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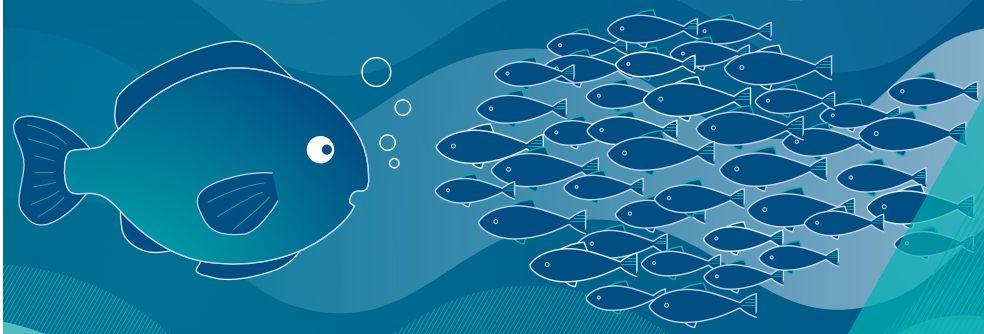
Dare to be Strong and Different

A new Union approach to Leveling the Playing Field on foreign subsidies – A report on the European Commission White Paper

Carolina Dackö



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At a Glance

by Pencho Kuzev

Europe's competitive openness is increasingly being challenged through foreign trade practices. With the **White Paper on levelling the playing field,** the European Commission seeks to deliver a key element of the vision of Europe's New Industrial Strategy based on competition, open markets, and a strong Single Market.

An analysis by **Carolina Dackö** from **Mannheimer Swartling** deals with the possible regulatory approaches and redressive measures proposed by the European Commission in June 2020. It analyzes the suitability of the suggested instruments in tackling distortive subsidies that should close the regulatory gap and stop unfair competition in Europe.

The following subsidies, i. e. contributions from foreign, non-European countries and public bodies, appear to have distortive effects on the single market:

European Commission:
https://ec.europa.eu/competition/international/overview/foreign_subsidies_factsheet.pdf

Why should we ask ourselves whether the level-playing field in the common market is at stake? Several recent cases show that foreign subsides are strategically applied, among others, in order to:

- **Systematically finance companies' on-going operations and harm the level-playing-field;**
- **Help foreign companies to buy European businesses;** ***and***
- **Help foreign companies to outbid rivals in public tenders.**

Some commentators, however, are questioning the need for a new regulatory instrument and wonder where the gap is. As in the case of abusive practices of big gatekeeper platforms, none of the existing instruments in the toolbox of the EU Commission can, on their own, addresses the problems:

- The EU framework on screening foreign investments focuses on threats to security and public order, but not on threats to the level playing field in a broader sense.
- EU state aid rules cover support only given by EU Member States, but not by foreign states.
- Merger control rules have also their limitations and are not conceptualized to practice protectionism. They look at whether an acquisition will significantly impede effective competition – but don't go into how that merger is paid for.

The study succinctly describes how international trade rules on subsidies have evolved and provides high level recommendations for preparing actual legislation. The study also brings attention to potential risks in framing the new rules and explains why, to the extent possible, clear

standards are needed. Europe's open strategic autonomy requires that it dares to be strong and different. The study's author makes the following recommendations:

- The new instrument should draw on lessons learned from previous experiences and international agreements, like the WTO, and inspiration from current ongoing trilateral negotiation that the EU is a party to;
- An **independent definition of a subsidy,** which does not need to build on WTO case law but instead allow the EU to act on subsidies that come from different types of foreign state-owned entities;
- Clear indications of **what distortion of the internal market may constitute** and reminders that future decision must stand judicial review;
- The legislator should consider construing **privileged market access as a particular type of subsidy,** rather than a factor to consider for distortive effects on the market; *and*
- **Procedural rules,** in addition to the new instrument, should be addressed in order to reduce the risk of unnecessary litigation and judicial annulment of future decisions. This is important because it would not only increase transparency and predictability for businesses and private operators, but would also strengthen the Union's in the WTO rules negotiations.

This report was presented during the "European Data Summit – The Winner Takes It All," which was held by the Konrad-Adenauer-Stiftung on September 30th, 2020. This study, together with a study on **Restoring Balance to Digital Competition** by **Philip Marsden** and **Rupprecht Podszun,** presents an input to the current and important discussion on modernizing competition policy in Europe within the Framework of the **German Presidency of the Council.**

Backdrop

The European Commission's White Paper takes centre stage in a very deep and strong debate on economic governance models. On the one hand, we see liberal market economy principles in which competition between private operators are presumed to lead to the best economic long-term outcome for businesses themselves and the economy as a whole, and on the other hand, non-market economies where decisions taken by companies may instead be driven by other forces than their economic gain and long-term viability. Beyond the economic rationale, in an even broader context, this tension is fundamentally also a question of differences in state governance models, for instance rights for citizens (such as ownership). In its simplest form and because of the state actors involved, this tension can be depicted as the fight between democratic and capitalist models on the one hand, and authoritarianism and socialist models on the other.

Discussing subsidies against that backdrop is not easy. Most states use subsidies to foster economic development, and not all subsidies are necessarily distortive. It is however widely recognised that too much government interference and government subsidies to private actors will have potentially distortive effects on market decisions and will disrupt competitiveness of individual businesses and the economy. Whether and how to regulate subsidies, in order to preserve competition, or to drive through a governmental policy on a particular market is from the outset up to each government in its respective jurisdiction. However, subsidies by one country may distort international trade with other countries, and have negative effects on market conditions in their countries or other third country export destinations where they compete. In a multilateral trading system, there is therefore a legitimate interest in agreeing to international rules and the possibility for countries to act against such trade distorting subsidies.

The first section of this report therefore describes how international trade rules on subsidies has evolved (in the WTO). Section two describes the current state of play of the negotiations, the failure in agreeing to new WTO subsidy rules, and the Union's approach in anti-subsidy cases. This is an important backdrop for understanding the rationale and legitimacy of the White Paper's proposal of introducing measures to counter the effects of trade distortive subsidies. In section three, some relevant concepts from the Union's state aid regime are examined. Under sections four and five, the report analyses key definitions of the White Paper; the definition of a subsidy and the concept of distortion, and provides a commentary on the proposed redressive measures. In section six, the report provides high level recommendations for preparing actual legislation.

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1. WTO rules on subsidies

1.1 The evolution of international rules on subsidies in the WTO

The General Agreement on Tariffs and Trade of 1947 (the "GATT 1947") is at the very source of the current WTO system. It was signed after World War II by 23 countries with the intention to boost economic recovery through reconstructing and liberalising global trade by eliminating or reducing quotas, tariffs, and subsidies, while preserving significant regulations. However, the scope of GATT 1947 was limited as it only concerned trade in goods.[1]

Following GATT 1947, eight rounds of negotiations were held between 1947 and 1994, *e. g.* the Tokyo Round negotiations in 1973–1979 (the "Tokyo Round"). The Tokyo Round had mixed results and the agreements of the negotiations were not accepted by the full GATT membership, hence, they are often informally referred to as "codes". One such code that was established was the subsidy code, however, no definition of the key terms "subsidy" was presented in it. [2]

The eighth negotiation round of 1986–1994 in Uruguay (the "Uruguay Round"), ultimately led to the establishment of the WTO, and with it the Agreement on Subsidies and Countervailing Measures (the "ASCM").[3] Unlike its predecessor code, the ASCM includes a definition of a subsidy: measures that entail a *financial contribution* from a *government or public body* that confer a *benefit* on the receiving firm.[4]

However, as pointed out in the White Paper, the ASCM, like GATT, addresses only subsidies that affect trade in *goods*. Subsidies provided in relation to services or investments fall outside the scope of the ASCM and are therefore currently unregulated under WTO rules.

