

The Procedural Framework of the Proposal for a Regulation on Foreign Subsidies Viewed from a Common Commercial Policy Perspective

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Abstract

The European Commission's proposal for a regulation on foreign subsidies provides a novel instrument for regulating economic activities which are facilitated by foreign subsidies, and which potentially distort competition in the internal market. Since the Draft Regulation will only apply to subsidies granted by third States, it will form part of the European Union's trade policy instruments. The article compares select procedural provisions of the Draft Regulation with the procedural rules contained in the Basic Anti-Subsidy Regulation, the main instrument the Commission has used to date to address economic activity in the internal market subsidized by third States.

Keywords: Foreign Subsidies Regulation, Trade Policy, Trade Defence, Basic Anti-Subsidy Regulation, European Commission, Facts Available, *Ex Officio* Procedure

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A. Introduction

Among the many policy initiatives of the *Von der Leyen* College of Commissioners, the draft regulation on foreign subsidies distorting the internal market (Draft Regulation) has certainly gathered significant momentum.¹ Not least because all three of the European Union's (EU) institutions involved in the legislative procedure agree – in remarkable unison – that the existing legal framework on subsidies leaves a regulatory gap, not being sufficiently equipped to address the issue of companies backed by subsidies granted by third states acting within the European Union.² The parallels exhibited by the proposed new instrument with the system of merger control under the EU Merger Regulation (EUMR) have already been the subject of academic contributions.³ Likewise, the similarities – and differences – between the Draft Regulation and EU State aid law, in particular as regards procedural issues, have also been addressed.⁴

However, attention should also be paid to the fact that the tools of the Draft Regulation not only draw from the European Union's internal market policies, but also from the bloc's trade policy arsenal. This is *inter alia* shown by the bifurcation of the proposal's legal basis: it is to be based on Art. 114 TFEU as well as Art. 207 TFEU. As such, the Draft Regulation will form part of the EU's trade policy instruments. Indeed, Christophe Hansen, Rapporteur of the European Parliament on the file, considers the Draft Regulation to be among “the most important trade policy instruments” of the European Union.⁵ It is thus expedient to examine the Draft Regulation from a Common Commercial Policy perspective, in particular concerning the procedural aspects of the *ex officio* review of third country subsidies the European Commission (Commission) may undertake.

To date, the Commission has attempted to address distortions of competition caused by foreign subsidies through its trade policy instruments. It did so by imposing measures on subsidised imports under the Basic Anti-Subsidy Regulation (BASR).⁶ For this reason – and since the Draft Regulation exhibits some clear simi-

1 *European Commission*, Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, COM(2021) 223 final, hereafter: Draft Regulation. Cf. on the legislative process *Krenek/De Smijter*, in: Chi et al. (eds.), pp. 1–20. The article is based on the text of the Draft Regulation as proposed by the European Commission in May 2021. Subsequent amendments to the text by the provisional agreement reached in interinstitutional negotiations in June 2022 are taken into account where indicated.

2 Cf. also *European Commission*, Commission Staff Working Document: Impact Assessment accompanying the Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, SWD(2021) 99 final.

3 *Bauermeister*, ZEuS 2022/3, p. 477.

4 *Weiβ*, ZEuS 2022/3, p. 467.

5 *Christophe Hansen*, speaking at the CCIA-webinar “The Foreign Subsidies Proposal and its Impact on the EU Economy”, 31/2/2022, Brussels.

6 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, OJ L 176 of 30/6/2016, p. 55, hereafter: BASR.

larities with the EU's trade defence instruments – it is against the benchmark of the EU's BASR that the present comparison of the respective legal frameworks will be undertaken. In doing so, this article traces the course of the investigation under the Draft Regulation while focusing on select provisions which might be of particular interest for legal practitioners.

