

Foreign Subsidies Regulation and EU International Procurement – Necessity, Changes and Challenges

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Abstract

Chapter 4 of the Regulation on foreign subsidies distorting the internal market is designed to fill a regulatory gap, to ensure that foreign subsidies can be addressed in individual public procurement procedures. This article describes the international context in which this “procurement pillar” is embedded, and illustrates the main features of the *ex ante* notification obligation that is at the heart of Chapter 4. It also explains the specific aspects and notions of the review procedure for foreign subsidies.

Keywords: Foreign Subsidies Regulation, International Public Procurement, Level Playing Field, *ex-ante* Notification, Unduly Advantageous Tender

A. Introduction / Overview

As highlighted in the 2020 White Paper,¹ the EU legal framework in the field of public procurement does not address distortions to the EU procurement markets

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¹ *European Commission*, White Paper on levelling the playing field as regards foreign subsidies, COM(2020) 253 final (White Paper).

caused by foreign subsidies. The White Paper identified the need for a specific tool to address the distorting effects of foreign subsidies in public procurement and to ensure equal conditions between competing tenderers.

Therefore, Chapter 4, the “procurement pillar” of the FSR, deals specifically with foreign subsidies that could have a harmful effect on the conduct of EU public procurement procedures. Foreign subsidies may enable bidders to gain an unfair advantage, for example, by submitting bids below market price or even below cost, allowing them to obtain public procurement contracts that they would otherwise not have obtained. Chapter 4 foresees a review procedure to address distortions in public procurement, with the aim to preserve the level playing field in that specific area. This review mechanism does not alter any of the existing rules in the EU public procurement Directives, but rather complements these existing rules.

B. FSR in the context of international procurement

At the outset, it is worthwhile to take a closer look at the international context in which the public procurement pillar of the FSR is embedded. The FSR is designed as a new instrument in the EU’s toolbox to restore the level playing field in the internal market, including in relation to public procurement where the existing legal instruments do not address the potentially harmful effects of foreign subsidies.

I. Open EU procurement markets vs. foreclosed international procurement markets

The EU procurement markets are largely open to third country bidders and are among the most open and accessible in the world.² The EU public procurement rules safeguard fair conditions for all economic operators competing for projects in the EU procurement market, and ensure a level playing field for open access to public contracts.

This openness is a direct result of the EU’s commitments in international agreements. The EU has committed itself under several international agreements (such as the Agreement on Government Procurement and bilateral Free Trade Agreements with Procurement Chapters), to grant access to its public procurement markets to certain works, supplies, services and economic operators of several third countries.

Accordingly, the EU public procurement Directives provide, for public buyers in the EU, to accord to the works, supplies, services and economic operators of the signatories to those agreements treatment that is no less favourable than the treatment accorded to the works, supplies, services and economic operators of the EU, in so far as these are covered by these agreements.³

² Cf. *Cernat/Kutlina-Dimitrova*, CEPS Papers 26698.

³ No further guarantee and thus no “secured access” is granted to economic operators from third countries, which do not have any agreement providing for the opening of the EU procurement market or whose goods, services and works are not covered by such an agree-

By contrast, EU businesses that want to compete against foreign rivals in their home markets often face difficulties in gaining access to foreign public contracts. On top of the *de facto* or *de iure*⁴ restrictions for foreign bidders, competition can also be highly distorted by government subsidies. Hence, the EU's openness is, in many cases, not matched by equal openness in other markets. This lack of reciprocity⁵ represents a burden for EU competitiveness and strategic autonomy, which in the long run may reduce the benefits and endanger the sustainability of continued open markets.

II. Uneven playing field as a result of foreign subsidies

Over the past few years, the benefits of the EU's open approach have come under increasing pressure from foreign trade practices that undermine the principle of reciprocal treatment. In particular, this is the case with subsidies granted by non-EU governments and protected public procurement markets.

As a result, unsubsidised EU companies suffer an unfair disadvantage, for different reasons, in both private EU markets and EU and foreign public procurement markets.