While the Uruguay Round represented a significant achievement, the years that followed suggested that there were still gaps in the WTO trade

remedy rules, which led to conflicting interpretations and practices.[5] Hence, discussions arose on how the ASCM could be improved, *e. g.* by clarifying prohibited subsidies provisions as it was argued that economies with large domestic markets had an apparent advantage due to contingency on export performance, which had been proven to be a relevant factor in dispute settlements.

Since the beginning of the Doha Development Round of multilateral trade negotiations in November 2001, negotiations have proceeded at a slow pace and have been characterised by lack of progress on significant issues and persistent disagreement on nearly every aspect of the agenda. Although several WTO members ("Members") have submitted proposals throughout the years to keep the negotiations going, little progress has been made as the talks are complex, with a broad array of subjects, and the Members have widely differing interests.

Thus, from a legal perspective, a key to understanding the White Paper is to look at some of the key definitions and features used in the ASCM.

1.2 Current instruments and key concepts in determining a "countervailable" subsidy

1.2.1 Transparency mechanism

To incentivise increased transparency of Members' different subsidy schemes, Article 25 of the ASCM requires Members to notify all subsidy schemes that qualify as subsidies under the current ASCM definition. This would give Members information of other Members' schemes, and allow Members to assess potential negative effects in order to also be able to take counteraction as agreed and foreseen under the ASCM. However, no sanctions exist for failing to notify subsidies and there is widespread non-compliance with the notification requirement.[6]

It is widely agreed that this causes a problem since it becomes difficult to understand what type of subsidy measures exist in different countries. This lack of transparency is relevant for the discussion on the use of "facts available", as proposed in the White Paper.

1.2.2 Definition of subsidy

The ASCM establishes a definition of the term "subsidy". It contains three basic elements: (i) a financial contribution (ii) by a government or any public body within the territory of a Member (iii) which confers a benefit. All three of these elements must be satisfied in order for a subsidy to exist.

One particular element, which is also very relevant for the White Paper, is the ASCM's definition of a "public body". This term has been further elaborated by the Appellate Body, which in turn has led to a contentious debate on whether the ASCM is apt to adequately regulate subsidies that distort trade, and has also led the European Commission to take a clear and extensively developed stance in its recent investigations into countervailing duties (also referred to in the below as anti-subsidy investigations). This evolution and its impact following the proposal in the White Paper is further discussed below.

Further, the ASCM defines two categories of subsidies: those that are prohibited, and those that are actionable (*i. e.*, subject to challenge in the WTO dispute resolution or to countervailing measures by a Member). Understanding the difference between these two types of subsidies is also important to understand the White Paper.

1.2.3 Prohibited subsidies

Prohibited subsidies are divided into two categories.[7] The first category consists of subsidies contingent, in law or in fact, whether wholly or as one of several conditions, on *export performance* (export subsidies). A detailed list of export subsidies is annexed to the ASCM. The second category consists of subsidies contingent, whether solely or as one of several other conditions, upon the *use of domestic over imported goods* (local content subsidies). These two categories of subsidies are prohibited because they are designed to have a direct impact on trade, *i. e.* a competitive advantage (export subsidies) or competitive disadvantage (local content), and thus are most likely to have adverse effects on the interests of other Members.[8]

If a Member considers that another Member is granting prohibited export subsidies, it can commence the WTO consultation and dispute

settlement procedure, which may allow it to impose "countermeasures" against the trade of the Member that has granted the prohibited export subsidies. It is important to note that because export subsidies are deemed harmful by design, a Member does not need to show any harm or damage to its interest to have a right to impose countermeasures; the harm is inherent in how the subsidy is designed.

The ASCM's concept of prohibited subsidies, and the international consensus that they have a predetermined harmful effect, is relevant also for the discussion in the White Paper on a predetermined set of subsidies that are considered distortive by nature. Just as for the ASCM's prohibited subsidies, a pre-determined set of subsidies would not require the investigator to establish harm or specific distortive behaviour, it is simply presumed to exist because the nature of the subsidy as such is deemed particularly harmful.

1.2.4 Actionable subsidies

Other subsidies, such as production subsidies, would fall into the "actionable" category. Actionable subsidies are not prohibited. However, if they cause harm to a Member (an "adverse effect"), that Member can challenge the Member granting the subsidies in the WTO dispute settlement system, which again may amount to a right for that Member to impose "countermeasures" against the subsidising Member. However, for actionable subsidies, the Member has to prove the "adverse effects" to its interest.

There are three types of adverse effects.

- First, there is *injury* to a domestic industry caused by subsidised imports in the territory of the complaining Member. This is also the sole basis for "countervailing duty" (as further defined below).

- Second, there is *serious prejudice*, which usually arises as a result of adverse effects (*e. g.*, export displacement) in the market of the subsidising Member or in a third country market.

- Finally, there is *nullification or impairment* of benefits accruing under GATT 1994. Nullification or impairment arises most typically where the improved market access presumed to flow from a bound tariff reduction is undercut by subsidisation.[9]

Using the WTO dispute settlement system to challenge the subsidies aims at encouraging the subsidising Member to remove the subsidies, at the threat of allowing the complaining Member to impose countermeasures. Simply stated, it is a state-to-state dispute, whereby the WTO dispute settlement body also determines the level of the countermeasures.

1.2.5 Countervailing duties

The ASCM Part V also allows a Member to act unilaterally against subsidies by imposing a countervailing duty on subsidised *products* that are imported into the Member's territory.[10] This right is however conditioned on a determination of injury to the domestic (importing country) industry. Thus, a Member may only impose a countervailing duty on such imports after it has performed an investigation showing (i) there is a subsidy linked to the imports, (ii) injury to a domestic industry, and (iii) a causal link between the subsidised imports and the injury.

The Union has implemented these provisions into its own Basic Anti-Subsidy Regulation ("ASR") under which it conducts investigations into countervailing duties (also referred to as anti-subsidy investigations).

1.2.6 The concept of injury to the domestic industry

To prove that injury to a domestic industry is caused by subsidised imports, evidence should be collected to show the evolution of the volume of the allegedly subsidised imports, the effect of these imports on prices of the like product in the domestic market and the consequent impact of the imports on the domestic industry. The ASCM lists factors and indices that are relevant to determine the state of the domestic industry.

The relevant factors and indices are listed in paragraphs 2 and 4 of Article 15 of the ASCM. Article 15.2 sets out how the investigating authority shall assess the volume of the subsidised imports and their effect on prices

on the domestic market, including whether "price undercutting" or "price suppression" has occurred.[11] Article 15.4 provides a non-exhaustive list of relevant economic factors that may be examined to determine the bearing of the domestic industry (these are also replicated in the ASR). This definition of injury is identical to the definition in the WTO agreement on anti-dumping measures.

In short, one could argue that there is an internationally agreed method of assessing if there is harm or distortion in the form of "injury" to the sector of the domestic industry that produces a particular product in a Member country, and which faces competition in the form of subsidised imports from another Member. The question is thus whether this method would be suitable for the White Paper's discussion on distortive effect on the internal market, which will be discussed below.

