisdiction is established on the basis of the need to prosecute and sanction certain types of crime which are internationally recognized (e.g. criminal law and actions related to the repair of damages in civil law) (Principle of universality); according to the effective control exercised by a State over the territory or individuals of another State (e.g. in situations where it is necessary to ensure respect for human rights) (Principle of “effective control”); when jurisdiction derives from the nationality or national character of the person who committed the offence or the person or national interest injured by the offence which will determine the application of national law (e.g. criminal law) (Principle of nationality); arising from the existence of a real and substantial connection between companies or persons in different jurisdictions (e.g. vis-à-vis subsidiaries of foreign companies).


\textsuperscript{17} The application of these principles should not, however, make us forget that, in determining extraterritorial competence, even when according to the exceptions allowed by Public International Law, some moderation is required, given the so-called “international comity”.

This moderation results, in some cases, from the application of norms of international law (or, as will be analysed below, EU law) or even of domestic law that aim to mitigate or prevent the production of extraterritorial effects of the law of a third country.


\textsuperscript{18} Luca Prete, On Implementation and Effects: The Recent Case-law on the Territorial (or Extraterritorial?) Application of EU Competition Rules, 9 Journal of European Competition Law & Practice (2018).

There are several examples of EU law use of this technique, for example in the field of environmental\textsuperscript{20} and animal protection\textsuperscript{21}; financial markets\textsuperscript{22}; rating agencies\textsuperscript{23} or Data Protection.\textsuperscript{24} At the same time, the EU has approved legal instruments in order to neutralize non-EU legislation that aims to produce extraterritorial effects whenever that legislation affects the interests of EU natural or legal persons.\textsuperscript{25}

Beyond territorial connections, EU courts have over the years moved towards an effect-based approach,\textsuperscript{26} namely in the context of competition law. This approach is to minimize competing or overlapping claims to exercise subject matter jurisdiction over the same conduct. Otherwise, identical activities would be governed by the law of the place where the activity occurred (i.e. the local jurisdiction), as well as by the law of the ‘foreign’ place which decided to exercise extraterritorial jurisdiction.\textsuperscript{27}


\textsuperscript{22} See article 4/1/(c) of Regulation 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

\textsuperscript{23} See article 4/3/(c) of Regulation 1060/2009 of 16 September 2009 on credit rating agencies.


\textsuperscript{26} Peter Behrens, The extraterritorial reach of EU competition law revisited: The” effects doctrine” before the ECJ. (2016). Europa-Kolleg Hamburg, Discussion Paper No 3/16, p. 8.


Discussing the application of the effects-theory in Israel, Michal Gal, Extra-Territorial Application of Antitrust - The Case of a Small Economy (Israel) (January 26, 2009). Cooperation,
In this matter, the application of the effects-theory under the umbrella of EU competition law has only recently been confirmed by the ECJ.

The Court of Luxembourgh has developed a jurisprudence based on specific links that try to attract law situations occurring outside the EU to EU competition. The Dyestuffs case can be considered as the landmark case. Here, the ECJ recognized the single economic entity” theory, according to which parent companies established outside the Union may be assigned the conduct of their subsidiaries located in the Union under certain circumstances. This case law was later developed in the Woodpulp case, where the ECJ established the “implementation” theory according to which competition law was also applicable to worldwide agreements as long as they were implemented in EU territory. In the late 1990s, the effects theory was recognized in the Gencor case which concerned a transnational merger operation (between companies based in the UK and in South Africa). In this regard, the General Court of the European Union (GCEU) considered that the extraterritorial application of European rules dealing with concentration operations would be “justified under public international law when it is foreseeable that a proposed concentration will have an immediate and substantial effect in the Community.” The “effects theory” was further advanced in the Intel case, first by the General Court, and then confirmed by the ECJ that stated that it would be possible to apply EU competition law to a conduct “which, while not adopted within the EU, has anticompetitive effects liable to have an impact on the EU market.”

The abovementioned evolution of the ECJ jurisprudence towards the “effects theory” represents a sign of convergence with US antitrust law.


In fact, the possibility of the so-called extraterritorial application of US antitrust law was historically recognized by the US Supreme Court in the famous Alcoa case, in 1945.36

Later, in 1982, the US Congress approved the Foreign Trade Antitrust Improvement Act ("FTAIA"), with the purpose of clarifying the extraterritorial application of the Sherman Act.37 Under this legislation, US competition law was applicable to behaviours practiced abroad, provided they had a direct, substantial and reasonably predictable effect in the USA. Moreover, in April 1992, the US Department of Justice announced that it would begin to oversee compliance with US extraterritorial competition law in relation to anti-competitive practices that restricted US exports, regardless of whether the practice actually harmed competition in the US domestic market.

This understanding of the Department of Justice was widely criticized, as it represented an attempt to apply extraterritorial US antitrust law to actions carried out outside the State, knowing that they did not have a direct and substantial impact on competition in the domestic market, which was understood as overcoming the international consensus on the extraterritorial application of competition laws in the light of the “doctrine of effects”.38 Furthermore, the FTAIA did not make it illegal for US

36 V. US v. Aluminum Company of America and others, 44 F. Supp. 97; 148 F. 2d 416. At stake was a cartel composed of foreign companies that agreed among themselves that each company would pay royalties to the others if its own aluminum production exceeded a certain level. Aluminum production was limited to the level set in the agreement, which resulted in the lack of aluminum in the USA due to the reduction in imports to this country. In this case, the US court applied national competition law because it considered that "any state can impose responsibility for conduct that occurs outside its borders that has consequences within its borders". This judicial understanding was supported by the Sherman Act. There was a general prohibition on the violation of competition law without any geographical limits.


38 This doctrine is recognized by the Association of International Law that identified it as a principle of international law at the 55th Conference held in New York, in 1972. The Association recognized that the extraterritorial application of domestic laws is legitimate if the following conditions are met: (a) the actions and their effects constitute activities that fall within the scope of the law; (b) there are significant domestic effects; and (c) these domestic effects are the direct and main result of extraterritorial actions. In 1977, the Institut de Droit International also declared that the jurisdiction over the rules that
domestic companies to engage in anti-competitive activity that only affects the export market which was seen by some as rather shocking.  

Nevertheless, the same understanding led the USA to be considered as the “world competition police”, especially since the American judicial system allowed consumers to be compensated for the damages caused by violation of competition law. This happened, for example, in the case of *Hoffmann-LaRoche v. Empagran*[^40], where foreign buyers of products that had been injured in countries outside the USA by the cartel discovered in the meantime filed actions in the USA and not in the country where they had suffered losses.

It is noteworthy that US courts have recently gradually begun to refuse actions founded on anti-competitive behaviour by companies based outside the United States. Thus, in the case of *Motorola Mobility v. AU Optronics*[^41], the Sherman Act was not considered to be applicable to a cartel involving price fixing by foreign manufacturers of LCD screens that had agreed prices applied to Motorola’s mobile phones. These were later sold in the USA. In this case, the famous judge Richard Posner stated that “no longer is the United States the world's competition policeman”.

