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TACKLING TRADE-DISTORTIVE FOREIGN SUBSIDIES ALONG THE SUPPLY CHAIN: A RECENT LANDMARK EU CASE

EXECUTIVE SUMMARY

The European Commission recently published a [decision](#) that represents a major step in strengthening its control of foreign subsidies in the area of trading goods. This illustrates the European Commission's current determination to combat the existing asymmetries between controlled subsidies in Europe and largely uncontrolled subsidies in some third countries. The decision relates to a case concerning stainless steel products and involving what is traditionally known as the "Silk Roads". The Commission tackled two main types of foreign subsidies. On the one hand, it acknowledged that **a regulatory measure in Indonesia (export restriction on nickel) lead to low prices for this raw material locally, subsidising local producers of finished products, which are then exported to the EU.** On the other hand, it decided to offset subsidies granted to a Chinese-Indonesian producer not only by the Government of Indonesia (tax exemption...), but also preferential loans indirectly granted by the Government of China. These are known as "**transnational**" subsidies.

This case is unquestionably a landmark decision that may be relevant in the future for **other sectors and other countries**. It is all the more emblematic in that it occurs in a fragile multilateral context that pushes the European Union to be innovative enough in its use of the available multilateral rules, and which also **demonstrates the increasing need for coherence between EU trade policy, its open strategic autonomy and its environmental commitments.**

BACKGROUND

On 16 March 2022, the European Commission (the Commission) published Implementing Regulation 2022/433 imposing definitive countervailing duties on imports of stainless steel cold-rolled flat products from India and Indonesia (SSCR AS Regulation). The Regulation sets an important precedent under the EU anti-subsidy discipline with regard to subsidies resulting from export restrictions on raw materials and transnational subsidies.

The SSCR AS Regulation addresses a complex system set up by the government of Indonesia in favour of the rapid creation of a downstream industry of nickel. Indonesia is one of the largest producers of nickel ore worldwide and, as such, intended to replace exports of this raw material by added-value products, i.e. stainless steel. To do so, the Government of Indonesia (GOID) introduced multiple export restrictions on nickel, including an export ban and entered into bilateral cooperation with China to direct their investments to Indonesia.

Under this setting, Chinese investors were guided by the government of China to build large nickel ore processing capacities as well as stainless steel plants in Indonesia. China's support notably took the form of preferential financing under China's Belt and Road initiative. In return for their commitment to artificially create an ex nihilo domestic industry of stainless steel in Indonesia, the government of Indonesia provided Chinese investors with access to nickel ore at a low price, which was ensured by various export restrictions regularly manipulated by the

government of Indonesia. Against this background, within only a couple of years, Indonesia emerged as a world-leading exporter of low-priced stainless steel.

The SSCR AS Regulation shows the commitment of the Commission to go forward with the possibility to address transnational subsidies since the Regulation marks the second time the Commission decided to countervail this type of subsidisation. Although the SSCR AS Regulation draws significantly from the previous glass fibre case, it also provides very useful clarifications on the methodology to address this particular subsidy scheme. Thus, SSCR AS Regulation should be closely analysed by any future complainants wishing to tackle translational subsidies.

On the other hand, through the SSCR AS Regulation, the Commission displays its determination to tackle subsidies resulting from export restrictions, the increasingly common subsidisation pattern. It notably decided to rely on a more innovative legal approach to this subsidy scheme, thus opening doors to a more flexible practice in this area.

The Commission's Executive VP in charge of trade – Vladis Dombrovskis – commented on the publication of the Regulation by acknowledging that “[s]ubsidies involving export restrictions are among the most distortive because they massively bring down the cost of raw materials in the exporting country—and directly undermine fair competition with EU companies. This calls for our robust response to level the playing field, in line with WTO rules.” It is important to note that the trade representative classifies export restrictions among the most distortive subsidies directly threatening the competitiveness of the EU producers. This marks a turning point to the previous position of the Commission, who seems to finally recognise the extent to which those practices negatively affect the EU industries.