1 See WTO website, available at: https://www.wto.org/index.htm
2 Ibid.
3 Ibid.
4 Brown, Chad P. and Hillman, Jennifer A, *WTO'ing a Resolution to the China Subsidy Problem*, Peterson Institute for International Economics, Working Paper No. 19–17 (October 2019), available at: https://scholarship.law.georgetown.edu/facpub/2206.
5 WTO, Negotiation Group on Rules, TN/RL/W/1, Improved Disciplines Under the Agreement on Subsidies and Countervailing Measures and the Anti-dumping Agreement, 15 April 2002.
6 See supra note 4, p 13.
7 Article 3 of the ASCM.
8 See supra note 1.
9 See supra note 1.
10 See Part V of the ASCM.
11 ASCM 15.2: "With regard to the volume of the subsidized imports, the investigating authorities shall consider whether there has been a significant increase in subsidized imports, either in absolute terms or relative to production or consumption in the importing Member. With regard to the effect of the subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree. No one or several of these factors can necessarily give decisive guidance."

2. Contentious topics in the ASCM

There are some controversial topics relating to the application of the ASCM, which stem in part from the collapse of the WTO negotiations on developing the rules in the ASCM and the Appellate Body's narrow definition of public body. These aspects are relevant for understanding the Commission's proposal in the White Paper.

2.1 Definition of "public body" – lessons learned

Reportedly, the Appellate Body's interpretation of a foreign subsidy through a "public body" has narrowed down the applicability of the term and suggests that financial contributions, which do not come from the government directly but from state-owned entities, do not necessarily qualify as a subsidy. In practice, this interpretation places a heavy burden of proof on the Member claiming that there is a subsidy to show that the state-owned entity indeed qualifies as a "public body".

In a case brought by China against the U.S. in 2011, the WTO Appellate Body ruled that an entity must exercise governmental functions, *i. e.* the entity must possess, exercise or be vested with "governmental authority".[12] For this purpose, it is not sufficient to only establish a formal link, such as majority ownership between a state and an entity; there has to be "meaningful control" over the state-owned entities for the subsidy to be said to be coming from a public body.[13] According to some reports, this statement effectively introduces a presumption and removes financial contributions from Chinese State-Owned Enterprises ("SOE") from the definition of a subsidy.[14]

Arguably, however, this ruling should not lead to an irrebuttable presumption. SOE's in China may very well be under "meaningful control" by the Chinese state; the "meaningful control" test may be cumbersome to investigate and verify, but will primarily from now on be a matter of facts

and evidence collected and made available to the investigator, and the subsequent analysis of that evidence.

In the recent EU anti-subsidy investigation into glass fibre fabric (the "GFF" case)[15], the Commission concluded *inter alia* that state-owned banks were public bodies by putting forward several different formal grounds (ownership and legal framework) for concluding that the Chinese state-owned financial institutions involved in that case were under meaningful control of the Chinese state. These included formal ownership and the legal framework that these entities operate under, in particular:

- Article 34 of the Chinese "Bank Law" which applies to all financial institutions in China and require them to "conduct their business of lending in accordance with the needs of the national economic and social development and under the guidance of the industrial policy of the state";

- Decision No. 40 which instructs all financial institutions to provide credit support to 'encouraged' projects, as well as the governance model for financial institutions, whereby [the CBIRC] has approval authority over appointment of managers at all levels in both private and public financial institutions; and,

- The fact that state-owned financial institutions had changed their articles of association to increase the role of the Chinese communist party ("CCP") at the highest decision-making level of the banks, including the Chairman of the Board being a CCP representative, CCP consultation for major decisions, and CCP supervision of the bank's implementation of CCP policies and guidelines.[16]

- A number of Chinese governmental central planning programs, demonstrating that the GFF sector is a prioritised product under such plans, including the conclusions that the 12th Five Year Plan and 13th Five Year Plan are of binding nature and the conclusion that the Made in China 2025 initiative has a *de facto mandatory* effect in the economy.[17]

The Commission thereafter sought to validate the assumption, by pointing to the fact that the Chinese GFF exporters had all benefited from similarly low interest rates from the SOE banks. Further, the banks in question claimed to have granted these interest rates based on sophisticated risk assessments, but when asked could not produce any such concrete risk assessments of the GFF exporters in question. Such risk assessments could have been used to rebut the presumption that the low interest rate was based on government policy rather than market principles. The Commission found that the GFF exporters had received interest rates on loans that were below or close to the People's Bank of China's benchmark interest rate, which therefore were deemed below market rate in relation to the GFF companies' risk profiles.

Thus, the ownership and the legal framework were used as evidence to prove that the financial institutions indeed qualified as "public bodies". Further, the fact that all the investigated GFF exporting companies had been granted low interest rates was used as support to confirm that assumption.

The low interest rates from the SOE banks in question was only one in several types of subsidies investigated in the GFF case. In short, the GFF case shows that, to have legitimate reason and in order to meet the standard imposed by the Appellate Body, the Commission has to provide extensive reasoning on how it arrived at the conclusion that the banks in question qualified as public bodies. As discussed further below, there is a risk that this burden of proof is transposed onto the measures proposed in the White Paper.

Further, it is also important to understand the Commission's use of "facts available" in the GFF investigation. As regards loans, which may be one of the easier types of subsidies to investigate, only one state-owned bank cooperated in the investigation. For those state-owned banks that did not cooperate in the investigation, the Commission concluded that the same legal framework applied to them, and that in the absence of cooperation, the same conclusions could be applied. These non-cooperating state-owned banks therefore also qualified as public bodies. As regards other banks (non-state-owned), which also did not cooperate in

the investigation, the Commission concluded that the same legal framework applied to them and pointed to the fact that the private banks also had given the GFF exporters in question similar conditions and lending rates as the state-owned banks. These banks were therefore also considered, in accordance with the Appellate Body's test for private actors, "entrusted" and "directed" by the State to pursue governmental policies and provide preferential loans to the GFF industry.

The question that arises is of course what would have happened if the banks in question had cooperated and were able to provide evidence to rebut the claim that they were entrusted or directed by the State. The Commission would in that case have to weigh the evidence and take a decision, knowing that its assessment and final determination may later be subject to judicial review in the European Courts.

The GFF (and other recent anti-subsidy cases) is therefore interesting as it projects the legal interpretation on subsidies forward, both at Union level and at the level of the WTO. The regulation imposing anti-subsidy measures in the GFF case provides extensive legal reasoning in relation to both WTO case law and international public law. Such extensive reasoning is crucial and critical for judicial reviews. Be it in the context of the European Court of Justice or the WTO dispute settlement mechanism, a judicial review will revolve both around procedural aspects such as rights of defence of the parties concerned and the Commission's obligation to provide reasoning, as well as the substance of that reasoning, *e. g.* whether the conclusions on public bodies is correct under the ASCM or EU's ASR.

One such judicial review has already started. One of the GFF exporters has appealed the case to General Court (T-480/20), amongst other on grounds relating to the public body definition and rights of defence. A ruling could subsequently be appealed to the European Court of Justice. As litigation on trade defence cases can take a long time, we will likely not see any definitive ruling, which would test the Commission approach, for another few years to come.

Thus, in sum, the definition of subsidy, and in particular the determination of if the subsidy comes from a government, through a public or

private entity, has in a way been pushed into an area of uncertainty, *i. e.* somewhere between the Appellate Body's ruling in 2011 and the Commission's reasoning in the GFF and other recent anti-subsidy cases.