In this vein, US courts have pointed out the need to mitigate the “doctrine of effects” through a “rule of reason” that involves considering the interests of other states and the complex nature of the relationships between the actors - states - involved and the USA. This was an appeal to the so-called principle of balancing national interests which is now linked to comity[^42].

What remains from this (brief) analysis of US competition law is the relevance that the “doctrine of effects” or the effects theory has had with a view to the application of competition law on both sides of the Atlantic.

[^41]: Motorola Mobility LLC v. AU Optronics Corp., No. 14-8003 (7th Cir. 2014).
[^42]: See *supra* footnote 16.
If, on the one hand, the application of the effects theory it is nowadays more clear, within the EU, when dealing with situations falling under the scope of articles 101 and 102 of the TFEU, on the other hand, it gets more complicated for worldwide NCAs, forced to cooperate among themselves when dealing with international cartels.

Finally, the application of the effects theory to EU and non-EU companies that benefit from foreign subsidies and, at the same time, act in the internal market remains less clear.

This can be better understood when looking in particular at the EU merger control regime or the EU state aid regime which will be analysed in the following section.

2.2. Current gaps in EU competition law. The case of the merger control regime

As explained above, the ECJ has recognized the role of the effects theory in the application of EU competition law. As a result, anti-trust behaviour that occurs outside the territory of the EU but produces anti-competitive effects inside the internal market can be attracted to the orbit of EU law. Somehow this is one of the consequences of the so-called externalization of the internal market which works both from and to the EU.43

Despite the application of the effects theory, some gaps related to the possible application of EU law remain to be filled.

One can identify several gaps when addressing competitive imbalances within the EU internal market arising from foreign subsidies granted by non-EU governments.

The existing breaches in the EU law – such as in the case of the merger control regime - do not assure a level playing field among EU and non-EU companies and investors within the internal market.

It is known that the number of cross-border merger operations involving different jurisdictions has been increasing. Similar to the GCEU Gencor case, non-EU jurisdictions can be called upon to intervene when the effects of cross-border merger operations are materialize on domestic markets. Accordingly, different merger control regimes can become applicable in a single transnational merger operation. Here, due to the

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involvement of different NCAs similar problems may arise, for example concerning access to information or possible enforcement of remedies.\textsuperscript{44}

Moreover, as is generally recognized, worldwide NCAs do not have the same \textit{global} power. Put differently, some competition authorities such as the European Commission, the Department of Justice\textsuperscript{45}, the Japan Fair Trade Commission\textsuperscript{46} or the Chinese State Administration for Market Regulation\textsuperscript{47} represent large economies and thus markets. As such, their final opinion on cross-border mergers is decisive and can represent a substantial \textit{veto} for global operations if that specific competition authority does not authorize the operation due to the importance that the specific market might have for the companies involved.\textsuperscript{48}

Here, one has to also consider that the different authorities involved will consider different national or regional competition policies, as reflected in the applicable legal regimes. In the end, those policies might represent different angles of intervention, sometimes considered to be protectionist,\textsuperscript{49} before the same merger operation.\textsuperscript{50}

\textsuperscript{44}Some of these problems could be solved through international cooperation between NCAs. See OECD working party no. 3 on Co-operation and Enforcement - Roundtable on the Extraterritorial Reach of Competition Remedies DAF/COMP/WP3(2017)4. Bruno Bastos Becker, Decentralized globalization: possible solutions for multiple merger control regimes in cross-border transactions, Revista do IBRAC, Volume 22 - Número 1- (2016), 99-122.
\textsuperscript{45}See https://www.justice.gov/atr/merger-enforcement (last accessed in October 2020).
\textsuperscript{46}See https://www.jftc.go.jp/en/ (last accessed in October 2020).
\textsuperscript{47}See https://en.nim.ac.cn/node/647 (last accessed in October 2020).
\textsuperscript{48}This is similar to the argument presented by Michal Gal concerning small economies: “the main problem is that small economies can rarely make a credible threat to prohibit the conduct of a foreign firm, especially if it has positive effects elsewhere that do not result only from the negative effects in the small jurisdiction.” Michal Gal, Extra-Territorial Application of Antitrust - The Case of a Small Economy (Israel) (January 26, 2009). Cooperation, Comity, And Competition Policy, Andrew Guzman, ed., Oxford University Press, 2009, Available at SSRN: https://ssrn.com/abstract=1333151 (last accessed in October 2020).
\textsuperscript{50}See, for example, the merger operation UTC/Goodrich in 2009. The EC decided that the operation would not have significant impediments to effective competition regarding aircraft lighting, provided that the companies involved accepted the remedies imposed by the EC. At the same, the FTC approved the transaction with non-conflicting remedies of divestitures of assets located in several jurisdictions, after working closely with other competition authorities such as the Canadian Competition Bureau (CCB), the Mexican CFC and the Administrative Council for Economic Defence in Brazil (CADE).
Furthermore, national or regional public interest may interfere with the strict application of merger control rules.

This is the case of the EU and China.

In the former – EU – it is known that Council Regulation 139/2004 of 20 January 2004 on the control of concentrations between undertakings authorizes Member States to take appropriate measures to protect legitimate interests other than those taken into consideration by the Regulation. Public security, plurality of the media and prudential rules are regarded as examples of legitimate interests.\footnote{Article 21 / 4 of the Merger Regulation. Alison Jones / John Davies, Merger Control and the Public Interest: Balancing EU and National Law in the Protectionist Debate, in European Competition Journal, vol. 10, no. 3, 2014, 453 ff., available at 

In the second case – China – the recent approval of specific foreign investment screening regulations emerges as an example of neo-protectionist measures that can be taken into account, in parallel, when investigating a merger operation.\footnote{See Foreign Investment Law (approved on 15 March 2019) (available at 
\url{http://www.fdi.gov.cn/1800000121_39_4872_0_7.html}) which includes two negative lists which enumerate the industries where foreign investment will either be prohibited or restricted. In China, see also the National Security Review Regime Under The New Foreign Investment Law, that came into effect on 1 January 2020. Referring to 2016, see the sixth WTO Trade Policy Review of China Report WT/TPR/S/342 available at 
\url{https://www.wto.org/english/tratop_e/tratop_e/s342_e.pdf} (last accessed in October 2020).} The case of China is quite interesting as it represents an example of FDI screening mechanisms that seem to have inspired the EU when approving the recent EU-FDI screening Regulation as we will see in section 3 of this paper.

In the context of merger control operations, the effects theory is called upon not only to determine the competence of the competition authorities – as was decided in the \textit{Gencor} case – but also in order to allow competition authorities to appreciate possible
impacts on effective competition that the merger operation may produce due to extraterritorial considerations such as foreign subsidies that the evolved parties might have benefited from in non-EU countries.

In the past, the need for evaluation of foreign subsidies given to undertakings when considering merger operations became evident on two occasions that considered concentrations between US-based firms. In the merger operation between Boeing and McDonnell Douglas, the EC cleared the operation after the acceptance of remedies by the parties involved. In a second merger - between General Electric and Honeywell – remedies were not accepted and the merger operation was blocked by the EC.

