

WHEN IS A FOREIGN SUBSIDY DISTORTIVE?

EUROPEAN COMMISSION PUBLISHES GUIDANCE ON SOME KEY CONCEPTS UNDER THE FOREIGN SUBSIDIES REGULATION

Just over a year after the **Foreign Subsidies Regulation** (FSR) came into force, the European Commission (EC) has published **some initial clarifications** in a **Staff Working Document** (SWD) on how certain concepts in the regulation, including the concept of “distortive” subsidies, should be interpreted and applied.

This comes shortly after the EC opened its first **in-depth merger investigation under the FSR** into the acquisition by Emirates Telecommunications Group Company PJSC (known as e&), a telecoms operator based in Abu Dhabi, of sole control of PPF Telecom Group BV (PPF Telecom), a European telecoms operator.

The SWD provides some useful, initial indications of how the EC will interpret and apply the relatively new regime in practice, especially when considered alongside the EC’s **published summary** of reasons for opening its in-depth investigation into the *e&/PPF Telecom* transaction.

This briefing highlights those areas where these publications bring additional clarity to certain key concepts under the FSR.

Background: a regime for distortive foreign subsidies

The FSR is intended to address distortions in the EU internal market caused by foreign subsidies. It introduced **a new mandatory and suspensory regime** for larger M&A (including joint venture) transactions and larger-scale public tenders above certain financial thresholds.

Under the FSR, the EC assesses the extent to which financial contributions granted by non-EU countries to companies engaging in an economic activity in the EU amount to distortive foreign subsidies requiring redress. See our previous client briefings [here](#), and [here](#), as well as

our Top 10 Tips for M&A Transactions [here](#), for further background on the FSR.

The EC’s initial clarifications on key concepts under the FSR

The SWD provides some initial clarifications on some important FSR concepts:

When is a foreign subsidy distortive?

The SWD outlines two conditions that must be met for a foreign subsidy to be distortive.

- First, the foreign subsidy must be **liable to improve the competitive position** of the undertaking in the internal market. This requires there to be a relationship between the foreign subsidy and the activities of the undertaking in the EU. By way of illustration, the SWD draws a distinction between (i) an interest-free loan provided by a third country directly to an EU entity active in the internal market (leading to an obvious relationship) and (ii) a foreign subsidy that has been granted to a subsidiary not active in the EU, where that subsidy has been used in order to develop the local activity of the subsidiary in a third country (where the relationship with the internal market is “not apparent”).¹
- Second, by improving the competitive position of the relevant undertaking in the internal market, the foreign subsidy must **actually or potentially negatively affect competition in the internal market**. The SWD notes that the FSR addresses actual distortions (i.e. those that are established with certainty) and also potential distortions. The SWD states that the EC may assess effects on competition across a number of different dimensions, including investments (e.g. acquisition of other undertakings or assets, or establishment of a production facility), or the provision or purchase of goods or services.

¹ The SWD however flags the need to consider whether a subsidy with no apparent relationships with an activity in the EU might still be used to cross-subsidise activities in the internal market.

- In the context of *e&/PPF Telecoms*, the EC in its preliminary review identified “*sufficient indications*” that both of these conditions were liable to be satisfied as a result of certain subsidies received by the acquirer (e&) that “*are likely to have improved e&’s competitive position in the acquisition process*” for PPF. The EC noted that it will further review in its in-depth investigation whether those foreign subsidies had actual or potential negative effects on the acquisition process, in particular in view of the existence of possible other parties interested in the acquisition of PPF Telecoms, or whether e& would have been able to perform the acquisition at the same conditions absent the foreign subsidies identified.

How will the EC apply the FSR’s “indicators”?

- Unlike the position under EU State Aid law, under the FSR the EC cannot presume that all subsidies are distortive. Article 4(1) FSR sets out a non-exhaustive list of “indicators” which the EC may use to assess whether a foreign subsidy is liable to give rise to a distortion.²
- The SWD clarifies that these indicators are not exhaustive or mandatory. The EC may use these or other indicators to carry out a detailed assessment of whether a subsidy is distortive or not (unless a subsidy falls under the list of “*most likely distortive*” subsidies identified under Article 5 FSR, in which case a distortion can be presumed).
- The EC preliminarily considered some of the foreign subsidies in the *e&/PPF Telecoms* transaction to be “*most likely distortive*”. However it also identified “*sufficient indications*” that certain other foreign subsidies received by e& may also be distortive (but without disclosing what indicators were used in this assessment).

How is the EC treating “most likely distortive” subsidies?

