

WHITE & CASE

The EC sheds light on the key concept of distortion under the EU Foreign Subsidies Regulation

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The European Commission (EC) has issued preliminary clarifications concerning the distortion test under the new Foreign Subsidies Regulation (FSR). These preliminary clarifications come only a year after the FSR came into force, and amidst calls from practitioners and businesses to shed more light upon the FSR substantive test. This guidance is a precursor to the EC's Guidelines on distortion and the balancing test due in mid-January 2026. The preliminary clarifications are in the form of a [Staff Working Document](#) (FSR SWD) published on 26 July 2024 and are of a non-binding nature. Below, we summarise the key highlights of the FSR SWD.

The distortion test is different for M&A deals and public tenders

The most important clarification of the FSR SWD is that the distortion test applied in the FSR review process is different for M&A deals than it is for public tenders in EU Member States. In summary:

I. **Distortion test for M&A deals.** The FSR SWD emphasises that the purpose of the FSR review of certain M&A transactions is to assess if non-EU subsidies could distort the EU market. An actual or potential distortion caused by non-EU subsidies is assessed in relation to:

(i) the **acquisition process** (e.g., a non-EU subsidy in the form of a direct grant, an unlimited State guarantee, or a loan below market terms to the Buyer to facilitate the acquisition process as a result of which the Buyer can outbid or discourage other potential bidders for the Target); and

(ii) the **post-acquisition process**, i.e., whether the non-EU subsidies of the Buyer can have an impact on the competitive position of the merged entity.

II. **Distortion test for public tenders in EU Member States.** The distortion test is limited to the public tender itself. The EC assesses:

(i) if the tender of the economic operator is unduly advantageous. This will be determined by benchmarking the suspected tender to the other bids submitted and the contracting authority's own estimate, and also by taking into account whether it can be justified by factors other than a subsidy; and

(ii) if there is a link between the grant of the non-EU subsidy and the tender itself, demonstrating a caused or risked distortion by enabling the bidding entity to submit an unduly advantageous tender.

No presumption of distortion, but for the "likely distortive" subsidies

The FSR SWD notes that there is no presumption that a non-EU subsidy will distort the EU market, except for the "likely distortive" subsidies under Article 5 of the FSR. In general, the FSR SWD (as well as the FSR) provides for two conditions to be met for a subsidy to distort the EU market.

First, there needs to be an EU nexus between the non-EU subsidy and the economic activity of the beneficiary in the EU. This comes as no surprise, as it is based on the wording of the FSR itself. The FSR SWD further clarifies that the EU nexus should not be an obstacle for the EC to investigate possible cross-subsidization of companies active in the EU through the entities belonging to the same group, which are not active in the EU. In the decision to open an in-depth investigation in relation to the solar public tenders (Cases FSP.100151; FSP.100154), the EC assessed that subsidies to the parent may benefit the bidder via intra-group financing.

Second, the EC will assess whether the non-EU subsidy improves the competitive position of the beneficiary, as a result of which it could actually or potentially affect competition in the EU market. In this context, the EC will assess on a case-by-case basis the subsidies that do not fall under the "likely distortive category" of Article 5, following the non-exhaustive indicators listed under Article 4.

The "likely distortive" subsidies falling under Article 5 of the FSR, however, are presumed to be distortive to the EU market. This presumption applies provided that they have a link to the EU and could have a negative effect on competition in the internal market. For these subsidies, the EC would not require a detailed assessment. The burden of proof to show no distortion from these subsidies is on the businesses.

The FSR SWD dedicates special attention to unlimited non-EU State guarantees as a form of "likely distortive" subsidies. This comes as no surprise, as the first FSR opening of an in-depth investigation for an M&A deal (Case FS.100011) concerns an alleged unlimited State guarantee in the form of a bankruptcy law exemption. The FSR SWD thus clarifies that unlimited guarantees "can take many forms and may go beyond an explicit statement or legal act referring to the undertaking concerned", including an exemption from standard bankruptcy laws and indications that the "State might intervene in the case of illiquidity".

Little guidance on the balancing test

Upon determining distortion caused by non-EU subsidies, the EC is bound to do the so-called balancing test to see if the distortion can be outweighed with positive effects (e.g., environmental protection, social standards, or the promotion of R&D). However, the EC has not yet gathered experience in the application of the balancing test. That said, the FSR SWD notes that the negative effects of the "likely distortive" subsidies is "less likely" to be outweighed by positive effects.