EU Commission Expands Foreign Subsidies Guidance

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The EU Foreign Subsidies Regulation, or FSR, is intended to prevent or remedy distortions of the EU internal market caused by "foreign" – meaning non-EU – subsidies benefitting companies active in the EU. The FSR draws on EU merger control, State aid and trade law, but it also introduces new legal concepts and procedures not fully explained in the regulation or the July 2023 implementing regulation.

The FSR requires the Commission to issue guidance on certain issues by January 2026. Meanwhile, a Staff Working Document (the SWD) provides some helpful indications. The SWD discusses the concept of distortion in the internal market and the application of the so-called "balancing test." The SWD supplements guidance the Commission has provided in the form of Frequently Asked Questions published by DG COMP and DG GROW, as well as a helpful FSR Brief on early lessons from FSR enforcement.

Distortion of the Internal Market

The FSR provides little guidance on how the Commission should determine whether foreign subsidies distort the internal market. Under Article 4(1) FSR, a "distortion in the internal market is deemed to exist where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market and where, in doing so, that foreign subsidy actually or potentially negatively affects competition in the internal market." Article 5(1) FSR identifies categories of foreign subsidies considered most likely to distort the internal market, as discussed below. Otherwise, the Commission can refer to "indicators," although the SWD notes that these indicators are neither exhaustive nor mandatory for every case.

The Article 4(1) FSR indicators are the amount and nature of the foreign subsidy; the situation of the beneficiary, including its size and the markets or sectors concerned; the beneficiary's economic activity in the EU; and the subsidy's purpose, conditions and use in the EU. The FSR does not indicate how these factors should be evaluated. For example, it is not clear whether the Commission's approach to assessing market power for EU Merger Regulation (EUMR) purposes should apply to the analysis of a subsidized company's "situation" or "size" in the EU markets or sectors concerned. Similarly, "sectors" concerned are presumably broader than relevant antitrust markets, but it is not clear how such sectors should be defined or what sectoral data may be required.

Unfortunately, the SWD does not address these questions. However, the SWD indicates that for a foreign subsidy to distort the EU internal market, there must be a relationship between the foreign subsidy and the beneficiary's activities in the EU. For instance, in the case of an interest-free loan provided by a third country directly to an EU entity active in the internal market, there is a connection between the alleged subsidy and the beneficiary's activity in the internal market. In the case of a foreign

subsidy granted to a subsidiary not active in the EU, the relationship requirement may not be met if the subsidy has been granted and effectively used in local activities outside the EU. However, the Commission can examine whether a subsidy with no apparent relationship to the EU is used by the group to cross-subsidize activities in the EU.

To determine whether a foreign subsidy negatively affects competition in the internal market (actually or potentially), the Commission can assess the subsidy's effects on any of the activities in which the beneficiary is, or will likely be, active in the internal market, including acquisitions or other investments, or the provision or purchase of any goods or services. A foreign subsidy has a negative effect on competition where it leads to an unlevel playing field, i.e. where the chances of succeeding in the market are altered by support from a third country in favor of one or more market players.

As mentioned, where a company has received a foreign subsidy of a type identified in Article 5(1) FSR the Commission does not need to conduct a detailed assessment based on indicators. These are foreign subsidies granted to an "ailing undertaking" (absent a restructuring plan including a significant own contribution); unlimited guarantees; certain export financing measures; and foreign subsidies directly facilitating a concentration or enabling a company to submit an unduly advantageous public tender. The SWD elaborates on the assessment of unlimited guarantees but does not address the other types of presumptively distortive foreign subsidy.

According to the SWD, "unlimited guarantees extend to all obligations of their beneficiary and therefore are liable to improve the competitive position of that undertaking in various situations. For instance, an undertaking benefitting from an unlimited guarantee may receive a loan from a private bank that prima facie appears to be on market terms, but the conditions of which actually reflect the existence of that guarantee. In that respect, unlimited guarantees can take many forms and may go beyond an explicit statement or legal act referring to the undertaking concerned. For example, if an undertaking can obtain more favorable funding terms because, rather than being subject to standard bankruptcy laws, there are indications that the State might intervene in the case of illiquidity, which, in turn might increase the chances of creditors recovering sums owed to them than would otherwise be the case, this could indicate the existence of an unlimited guarantee." In the Commission's view, therefore, a "comfort letter" or other support short of a formal guarantee may be characterized as an "unlimited guarantee" for FSR purposes.

Concentrations

Under Article 19 FSR, the Commission assesses whether the internal market may be distorted by foreign subsidies through a notifiable concentration. The FSR does not indicate how such a distortion should be identified in the M&A context, but the SWD explains that in this context foreign subsidies may distort the internal market in two ways.

First, they may affect the acquisition process itself, affecting competition for acquiring the target by outbidding or discouraging potential competitors. These foreign subsidies could include a direct grant, an unlimited state guarantee or a below-market loan. For example, an unlimited guarantee can facilitate a concentration by enabling the acquirer to obtain financing from public or private banks below market terms to be able to offer a higher purchase price, thus improving the bidder's capacity to finance the transaction.

According to the SWD, subsidies granted to the target or even the seller may also be relevant from this perspective. The SWD does not give examples, but a buyer and target could potentially arrange for a subsidy to be paid to the target or seller to avoid detection.

Second, foreign subsidies may have a negative effect on competition in the internal market. For example, an unlimited guarantee could distort competition by improving the competitive position of the merged entity and thereby negatively affect competition in the internal market.