- If a foreign subsidy falls under one of the categories of “*most likely distortive*” subsidies under Article 5 FSR, it will be presumed to be distortive, and the EC will generally not perform a detailed assessment based on indicators. However, the SWD emphasises that, even where a subsidy falls under this category, the acquirer will still have the opportunity to show that the subsidy will not distort the internal market.
- In practice, this means that the existence of a “*most likely distortive*” subsidy will materially increase the risk of an in-depth investigation,

unless it can be shown that (a) there is no relationship between the relevant subsidy and the activities of the undertaking in the EU or (b) that there are facts which clearly demonstrate that the subsidy will not have any distortive effects (which is likely to be a high standard to meet).

- One such category of “*most likely distortive*” subsidy discussed in the SWD is a “*foreign subsidy in the form of an unlimited guarantee for the debts or liabilities*”. Unlimited guarantees may be liable to improve the competitive position of an acquirer in various situations. For example, the SWD explains that, in an M&A context, an unlimited guarantee can facilitate a transaction by allowing the acquirer to obtain financing from banks below market terms to be able to offer the seller a higher purchase price for the target, and therefore improve the bidder’s capacity to finance the transaction. Similarly, if a pre-existing unlimited guarantee extends to the merged entity, this could also potentially distort competition in the internal market post-transaction.
- In the context of *e&/PPF Telecoms*, the EC considered the unlimited guarantee granted by the UAE to e& along with a term loan granted by five syndicated banks (whose actions are attributed to the UAE) to be “*most likely distortive*”. The existence of these subsidies was a material contributing factor in the EC’s decision to refer the case for an in-depth investigation.

What does “limited to the concentration concerned” mean?

Article 19 FSR provides that, in an M&A context, the EC’s assessment of whether a foreign subsidy distorts the internal market “*shall be limited to the concentration concerned*”. There is some uncertainty as to what this means in practice. The SWD provides some examples:

- First, the SWD explains that foreign subsidies can distort the internal market by leading to actual or potential negative effects on the acquisition process, affecting competition for acquiring the target. In this context, subsidies received by the acquirer, granted to the target or granted to the seller may be relevant.
- Second, the SWD explains that the EC will consider whether the merged entity will benefit from (distortive) foreign subsidies post-transaction. By way of example, in *e&/PPF Telecoms*, the EC found that certain subsidies, including e&’s unlimited guarantee from the UAE, were liable to improve the competitive position of the merged entity following the completion of

² Including: (a) the amount of the foreign subsidy, (b) the nature of the subsidy, (c) the situation of the undertaking, including its size and the markets or sector concerned, (d) the level of evolution of economic activity of the

undertaking on the internal market and (e) the purpose and conditions attached to the foreign subsidy as well as its use on the internal market (Article 4(1) FSR).

the transaction, by allowing the entity to raise finances for its EU activities at preferential terms.

In both cases, the relevant subsidy must be granted in the three years prior to the transaction in order to be in scope under Article 19 FSR.

How will the EC apply the balancing test?

- Similar to the approach under EU State Aid law, Article 6 FSR allows for the EC to balance the negative/distortive effects of a foreign subsidy against the positive effects on the development of the relevant subsidised activity (including in the context of broader positive effects in relation to EU policy objectives, such as environmental protection). The FSR goes on to state that “*most likely distortive*” subsidies are less likely to see their negative effects outweighed by positive effects.
- The EC acknowledges in the SWD that it “*ha[s] not yet gathered substantial experience on the application and interpretation of the balancing test.*” However, it clarifies that evidence on positive effects may be submitted at any point during the EC’s investigation and may be submitted by the notifying parties or by Member

States or other third parties. The SWD goes on to state that the application of the balancing test can only lead to a neutral or positive outcome on the EC’s assessment case, which seems to imply that it would be in the interests of undertakings to submit evidence on potential positive effects of any subsidy.

What’s next?

The SWD confirms that the initial clarifications in this document are “*of a preliminary nature*” and will be further developed through case practice (and, in due course, the EU courts’ case law). The EC also promises to publish further guidelines on the application of the FSR provisions by 12 January 2026. More immediately, those interested in how the FSR is being applied in practice will also be interested to see the outcome in *e&/PPF Telecoms*, with the EC due to reach a decision by 15 October 2024.

CONTACT



JONATHAN SLADE
PARTNER
T: +32(0) 2 737 94 36
E: Jonathan.Slade@slaughterandmay.com



NELE DHONDT
PSL COUNSEL
T: +44(0) 20 7090 4023
E: Nele.Dhondt@slaughterandmay.com

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650

Published to provide general information and not as legal advice. © Slaughter and May, 2022.
For further information, please speak to your usual Slaughter and May contact.

www.slaughterandmay.com