The evaluation of foreign subsidies in the context of merger operations was also appreciated, in the past, by the EU courts. In the 2001 RJB Mining case, the Court of First Instance (CFI) considered that the Commission had not analysed the effect of supposed state aid promised by the German government on the merged entity's financial strength. Accordingly, the CFI annulled the Commission's decision in the case RAG/Saarbergwerke/Preussag Anthrazit, which had been assessed under the Treaty establishing the European Coal and Steel Community (ECSC).

Although Article 2 / 1 / (a) of the EC Merger Regulation can be understood as wide enough when considering facts that the Commission should appraise in a concentration operation, the truth is that those objectives do not clearly include foreign subsidies granted to undertakings but only the “market position of the undertakings concerned and their

53 Case no IV/M.877 - Boeing/McDonnell Douglas.
54 Case COMP/M.2220 - General Electric/Honeywell.
55 Concerning these two cases and concluding that the EU’s exercise of extraterritorial competition policy derives from reasonable objections to the merger, the practical desire co-ensures market access opportunities for European firms and the need to enhance Union credibility in the eyes of member states, see Chad Damro (2001) Building an international identity: the EU and extraterritorial competition policy, Journal of European Public Policy, 8:2, 208-226, DOI: 10.1080/13501760110041550.
56 Case IV/ECSC.1252.
economic and financial power”. This allows the EC not to consider foreign subsidies when analysing an operation.

Nevertheless, after the RJB Mining case the evaluation of foreign subsidies in the context of merger operations was once again analysed by the EC, in the 2008 STX/ AKER YARDS case, this time with more detail.58

In this merger operation, there was a claim that the merged entity would benefit from state subsidies from South Korea, such as low labour, energy and steel costs. The merged entity would, therefore, be able to use such unfair subsidies to undercut prices, with the result of marginalising the existing competitors and driving them out of the cruise ship business, monopolising it and creating thus a dominant position on the market for cruise ships.59

In the decision, the EC explained how state aid could potentially increase a company’s financial strength if financial means were allocated to the company, for example by a reduced price for a state-owned target, by a simple transfer of money or in the form of loans or guarantees provided at conditions which do not correspond to market terms.

After, the EC went back to the RJB Mining judgement and clarified that, contrary to what was claimed, that ECJ’s case law didn’t provide grounds for imposing a general obligation on the Commission in a merger control procedure to carry out an independent analysis – comparable to a state aid procedure - in order to establish whether financial measures extended by third countries were granted on non-market terms and therefore constitute subsidies.

The EC considered that the RJB Mining judgment related to very specific circumstances, in which the alleged state aid was directly linked to, and indeed triggered by, the merger which was not the similar to the merger under scrutiny.

Finally, one key question referred by the EC in the 2008 STX/ AKER YARDS case related to the adequacy of WTO-procedures.

In the case, the complainant argued that the Commission should not leave the assessment of foreign subsidies to the ex post control exerted by the WTO but instead it

58 Case No COMP/M.4956.
59 See paragraph 70 of the decision.
should use merger control and its *ex ante* assessment to efficiently address foreign subsidies.

The EC explained that the conclusion on serious prejudice or injury to the domestic industry, which are tests used in the Agreement on Subsidies and Countervailing Measures Agreement (SCM), would not be sufficient to 'block' a merger⁶⁰, as it would be necessary to find a significant impediment of effective competition, which is the (strict) test applicable under Article 2 of the Merger Regulation.

Furthermore, the EC concluded that any alleged difference or alleged inadequacy in the WTO procedure would not be a sufficient reason to consider that the Commission could extend the limits of merger control proceedings in order to "correct" allegedly inadequate WTO procedures.⁶¹ Nevertheless, the EC proceeded to consider whether the alleged subsidies could have an impact on the competitive assessment and concluded that the facts didn’t confirm that the financial strength of the merged entity would be significantly increased.

Following the STX/ AKER YARDS decision, and more recently the EC has recognized, once again, that the EU merger control does not directly take into account whether an economic operator may have historically benefited from foreign subsidies (even if in principle it could form part of the assessment) and does not allow the Commission (or Member States) to intervene and decide solely or even mainly on this basis.⁶²

Put it differently, the fact that a firm has been granted subsidies by a third country may not be enough to trigger an intervention under EU merger rules.⁶³

This reveals the insufficiency of the EU merger control regime and the need to consider other EU instruments in order to fill the perceived gap when dealing with foreign subsidies.

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⁶⁰ See paragraph 82.
⁶¹ See paragraph 84.
⁶² See White Paper on levelling the playing field as regards foreign subsidies, p. 9.
2.3. EU state aid rules:

The application of the “effects theory” is still unclear when it comes to applying the EU state aid regime to subsidies given by third countries to companies (foreign subsidies).

EU state aid rules were defined in order to ensure that competition in the internal market is not distorted or threatened to be distorted through economic advantage somehow granted by Member States to companies.

Interestingly, the general prohibition of state aid defined in article 107 / 1 of the TFEU and the exceptions stated in article 107 / 2 and 3 have provided for the creation of a level playing field for Member States and undertakings inside the EU.

Paradoxically, the EU is the only territory in the world that has a system of control of public subsidies – state aid control – that creates a level playing field among undertakings inside the internal market but, at the same time, makes it much more difficult for EU companies to compete with non-EU companies both inside and outside the internal market.

The truth is that the effects of foreign subsidies can be felt within the internal market and may distort competition between EU and non-EU companies.

However, financial support granted by non-EU authorities to undertakings that act in the EU, either directly or through their parent companies outside the EU, are not covered by EU State aid rules64 and cannot be scrutinized by the EC.

In this matter, one can recall the role of the WTO system in order to ensure the maintenance of a certain level playing field among all companies. According to article 1 of the SCM, governments are prohibited from granting subsidies.

Nonetheless, the SCM Agreement only covers subsidised imports of goods from third countries and does not apply to subsidies related to trade in services and in relation to the establishment and operation of undertakings in the EU which are backed by foreign subsidies and which do not entail any trade in goods.65

The definition of subsidy, stated in article 1 of the SCM agreement, only considers “financial contribution” given by governments “within the territory of a Member”.

64 See White Paper on levelling the playing field as regards foreign subsidies, p. 9.
65 See White Paper on levelling the playing field as regards foreign subsidies, pp. 40-41.
Apparently, this definition narrows the concept of subsidy and refrains its application to situations where subsidies that have an effect over the EU internal market are given with the intermediation of other countries besides the original donor.

Consequently, a gap can be found in the WTO system besides the perceived breach in EU law when dealing with the effects of foreign subsidies that are felt within the internal market.

This question was one of several asked in a case that involved the Public Republic of China (PRC), Egypt and the EC in 2019, decided in June 2020 (“the GFF case”).

The facts were as follows.

On 16 May 2019, based on Article 10 of Regulation (EU) 2016/1037 of the European Parliament and of the Council of 8 June 2016 on protection against subsidised imports from countries not members of the European Union, the EC initiated an anti-subsidy investigation with regard to imports into the Union of certain woven and/or stitched glass fibre fabrics (‘GFF’) originating in China and Egypt.

A particular element of this case was that the alleged subsidisation in Egypt concerned two companies in the China-Egypt Suez Economic and Trade Cooperation Zone (‘SETC-Zone’), a special economic zone which was set up together by the PRC and Egypt, the two countries targeted by the complaint.