B. Initiation of Proceedings

The Draft Regulation consists of three different components, with each module being designed to address another aspect of market distortions arising from foreign subsidies: Component 1 is described as a notification-based investigative tool for concentrations where the turnover of the EU target exceeds EUR 500 million and the foreign financial contributions exceed EUR 50 million, and Component 2 as a notification-based investigative tool for bids in public tenders with a contract value above EUR 250 million. By contrast, Component 3 is designed as an *ex officio* investigative tool for all other market situations as well as concentrations and public procurement procedures which do not meet the thresholds set out in Components 1 and 2.⁷ Accordingly, the third component is intended to act as a “catch-all” instrument under which the Commission can investigate any market situation, such as greenfield investments or private tenders which are affected by subsidised bids.⁸

As vast as the field of market situations the Commission is supposed to be able to address by means of starting an *ex officio* review under Component 1 is, as imprecise are the preconditions under which it may commence proceedings. The proceedings themselves are carried out as a two-step procedure. As the first step, the Commission decides on whether to initiate a preliminary review. It does so based on information from any source regarding alleged distortive foreign subsidies.⁹ Should the Commission then find, at the end of the preliminary review, that the situation warrants further review, it will open an in-depth investigation.¹⁰

What should be taken note of is the broad discretion the Commission is awarded regarding the decision on whether to initiate a preliminary review or not. As mentioned, pursuant to Art. 7 of the Draft Regulation, the Commission may act on information presented to it by any source. However, there is no precise evidentiary threshold to be fulfilled, and neither can the individual(s) alerting the Commission of potentially distortive foreign subsidies appeal a Commission decision should it decide not to act on the evidence presented to it.

7 *European Commission*, Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, COM(2021) 223 final, p. 10.

8 Cf. also *European Commission*, Press Release: Commission proposes new Regulation to address distortions caused by foreign subsidies in the Single Market, 5/5/2021, Brussels, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1982 (29/7/2022).

9 Art. 7 Draft Regulation.

10 Art. 8, 9 Draft Regulation.

The aspects described above differ significantly from the rules on the initiation of proceedings under the EU BASR. There, most proceedings are initiated following a complaint by members of the Union industry or an industry association regarding the presence of subsidised products on the internal market. Should the Commission decide not to act on a complaint, the complainants can bring an action for annulment before the General Court.¹¹ Given the lack of a complainant in the formal sense under Component 3 of the Draft Regulation, no legal recourse against a Commission decision deciding not to act on the information presented to it is available. Lastly, any complaint submitted to the Commission must include sufficient evidence of the existence of countervailable subsidies, injury and a causal link between the allegedly subsidised imports and the alleged injury.¹² As indicated above, a comparably precise evidentiary threshold is lacking from the Commission proposal, thereby providing for even more discretion on part of the European Commission with regard to the decision on whether to initiate proceedings. On the whole, one must therefore conclude that, under the current Draft Regulation, the Commission enjoys almost unlimited discretion with regard to the initiation of an investigation.

While the BASR and the Basic Anti-Dumping Regulation (BADR)¹³ also foresee the possibility of the Commission initiating investigations *ex officio* in special circumstances,¹⁴ the provisions are rarely applied in practice. In the past, the Commission has only had recourse to the corresponding provisions in the BADR in two instances.¹⁵ Since the entry into force of the Trade Defence Modernisation Regulation in 2018, the trade defence instruments explicitly state that the special circumstances under which the Commission may initiate proceedings include the threat of retaliation by third countries.¹⁶ Consequently, under the modernised basic regulations, if

11 ECJ, C-191/82, *Fediol/Kommission*, ECLI:EU:C:1983:151, para. 29 et seq. It should be noted that only a small percentage of complaints to the EU Commission in trade defence proceedings does not result in the initiation of an investigation by the Commission. In part, this is due to the practice of the complainant undertakings or industry association informally consulting with the Commission before formally submitting the complaint. On this practice cf. also *European Court of Auditors*, Special Report: Trade defence instruments: system for protecting EU businesses from dumped and subsidised imports functions well, Luxembourg 2020, available at: https://www.eca.europa.eu/lists/ecadocuments/sr20_17/sr_trade_defence_instruments_en.pdf (29/7/2022).

12 Art. 10(2) BASR.

13 Regulation (EU) 2016/1036 of the European Parliament and of the Council of 8 June 2016 on protection against dumped imports from countries not members of the European Union, OJ L 2016 176 of 30.6.2016, p. 1, hereafter: BADR.

