Kluwer Competition Law Blog

Calling it in: EU Commission Launches First in-depth Investigation of M&A Deal under Foreign Subsidies Regulation

Anne-Kathrin Lauer, Florian von Schreitter (Hogan Lovells) · Tuesday, June 18th, 2024

It was only a matter of time before the European Commission ("**EC**") launched its first ever in-depth investigation of an M&A transaction under the Foreign Subsidies Regulation ("**FSR**"). On 10 June 2024, that time came: The EC referred the acquisition of the Czech telecom operator PPF Telecom Group B.V. ("**PPF**") by the Emirates Telecommunications Group Company PJSC (also known as "**e&**") to "Phase 2" of the FSR investigation (see EC press release).

The buyer, e&, is a state-controlled telecommunications operator based in the United Arab Emirates ("**UAE**") and provides telecommunications services such as mobile phone service. The EC suspects that e& has received distortive subsidies in the form of an unlimited guarantee from the UAE and a loan from UAE-controlled banks directly facilitating the transaction. Should the EC's concerns be confirmed, the EC could prohibit the transaction or approve it only under certain conditions, such as the repayment of the subsidies.

The FSR – starting strong

The opening of a Phase 2 investigation into the e&/PPF deal is the latest in a series of recent actions taken by the EC which demonstrate that the FSR is not to be taken lightly.

The FSR, which fully entered into force in October 2023, enables the EC to investigate and, where necessary, take action against distortions of competition caused by foreign (i.e. non-EU) subsidies. To this end, the FSR provides the EC with three new regulatory tools: (1) a notification requirement for certain M&A transactions which is separate from the existing merger control and foreign direct investment (FDI) screening regimes, (2) a notification requirement for bidders seeking to participate in large public procurement procedures in the EU, and (3) an ex-officio tool giving the EC wide-ranging powers to investigate suspicious market conduct on its own initiative.

In the few months that the FSR has been in force, the EC has already launched three Phase 2 investigations into public procurement procedures and two ex-officio investigations. While the public procurement investigations (which related to tenders for a photovoltaic park and a tender for trains) were closed after the bidders withdrew (see EC press release), the ex-officio investigations (which concern wind turbines and security equipment) are still ongoing. The acquisition of PPF by e& is now the first M&A deal to be referred to a Phase 2 investigation under the FSR, underlining

once again that the EC takes the enforcement of the FSR seriously.

No "lex China"

Unlike the previous Phase 2 investigations into public procurement procedures and the ongoing ex-officio investigations, this case does not involve Chinese companies or Chinese subsidies. Instead, this time the spotlight is on the UAE – drawing attention to the political dimension of the FSR. The question arises whether there is a link with the strong complaints that the previous investigations have triggered on the part of China, such as those repeatedly voiced by the Chinese Chamber of Commerce to the EU.

It is doubtful that these concerns have actually swayed the Commission and influenced its enforcement priorities. But regardless of whether political motives are involved, it is now clearer than ever that companies are not immune from in-depth FSR investigations, even if they have no ties, financial or otherwise, to the Chinese government. Rather, all companies with war chests full of foreign monies, including companies domiciled in the EU, will have to pass FSR scrutiny once they meet the FSR filing thresholds (or find themselves in the crosshairs of an ex officio investigation). That said, it does stand to reason that future enforcement practice will continue to zero in on subsidies received from China and the EMEA region, where targeted industrial policies and economic expansion are fuelled by substantial public spending, including on national champions and sovereign wealth funds.

(Finally) more clarity on the substantive test?

While the launch of Phase 2 is likely to hit e& and PPF hard, practitioners have almost longed for the first in-depth FSR investigation into an M&A deal. Why? Because it offers the chance to finally shed some light on an assessment that is still shrouded in mystery.

Since the beginning of the legislative process, there has been criticism that there is little clarity on the substantive analysis under the FSR and that the criteria for when a subsidy distorts competition are blurry. Guidelines, originally announced by the EC for 2024, are nowhere in sight. While Article 46 of the FSR requires the EC to publish guidelines on the substantive analysis by 12 January 2026, this leaves many deal makers in limbo with regard to their legal risk analysis – especially as the number of M&A transactions notified to the EC is drastically higher than originally anticipated. Between October 2023 and the first week of June this year, some 95 cases have undergone pre-notification discussions; the EC's initial caseload projection was 30 cases – per year.

Depending on the nature of financial contributions received from third countries, it can be very challenging at this point to accurately assess the FSR risks for a particular transaction, both in terms of timing and overall deal certainty. The current investigation of the e&/PPF deal therefore gives reason to hope that the EC's decision, once published, will provide more insight into the substantive analysis – perhaps to the point of explicit criteria or even an analysis grid. It will also mark the first time that the EC has to demonstrate its ability to predict and assess the effects of foreign subsidies on competition.