Subsidised companies may be able to make more advantageous offers, thus either discouraging non-subsidised companies from participating in the first place or from submitting competitive bids. In certain cases, foreign subsidies are granted by third-country governments with the express objective of enabling undertakings to submit bids for public contracts, at prices below market price or even below cost, directly "underbidding" to the detriment of competing non-subsidised undertakings. Where unsubsidised competitors are not able to compete on an equal footing, thereby missing out on business opportunities and losing market shares, this creates an uneven playing field.

ment. (cf. Communication of the European Commission, Guidance on the participation of third-country bidders and goods in the EU procurement market, C(2019) 5494 final, p. 6).

- 4 Such *de iure* restrictions can relate to rules requiring preferential market access to domestic products (exemplified by so-called 'Buy national' policies) or the imposition by governments of unfair and unreasonable bidding requirements to exclude or restrict market competition to foreign businesses. In addition, this may extend to requirements imposing technology transfers including industrial property rights, other intellectual property rights and undisclosed information, as a condition for the award of public contracts or local content requirements.
- 5 To address the lack of reciprocity, the EU has recently adopted the so-called International Procurement Instrument (IPI) (Regulation (EU) 2022/1031, OJ L 173, 30/6/2022, p. 1–16). Its main objective is to incentivize third countries to negotiate with the EU the opening of their respective procurement markets for EU businesses. Rather than tackling distortions of the procurement processes in the internal market arising from foreign subsidies, the IPI aims at improving the conditions of access to public procurement markets outside the EU.

C. Need to fill a regulatory gap

The Commission, in its “gap analysis” in the White Paper, looked at whether and to what extent distortions are caused by foreign subsidies in public procurement procedures. It concluded that the existing EU legal framework in the field of public procurement does not adequately address distortions to the EU procurement markets that are the result of foreign subsidies.

The EU Public Procurement Directives do not set out any specific rules regarding the participation of economic operators benefitting from foreign subsidies. Contracting authorities and entities in the EU enjoy a wide margin of discretion, both in the design of a public tender procedure as well as in the evaluation of tenders submitted in the procedure.

Article 69 of Directive 2014/24/EU⁶ provides the legal framework for contracting authorities in the assessment of abnormally low tenders. Under Article 69 (1), contracting authorities shall investigate the overall financial viability of an offer and may reject an offer as abnormally low, where it can be demonstrated that there are doubts as to the bidder’s capacity to execute the contract at the (abnormally low) price offered.⁷ In the investigation, they may also consider the existence of (foreign) subsidies when evaluating risks in terms of contract performance and execution. Where, as part of that assessment, it can be established that a bidder has obtained EU State aid incompatible with the TFEU, enabling it to make a low offer, the tender may – under additional conditions – be rejected on that ground alone.⁸ In contrast, Article 69 of Directive 2014/24/EU contains no corresponding provision for *foreign* subsidies enabling bidders to submit low offers, and no specific legal consequences are attached to the existence of foreign subsidies causing a distortion.

Even if public buyers wanted to take into account the existence of foreign subsidies, in practice they regularly do not have the information or means necessary to investigate whether bidders benefit from foreign subsidies, let alone to assess to what extent such subsidies have the effect of causing distortions in procurement markets. Moreover, there may often be an incentive to award contracts to subsidised bidders offering lower prices.

Hence, the existing EU public procurement rules are not sufficient to address and remedy distortions caused by foreign subsidies facilitating the bidding in an EU public procurement procedure.

6 Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC, OJ L 94, 28/3/2014, p. 65.

7 For guidance, see Communication of the *European Commission*, Guidance on the participation of third-country bidders and goods in the EU procurement market, C(2019) 5494 final, section 2.

8 Article 69(4) of Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC, OJ L 94, 28/3/2014, p. 65.

D. Chapter 4 FSR – main features

Chapter 4 of the FSR shall ensure that foreign subsidies can be addressed in individual public procurement procedures, by requiring EU public buyers to exclude from public procurement procedures those economic operators that have received distortive foreign subsidies.