14 Art. 10(8) BASR and Art. 5(6) BADR.

15 *European Commission*, Statement by EU Trade Commissioner Karel De Gucht on mobile telecommunications networks from China, Brussels 2013. The case was later settled in the Joint Committee. The other case concerned synthetic fibre ropes from India, Commission Regulation (EC) No 18/98 of 7 January 1998 imposing a provisional anti-dumping duty on imports of synthetic fibre ropes originating in India, OJ L 4 of 8/1/1998, p. 28.

16 Regulation (EU) 2018/825 of the European Parliament and of the Council of 30 May 2018 amending Regulation (EU) 2016/1036 on protection against dumped imports from countries not members of the European Union and Regulation (EU) 2016/1037 on protection against subsidised imports from countries not members of the European Union, OJ L 143 of 7/6/2018, p. 1.

the Commission finds that a threat of retaliation exists, this will automatically qualify as a special circumstance enabling the Commission to initiate an investigation under the BASR or the BADR. While the Commission has not yet made use of this option under the reformed trade defence instruments, it shows that the EU is adapting to the increasingly hostile climate in international trade by seeking to mitigate the risk of individual companies becoming the target of retaliatory action by third countries. The decision of opting for an *ex officio* initiation of proceedings under the Draft Regulation instead of a notification-based system may be seen as evidence of the EU legislator attempting to also shield EU companies from retaliatory action under the new instrument.

C. Procedural Rights

The following section will address the procedural rights granted to the parties during the investigation under the Draft Regulation, namely the rules on when the parties are to be informed of the initiation of proceedings and the provision on access to the file.

I. Information on the Initiation of Proceedings

Once the Commission has decided to open an in-depth investigation, the undertaking concerned is to be informed of the proceedings.¹⁷ This applies to all three Components of the Draft Regulation. The third country or countries providing the financial contribution in question do not have to be notified of the Commission's decision to initiate an in-depth investigation. This is another difference to the BASR, which provides that as soon as possible after the receipt of a complaint fulfilling the requirements set out under the BASR, and in any event before the initiation of an investigation, the Commission shall notify the country of origin and/or export of the potentially subsidised goods. Moreover, the third country shall be invited for consultations with the aim of arriving at a “mutually agreed solution”.¹⁸

As indicated, a comparable obligation on part of the Commission to notify the third country is lacking in the Draft Regulation, as are rules on cooperation or consultation between the Commission and the third country government.

The legislators' decision not to include a provision setting out a duty to inform the third country of the initiation of proceedings can be called into question. One of the reasons behind this decision might be that the Draft Regulation is to apply to the behaviour of undertakings and not of States, as is frequently emphasized by the Commission. Such a line of reasoning however fails to take into consideration that wherever measures against subsidies are taken, the involvement of a (third) country is necessarily implicated. Accordingly, it could be argued that the third country should also be involved in the proceedings. This would encompass the right

¹⁷ Art. 8 (2) Draft Regulation.

¹⁸ Art. 11(7) BASR.

to be informed at an early stage of the proceedings, as it also is the case under the BASR which – incidentally – also applies to the behaviour of undertakings, namely the export of subsidised goods to the European Union.

II. Access to the File

Under the rules of the BASR, the undertaking concerned as well as the country of origin and/or export as well as other interested parties may inspect all information made available to the Commission which is relevant to the presentation of their cases, unless said information is confidential, once the investigation has been initiated. In addition, the comments must be taken into consideration by the Commission wherever sufficiently substantiated.¹⁹

A corresponding provision is not included in the Commission proposal. While Art. 38 Draft Regulation provides that the Commission must give the undertaking concerned the opportunity to submit observations, the provision lacks details. Additionally, as the undertaking concerned need only be informed of the initiation of proceedings following the Commission's decision to initiate an in depth-investigation,²⁰ it appears that the Commission does not have to inform the undertaking while carrying out the preliminary investigation. It might however be argued that an earlier and more comprehensive involvement of the undertaking concerned might aid in clearing up any factual errors and in avoiding “false positives”, i.e., avoiding a situation where the Commission decides to open an in-depth investigation which it later concludes without a finding of market distortions.