The Commission was further incentivised to strongly counter unfair practices of Indian and Indonesian exporting-producers in the EU market due to the environmental and strategic issues at stake. Subsequently to the rolling out of Green Deal and Fit-for-55 package, the Commission becomes particularly watchful to trade defence cases involving environmental considerations. In the case at hand, the development of stainless steel production in Indonesia by Chinese investors involved a particularly heavy environmental toll, including intensive mining, increased carbon dioxide emissions and extensive water pollution. Although the Commission is not equipped with a possibility to translate the environmental impact of a third country's unfair exports in its trade defence measures, it is particularly attentive to this issue from a policy standpoint. Similarly, the Commission has been particularly interested in the strategic positioning of the EU stainless steel industry in the market and highlighted its essential role “for construction, energy equipment, infrastructure, consumer goods and vehicles.”

To further analyse the SSCR AS Regulation, the first part of this document will analyse the Commission's renewed approach to the subsidy consisting in the provision of raw materials at less than adequate remuneration, while the second part will focus on the Commission's increased vigilance against transnational subsidies.

1. THE COMMISSION'S RENEWED APPROACH TO THE SUBSIDIES RESULTING FROM EXPORT RESTRICTIONS

The treatment of subsidies involving export restrictions on raw materials has never been a straightforward exercise for the Commission. Prior to the SSCR AS Regulation, the Commission's assessment of subsidies resulting from export restrictions involved a demonstration that raw materials suppliers are private bodies entrusted or directed by the

government. This approach placed a significant evidentiary burden on the complainants, who had to demonstrate to the Commission that the lower prices of raw materials are an intended result of the government's action, and not a mere side-effect. This involved a burdensome identification and examination of the government's intention behind the export restrictions to depress prices of a raw material concerned.

In the SSCR AS Regulation, the Commission adopted a different methodology and concluded that nickel ore mining companies in Indonesia and chromium mining companies in India are public bodies. It is only as an alternative to this approach that the Commission determined that mining companies are entrusted or directed by the government of Indonesia to supply nickel ore at low price and by the government of India to provide chromium at low price.

The Commission's qualification of mining companies as public bodies is particularly insightful, as it had to go beyond a mere demonstration of the existence of formal links between an entity and government. The Commission thus demonstrated that mining companies have been meaningfully controlled by the government in the sense that their freedom to organise their production and processing activities, to choose to whom they want to sell, to determine the quantity of production and the price have been restrained. In addition, with regard to the nickel ore mining companies in Indonesia, the Commission concluded that their formal designation as 'National vital objects' shows that they possess, exercise or are vested with governmental authority.

In other words, taking the example of Indonesia, the Commission accompanied its demonstration of a subsidy resulting from export restriction with the following elements:

- (i) Ownership and formal indicia of control of the entity providing the raw material by the government

In the SSCR AS Regulation, the Commission identified that the share of the State-owned companies in the total production in 2020 was more than 27% and considered that this already represents a substantial market share of companies owned by the State. The Commission also found that a substantial share of the production of nickel has been managed and/or controlled by the State in view of the relation of the board members with the government of Indonesia.

- (ii) Entity providing the raw material possesses governmental authority and exercises this authority in the performance of governmental functions

In the SSCR AS Regulation, the Commission decided, for example, that, regardless of their ownership, mining companies in Indonesia were subject to and had to implement a number of government-prescribed measures concerning the provision of nickel ore, namely (1) domestic processing obligation, (2) export restrictions and/or export ban, (3) mandatory annual working plan and budget, (4) divestment obligations, (5) mandatory pricing mechanism. The Commission concluded that these obligations clearly show that the mining companies are performing governmental functions.

The key implications of the Commission's approach is encouraging for the EU producers and for future anti-subsidy cases targeting subsidies resulting from export restrictions. In the SSCR AS Regulation, the Commission developed an alternative, more flexible, approach for the complainants to evidence those subsidies. As demonstrated above, the standard of evidence required under the "public body" approach does not imply a particularly complex examination of the intention of the government behind the export restriction, which had previously been required under the "entrustment and direction" approach.