From a Union perspective, it is important to recall the principle of rule of law. It is up to the courts to put down the marker and decide on how the definitions should be used and facts be evaluated. The legislator could however think ahead and decide what definitions to put in the law in the first place.

2.2 WTO negotiations and systematic state support – proposed new list of "prohibited subsidies"

As mentioned above, the WTO Doha Development Round has seen very little progress in relation to negotiating new or updated subsidy rules. In a 2011 report issued by the Chairman of the Trade Negotiations Committee, instead of presenting any draft negotiation text, the Chairman summarised what main issues had been discussed in the negotiations.[18]

In his report, the Chairman noted the European Union's proposal to create a new category of prohibited subsidies to cover governmental financing, where the terms and conditions of the financing do not cover long-term operating costs and losses of such financing. This approach was questioned as it took a "cost-to-government" approach to subsidies, rather than a "benefit-to-recipient" approach. Discussions also centred around the relevance of losses by financial institutions and the link to whether a subsidy therefore exists, as well as the creditworthiness or equity worthiness of the recipient of the financing.

According to the report, the discussions landed in two camps where one group supported a new set of disciplines, focused on systemic issues that are not addressed under the current rules. This group wished to regulate certain loans and loan guarantees from governmental financial institutions, that do not operate on an independent commercial basis and benefit from the fact that the state supports its state-owned enterprises, which cannot obtain funding from com-

mercial lenders. The same enterprises also benefit from equity capital under terms that are inconsistent with the usual investment practice of private investors. Simply put, an interdepended subsidy ecosystem.

2.3 Break out from the WTO, the U.S., Japan and EU negotiations

Since the break-down of the WTO negotiations, the three main trading blocks, the Union, the U.S. and Japan, have met in a trilateral constellation and tried to push the agenda for new international rules on subsidies. Several joint statements have been made by the respective trade representatives since 2017.[19] These statements have a dual approach; on the one hand trying to define "market conditions", and on the other, focusing on trade distortive subsidies (in which businesses do not respond to market signals).

In 2018, after meeting in Paris, the representatives agreed on shared "objectives to address non market-oriented policies and practices." They also agreed on a common set of elements and indicators that signal that market conditions exist for businesses and industries. These focused on free market decision and non-interference of the government and include companies' decisions on prices and investments that are freely determined and made in response to market signals, companies being subject to international accounting standards and independent auditors, corporation law, bankruptcy law and private property law, and that there is no significant government interference in business decisions.[20] Thus, the 2018 declaration set a standard for what the parties agreed is required for "market conditions".

On 14 January 2020, the representatives took another step by discussing ways to strengthen existing WTO rules, particularly in the area of industrial subsidies. In a joint statement, they agreed on a six point list with specific actions to strengthen the WTO rules on industrial subsidies.[21] The six-point proposal is relevant for understanding the proposal in the White Paper, and the mechanisms suggested therein.

The first of the six-point list proposal was to add four additional types of *prohibited subsidies*, beyond those already listed in the ASCM (*i. e.* export subsidies and local content subsidies):

> *"...new types of unconditionally prohibited subsidies need to be added to the ASCM. These are:*
>
> **a.** *unlimited guarantees;*
>
> **b.** *subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan;*
>
> **c.** *subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity;*
>
> **d.** *certain direct forgiveness of debt."*[22]

Turning to the White Paper (section 4.1.3.1), it is evident that the suggestions therein of a category of subsidies that are presumed to distort the internal market, have been inspired by the above proposal on prohibited subsidies. The White Paper's proposal covers export subsidies, debt forgiveness, subsidies to ailing companies without a restructuring plan, government guarantees of debt or liabilities without limitation (as well as tax relief and subsidies to facilitate an acquisition).

Similar to the current regime for prohibited subsidies under the ASCM, the White Paper also suggests that for these type of "pre-set category" of "distortive subsidies", there would be no need to determine a distortive effect on the internal market (compare adverse effect or injury to the domestic industry), and the investigating authority could directly propose redressive measures (and the EU interest test).

The other items on the trilateral parties list also included mechanisms to increase transparency and effectiveness of the rules by reversing the burden of proof. These proposals should be read in light of Members non-compliance with the reporting requirements in Article 25 in the ASCM.

The reversed burden of proof was proposed for certain specifically harmful subsidies, so that the *subsidising* Member has to demonstrate the lack of negative effects for other Members. If no such proof is provided, and the subsidising Member cannot rebut the presumption of a harmful effect, the subsidising Member would have to withdraw the subsidy immediately. The type of subsidies listed as particularly harmful were:

> *"...excessively large subsidies; subsidies that prop up uncompetitive firms and prevent their exit from the market; subsidies creating massive manufacturing capacity, without private commercial participation; and, subsidies that lower input prices domestically in comparison to prices of the same goods when destined for export."*[23]

Turning to the White Paper, it is also suggested that overcapacity on the domestic market should be assessed as a factor, amongst others, that is more likely to cause distortion than others.

Along the line of increasing transparency and reversed burden of proof, the parties proposed to amend Article 25 ASCM, by making all subsidy schemes, that are not notified, prohibited subsidies, unless the subsidising Member provides the required information in writing within a specific time frame.[24]

The White Paper does not present any proposal similar to this mechanism. However, the White Paper does acknowledge the "difficulties in obtaining necessary information", and suggests that the investigating authorities may rely on the concept of facts available as used in trade defence investigations (as discussed above in the GFF case). In other words, if no information is made available, the investigator can choose how to interpret the information that is at hand.

The trilateral parties' proposal also highlighted that many subsidies are granted through "State Enterprises", and underscored the importance of ensuring that these subsidising entities are captured by the term "public body", despite the fact that such an understanding would run contrary to the WTO Appellate Body rulings:

> *"To determine that an entity is a public body, it is not necessary to find that the entity "possesses, exercises or is vested with governmental authority." The Ministers agreed to continue working on a definition of "public body" on this basis."*[25]

On this point, the White Paper does not explain how to approach the concept of public body, but instead simply refers to the definition of foreign subsidy in the ASCM and ASR. This may cause difficulties and is therefore discussed further below.

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12 WT/DS379/AB/R, *United States – Definite Anti-Dumping and Countervailing Duties on Certain Products from China*, Report of the Appellate Body, 11 March 2011.

13 See supra note 12, as further explained in the Commission Implementing regulation (EU) 2020/776 of 12 June 2020, recital 225.

14 See supra note 4, page 11.

15 Investigation into subsidies on certainwoven and/or stitched glass fibre fabric against China and Egypt, see Commission Implementing Regulation (EU) 2020/776 of 12 June 2020, Official Journal L 189, p. 1.

16 Law of the PRC on the Commercial Bank, as set out in recital 241 of the GFF anti-subsidy case.

17 See recitals (139) to (146) of the GFF case.

18 See Annex to the Report by the Chairman of the Trade Negotiations Committee on the Doha Round to the General Council on 30 November 2011, available at: https://www.wto.org/english/news_e/news11_e/gc_rpt_30nov11_e.htm#annex

19 United States Trade Representative, "Joint Statement by the United States, European Union, and Japan at MC11," December 12, 2017, Buenos Aires. See also USTR's Joint Statements of the Trilateral Meeting of the Trade Ministers of the United States, European Union, and Japan, issued May 23, 2019, Paris; January 9, 2019, Washington; September 25, 2018, New York; and May 31, 2018, Paris. See also The Economist, 'The World Trading System Is Under Attack. But a Peace Plan May Be Emerging', July 19, 2018.