The SWD confirms that the Commission's review does not concern foreign subsidies granted after the concentration but is limited to foreign subsidies granted in the three years prior to the concentration. Nevertheless, the assessment will include distortions that may "materialize" after the concentration has been completed. The SWD does not discuss the timeframe for such an assessment, but the remedies offered in the Commission's first in-depth FSR investigation of a notified concentration reportedly last for 10 years, suggesting that remedies may be required to address distortions materializing at least 10 years after a notified transaction.

Public procurement

In the public procurement context, Article 27 FSR provides that foreign subsidies that cause or risk causing a distortion in a public procurement procedure shall be understood as subsidies that enable an economic operator to submit a tender that is unduly advantageous in relation to the works, supplies or services concerned. The SWD clarifies that the Commission examines two separate factors.

First, whether the tender submitted by the subsidized economic operator is unduly advantageous in relation to the works, supplies or services concerned. Second, whether there is a link between the granting of the subsidy and the tender, i.e. whether the subsidy caused or risked causing a distortion in a public procurement procedure by enabling the undertaking, directly or indirectly, to submit an unduly advantageous tender.

To ascertain that the tender in question is "advantageous" in relation to the works, supplies or services concerned, the Commission will compare the tender with other bids submitted in the tender procedure and consult the documents used by the contracting authority in preparing the procurement documents. Where the tender has been found to be advantageous, the undue nature of the advantage will depend on whether the advantage can be justified by other factors not related to the subsidy itself, such as the elements identified in EU public procurement rules to justify "abnormally low tenders" (such as the particular cost-effectiveness of a production process, innovations or novel technical solutions, or exceptionally favorable conditions from which the economic operator benefits in the supply of goods or services). The SWD does not discuss potential differences between the FSR concept of "unduly advantageous" tenders versus the public procurement law concept of "abnormally low" tenders.

Second, to show a causal link between the subsidy and the tender, the Commission must show that the foreign subsidy enabled or likely enabled, the economic operator to submit the unduly advantageous bid. If, for example, foreign subsidies were granted expressly with the aim of favoring the production of the goods to be supplied, this is a prima facie indication that the foreign subsidy enabled the submission of the unduly advantageous bid. When assessing the existence of distortions in the internal market, foreign subsidies covering a substantial part of the estimated value of a contract to be awarded are more likely to cause distortions.

Balancing test

Article 6 FSR introduces the so-called “balancing test,” which the Commission applies to determine whether a distortion in the internal market is outweighed by benefits (similar to the “efficiency defense” in the EUMR context). The balancing test proved controversial in the legislative debates before the FSR’s adoption, and the final text requires the Commission to adopt guidelines to clarify its application.

The SWD provides that the Commission will consider whether and to what extent the foreign subsidies distorting the internal market under consideration have positive effects on the “development of the relevant subsidized economic activity on the internal market” and “in relation to the relevant policy objectives, in particular those of the Union”. Relevant policy objectives can include, for instance, environmental protection, social standards, or the promotion of research and development, including by reference to EU State aid rules (presumably including the EU’s General Block Exemption Regulation).

In “balancing” those positive effects, the Commission needs to weigh them against the distortion in the internal market caused by the foreign subsidies. Foreign subsidies deemed presumptively distortive under Article 5 FSR are less likely to see their negative effects outweighed by positive effects.

The notification forms published by the Commission allow notifying parties to provide information on the existence of positive effects both in the concentration and public procurement contexts. The SWD notes that the Commission can also rely on submissions by all relevant stakeholders, although the Commission’s FSR procedures do not specifically contemplate a formal market test or a role for complainants in FSR reviews.

The application of the balancing test may lead to several outcomes. First, the Commission may adopt a “no objection decision” if the positive effects identified fully outweigh the negative effects of the foreign subsidies. Second, the balancing test may lead the Commission to adapt the nature and scope of any redressive measures or commitments to cater for those positive effects, while still ensuring that the negative effects are fully and effectively redressed. Third, the Commission may conclude that the foreign subsidies do not have any, or only insignificant, relevant positive effects. The application of the balancing test cannot lead to a less favorable outcome than if the balancing test had not been applied.

Conclusion

The SWD is a close explication of certain FSR provisions relating to the “distortion of the internal market” test and the FSR’s balancing test, but it does not elaborate on the Commission’s enforcement policy, and it has unfortunate omissions. For example, the SWD does not discuss the application of the Article 4(1) “indicators” of distortion and their relationship to assessments under other EU law frameworks, such as the EUMR. Similarly, except for unlimited guarantees, the SWD does not discuss presumptively distortive foreign subsidies under Article 5(1) FSR.

Nonetheless, the SWD offers some helpful clarifications regarding the assessment of distortions of the internal market. In a corporate group context, for example, the explanation that foreign subsidies granted to non-EU sister companies will likely be found distortive only if the Commission can show that the group uses those subsidies to cross-subsidize its EU subsidiaries’ activities will help sharpen FSR notifications. Similarly, the SWD’s breakdown of its approach to distortions in the concentration context between

distortions to the acquisition process itself and distortions caused by pre-concentration foreign subsidies that "materialize" after the concentration will sharpen notifying parties' arguments. This distinction, however, may raise more questions than it addresses. How must the Commission show a causal link between a pre-concentration subsidy and post-concentration distortions (except in the rare example of an unlimited guarantee that extends to the merged entity)? Conversely, the analysis of distortions in the public procurement context is limited to foreign subsidies' effect on the relevant tender, not their indirect effects on the internal market.

In sum, the SWD is a welcome addition to the Commission's FSR guidance. But it leaves many questions unanswered and raises some new questions to be addressed through the Commission's enforcement practice in the coming months and years.