Ashurst

New guidance on the EU Foreign Subsidies Regulation

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On 26 July 2024, the European Commission published a staff working document setting out some initial clarifications on the EU Foreign Subsidies Regulation (Regulation 2022/2560) (**FSR**). The FSR entered into force on 12 July 2023 and requires companies active in the EU to monitor the foreign financial contributions that they receive. Companies need to notify foreign financial contributions received in the context of M&A and public procurement procedures where certain monetary thresholds are met. See our February 2023 update and July 2023 update.

Key takeaways

- The staff working document provides some initial clarifications on how the European Commission is interpreting "distortion" under the FSR.
- The guidance focuses on the meaning of distortion in merger control and public procurement procedures, as well as providing guidance on the balancing test and the concept of unlimited guarantees.
- This is non-binding guidance which will be supplemented as the European Commission gains more practical experience of applying the FSR tools. Further guidance is due to be published by 12 January 2026.

Background

Subsidies granted by EU Member States are subject to EU State aid control (see our Quickguide). However, there have been concerns that subsidies granted by non-EU Member States may also impact the internal market. Before the FSR, these foreign subsidies were not taken into account in the context of EU M&A and public procurement procedures. The FSR was designed to address this by enabling the European Commission to scrutinise subsidies granted by non-EU Member States. The notification obligation entered into force on 12 October 2023.

Staff working document

On 26 July 2024, the European Commission published a staff working document which sets out preliminary clarifications, which will be further refined through cases and guidelines which are due to be published 12 January 2026. The staff working document focuses on:

- the concept of distortion in a merger control review;

- the application of the balancing test when weighing the positive effects against the distortion to the internal market caused by the relevant foreign subsidies;
- the concept of distortion in public procurement procedures; and
- the concept of unlimited guarantees.

"Distortion" in merger control

The FSR sets out two conditions for determining whether a foreign subsidy distorts the internal market:

- The foreign subsidy is liable to improve the competitive position of an undertaking in the EU. For this, there needs to be a relationship between the foreign subsidy and the activities in the EU. However, the European Commission can examine whether a subsidy with no apparent relationship to an activity in the EU is used by the group to cross-subsidise activities in the EU.
- The foreign subsidy (actually or potentially) negatively impacts competition in the EU. The effects on competition could be assessed for any of the beneficiary's activities (or likely future activities) in the EU. The staff working document highlights that this will develop through the European Commission's case practice.

The staff working document emphasises that the indicators set out in Article 4(1) of the FSR are not exhaustive and are not mandatory for every case. The European Commission will assess each case on its particular facts, however, a detailed assessment based on the indicators is not required for subsidies which the FSR identifies as most likely to distort the internal market. Unlike in State aid cases, the European Commission cannot presume that a foreign subsidy distorts the internal market simply because the beneficiary is engaged in an activity in a liberalised sector in the internal market.

Balancing test

The staff working document notes that the European Commission has not yet gathered substantial experience on the application of the balancing test. For the balancing test, the European Commission needs to examine whether the foreign subsidies have any positive effects on the "*development of the relevant subsidised economic activity on the internal market"* and *"examine broader positive effects in relation to relevant policy objectives*", such as environmental protection or the promotion of research and development. For public procurement procedures, the European Commission should also consider the availability of alternative sources of supply for the relevant goods or services.

In balancing these positive effects against the distortion caused by the foreign subsidies, the European Commission will need to consider whether, and to what extent, the positive effects offset the negative effects: this is less likely to be the case for foreign subsidies which the FSR has identified are most likely to be distortive. The European Commission will consider evidence submitted by all relevant stakeholders, including the parties, Member States and other third parties.

Finally, the staff working document notes that the balancing test "*cannot, under any circumstances, lead to a less favourable outcome*" for the companies involved.

"Distortion" in public procurement procedures

In public procurement processes, there are two conditions for determining whether a foreign subsidy distorts the internal market:

- the tender submitted by the subsidised economic operator must be unduly advantageous (this is determined by comparing the tender to other bids received and the contracting authority's own estimate, as well as other facts); and
- there must be a link between the granting of the subsidy and the tender: for example, the subsidy (likely) enabled the operator (directly or indirectly) to submit an unduly advantageous tender.

Unlimited guarantees

The FSR contains a list of categories of subsidies which are most likely to distort the internal market, including "*unlimited guarantees*" which can take many forms, such as more favourable funding terms because there is an indication that the State may intervene. In the context of a merger or acquisition, an unlimited guarantee can facilitate the transaction taking place by enabling the acquirer to obtain financing on more advantageous terms meaning the acquirer can offer a higher price for the target.

While the European Commission's assessment considers subsidies granted in the three years prior to the agreement, it may assess distortions from these earlier subsidies that may materialise after the transaction is completed.

Comment

As the FSR has only been in force for a year, the European Commission's practice is still developing. In the first year, there have been a handful of in-depth investigations (one in relation to a proposed acquisition and three in relation to public procurement procedures) and two ex officio investigations. The first dawn raids under the FSR were conducted in April 2024.

Further guidance is expected as the European Commission builds up its experience.