20 See Joint Statement on Trilateral Meeting of the Trade Ministers of the United States, Japan, and the European Union, 31 May 2018, Annex 3, available at: https://trade.ec.europa.eu/doclib/docs/2018/may/tradoc_156906.pdf

21 See the Minister's statement, available at: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/joint-statement-trilateral-meeting-trade-ministers-japan-united-states-and-european-union

22 See supra note 21.

23 See supra note 21, point 2.

24 See supra note 21, point 4.

25 See supra note 21, point 6.

3. EU – state aid rules

Based on the above, it is clear that many concepts in the White Paper stem from the Union's position and reasoning in relation to the ASCM. Nonetheless, it is also important to compare some key concepts in the White Paper with those in the Union state aid rules.

EU state aid rules

Regulating state aid is one of the fundamental elements that protect competition on the internal market, together with merger control and actions against entities with dominant positions. The Union has a well-established practice of how to detect and act against incompatible state aid, and the Union courts have developed significant case law on how the rules have been interpreted, which is reflected in the European Commission Notice on State Aid ("Notice").[26]

The Treaty of the Functioning of the Union ("TFEU") governs state aid rules under Article 107.1:

> *"Save as otherwise provided in the Treaties, any aid granted* ***by a Member State or through State resources*** *in any form whatsoever which* ***distorts or threatens to distort competition*** *by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."*

For the purpose of analysing the White Paper, the two underlined definitions in the above are interesting; (i) what governmental or public authorities entities can grant state aid, and (ii) what constitutes "distortion".

What entity can grant state aid?

For there to be state aid according to Article 107(1) TFEU, the advantage has to derive from a state resource and there has to be imputability of the measure to the state. The Notice points to the different types of state or public entities that may be involved and the imputability of the measure to the state.

To note is that if a *public authority* grants an advantage, the measure is by definition imputable to the state.[27] If the measure is given by a private or public body which has been designated by a public authority to administer a measure, the measure is also by definition imputable to the state.[28] However, if the advantage is granted by a *public undertaking*, the public authorities have to have been involved in adopting the measure for there to be imputability to the state. A public undertaking is:

> *'public undertaking' means any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it.*[29]

The imputability test for public undertaking under the Union state aid rules is interesting to use as a benchmark in relation to the definition of a subsidy granted by "a government or any public body" as has been discussed above under the ASCM and the ASR. Thus, in short, it would appear that the Appellate Body's definition of "meaningful control" over a public body, does not necessarily equate to the terms of imputability and public undertakings under Union state aid rules.

Distortion

The Union state aid rules on "distortion" do not appear as rigid as the ASCM and ASR provisions on injury. Whereas the ASCM and ASR set specific lists of injury indicators, there is no similar nomenclature of factors or indices that have to be considered and assessed to arrive at a conclusion of distortion. Rather, the distortion analysis rests on the finding of a financial contribution and very little is needed to conclude that the financial contribution causes distortion.[30]

Monitoring and correcting state aid in the Union

In order to determine whether a measure is to be classified as state aid and whether the aid is illegal, it must be reported to the Commission. This is the Commission's monitoring function. In accordance with Article 108(1) TFEU, the Commission shall keep all systems of aid existing in the Member States under constant review, and propose any appropriate measures required by the progressive development or by the functioning of the internal market.

Further, there is also a pre-notification phase in which the Member states are offered the possibility to discuss and receive guidance about *e. g.* legal issues, economic analysis, identification of key issues, etc. The pre-notification phase also ensures that notifications to the Commission are of the right quality and helps identifying more clearly the information that the Member State must submit for notification.[31] Although the pre-notification phase is not mandatory for all state aid cases,[32] it is encouraged even in seemingly non-problematic cases. Except in particularly novel or complex cases, the Commission should aim to provide the Member State concerned with an informal preliminary assessment of the project at the end of the pre-notification phase. This non-binding assessment is however not an official position of the Commission, but informal guidance on the completeness of the draft notification and the *prima facie* compatibility of the planned project with the Common Market.[33] Further, according to Article 108(4) TFEU the Commission may allow exceptions from the notification obligation for State aid through adopted regulations.[34]

Thus, compared to the ASCM transparency obligation under article 25, which is non-functioning, the Union has a more comprehensive system and means of ensuring that state aid is notified and reviewed. There is clearly a stark difference in access to information concerning the existence of state aid that may affect the internal market, depending on whether the financial contribution comes from a Member State or a non-Member State.

Further, Article 108.3 TFEU requires cooperation by the Member States, as the Commission must be informed in sufficient time of any plans to grant or alter aid. If, after giving notice to the parties concerned to submit their comments, the Commission considers any such plans not compatible with the internal market with reference to the state aid rules in Article 107 TFEU, it shall decide that the concerned Member State shall *abolish or alter* such aid. This is the Commission's correcting function, as stated in Article 107(2) TFEU. Thus, the Commission can find that the aid is incompatible and require the Member State to abolish it, or, it can find that the aid is compatible but subject to stated conditions or to be amended within a stated period of time.[35]

The obligation of the Member State to abolish aid that the Commission considers incompatible with the common market aims to restore the situation to the state existing before the aid was granted. This is achieved by repaying the aid in question, where applicable together with default interest.[36] Such a claim for reimbursement can have serious consequences for the company that received the unlawful aid. Objections are therefore often raised against reimbursement decisions. However, the European Court of Justice has taken a restrictive approach to the possibility of escaping reimbursement, reminding companies receiving aid that they generally cannot expect aid to be lawful, unless it has been granted in accordance with the accurate procedure. Only under exceptional circumstances may a company be found to have had legitimate expectations that the aid was lawful and for this reasons oppose to repay it.[37]

If the concerned Member State does not comply with the Commission's decision regarding the aid in question, the Commission (or any other interested Member State) may refer the matter to the European Court of Justice for review according to Article 108.2 TFEU.

By comparison, the ASCM does not allow a Member to require that a company having received subsidies to repay them to the granting Member in question. For example, the Union simply does not have jurisdiction over companies in China to order them to repay subsidies to banks or other public bodies that have granted a subsidy.

We now turn to the analysis and recommendation for what is proposed in the White Paper.

26 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01).
27 See the Notice, para. 39.
28 Ibid.
29 See the Notice, footnote 53, referring to how the concept of public undertakings can be defined by reference to Commission Directive 2006/111/EC, of 16 November 2006, on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (OJ L 318, 17.11.2006, p. 17). Article 2(b) of this Directive states that 'public undertakings' means any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it'.
30 See the Notice, para. 187–189.
31 See the State Aid Manual of Procedures Internal DG Competition working documents on procedures for the application of Articles 107 and 108 TFEU, available at: https://ec.europa.eu/competition/state_aid/studies_reports/sa_manproc_en.pdf
32 The pre-notification phase is however mandatory for cases subject to Simplified Procedure, see supra note 31, section 8, sub-section 2.
33 See supra note 31, section 4, sub-section 5.1.
34 One such regulation is the Commission Regulation (EU) No 651/2014 (the "Block Exemption Regulation"), in which the Commission has taken measures to standardise what types of aid can be exempted from the notification obligation, and in practice automatically be regarded as legal state aid. According to Article 3 of the Block Exemption Regulation, aid mentioned in the regulation shall be considered compatible with the internal market and, hence, not be subject to the notification obligation to the Commission. For instance, some types of regional aid are exempted depending on e. g. the amount of the aid and therefore do not have to be reported to the Commission.
35 See supra note 31, section 6, sub-section 4.7.
36 See case C-350/93, Judgment of the Court of 4 April 1995, Commission of the European Communities v Italian Republic, p. I-699, and case C-110/02, Judgment of the Court (Full Court) of 29 June 2004. Commission of the European Communities v Council of the European Union., p. I-6333.
37 See case C-5/89, Judgment of the Court of 20 September 1990, Commission of the European Communities v Federal Republic of Germany; case C-69/95, Judgment of the Court of 5 December 1996, Italian Republic V Commission of the European Communities, and; case C-24/95, Judgment of the Court of 20 March 1997, Land Rheinland-Pfalz v Alcan Deutschland GmbH.