The subsidisation occurred due to financial contributions made by Chinese banks to the companies operating in Egypt.

The Chinese and the Egyptian governments alleged a long series of arguments against the EC’s opinion which were not accepted. One, in particular, is especially relevant for the purpose of this paper. It dealt with the concept of territoriality under the definition stated in the SCM agreement and Regulation (EU) 2016/1037 of the European Parliament and of the Council of 8 June 2016, on protection against subsidised imports from countries not members of the European Union (EU Regulation).

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According to article 1 (a)(1) of the SCM Agreement, a subsidy shall be deemed to exist if, among other conditions, “there is a financial contribution by a government or any public body within the territory of a Member”. Moreover, Article 2 (b) of the Regulation defines “government” as a government or any public body within the territory of the country of origin or export.

In light of the aforementioned, the Chinese and the Egyptian governments argued that there was no room for attributing the conduct of the Chinese government to Egypt under the EU’s Regulation as the definition of “government” was expressly linked to the territory of the granting authority. According to those countries, the words “within the territory” were aimed at providing legal security and could not be interpreted in a different way in the light of WTO or international law.\(^{68}\)

The Chinese government claimed that, according to Article 1.1(a) of the SCM Agreement, a subsidy only exists where there is a financial contribution by a government – or a public body – within the territory of the WTO member.\(^{69}\) Thus, any alleged direct transfer of funds by a financial institution operating in China to producers/exporters of GFF in third countries “cannot be attributed to China or considered a financial contribution given by the GOC”.

In the Chinese Government’s view, the Commission itself had supported a “territorial limit of subsidization” in the HRF case, when it declared “that there must be a financial contribution by a government or a public body within the territory of the subsidizing country” under recital 5 of the Regulation.\(^{70}\)

Moreover, the context of Article 1.1(a)(1) of the SCM Agreement, such as Articles XVI GATT, 2.1 and 2.2. SCM Agreement on specificity, Article 14 of the SCM Agreement on benefit calculations, Article 25.2 of the SCM Agreement on notification requirements all contain references that the beneficiary should be located in the territory of the subsidizing WTO Members.

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\(^{68}\) See paragraph 715 of the GFF case.
\(^{69}\) See paragraph 671 of the GFF case.
Finally, the negotiating history of the Agreement demonstrated – in the PRC’s view – that payments given by a government outside its territory would not be covered by the agreement.

Hence, the Chinese Government claimed that, even if there was a subsidy, it was given to companies located in Egypt and not in China and, as such, part of the definition of subsidy under article 1, 1.1. (a) (1) of the SCM Agreement – “within the territory of a Member” - was missing.

This argument was accepted by the EC.

The consensus reached in this argument allows us to recognize the existence of a gap in WTO law when dealing with subsidies for the production of goods overseas which are then exported to third WTO members.71

However, in this case, the EC considered that Egypt was accountable under the SCM Agreement for having actively sought, acknowledged and adopted such foreign subsidies for the benefit of the products made therein.72 The EC claimed that Article 2(b) of the EU Regulation 2016/1037 did not refer to the separate question of what action the government may authorize on its territory and acknowledges as its own.

In other words, the EC argued with a wide interpretation of Article 2(b) of the Regulation 2016/1037 as, according to it, the notion of “government” was open to interpretation, taking into account its context, object and purpose, similar to the notion of “public body”. Thus, the actions attributable to the government of the country of origin or export may not only be actions directly emanating from such a government but also actions imputable to such a government.

Put it differently, the claim of the Egyptian and Chinese government derived from an alleged strict notion of territoriality under Article 2(b) of the EU Regulation and Article 1.1(a)(1) of the SCM Agreement.

Still, for the EC, while it is true that the EU Regulation “must be interpreted, as far as possible, in the light of the corresponding provisions of the SCM Agreement”, these

71 In the same direction, see paragraph 672 of the GFF case.
72 According to paragraph 684 of the decision, “the Commission considered that the term ‘by the government’ in Article 3(1)(a) of the basic Regulation should include not only measures directly emanating from the GOE but also those measures by the GOC which can be attributed to the GOE on the basis of the available evidence.”
provisions do not go against the proposition that a financial contribution may be provided by another state which the territorial government of the country of origin or export acknowledges and adopts as its own.\textsuperscript{73}

This argument would be further confirmed by the terms in Article 3(1)(a) of the EU Regulation when referring to a financial contribution “by” a government. For the same reasons, the arguments invoked by the PRC, supported in several provisions of the SCM Agreement (e.g. Articles 1.1(a)(1), 13, 18.1(a)) were not considered.

Accordingly, the EC was entitled to verify whether the resources provided to the Egyptian companies were be qualified as countervailable subsidies granted within the meaning of Articles 2, 3 and 4 of the EU Regulation.

As such, the argument of the Egyptian and Chinese government derived from the alleged strict notion of territoriality under Article 2(b) of the basic Regulation and Article 1.1(a)(1) of the SCM Agreement, although understood in a literal way by the EU, was rejected.\textsuperscript{74}

The EC’s understanding made clear two points:

i) The concept of subsidy for the purposes of the ASM agreement and the EU Regulation is linked to a territory of the country where this is granted by the government;

ii) The definition includes cases where national governments do not grant the subsidy directly but acknowledge and adopt foreign subsidies as their own;

In our view, this later conclusion (see ii) supra) cannot be taken as definitive as it is based on interpretation principles that are to be discussed according to public and economic international law in the following terms.

The WTO Dispute Settlement Understanding requires that agreements must be interpreted in accordance with the customary rules of the interpretation of public international law as codified in the Vienna Convention. Article 31 of this Convention provides the following under the heading ‘General Rule of Interpretation’:

\textsuperscript{73} See paragraph 716 of the GFF case.
\textsuperscript{74} See paragraph 717 of the GFF case.
1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

This means that interpretation cannot be used to create new obligations or to resolve a true conflict of treaty norms by choosing one norm over another.\(^{75}\)

As such, one can discuss if article 1 of the ASM agreement was interpreted, by the EC in the “GFF case”, in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

If the EC’s argument is understandable – the concept of subsidy should include cases where national governments do not grant the subsidy directly but acknowledge and adopt foreign subsidies as their own – it is also true that there is room to discuss this interpretation in the light of the subsidy concept stated in the SCM agreement, especially when it considers the need for the subsidy to be granted “within the territory of a Member”. If we consider this latter option then one can conclude the EC’s argument had no support in the ASM agreement and consequently no specific action could have been taken, according to Article 32.1 of the SCM Agreement.\(^{76}\)

In any scenario, as seen, is clear the existence of a gap in EU law is clear and, furthermore, in the WTO system when dealing with the possible scrutiny of financial support given by non-EU governments to undertakings that operate within the EU internal market. This breach was not solved either by anti-dumping or countervailing regulations [Regulation 2016/1036 and Regulation 2016/1037, respectively], which apply to imported goods and do not cover services, foreign investment or foreign purchases of assets in the EU, nor by the FDI-screening Regulation (as will be explained later).