Of course, a decision will only be issued if the current investigation does not drive e& and PPF to abandon the deal. The fact that an in-depth FSR investigation can cause companies to abandon their commercial plans has already been demonstrated in the three public procurement cases, each of which was closed after the bidders withdrew because of FSR scrutiny.

Unless the deadline is extended, the EC has until 15 October to issue a decision on this case – and it may be even longer before any meaningful details emerge.

Two market dimensions

Looking at what is known at this point about the EC's substantive concerns, a couple of things already stand out.

The first one relates to the markets under investigation. As anticipated by most practitioners, the EC has announced that it will assess potential negative effects both on the acquisition process *and* on the market in which the merged entity will operate post-closing.

The M&A market

As regards the acquisition process, the EC will assess whether the foreign subsidies altered the outcome of that process by allowing e& to deter or outbid other potential buyers and/or by allowing e& to acquire PPF in the first place.

According to press reports there is no indication that the deal was initiated through a M&A auction. If there had been an auction process, this could have enabled the EC to compare the bids and determine whether e&'s offer was on market terms. In this case, however, the EC will likely need to investigate whether the fact that a UAE-backed buyer was involved discouraged other potential buyers from making an offer in the first place – a determination the EC may wish to make by asking other market players directly.

It is also likely that e& will be asked to demonstrate whether it would have pursued the acquisition had it not been for the subsidies in question, i.e. the unlimited guarantee from the UAE and the loan from UAE-owned banks. e& may therefore try to argue that it could have secured similar loans from other banks that are not state-owned. With regard to the unlimited guarantee, the position may be even more challenging, as e& will likely have to show that this subsidy was not a determining factor in the commercial decision to pursue the acquisition.

The sales market

With regard to the market in which the merged entity will operate post-closing, the EC will have to make a prediction of the market conditions. In principle, this approach is familiar, as this type of assessment is broadly what "classic" merger control entails, too. However, the difficulty here will be to demonstrate the link between the subsidies and the distortion of competition. According to Article 4(1) FSR, an illegal distortion in the internal market "*shall be deemed to exist where a*

foreign subsidy is liable to improve the competitive position of an undertaking […] and where, in doing so, that foreign subsidy actually or potentially negatively affects competition". In M&A scenarios, this assessment is limited to the specific concentration concerned and to the subsidies granted in the three years before the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest (Article 19 FSR). In other words, the EC will need to take a stand on the conditions under which a subsidy received *in the past* can lead to a distortive advantage for the (merged) company on its sales markets *in the future*.

In its press release, the EC refers to concerns that the "*subsidies may have improved […] the competitive position of the merged entity in the EU going forward, notably by improving its capacity to finance its EU activities at preferential terms.*" This could point to a theory of harm in which UAE subsidies are used to finance price reductions or a high rate of investment – thereby driving competitors out of the market. Here, the 'balancing test' under Article 6 FSR might come into play, as the parties may decide to bring up customer benefits in the countries where PPF is active (Czech Republic, Bulgaria, Hungary, Serbia and Slovakia). For example, they could try to argue that the transaction will enable much needed investments in telecommunications networks that competitors cannot afford. However, e& would probably also have to substantiate its incentive to finance these investments and how it will ensure that sufficient competition remains.

These considerations could then also be the gateway to a discussion about commitments. Article 7 FSR provides a colourful bouquet of possible remedies that could serve as inspiration for e&. If so, this case could provide insight not only into the general substantive test, but also into the EC's thinking on when a commitment can remedy concerns under the FSR.

Focus on the Article 5 catalogue

Another aspect that stands out is that the investigation into the e&/PPF deal appears to focus on subsidies that fall under Article 5 FSR, i.e. the (rather short) catalogue of subsidies most likely to distort competition. As described, the EC's concerns relate to an unlimited guarantee (Article 5 (1) b FSR) and a loan directly facilitating the transaction (Article 5 (1) d FSR).

The fact that the investigation so far focuses on Article 5 FSR could be interpreted as an indication that these types of subsidies will also be at the centre of future Phase 2 cases under the FSR. On the other hand, Article 5 is not an exhaustive list and the EC is in principle free to include other forms of subsidies in its theory of harm. At this stage, it seems somewhat premature to draw clear conclusions regarding the EC' approach to subsidies that fall outside the scope of Article 5 FSR. This is yet another area where more guidance is needed from the EC.