In any event, depending on the underlying facts of the case, the future complainants and the Commission are offered a greater room for manoeuvre to legally address the subsidy resulting from export restrictions, thus having a possibility to choose to most convenient approach between the “public body” and “entrustment and direction”.

2. THE COMMISSION’S INCREASED APPETITE FOR TRANSNATIONAL SUBSIDIES

Another crucial element provided in the SSCR AS Regulation pertains to transnational subsidies. The Commission classifies transnational subsidies as indirect subsidies, provided by the exporting country (in this case Indonesia) within its territory, when the exporting country actively sought, acknowledged and adopted the subsidies granted by a third country for the benefit of the producers established in the exporting country.

In the SSCR AS Regulation, the Commission set out, even more explicitly, the principles and standards of proof applicable in the situation of transnational subsidies. In the previous fibreglass regulation that addressed for the first time transnational subsidies, the Commission had stated that in transnational subsidy cases, there should be a clear and explicit link between the affirmative actions taken by the third country in order to provide the agreed financial support to the exporting producers and the government of the exporting country.¹

While reiterating this principle in the SSCR AS Regulation, the Commission expanded types of government acts that may indicate a clear and explicit link. Unlike the fibreglass regulation, where the Commission identified a cooperation agreement signed by the governments of China and Egypt providing a clear written framework for the cooperation between the two countries within the China-Egypt Suez Economic and Trade Cooperation Zone, in the case at hand the Commission could not access any explicit and written agreement between Indonesia and China proving for the development of the specific industrial zone, Morowali Industrial Park, where exporting producers were operating.

In this context, the Commission had to further clarify the standard of proof required to demonstrate the existence of a transnational subsidy. Accordingly, the Commission indicated that acknowledgement and adoption of conduct of a third country by a state might be express, or it might be inferred from the conduct of the state in questions. Thus, such acts might be in the form of words or deeds, which warrants an in concreto examination of the behaviour of the exporting country. Otherwise speaking, the appraisal of a bilateral cooperation between governments on an industrial project should be carried out on a case-by-case basis and should involve a thorough assessment of all evidence at hand, whether in the form of words or of conduct.

In the SSCR AS Regulation, the Commission still attributed subsidies provided by China in the Morowali Industrial Park to Indonesia because, among other things, (i) there were numerous policy and legal documents signed by the government of Indonesia and the government of China foreseeing investment by China to the steel industry and industrial zones, (ii) the government of Indonesia was aware of the fact that Morowali Industrial Park was part of the Belt and Road Initiative, which is known to involve preferential financing (iii) high ranking

¹ Commission Implementing Regulation (EU) 2020/776 of 12 June 2020 imposing definitive countervailing duties on imports of certain woven and/or stitched fibreglass fabrics originating in the People's Republic of China and Egypt and amending Commission Implementing Regulation (EU) 2020/492 imposing definitive anti-dumping duties on imports of certain woven and/or stitched fibreglass fabrics originating in the People's Republic of China and Egypt, Recital 698.

government officials of both countries were present during the negotiations and signing of agreement establishing Morowali Industrial Park by Chinese and Indonesian businesses, and (iv) the government of Indonesia was involved in the monitoring and operation of the Morowali Industrial Park together with the government of China. Consequently, the words and conduct of the government of Indonesia was sufficient to prove that it acknowledged and adopted preferential financing provided by the government of China and indirectly provided subsidies.

In terms of the financial contributions indirectly provided by the government of Indonesia through the government of China, the Commission countervailed the following schemes:

- Loans from Chinese policy banks
- Loans from intergroup companies
- Short-term credit lines provided by Chinese financial institutions
- Equity injection
- Provision of capital in kind for less than adequate remuneration

Nonetheless, it is important to highlight that the fibreglass regulation was brought before the General Court by the countervailed exporters (Case T-480/20). Thus, if the General Court, or subsequently the Court of Justice, rules against the reasoning of the Commission, the later would have to amend this methodology in subsequent cases.

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