Until now, the EU has tried to fill this gap in the context of bilateral PTAs, such as CETA or the Singapore Agreement, where rules on subsidization similar to state aid


\(^{76}\) Considering possible EU liability and protection of individual rights for breaches of WTO law, see Hans-W Micklitz / Andrea Wechsler (eds), The transformation of enforcement — European Economic Law in a Global Perspective, Hart Publishing, 2018.
were defined. Here, the EU broadly applies two different approaches to subsidies: the “WTO+ approach” (SCM Agreement with an additional prohibition of the most harmful subsidies, transparency obligations and bilateral consultation) and the “State aid approach” (rules similar to the EU State aid rules).77

Recently, the EC proposed that, in the case where a PTA does not exist, the above identified gap could be covered by a new EU legal instrument that could define a level playing field for the possible scrutiny of financial support given by non-EU governments to undertakings that operate within the internal market (see section 4 infra).78

3. The FDI screening Regulation79:

As seen above, China approved specific foreign investment screening regulations.80 This was possible because according to several international instruments – such as the WTO rules or bilateral trade and investment agreements – countries can adopt restrictive measures relating to FDI on the grounds of security or public order. However, in some countries the scope of FDI screening is based on a general national interest or even a net benefit test.81

Being a “systemic rival” of the EU as defined by the EC82, the case of China is quite interesting as it seems to have inspired the EU when approving EU Regulation 2019/452 that established “a framework, for the screening by Member States of FDI into the Union, on the grounds of security or public order”.83 After that, in 2020, the EC issued a

77 See the White Paper on levelling the playing field as regards foreign subsidies, p. 43.
78 Here, it may happen that if a new legal EU instrument is approved, overlaps may occur due to the aforementioned bilateral approach. In this scenario, the EU proposes, in the White Paper, that the action under a new instrument could be suspended.
80 See the Foreign Investment Law (approved in 15 March 2019) (available at http://www.fdi.gov.cn/180000121_39-4872_0_7.html) which includes two negative lists enumerating the industries where foreign investment will either be prohibited or restricted. In China, see also the National Security Review Regime under the New Foreign Investment Law, that came into effect on 1 January 2020.
83 For the purposes of the Regulation FDI means an investment of any kind by a foreign investor aiming to establish or to maintain lasting and direct links between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry
communication providing guidance to Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe’s strategic assets, ahead of the FDI Screening Regulation (2020 FDI Communication).\(^{84}\)

The Regulation defines a cooperation method between the EC and Member States when screening FDI. Member States are not obliged by the FDI-Regulation to keep a screening mechanism\(^ {85}\) but it empowers and encourages Member States to provide comments between each other in respect of the FDI undergoing screening.

A reason for the voluntary nature of the FDI-Regulation is that the screening of FDI on the grounds of security or public order mainly falls within the scope of Art. 4 (2) TEU and the sole responsibility of Member States for their national security. The framework constitutes basic requirements that screening mechanisms have to ensure, for example the possibility to seek judicial recourse against a decision.

At this point, the lack of a “one-stop shop” mechanism, similar to the EU merger control, may harm a coordinated and harmonized application of the Regulation.

It goes without saying that, according to the Regulation, the Commission itself cannot decide on the admissibility of FDI. In the case of FDI likely to affect projects or programmes of Union interest, Member States are obliged to take note of the opinion of the Commission and provide an explanation if they do not follow it.\(^ {86}\)

The FDI-Regulation offers a non-exhaustive list of factors that may be considered by Member States or the Commission, when determining whether a FDI is likely to affect security or public order. This includes all relevant factors, such as the effects on critical infrastructure, technologies (including key enabling technologies) and inputs which are essential for security or the maintenance of public order, the disruption, failure, loss or destruction of which would have a significant impact in a Member State or in the Union.


\(^{85}\) See article 3 / 1 of the Regulation.

\(^{86}\) See Article 8 / 2 / c) of the FDI-screening Regulation.
Later, the 2020 FDI Communication has provided specific explanation on possible justifications to restrictions on capital movements.\footnote{See page 3 of the 2020 FDI Communication referring for instance whether investments may lead to over-reliance on foreign investors from third countries for the provision of essential supplies or essential services.}

Accordingly, opposite to that which happens with other similar regimes, the FDI Regulation has a more restrictive scope than it would apparently appear.

Screening can only happen on the grounds of security or public order.

However, it is still unclear how the concepts of \textit{security or public order} established in the Regulation will be interpreted both by the EC and national authorities since no definition is provided and different ranges of interpretation – one, more restrictive, following ECJ jurisprudence when dealing with TFEU (e.g. Articles 46 and 65 / 1 / (b))\footnote{Judgment of 4 June 2002, Commission / Belgium, C-503/99, paragraph 47: “the Court has also held that the requirements of public security, as a derogation from the fundamental principle of free movement of capital, must be interpreted strictly, so that their scope cannot be determined unilaterally by each Member State without any control by the Community institutions.” See Catherine Kessedjian, Public Order In European Law, Erasmus Law Review, Volume 01 Issue 01, (2007), 25-36.} and another, more literal, according to the decisions taken by the WTO panels\footnote{Nicolas F. Diebold, The morals and order exceptions in WTO law: balancing the toothless tiger and the undermining mole, Journal of International Economic Law 11(1), (2007), 43–74, doi:10.1093/jiel/jgm036 and William W. Burke-White & Andreas Von Staden, Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties, Virginia Journal of International Law [Vol. 48:2] (2008), 357-368.} – are known.\footnote{This argument can be perceived after reading Recital 4 of the Regulation, according to which this is without prejudice to the right of Member States to derogate from the free movement of capital as provided for in point (b) of Article 65(1) TFEU.}

Some scholars say that due to the voluntary nature and the broad provisions of the FDI-Regulation, the circumstances for investors from outside the EU will not change significantly. However, the FDI-Regulation stands as a sign of the new approach of the EU to international trade and can have an equivalent effect to a possible exercise of a \textit{veto} power that, although never used, will be previously red-flagged by foreign investors before deciding to invest in the EU.

In our opinion, the FDI-screening Regulation aims to send a clear message to countries such as China saying that investment in the EU – such as 5G technology - can
be scrutinized so that, in the end, EU reciprocity is indirectly assured. However, the concepts of security or public order cannot be confused with that of reciprocity.

Nevertheless, it is clear that the FDI-screening Regulation is insufficient in order to create a level playing field between EU and non-EU companies when dealing with foreign subsidies.

This led the EC to issue the White Paper on levelling the playing field as regards foreign subsidies that once more will be analysed in the next section.

4. **The White Paper on levelling the playing field as regards foreign subsidies and the proposal of a new Regulation to address distortions caused by foreign subsidies in the Single Market**

As stated above, gaps can be found in EU law when considering foreign subsidies given by third countries as this may cause distortions in the internal market. Knowing this the EC issued the White Paper on levelling the playing field as regards foreign subsidies\(^91\) on 17 June 2020 and launched a public consultation about it.