Therefore, Chapter 4 foresees a review mechanism that is similar to that for concentrations under Chapter 3 of the FSR. It requires economic operators participating in public procurement procedures, with an estimated value of the public tender equal or greater than EUR 250 million, to notify to the contracting authority, when submitting their bid whether they, including any of their consortium members, or subcontractors and suppliers, have received a financial contribution within the last three years preceding the participation in the procedure.

I. *Ex ante* review mechanism: targeted, coherent and effective

At the core of Chapter 4 lies an (*ex ante*) notification obligation, which requires all economic operators submitting bids in public procurement procedures with a value of equal or above 250 million EUR, to notify to the contracting authority whether they or any of their consortium members, or subcontractors and suppliers, have received a foreign financial contribution within the meaning of Article 2(2) of the FSR.

The *ex ante* review mechanism under Chapter 4 of the FSR is designed to ensure that foreign subsidies in public procurement are addressed in a *targeted*, *effective* and *coherent* way.

(1) The review mechanism is *targeted*, for the following reasons:

- Chapter 4 foresees a relatively high notification threshold based on the value of the public contract in question. Prior notification is mandatory only in cases where the estimated total value of the public procurement is equal to or greater than EUR 250 million, in order to capture the most economically significant cases while minimising the administrative burden on undertakings and not hindering the participation of SMEs in public procurement.
- Below the notification threshold, the Commission may still request the prior *ad hoc* notification of a foreign financial contribution during an ongoing public procurement procedure. The Commission's discretion to make such a notification request under Article 28(6) FSR shall ensure that the Commission can target its investigations on specific procurement procedures even below the threshold, where there are grounds to suspect that a bidder has benefitted from potentially distortive foreign subsidies. This right to request an *ad hoc* notification is without prejudice to the Commission's general powers under Article 7 FSR to exam-

ine information from any source regarding alleged distortive foreign subsidies on its own initiative.⁹

- It clearly sets out who is caught by the notification obligation. The obligation to notify foreign financial contributions shall apply to economic operators, groups of economic operators¹⁰ as well as main¹¹ subcontractors and main suppliers known at the time of submission of the notification.

(2) Furthermore, the *ex ante* review mechanism in Chapter 4 FSR is designed to be as *effective* as possible, because:

- It lays down in clear terms the conditions under which a foreign subsidy shall be considered to distort the internal market in a public procurement procedure. The specific distortion test, enshrined in Article 26 FSR, requires that the foreign subsidy causes or risks causing a distortion in a public procurement procedure by enabling the economic operator to submit a tender that is *unduly advantageous* in relation to the works, supplies or services concerned. The assessment whether a tender is unduly advantageous is limited to the public procurement procedure in question, and will be made on the basis of a non-exhaustive set of indicators,¹² to determine how the foreign subsidy distorts competition, by improving the competitive position of an undertaking and enabling it to submit an advantageous tender. In this process, the Commission will give the economic operators under investigation the opportunity to explain why the tender is not unduly advantageous, including by adducing the elements referred to in Article 69(2) of Directive 2014/24/EU on abnormally low tenders.¹³
- It is governed by clear rules on deadlines¹⁴ for the respective investigation phases. Setting the right deadlines in public procurement constitutes a specific challenge.

9 Article 7(2) FSR clarifies that *ex officio* reviews into public procurements shall be limited to awarded contracts, and that such reviews shall not result in the cancellation of the decision awarding a public contract or a termination of a public contract.

10 As referred to in Article 26(2) of Directive 2014/23/EU, Article 19(2) of Directive 2014/24/EU and Article 37(2) of Directive 2014/25/EU.

11 A subcontractor or supplier is deemed to be “main” where their participation ensures key elements of the contract performance and in any case where the economic share of their contribution exceeds 20% of the estimated value of the submitted tender. Key elements may be based, in particular, on their particular relevance for the quality of the tender, including specific know how, technology, specialised staff, patents and similar advantages available to the subcontractor or supplier.