4. Key legal definitions of the proposed EU instruments

4.1 The definition of a foreign subsidy

According to the White Paper, the purpose is to use a definition that reflects the WTO case law and Commission practice in anti-subsidy investigations. A "foreign subsidy" refers to a financial contribution by a *government or any public body* of a non-Union State. Furthermore, it also explains that a private body "entrusted" with functions normally vested in the government or "directed" by the non-EU government can also grant a "foreign subsidy".[38] We recognise this from the WTO Appellate Body definition and Commission recent practice in anti-subsidy investigations.

The White Paper thus suggests relying on two existing EU instruments to draw up a definition of a foreign subsidy, *i. e.* the Basic Anti-Subsidy Regulation, Regulation (EU) 2016/1037 ("ASR")[39] and the EU regulation 2019/712 on safeguarding competition in air transport ("Air Transport Regulation" or "ATR" in the below).[40] As set out in the table below, the definitions are fairly similar to the ASCM.

Table 1: Comparison – Definitions of Source of State Funding which sets the Scope of the law

ASCM	ASR	ATR	State aid rules
"by a government or any public body"	"by a government", means a government or any public body	"by a government or other public organisation"	"public authority" or "public undertaking" (requires state imputability)

In this context, it should be noted that the European Court of Justice has consistently held that the WTO agreements and the interpretation of such agreements by the WTO dispute resolution are not legally binding in the Union context, but should be interpreted in line with the WTO agreements.[41] As evidenced by the GFF case, explained above, the Commission interpretation of the definition of "public body" is intrinsically aligned with WTO case law. Thus, it would be reasonable to assume that in case of judicial review at the ECJ of a Union legislation that has adopted the definition stemming from the ASCM, the court would be inclined to review and bring in the full body of WTO case law into such a new instrument.

The main difference compared to the ASCM and the ASR is that a foreign subsidy under the White Paper would benefit an undertaking **in the EU, offering goods or services,** or **engaging in investments,** whereas subsidies under the ASR, the ATR, and the ASCM are granted to beneficiaries outside the EU (e. g. an exporter of goods).[42] The beneficiary and the financial contributor thus are in different territorial jurisdictions.

4.1.1 Difficulties in identifying the status of the foreign entity and use of facts available

As explained in the above, one of the main controversial or "open" questions at present is the definition of a subsidy, when the financial contributions come from other entities than the government, *i. e.* state-owned entities or private entities. The main question is how to determine that such entities in fact are under "meaningful control" of the government, when granting financial contributions, or whether private entities are "entrusted" or "directed" to provide such funding by the government. Because of existing WTO case law, and as evidenced by the GFF case, investigating such facts requires substantial competence to understand other countries legal framework and vast resources to analyse and assess the actual facts.

Furthermore, considering the actual backdrop to such investigations, namely that the ASCM requirements on transparency on subsidies (*i. e.* allowing other countries to understand what schemes exist) is also dysfunctional, leaves authorities that want to investigate subsidies of other countries at an disadvantaged starting point. The investigating authority would have to do more of the fact finding and analysis than what is foreseen in the ASCM.

At the same time, compared to an anti-subsidy investigation against an exporter in a foreign country, it would seem that the investigation into the "benefit" of a subsidy to a company established in the Union will be easier and more efficient.

The Commission or the national authority will have easier access to information available in the Union by means of access to public records in Union languages as well as more detailed and reliable company information from the companies themselves. It is also likely that a company operating in the Union will have more to lose from not cooperating, faced with the risk that the Commission or national authority may impose a wide range of draconian redressive measures.

This might make it less likely that the Commission will apply "facts available" as regards information concerning the company in the Union allegedly receiving subsidies. However, when it comes to the origin and means of payment of financial contributions (*e. g.* foreign direct contributions or through for example parent company loans or capital infusions), the entity in the Union might be caught between an obligation to cooperate with the Commission, while at the same time not obtaining adequate information from its parent company or the ultimate financial contributor (*e. g.* a foreign bank or credit institution). For example, in the GFF case, the exporting companies in China cooperated and provided information on their loans from their banks. The Chinese banks, however, refused to provide information for reasons of confidentiality, despite the exporting companies having provided a waiver for the banks to disclose information.[43] The Commission then resorted partially to "facts available" determinations.

In practical terms, it might be easier, based on information from a company in the Union, to net backwards from a "benefit" to also track down and assess the entity granting a financial contribution. By comparison,

in the GFF case, the sampled exporters (*i. e.* recipients of the benefit), cooperated in the investigation, and the Commission was able through the information submitted by these cooperating exporters to identify the state-owned or private banks and other "public bodies" that had provided subsidies, despite the lack of cooperation from the public and private banks.

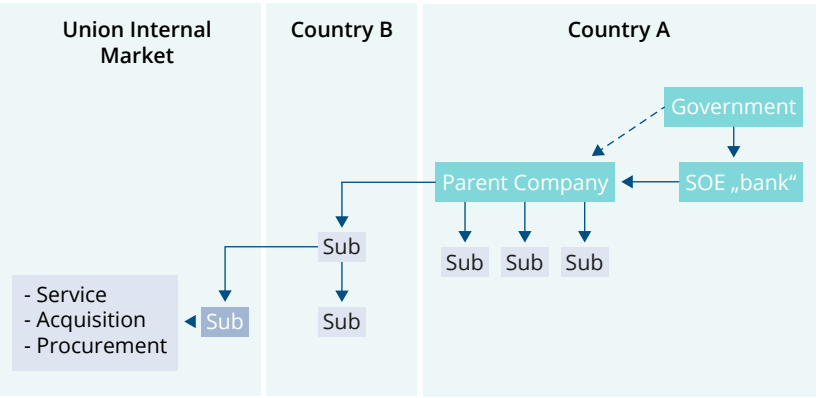
However, for example, even if there is full cooperation by an entity in the Union that is suspected of having received a foreign subsidy, in reality, the likeliness of that entity having received a financial contribution directly from a foreign government is very small. Such direct cases are likely not very common. For the more common types of systematic subsidies in a foreign country, the investigator would be faced with the difficult task of finding a financial contribution to a company in the Union, and then to link and trace that contribution back through different layers and forms as explained by the example below.

4.1.2 Analysis and recommendation

If the definition of a subsidy is taken directly from the ASCM and ASR, there is a risk that the instruments will inherit the difficulties in tracing and proving such subsidies. These difficulties stem from the necessity of proving a financial contribution and determining that entity (public or private) to be "under meaningful control" or "entrusted" or acting under "direction" of a foreign government. Furthermore, as explained above, the Commission's methodology as set out in the GFF case remains "open" to a certain extent, and may evolve if and when that or coming cases are made subject to judicial review in the European Courts or in WTO dispute settlement.