Later, on the 5\(^{th}\) May 2021, the EC presented a formal proposal for a new Regulation to address distortions caused by foreign subsidies in the Single Market.\(^92\)

In a changing global arena, the EU is preparing itself with new legal instruments that will enable it to offer prompt responses to challenges that a new approach to globalization will produce in a near future. The White Paper represents a sign of this new approach. Some even identify it as a sign that the EC is willing to face China, and respond to the Chinese “Belt and Road initiative” and “Made in China 2025” programmes in a competition among systems.\(^93\)

This was not the first time the subject was addressed within the EU.

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The Dutch government had already issued a similar document where possible answers to threats from unfair foreign competition were raised.\textsuperscript{94} Similarly three Ministers of the Economy – from Germany, France and Italy – expressed their worry with the lack of reciprocity that EU faced in global trade in a joint letter to Commissioner Malmström sent in February 2017.\textsuperscript{95}

In order to fill regulatory gaps, the White Paper proposes a number of legal solutions and tools called “Modules”. This includes the possibility of reviewing acquisitions facilitated by foreign subsidies and/or market behaviour by a subsidized bidder in public procurement. Foreign subsidies would be actionable if they benefit an undertaking established in the EU or an undertaking “active” in the EU as when, for example, it seeks to acquire a controlling interest in an EU company.

The following three Modules were detailed in the White Paper, each tackling three distinctive issues which the EC had identified as being potentially negatively impacted by foreign subsidies. As in May 2021 it was proposed a new EU Regulation following the White Paper, correspondence of the modules with the chapters of the proposal is made accordingly:

(i) The EU internal market generally (module 1 and chapter 1 and 2 of the proposed new EU Regulation)

(ii) Acquisitions of EU companies (module 2 and chapter 3 of the proposed new EU Regulation); and

(iii) Public procurement procedures (module 3 and chapter 4 of the proposed new EU Regulation);

Module 1 has a broad material scope and aims to address distortive foreign subsidies in all market situations.

The suggested notion of "foreign subsidies" builds on the subsidy definition set out in the EU Anti-subsidy Regulation\textsuperscript{96}; the EU Regulation on safeguarding competition


\textsuperscript{95} The letter is available at https://www.bmwi.de/Redaktion/DE/Downloads/S-T/schreiben-de-fr-it-an-malmstroem.pdf?__blob=publicationFile&v=5 (last accessed in October 2020).

in the air transport sector\textsuperscript{97} and the SCM Agreement. It is considered to be “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.”

The concept “foreign subsidy” focuses on “financial contributions” and includes grants given by a private body when entrusted with functions normally vested in the government or directed by the non-EU government. This large scope can make it difficult to identify if, for example, loans given by state-owned banks fall within the concept of foreign subsidies.\textsuperscript{98} As such, the EC should work on a more precise definition of “foreign subsidy”.

The White paper classifies subsidies likely to distort the internal market into the following categories\textsuperscript{99}:

a) Export financing not in compliance with the OECD rules on export credit;
b) Subsidies (such as debt forgiveness) to “ailing undertakings” without a prior restructuring plan;
c) Unlimited state guarantees;
d) Operating subsidies in the form of tax reliefs, outside general measures;
e) Foreign subsidies directly facilitating an acquisition;
f) Other foreign subsidies according to a non-exhaustive list of relevant indicators that includes (i) the size of the subsidy; (ii) the situation of the beneficiary; (iii) the situation on the market concerned; (iv) the market conduct in question and (v) the level of activity in the internal market of the beneficiary;


\textsuperscript{98} This is clearly the case with China. As is recognized by the European Court of Auditors in the EU’s response to China’s state-driven investment strategy document, p. 5, “State-Owned Enterprises benefiting from Chinese public financing form part of this Chinese investment strategy. Under EU rules such subsidies, if granted by Member States, would be treated as state aid. This difference in treatment makes it difficult for the EU to achieve a level playing field vis-à-vis China.”

The same document (p. 54) recognizes that the Chinese “Belt and Road Initiative” (BRI) is mainly financed by the Chinese state (in 2018, the funding was calculated to be more than US$750 billion).

\textsuperscript{99} See White Paper on levelling the playing field as regards foreign subsidies, p. 16.
Once it is established that a foreign subsidy is capable of distorting the internal market, and where there is evidence of a possible positive impact that the supported economic activity or investment might have within the EU or on public policy interests recognised by the EU, the distortion should be weighed against such possible positive impact.

This is what the White Paper defines as the “EU interest test”. Action would be taken against foreign subsidies if they frustrated the achievement of EU policy objectives such as job creation, climate neutrality and environmental protection, digital transformation, security, public order and public safety and resilience.

To apply the “EU interest test” the effects theory would be called upon again as the analysis is based on the possible positive impact that the supported economic activity or investment might have within the internal market or on public policy interests recognized by the EU.

For this reason, the White Paper proposes a different and wider approach than the one used in the FDI-screening Regulation. In the latter, it is suggested to take into account “whether the foreign investor is directly or indirectly controlled by the government, [...] including through ownership structure or significant funding (Art.4 II lit. a))” under its effects on security or public order. In the White Paper the effects theory is called based on the impact of foreign measures in internal market functioning and competition.

The criteria for defining the scope of potential beneficiaries is based on the country granting subsidies, independently of where the beneficiaries are based. This means that an EU company can be caught in this instrument if it receives any type of subsidies from non-EU countries that have an effect in distorting the internal market.

For this, the White Paper defines a two-step system, similar to the known phase 1 and phase 2 in the merger control regime.100

The EC and the relevant Member State authorities would initiate a case with a “preliminary review” to establish whether there is evidence that a foreign subsidy distorts

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100 See paragraph 4.1.5. of the White Paper. Phase 1 is equivalent to a preliminary review of a possible distortion on the internal market arising from the existence of a foreign subsidy and phase 2 an in-depth investigation.
the internal market. Information could be gathered from market operators or Member States.

In this matter the concept of distortion in the internal market will depart from that used in state aid rules. However, not only is the scope of Article 107(1) TFEU extremely wide but the exceptions that can consider state aid to be compatible with the internal market are relatively discretionary (see, for example, Article 107(3)(c) TFEU). Furthermore, the EC has single competence to enforce state aid rules which allows it to have a significative track-record in this area, as opposed to Member States that are excluded from this analysis.

Moreover, the White Paper proposes a system where Member States will also be able to investigate foreign subsidies and take remedial action following, *mutatis mutandis*, state aid rules. Accordingly, it remains to be seen how coherence will be kept across the EC and all the Member States involved, knowing that some Member States may opt against the instrument to keep national FDI attractive. A possible solution would be to concentrate on the EC exclusive competence to enforce module 1.

If there are no indications of a distortion in the internal market, they would close the case. If there is evidence of distortion, the preliminary review would be followed by an “in-depth investigation”. The competent authority would request the company under investigation to provide it with all the relevant information. In the event the company does not comply with that request, the competent authority can take a decision on the basis of the available facts. If the investigation confirms that the “proper functioning” of the internal market “may have been or may be distorted”, the competent authority would be able to impose “redressive measures” to eliminate those distortions or accept “commitments” by the company in question.