12 Pursuant to the FSR recitals, the Commission should publish and regularly update guidelines regarding a number of criteria mentioned in the FSR, including on the assessment of a distortion in a public procurement procedure.

13 The Commission’s review under Chapter 4 FSR is without prejudice to the powers of contracting authorities to examine whether a tender is abnormally low. However, contracting authorities shall not initiate such an assessment if it is based on the suspicions of the presence of foreign subsidies alone.

14 Under Art. 29 FSR, the Commission shall carry out a preliminary review no later than 20 working days after having received a complete notification, and it may adopt a decision closing the in-depth investigation no later than 110 working days after having received the complete notification (with a possibility to extend both deadlines in duly justified exceptional cases).

The deadlines should be sufficiently long to give the Commission enough time to carry out its fact-finding and assessment tasks, while at the same time ensuring that the review procedure does not delay the public procurement procedure that the contracting authorities are carrying out in parallel. A particularity of the Chapter 4 review mechanism is the fact that both administrative procedures are conducted independently and in parallel, by two different authorities. This parallelism of the two procedures requires that the contract award be suspended during the Commission's review. This effectively means a standstill obligation for the contracting authority: once the Commission has taken a decision to open an in-depth investigation, the contracting authority may not award the contract to the economic operator concerned until the Commission has reached a no objection decision.¹⁵

- When it comes to decision making, under Article 30 FSR, the Commission has at its disposal a number of effective tools to remedy distortions on the internal market actually or potentially caused by a foreign subsidy. Where, after the in-depth investigation, the Commission finds that an economic operator benefits from a foreign subsidy that distorts the internal market, it shall adopt a decision prohibiting the award of the contract to the investigated economic operator. Such decisions shall be addressed to the contracting authority concerned, which shall comply with the decision by rejecting the tender. Alternatively, the Commission may also adopt a decision with commitments in cases where the economic operator offers commitments that fully and effectively remove the distortion.

(3) Furthermore, the ex ante review mechanism is designed to be as *coherent* as possible, in particular because it provides for an exclusive competence of the European Commission as the sole enforcer of the instrument, thereby guaranteeing a uniform and consistent decision-making practice across the EU. The exclusive Commission competence furthermore guarantees that the contracting authorities' role in the review procedure is limited to forwarding bidders' notifications, informing the Commission of any decision relating to the outcome of the public procurement procedure, and taking award decisions in line with the decisions by the Commission in the review procedure.

II. Addressing specific situations in public procurement

In the course of the negotiations of the FSR proposals with the co-legislators, it emerged that there is a need to address the procedural implications of certain specif-

15 By contrast, where the contracting authority finds that the most economically advantageous tender was submitted by an economic operator that is not subject to a Commission investigation under Chapter 4 FSR, it may award the contract to the economic operator submitting such a tender, before the Commission takes a decision regarding any other tenders under investigation.

ic situations in public procurement that the initial Commission proposal¹⁶ did not expressly address.

This concerns, in particular, situations where the contracting authority decides to divide the public procurement into lots. In such cases, the FSR sets out a notification obligation if the estimated value of the procurement exceeds the notification threshold of EUR 250 million and the combined value of the lots for which an economic operator is bidding is equal or above EUR 150 million.

In addition, the FSR exempts from the notification obligation procedures for which the EU procurement Directives foresee the possibility of contract award by a negotiated procedure without prior publication in cases of extreme urgency,¹⁷ if the respective conditions set out in the Directives are met. A derogation from the notification obligation also applies in procurements where only one economic operator can make a bid due to technical reasons of the procurement at hand.¹⁸

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17 Cf. Article 32(2)(c) of Directive 2014/24/EU, and Article 50 point (d) of Directive 2014/25/EU. The award of contracts in such situations may still be subject to an investigation under the provisions of Chapter 2 of the FSR.

18 Cf. Article 32(2b) of Directive 2014/24/EU, Article 50(c) of Directive 2014/25/EU and Article 31(4) of Directive 2014/23/EU.