Example

A company in the Union has received a capital injection from its immediate parent company, but is suspected of receiving a foreign subsidy. The company is however a subsidiary of a larger group, with several layers of parent and holding companies in various jurisdictions different from the country of the government suspected of providing the financial contribution. There may be various different types of support between the different layers of holding companies and parent companies (intra company loans, or loan guarantees facilitating external loans), and the ultimate parent might have been provided with a tax exemption or lower interest rates from state-owned banks. The investigator in question would not only have to trace a financial contribution back through each layer, it would also at the end of the exercise have to ensure that the financial contribution also comes from a public body, as defined by case law.



A logical and consequential question is whether the definition of a subsidy should be so tightly aligned with the ASCM and the relevant case law. As the instruments proposed in the White paper would target trade on the internal market that falls outside the scope of the ASCM or ASR, the Union is arguably not obliged to apply the same standard. The legislator could in fact adopt a definition that differs from that of the WTO and is more aligned to the negotiations between the U.S., Japan and the EU (as explained above), or could lean on the definitions and case law established under Union state aid rules.

If the same definition is used, it is also reasonable to consider whether the instruments proposed in the White Paper could elaborate and define

the legal standard of what evidence is deemed sufficient to determine that a subsidy stems from a government or public body. For example, the instrument could introduce a rebuttable presumption that if an entity is by majority owned by the state of a foreign country, coupled with specific monitoring laws, that the entity is then in fact acting as a public body. Any financial contribution from such a body would therefore be presumed to qualify as a foreign subsidy.

4.2 The "distortion" on the internal market

The White Paper does not explain how "distortion" on the internal market would be assessed.

Module 1 has a broad material scope and would allow to address distortive foreign subsidies in all market situations. It would be possible to impose measures to redress distortions in the internal market if it is confirmed that the proper functioning of the internal market may have been or may be distorted through the foreign subsidy. However, as the criterion distortion is not further defined, the term is yet to be clarified.

4.2.1 The "injury" standard of the ASR and ASCM used

As stated above, the ASR largely replicates the ASCM. In terms of the definition of injury, the ASR Article 8.4 uses much of the same terminology and lists the same factors (albeit in a different order) to be investigated as those listed in the ASCM Article 15.4.

ASCM 15.4 Injury indicators	ASR 8.4 Injury indicators
"... actual and potential decline in output, sales, market share, profits, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; actual and potential negative effects on cash flow, inventories, employment,	*"... actual and potential decline in sales, profits, output, market share, productivity, return on investments and utilisation of capacity; factors affecting Union prices; actual and potential negative effects on cash flow, inventories, employment,*
wages, growth, ability to raise capital or investments and, in the case of agriculture, whether there has been an increased burden on government support programmes. This list is not exhaustive, nor can one or several of these factors necessarily give decisive guidance."	*wages, growth, ability to raise capital or investments and, in the case of agriculture, whether there has been an increased burden on government support programmes. This list is not exhaustive, nor can any one or more of these factors necessarily give decisive guidance."*

The use of these factors is well established in practice as there is an abundance of established case law at both WTO (dispute settlement mechanism) and Union level. All of the factors listed above have to be evaluated, however, not all of the factors listed as injury indicators have to show a negative trend in order to reach the conclusion that the Union industry is suffering injury. Thus, if certain factors show a positive trend, the investigating authority has to analyse and determine that the positive trend is outweighed by the negative trend for other factors. In doing so, the investigating authority has to determine the importance and significance of each factor. In practice, the Commission (as the investigating authority in the Union) usually attaches high importance to the factors sales, profit, market share, prices and capacity utilisation.

The advantage of having a set list of "injury indicators" as a legal standard in the investigation is that it gives the parties concerned (the exporter and Union industry producers) a certain level of predictability and transparency of an important element of the Commission's decision-making. The fact that the injury indicators stem from the ASCM has also likely had a tightening effect on how the rules in the Union have been interpreted both by the Commission and the Union courts, in the sense that the Union cannot deviate too much from the interpretation at WTO level without losing credibility in the WTO rules negotiations. However, this does not necessarily shield procedures from becoming politically sensitive and politicised.

4.2.2 Injury under the ATR

The ATR Article 2.6 also defines "practices distorting competition" to include two concepts; discrimination and subsidies (defined in Art 2(8) and Art 2(9) respectively). Thus, the discrimination or the subsidies by a third country or third country entity, are as such pre-determined as distortive. In other words, the Commission does not need to show that the subsidy or discrimination had a distortive effect.

Nonetheless, the Commission would, as in the ASR, have to determine "injury" to the Union carrier, and that there is a causal link between the discrimination or subsidy in a third country and the injury caused to the Union air carrier. Similar to the ASR, the ATR contains a set of factors (compare injury indicators) that need to be assessed.

ATR Article 12.1 Determination of Injury

"A finding of injury... shall be based on evidence and shall take account of the relevant factors, in particular:

(a) *the situation of the Union air carriers concerned, notably in terms of aspects such as frequency of services, utilisation of capacity, network effect, sales, market share, profits, return on capital, investment and employment;*

(b) *the general situation on the affected air transport services markets, notably in terms of level of fares or rates, capacity and frequency of air transport services or use of the network."*

4.2.3 Distortion of competition under state aid rules

As previously discussed, the term "distortion" under the Union state aid rules is less rigid than the concept of injury under the ASCM and the ASR. There is no specific list of factors that have to be considered and assessed to arrive at a conclusion of distortion. Rather, the distortion analysis rests on the finding of a financial contribution, and very little is needed to conclude that the financial contribution causes distortion.

A measure granted by the state is considered to distort or threaten to distort competition when it is liable to improve the competitive position of the recipient compared to other undertakings with which it competes. Further, the definition of state aid does not require that the distortion of competition or effect on trade is significant or material. The fact that the amount of aid is low or the recipient undertaking is small will not in itself rule out a distortion of competition or the threat thereof.

4.2.4 Analysis of distortion proposed by the White Paper

4.2.4.1 Module 1

Regarding Module 1 of the White Paper, the competent supervisory authority will assess whether an established foreign subsidy causes a distortion on the internal market. Both actual and potential distortions are considered. Certain categories of foreign subsidies would be considered to most likely cause distortions on the internal market. All other foreign subsidies would require a more detailed assessment according to indicators that help to determine whether a foreign subsidy actually or potentially causes a distortion of *the proper functioning* of the internal market. In any event, the concerned undertaking would have the right to rebut the claim, by showing that the foreign subsidy in question is not capable of distorting the internal market in the specific circumstances of the case.[44]

As set out above, against the backdrop of the failed WTO negotiations and the trilateral negotiations, there is arguably a legitimate reason to introduce a list of subsidies that are pre-determined as distortive by nature and by which there is no need to prove also the distortive effects.

However, for other subsidies, the legislator could consider to set out indicators of factors or indices (similar to injury factors under the ASR and ATR) which could be used as a nomenclature for assessing distortion.

4.2.4.2 Module 2

Subsidised acquisitions, as set out in Module 2 of the White Paper, may distort the level playing field with regard to investment opportunities in the internal market. An example of such a distortion is the possibility for a subsidised acquirer to outbid competitors for the acquisition of an undertaking. Such outbidding distorts the allocation of capital and

undermines the possible benefits of the acquisition for example in terms of efficiency gains.

The White Paper distinguishes between foreign subsidies that facilitate an acquisition either directly or *de facto*. Direct subsidies would be deemed distortive, but may be difficult to prove (see example above on different layers of ownership by parent or holding companies). A *de facto* facilitation would arise in cases where foreign subsidies reinforce the financial strength of the acquirer. In case of *de facto* facilitation, subsidised acquisitions have to be examined in more detail to assess whether they actually or potentially distort the level playing field in the internal market.