Since it cannot be ensured that prohibited subsidies would be recovered with interest by the granting authority, the White Paper establishes that the EU may accept other remedies such as divestment, prohibition of the intended acquisition, prohibition of conduct linked to the subsidy, licensing of IPRs, publication of R&D results, payments to the EU or Member States.
Here, a similar key issue related to transnational public enforcement of competition law emerges since it is unclear if foreign companies will accept, on a voluntary basis, to transfer technology or to make payments to the EU or Member States, as is proposed. Some of the companies may simply decide to leave the EU market. These remedies can also produce, in themselves, distortions between EU and non-EU companies inside the internal market that should be balanced in advance, and it is also not clear how this will be achieved.

The supervision of this module would be shared between multiple enforcers, namely the EC and Member States, based on the EU interest test, as seen above. There is a range of prosecutorial discretion for both the EC and Member States or the status and rights of complainants, beneficiaries or foreign investors, namely when compared to the rights of defence established in EU state aid rules.

In such a context, the EC may be tempted to create a legal instrument where third countries have fewer and stricter rights than Member States or EU companies. This would not be compatible with the non-discrimination principle stated in the WTO agreements – such as GATS; SCM or the Agreement on Trade-Related Investment Measures (TRIMs) - nor with several existing trade and investment agreements between the EU and third countries.

The instruments under module 2 are intended to specifically address distortions caused by foreign subsidies that facilitate the acquisition of EU companies. The same test, procedure and redressive measures are envisaged as for module 1. According to the White

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102 In June 2014, the Lithuanian Competition Authority imposed a fine of almost 36 million euros, the largest anti-trust fine ever in the country, on Gazprom for its refusal to negotiate. Bailiffs were tasked with enforcing the payment after the Russian company missed a deadline for paying the fine, but they failed to find any Gazprom assets in Lithuania. See https://www.baltictimes.com/lithuanian_anti-trust_body_says_recovering_fine_from_gazprom_is_difficult/ (last accessed in October 2020).

103 Under EU State aid rules, this status (and corresponding due process rights, such as access to information) is traditionally limited because the EU Member State granting the aid is the main defending party and is bound by a duty to cooperate with the EU institutions. This might not be possible here, even in cases where the beneficiary faces sanctions in the form of fines or a prohibition from acquiring a company.
Paper, the percentage threshold of shares above which action would be taken should be determined at a later stage. Here, an alignment with the EU merger control regime seems to be desirable.

The EU legal instrument should work in parallel with ongoing investigations on merger operations. Moreover, this may overlap with the application of competition law. However, in this case, the possible concentration of powers in the EC (“one-stop shop”) is desirable as it can increase transparency and dissipate tensions that could emerge from the different entities evolved. Here, implementation of Chinese walls inside the EC would be desirable as it could be tempted to use module 2 as a way to circumvent possible obstacles regarding the application of competition law.

Module 3 deals with distortions in public procurement procedures. For the moment, EU public procurement directives do not lay down specific rules regarding bidders benefitting from foreign subsidies.

This module differs from the other two modules as it is proposed that companies participating in tender procedures should notify the procuring authorities of subsidies exceeding 250 million € thresholds that they received in the previous three-year period. If it is found that a bidder has benefited from subsidies, it would be excluded from the related public procurement procedure. It is still unclear how this will work for public authorities, due to the administrative burden created, and for companies that can try to dissimulate possible foreign subsidies granted. Moreover, access to EU funds can also be scrutinized, according to the White Paper, following the same procedure as in modules 1 and 3 for funds that are under shared or direct management by Member State authorities.

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104 The White paper recognizes this possibility (p. 9, footnote 12). Nevertheless, it states that 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.
105 Article 69 of Directive 2014/24 on public procurement allows procuring authorities to reject “abnormally low tenders” due to State aid.
106 See article 27 (2) of the proposal for a new Regulation to address distortions caused by foreign subsidies in the Single Market. The White Paper had undefined thresholds.
107 See article 26 of the proposal for a new Regulation to address distortions caused by foreign subsidies in the Single Market.
108 The possible scrutiny of EU funds can be exemplified with the construction of the Pelješac bridge in Croatia. In 2017, the Commission allocated €357 million of Cohesion Policy funds to cover 85% of the cost of the bridge in order to connect the area in the South around Dubrovnik to the rest of mainland Croatia. In 2018, the Croatian authorities awarded a major construction
Following the publication of the white paper, on the 5th May 2021, the EC proposed a Regulation to address distortions caused by foreign subsidies.

The proposed Regulation has 48 articles, divided in the following six chapters:

Chapter 1: sets out general provisions, including the subject matter and scope of the regulation (Article 1); when a foreign subsidy is deemed to exist (Article 2); under what conditions it is considered to distort the internal market (Article 3); what types of subsidy are most likely to have a distortive effect (Article 4); describes the balancing that the Commission performs (Article 5) before imposing any redressive measures, and the possible types of redressive measure and commitment (Article 6).

Chapter 2: governs the ex officio review of subsidies, by the EC (Articles 7 to 16).

Chapter 3: lays down the conditions under which a foreign subsidy in a concentration is considered to distort the internal market (Articles 17 to 25).

Chapter 4: contains the conditions under which a foreign subsidy is considered to distort the internal market in a public procurement procedure (Articles 26 to 32).

Chapter 5: describes common procedural provisions (Articles 33 to 39).

Chapter 6: describes the relationship between the regulation and other legal instruments (Article 40).

Chapter 7: contains further general provisions (Articles 41 to 48), such as the committee procedure for decisions (Article 41), as well as the possibility of adopting implementing provisions (Articles 42, 43) and delegated acts (Article 44), in accordance with specific rules on the delegation of powers (Article 45).

This proposal will face some hurdles.

One comes from the fact that the SCM Agreement only covers subsidised imports of goods from third countries.

As such, the existing breach in the WTO system has primarily to do with subsidies related to trade in services and in relation to the establishment and operation of contract for this bridge to a Chinese consortium led by the SOE China Road and Bridge Corporation, thereby financing a project which is part of the Chinese investment strategy. See European Court of Auditors, The EU’s response to China’s state-driven investment strategy, p. 39:
undertakings in the EU which are backed by foreign subsidies and which do not entail any trade in goods.

This legal instrument created by the EU will have to differentiate these two categories of subsidies in order to respect the ASM agreement. If not, the definition of subsidy would have to be similar to that of the ASM agreement which might create a risk of overlap and possible infringement of the non bis in idem principle.¹⁰⁹

Another hurdle comes from knowing that the screening of foreign subsidies should follow the same rules and exceptions applicable to EU state aid law.

Apparently this is recognized by the EC in the White Paper document as it says that, similar to de minimis state aid rules, foreign subsidies below a threshold of EUR 200,000 to an undertaking over a period of three years do not create distortions in the internal market.¹¹⁰

Moreover, the proposal of EU Regulation on foreign subsidies establishes a quite higher de minimis threshold by defining, in article 3 (2), that a foreign subsidy is unlikely to distort the internal market if its total amount is below EUR 5 million over any consecutive period of three fiscal years.

Furthermore, considering the possible equivalence between foreign subsidies and EU state aid, some questions remain to be answered.