Resulting from the lack of any involvement of the third country providing the financial contribution under the Draft Regulation, the government of said country neither has access to the file, nor may it submit comments to the Commission. While including provisions on such procedural rights of the third country would certainly have made the investigation more political, it would also have brought with it an element of cooperation. Moreover, granting procedural rights to the government of the third country might have been beneficial for the reasons outlined above and have aligned the Draft Regulation with the procedural rights granted to third countries under the BASR. Lastly, the decision not to present the third country with any procedural rights appears somewhat counterintuitive as the third country is involved in the investigation in other ways, as will be outlined in the following section.

D. Investigative Powers of the Commission

In carrying out an in-depth investigation, the Commission may investigate the potentially distortive market situation by making use of the investigative powers

19 Art. 11(7) BASR. Cf. on the subject of procedural rights in trade defence investigations Kuplewatzky, *Global Trade and Customs Journal* 2020/8, pp. 366–388.

20 Cf. above and Art. 8(2) Draft Regulation.

granted to it. These include requesting information from the undertaking concerned as well as other undertakings and associations of undertakings and the third country concerned,²¹ but also carrying out inspections within and outside the European Union.²²

In particular the power to carry out inspections in the territory of a third country draws from the investigative powers of the Commission under the BASR.²³ As is the case under the EU's BASR, such inspections may only be carried out where the undertaking concerned has given its consent and the government of the third country has officially been notified and has agreed to the inspection.²⁴

However, the provision of the Draft Regulation where the parallels to the EU's trade defence instruments are clearest is Art. 14. The provision addresses the issue of non-cooperation. It prescribes that the Commission may take a decision on the facts available where an undertaking concerned or a third country fails to cooperate, *inter alia* by providing wrong information to an information request or refusing to submit to the Commission's inspection within or outside the Union ordered under the corresponding provisions under the Draft Regulation.

As indicated above, the provision is clearly modelled after the BASR and the BADR, which both contain provisions on non-cooperation the wording of which is nearly identical to that of the Draft Regulation.²⁵ In general, the rule is intended to provide an incentive to both the third country government and the undertaking concerned to cooperate. The use of facts available usually results in findings of the Commission which are less favourable than they would have been had the undertaking – or the third country government – cooperated.²⁶ The decision to include such a rule in the Draft Regulation draws on experience from investigations under the BASR and the general international trade context, as it is frequently the case that the government of the third country does not provide full cooperation, thereby impeding the Commission investigation.

It is noteworthy that the Draft Regulation names failure to submit to the Commission's inspection outside the Union a situation which allows the Commission to have recourse to the facts available. Viewed in conjunction with the other provisions of the Draft Regulation which state that an inspection outside the European Union may only be carried out where the government of the third country has consented to the inspection, this appears to indicate that the third country government may not retract its consent to an inspection, thereby making it highly unattractive for the government to grant its consent in the first place. Another interpretation of the provision would be that already failure to consent to an inspection on its territory on part of the third country would constitute a failure to cooperate and potentially result in the use of facts available. Such an interpretation, however, would effectively

21 Art. 11 Draft Regulation.

22 Art. 12, 13 Draft Regulation.

23 Art. 11(4) BASR and Art. 26(2) BASR.

24 Art. 13 Draft Regulation.

25 Art. 28 BASR and Art. 18 BADR.

26 Cf. explicitly Art. 14(6) Draft Regulation.

deprive the consent requirement of its meaning. It thus remains to be seen whether this somewhat ambiguous wording will be changed during the Trilogue and, of course, how the Commission will apply the provision in practice.

Another provision that might prove relevant – especially for lawyers advising State-backed undertakings on mergers and acquisitions – is Art. 14(3) of the Draft Regulation, which explicitly mentions State-owned enterprises. It states that where an undertaking concerned, including a public undertaking, which is directly or indirectly controlled by the State, fails to provide the necessary information to determine whether a financial contribution confers a benefit to it, that undertaking may be deemed to have received such a benefit.

First, the provision is exceptional in that it introduces a special rule for State-owned undertakings, something which is not the case under the already existing system of EU merger control. Second, the provision potentially applies to a large number of undertakings which are very active on the European merger market. Accordingly, the provision provides a further effective incentive for the addressees to cooperate fully with the Commission in the event of an investigation.