As set out above for Module 1, the concept of a list of indicators would be preferable, and the White Paper does indeed suggest certain criteria, including size of the subsidy, size of target or acquirer, type of market (overcapacity and high-tech).

A particularly sensitive factor raised by the White Paper is an acquirer's "privileged access to its domestic market", through *e. g.* special or exclusive rights, leading to artificial competitive advantages.[45]

Whereas this could indeed be treated as a factor to determine distortion, it could perhaps instead be used as a concept to define a specific type of harmful subsidy from a government. If a foreign government does not allow its market to adhere to market principles (see above regarding the trilateral proposal for defining market signals), and instead promotes the growth of large and dominant positions through legal means (*e. g.* exclusive rights or legal frameworks giving larger company specific benefits), this could possibly be construed as a definition of a distortive subsidy. The trade law rationale would be clear. A large company, protected on its home market, would obtain large economies of scale leading to lower production costs and ability to invest in research and development. Being shielded from external competition (foreign or domestic) also allows such companies to set prices on the domestic market, in order to allow for lower prices of their products or services on foreign markets, where they are exposed to competition, or conversely, pay a premium in acquisitions in order to acquire a specific target.

This allows such large companies to effectively undercut competitors on foreign markets, while other competitors on such markets are faced with competition under normal market conditions.

A parallel may be drawn to a concept of predatory dumping, where an entity exporting into the Union is found to dump prices in a particular market simply to "kill" the Union competition, and later recuperate the losses by increasing prices once the competition has disappeared.

Thus, one recommendation would be for the legislator to consider construing the privileged market access as a particular type of subsidy rather than factor to consider for distortive effect on the market.

4.2.4.3 Module 3

Module 3 of the White Paper ensures that foreign subsidies can be addressed in individual public procurement procedures where EU public buyers would be required to exclude those economic operators that have received distortive foreign subsidies.

Similar considerations should be considered as per the comments for Module 2.

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38 See Annex I of the White Paper.

39 Regulation (EU) 2016/1037 of the European Parliament and of the Council of 8 June 2016 on protection against subsidized imports from countries not members of the European Union.

40 Regulation (EU) 2019/712 of the European Parliament and of the Council of 17 April 2019 on safeguarding competition in air transport, and repealing Regulation (EC) No 868/2004.

41 "Admittedly, it follows from the Court's settled case-law that the primacy of international agreements concluded by the European Union over provisions of secondary legislation means that such provisions must, so far as possible, be interpreted in a manner that is consistent with those agreements (judgments of 14 April 2011, British Sky Broadcasting Group and Pace, C-288/09 and C-289/09, EU:C:2011:248, paragraph 83, and of 22 November 2012, Digitalnet and Others, C-320/11, C-330/11, C-382/11 and C-383/11, EU:C:2012:745, paragraph 39).

42 Ibid.

43 See recitals (196) to (199) of the GFF case.

44 See section 4.1.3 of the White Paper.

45 See section 4.2.3 of the White Paper.

5. Redressive Measures

5.1 Proposed types of redressive measures

Compared to the ASCM, which only addresses countervailing measures, *i. e.* a specific customs duty on specifically identified imported products, the White Paper naturally proposes a very wide set of redressive measures.

5.1.1 Module 1

As the White Paper notes, the EU state aid rules of repayment will not be practically possible as the repayment would have to be done to a foreign government. Instead, a wide range of redressive measures could be imposed. Because such measures can be coupled with fines and penalties against an entity in the Union, the redressive measures would likely be adequately enforceable.

One outstanding question is whether the redressive measures would also have a preventative effect. The White Paper expressly refers to these measures as "redressive" which indicates that their purpose is to restore a detrimental situation (rather than preventing a certain behaviour). In doing so, the measures would also have to comply with basic fundamental principles of Union law such as proportionality.

5.1.2 Module 2 and Module 3

The review proposed under both Modules 2 and 3 of the White paper are *ex ante*, and the redressive measures include the possibility of a decision that a particular transaction or procurement is null and void.

In both cases, the mere threat of having an acquisition being declared null and void or being excluded from a procurement is likely to have a very efficient compliance effect on the parties involved. In the world of mergers and acquisitions, the dynamics of a transaction require "deal certainty". Already in the initial phases of a transaction, the seller wants to understand any risks associated with the potential bidders and that they are not blocked from buying a particular company or assets that is

up for sale. By comparison, at a very early stage of a transaction, the particulars of the transaction are reviewed against competition law and foreign direct investment screening rules in order to obtain deal certainty.

Thus, for both Modules, it can be expected that the mere possibility for the authorities to take an ex post ruling to undo the transaction or procurement, would "front load" enforcement of the provisions already by private operators.

5.2 Redressive measures – legal review

It is very likely that the issuance of a redressive measures would be subject to judicial appeal before national courts or the European Courts. Based on the abundance of ECJ case law in relation to Union competition law, whereby the parties challenge the European Commission's decision such as blocking a merger, it is highly likely that many cases on the imposition of redressive measures will end up being tested by judicial review.

In such reviews, as noted above in the case of trade defence measures, a judicial appeal could revolve around procedural aspects such as the right to be heard, due process in the administrative proceeding as well as the material aspects, such as the definition of a public body or that the assessment is made on incorrect or incomplete facts. For example, if the investigator has assumed but not provided evidence that a subsidy is linked to a public body, a court would not be inclined to uphold the decision.

Further, even if there is a clear chain of evidence, the redressive measures may be perceived as too invasive or disproportionate. These types of claims could be also brought before the courts.

In sum, all three Modules are based on a new type of instrument; a form of hybrid between trade defence rules, Union state aid rules and completely new type of provisions. This makes it difficult to predict how the courts would try cases that are brought before judicial review. Nonetheless, once the first cases have been tried and case law has started to develop, the picture will become clearer on how these Modules will be applied in practice.

6. Final Remarks and Recommendations

Based on the analysis above, the following four main recommendations could be considered for preparing a legislative proposal.

1. As suggested by the title of this report, the European Union should be brave and act independently from the existing ASCM definition on subsidies. At the same time, in line with its commitment to the rule of law, it should show strength and develop clear definitions on distortion and set detailed procedures, to ensure that decision will stand judicial review.

2. As regards the use of the definition of subsidy, relying and referencing the definition as set out in WTO case law would likely set unnecessarily difficult standards for an investigator to prove that the subsidy came from a public body. In view of the Unions negotiating position and efforts to renegotiate the ASCM definitions, the Commission should reconsider the definition and detach it from that of the WTO ASCM.

3. As regards distortion, the definition of distortion should be clearly defined in the legislation, for example by listing specific factors to be evaluated, as this is one of the key elements under which all three Modules rest. If necessary, the Modules should have slightly different definitions to distinguish the subsidies' negative effects on the internal market, a particular acquisition or a procurement procedure.

4. As with all investigations that carry a potential negative outcome for an interested party, there is a risk that the party will challenge the outcome in court. The risk that a redressive measure is challenged on procedural ground, i. e. based on errors in the procedure or lack of due process, will likely increase if the procedural rules for an investigation are left unclear. The Commission should ensure that a proposal for measures sets very clear procedural rules that ensure a sufficient due process. This would not only reduce the risk of unnecessary litigation and judicial annulment of decisions, it would also increase transparency and predictability for business and private operators.

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