In any case, and not by surprise, the present investigation confirms that companies which have received Article 5 subsidies must be prepared for a demanding FSR process. In assessing the FSR risks of a transaction, companies should therefore investigate very carefully and at an early stage whether they – or their transaction partner – have received Article 5 subsidies.

Timing implications

The present investigation also confirms the concerns of many practitioners that the FSR process

could throw a transaction off schedule. According to the parties' press release, the deal was already signed in August 2023. However, it was not notified until April 2024, suggesting that the parties went through intensive pre-notification discussions. It has also been reported that the parties have already been able to secure a number of other regulatory clearances around the world, with the FSR decision apparently being the last hurdle to be cleared.

This highlights once again the importance of addressing FSR risks in the transaction agreements. For example, this concerns the long stop date, the purchase price formula (e.g., to which date the price should be linked in view of a potentially lengthy FSR review), representations/warranties (e.g., for the completeness and accuracy of information on subsidies received) as well as the overall deal timetable and "filing choreography" with international regulators. With respect to the latter, it is worth pointing out that that, while the FSR has modelled its review process based on EU merger control (including for the statutory timelines), both the individual officials involved as well as the substantive test and pertinent factual questions are *not* the same – meaning that dealmakers can only do so much to keep the review processes in sync.

Conclusions for M&A practice

It remains to be seen whether the EC will issue (and publish) a final decision on the case or whether e& – despite having spent about a year on it – will withdraw from the deal in view of the FSR scrutiny. Should the EC issue a decision, it will hopefully provide more clarity on the substantive test, in particular with regard to possible theories of harm and the required link between a subsidy and the competitive advantage in the sales market.

Given the uncertainties surrounding the substantive test, the FSR continues to pose significant challenges for the M&A practice, both in terms of timing and risk allocation in the transaction agreements. Practitioners around the globe will therefore eagerly await the conclusion of this case and keep their fingers crossed that the parties carry on. Only then will the EC's obligation to publish its final decision be triggered (Article 40(2) FSR).

In the meantime, and regardless of the intricacies of the substantive test, the case is also a reminder of a home truth: that despite all the uncertainties, companies must at all times endeavour to have a clear picture of the foreign financial contributions they have received – both within their own group and, in a transaction context, also on the side of the other party or parties involved. The case at hand underlines that the FSR is in full force and that managing its legal risks hinges on the tracking of foreign financial contributions internally in a structured manner.

This requires new and complex reporting processes but is essential for the assessment of whether a FSR notification is required, as well as for the notification as such – particularly in terms of identifying potential challenges in the review early on. As has been widely discussed, this exercise is not limited to potentially problematic subsidies, but rather to the broadly defined term 'financial contributions'. Tracking and documenting this information is a large and ongoing task, but also a necessary step in assessing and, where necessary, mitigating FSR-related risks. Preparation is key. And while it is certainly a coincidence, it is very appropriate that this case is being set in the telecoms sector. It may well be the final wake-up call: The FSR is here to stay – and it is looming large.

To make sure you do not miss out on regular updates from the Kluwer Competition Law Blog, please subscribe here.

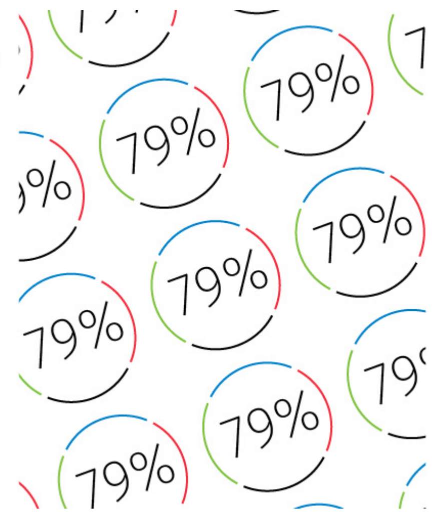
Kluwer Competition Law

The **2022 Future Ready Lawyer survey** showed that 79% of lawyers are coping with increased volume & complexity of information. Kluwer Competition Law enables you to make more informed decisions, more quickly from every preferred location. Are you, as a competition lawyer, ready for the future?

Learn how **Kluwer Competition Law** can support you.

79% of the lawyers experience significant impact on their work as they are coping with increased volume & complexity of information.

Discover how Kluwer Competition Law can help you.
Speed, Accuracy & Superior advice all in one.



2022 SURVEY REPORT
The Wolters Kluwer Future Ready Lawyer
Leading change

This entry was posted on Tuesday, June 18th, 2024 at 9:00 am and is filed under European Commission, Foreign subsidies, Foreign Subsidy Regulation
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.