E. Balancing Test

The final provision of the Draft Regulation to be addressed in this contribution concerns the balancing test contained in Art. 5 Draft Regulation. Pursuant to the provision, the Commission shall, 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.

The provision underwent significant changes compared to the version initially published in the Commission White Paper of 2020.²⁷ Originally, the provision bore the heading “Union Interest Test”, a terminology borrowed from the European Union’s Trade Defence Instruments. These likewise prescribe that a balancing test must be carried out before the Commission decides on whether to impose anti-dumping or anti-subsidy measures or not.²⁸ However, the remodelled version of the provision did away with the trade policy terminology, instead opting for the more neutral phrasing of “balancing test”, thereby also aligning the provision with corresponding concepts in EU competition and State aid law to some extent.

Furthermore, the balancing test of the White Paper foresaw the possibility of taking into consideration a variety of public policy objectives, such as achieving climate neutrality and protecting the environment or digital transformation. This led some commentators to criticize this first version of the balancing test as granting the Commission too much discretion. As can be inferred from the above, under the version of the balancing test included in the Draft Regulation, the Commission may only take the positive effects of the subsidized market activity on the development

²⁷ *European Commission*, White Paper on levelling the playing field as regards foreign subsidies, Brussels, 17/6/2020, COM(2020) 253 final.

²⁸ Cf. Art. 21 BADR and Art. 31 BASR.

of the relevant economic activity into consideration, and balance them against the market distorting effects. While this to some extent limits the discretion granted to the Commission, it does not do away with all concerns. In particular, under the present wording, it remains unclear whether only positive effects on the internal market or on the foreign undertaking's home market as well may be taken into consideration. This issue has also been identified by European Parliament Committee INTA. Accordingly, the Committee submitted an amendment to the provision clarifying the wording to restrict the balancing test to considering only positive effects on the respective economic activity in the internal market. Indeed, the text on the provisional political agreement published by the EU legislators on the file in July 2022 included this clarification.²⁹ Thus, it appears that INTA's concerns regarding the ambiguity of the wording have been addressed. This would be welcomed for the reasons set out above.

Lastly, INTA's amendments to the Commission's Draft Regulation further foresaw the adoption of guidelines on the balancing test, thereby providing for more legal certainty while at the same time limiting the Commission's discretion. It remains to be seen whether this amendment will be reflected in the final text of the regulation. The Commission has consistently rejected similar requests under the BASR and BADR, arguing that such guidelines would limit its discretion excessively.

F. Conclusion

The above comparison has shown that some aspects of the procedural rules as foreseen in the Draft Regulation clearly draw from the EU's trade defence instruments and the Commission's experiences in the international trade context. This applies in particular to the Commission's right to carry out investigations in third countries (Art. 13 Draft Regulation) and the possibility of basing its decisions on the facts available (Art. 14 Draft Regulation). Conversely, with regard to other aspects of the procedure, the Draft Regulation differs significantly from the framework set out under the BASR and the BADR. In particular the absence of any procedural rights of the government of the third country should be noted in this regard. However, the present contribution has also sought to identify some of the many questions left open by the Draft Regulation, especially regarding procedural aspects of the investigation. As the trilogues are progressing swiftly,³⁰ it appears that the Commission's timetable of the Draft Regulation entering into force in the first half of 2023 might be kept. While much depends on the final wording of the regulation and – of course

29 *European Parliament*, Committee on International Trade, Provisional Agreement Resulting from Interinstitutional Negotiations, 11/07/22, Brussels, available at https://www.eur-parl.europa.eu/meetdocs/2014_2019/plmrep/COMMITTEES/INTA/DV/2022/07-13/1260231_EN.pdf (16/9/2022).

30 Cf. *European Commission*, Press release: Foreign Subsidies: Commission welcomes political agreement on Regulation on distortive foreign subsidies, 30/6/2022, Brussels, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_4190 (29/7/2022).

– the way it is applied by the Commission, it can already be said that the Draft Regulation has raised a whole series of novel legal issues. Practitioners and academics alike will certainly be monitoring the further course of the legislative process closely.

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