Firstly, it is known that State measures take diverse forms and must be analysed in terms of their effects, for example when advantages are given in the form of a State guarantee.¹¹¹

¹⁰⁹ In the White Paper, the EC is silent on whether the same subsidy (with respect to a company manufacturing goods) might be caught both by anti-subsidy duties and by measures of redress under Modules 1 or 2. The White Paper interestingly contemplates the possibility of suspending actions under the new legal instruments if it appears “more appropriate” to use the relevant agreement’s dispute settlement provision to tackle the foreign subsidy. It remains to be seen how the EU will attempt to implement these principles while complying with its international commitments.

¹¹⁰ See White Paper on levelling the playing field as regards foreign subsidies, p. 46.

This means that a borrower who has subscribed to a loan guaranteed by the public authorities of a Member State normally obtains an advantage inasmuch as the financial cost that it bears is less than that which it would have borne if it had had to obtain that same financing and that same guarantee at market prices.\textsuperscript{112} If this wide concept of financial contribution was included in Articles 2 and 4 of the proposed EU Regulation, it remains uncertain how this will be analysed when dealing with different third country measures.

Secondly, it is unclear how the burden of proof will be established when dealing with foreign subsidies. In the past, the ECJ decided that Article 13(1) of Council Regulation (EC) No 659/1999 of 22 March 1999 empowers the Commission, once it finds that aid has been granted or altered without notification, to adopt a decision on whether the aid is compatible or not with the common market on the basis of the information available, where it is faced with a Member State which does not fulfil its duty to cooperate and has not provided the Commission with the information requested.\textsuperscript{113}

As it is recognized by the ECJ at the same time, the possibility which is granted to the Commission cannot be interpreted as releasing that institution entirely from the obligation to base its decisions on reliable and coherent evidence to support the conclusions which it arrives at.

In this regard, it is blurred how the EC will deal with a situation where a third country does not provide information regarding foreign subsidies.\textsuperscript{114} In this scenario the White Paper mentions that information could e.g. stem from market operators or Member States\textsuperscript{115} and that, given this, the competent supervisory authority could impose fines and periodic penalty payments for failure to timely supply the information requested or for supplying incomplete, incorrect or misleading information.

\textsuperscript{114} This hypothesis is recognized in the White Paper on levelling the playing field as regards foreign subsidies, p. 18.
\textsuperscript{115} See White Paper on levelling the playing field as regards foreign subsidies, p. 13.
The recent proposal of an EU Regulation defines, in Article 14, that the EC may take a decision if an undertaking concerned or a third country provides incomplete, incorrect or misleading information or fails to provide information.

Furthermore, it defines possible fines and penalty payments if an undertaking provides incorrect information (see Article 15).

However, it remains unclear how the EU will act if a third country decides not to cooperate, knowing that the possible EU reaction can happen in the light of geo-politics.

Furthermore, a grey area remains when it comes to the possible application of article 107 / 2 and 3 TFEU to foreign subsidies.

As seen above, the White Paper makes a parallel between foreign subsidies and EU state aid just when considering de minimis situations.

This said, it is still unclear if distortions in the internal market can be justified by third countries under the analogous application of article 107 / 2 and 3 TFEU to foreign subsidies.

If not, non-discrimination principle established in the WTO rules may be harmed.

On the other hand, if the analogous application of article 107 / 2 and 3 TFEU is considered one can ask, for example, how the EC would deal with and verify an argument provided by a third country that a subsidy was given to a certain undertaking in order to promote the economic development in third country areas where the standard of living is abnormally low or where there is serious underemployment (see article 107 / 3 (a) TFEU).

The proposal for a EU Regulation on foreign subsidies distorting the internal gives the EC the power to, where warranted, balance the negative effects of a foreign subsidy in terms of distortion on the internal market with positive effects on the development of the relevant economic activity (see Article 5).

Still, the proposal nothing says about the possible application of article 107 / 2 and 3 TFEU to foreign subsidies and therefore, the question remains to be answer.

Finally, two points remain unclear regarding possible EU screening of foreign subsidies.
Firstly, third countries would have rights to defence as this is a fundamental principle of EU law\textsuperscript{116} and could even appeal to the Charter of Fundamental Rights of the European Union. The EU proposal for a Regulation refers to the need to comply with general principles of Union law, such as proportionality, legal certainty, and with fundamental rights (see considering 41). In this scenario, the EU will have to follow the application of the EU proportionality and equality principles to third countries and non-EU companies the same way as it does to Member States and EU-companies.

Secondly, possible overlaps with other EU law regimes, such as the FDI screening mechanism, may occur.

On balance, the White Paper – and the recent proposal for an EU Regulation - seem to tackle the identified breaches.

Both target the identified harm – competitive imbalances caused by foreign subsidies granted by third countries - and provide remedies. Notwithstanding the foregoing, if the White Paper was ambiguous, it remains to be seen how the procedure and the parameters defined in the proposal for an EU Regulation will be executed, namely considering the potential administrative and compliance burden.

Although the reaction to the White Paper was positive across the EU, the nature and the content of the proposals to be specified in a legal instrument remain open. Here, a narrow and strict approach would be preferable instead of a wider one that may create grey areas and unbalance the possible application of the EU law. Gradually, the EU could increase the fine-tuning of the instrument and, by doing so, promote legal certainty and security.

5. Conclusions:

The ECJ has recognized the important role of the “effects theory” in the application of EU competition law. As a result, anti-trust behaviour that occurs outside the territory of the EU and produces anti-competitive effects inside the internal market is attracted to the orbit of EU law.

\textsuperscript{116} Judgement of 13 February 1979, Hoffmann-La Roche, C-85/76, EU:C:1979:36.
Despite the range of application of the “effects theory”, some gaps remain to be filled. This is the case of situations where the application of EU law could be necessary in order to assure a level playing field among all companies and investors that compete within the internal market.

In a globalized economy, non-EU companies and investors can benefit from the regulatory and financial support given from non-EU countries and, at the same time, compete within the EU internal market. This is hardly scrutinized according to the existing EU rules.

In many cases, non-EU jurisdiction regimes – such as merger control or public procurement - appear to be neutral towards national and non-national companies but, in the end, pursue protectionist measures. Here, possible application of WTO rules to assure the maintenance of a certain level playing inside the EU remains insufficient.

A multilateral approach to international trade is, nowadays, less enthusiastic and it was replaced by a bilateral approach, followed by many world states and the EU, in the context of world trade relations. In this context, the EU is gradually becoming more proactive and equipped with legal instruments that will allow it to evaluate economic policies followed by third countries, especially related to investment in the EU when associated with foreign subsidies. This is the case with the FDI-screening Regulation and the new EU Regulation based on the White Paper that defines a level playing field for both EU and non-EU companies that benefit from foreign subsidies.

This instrument may face some hurdles as it has to be compatible with WTO rules, EU state aid rules and provide non-EU companies and states the same rights of defence as those given to EU Member states, companies and citizens.

It remains to be seen how third countries will react to this new legal instrument, particularly considering the reciprocity principle and possible reaction from those countries. This might actually hinder the Council when deciding on the approval of the new legal instrument, fearing the possible deterioration of trade relations, especially with China.

In any scenario, the new attitude of the EU in world trade would not be possible without seeking, in the upcoming EU legal instruments, some degree of connection or
link with the EU internal market and, in doing so, recognizing the importance of the *effects theory* in EU economic law.
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