

AN OVERVIEW OF THE STATE AIDS REGIME

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This paper gives a general account of the rationale and principal features of the Community rules in respect of State aid. The more detailed issues arising in respect of taxation are addressed in the papers of Christopher Vajda QC and James Flynn that follow in this issue.²

The Rationale of the State Aids Regime As Part of the Community Rules on Free Competition

One of the fundamental principles underlying the EC Treaty is that of fair and undistorted competition within the Community: Article 3(g). There are five principal tools used to achieve that end: the prohibitions on (i) collusive and (ii) abusive conduct contained in Arts. 81 and 82 of the EC Treaty, aimed at preventing undertakings from inhibiting the competitive process; (iii) the rules developed from Article 86 (ex 90) extending the application of the EC Treaty, and in particular the competition rules, to national measures in respect of undertakings performing a public function; (iv) the "Merger Control Regulation", Regulation (EEC) No. 4064/89, which has enabled the Commission to regulate major structural changes that threaten to create or strengthen a "dominant position" within the Community; and (v) the rules on State aid. In combination, those rules provide for a flexible and comprehensive set of regulatory tools, subject only to the requirements that the

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² There is a large case law on the State aid rules and there are also numerous legislative instruments and administrative publications: the latter are listed on the Commission Competition Directorate, DGIV, web-site at: http://europa.eu.int/comm/competition/state_aid/legislation. Leading specialist texts providing detailed accounts of the State aid rules include Bellamy and Child, *Common Market Law of Competition*, Sweet & Maxwell, 5th edn., 2001; and *Competition Law*, Butterworths, looseleaf.

conduct in question falls within the scope of Community law, normally because of its actual or potential effect on trade between the Member States.

The State aid rules contained in Arts. 87 to 89 of the EC Treaty are to be viewed against this overall competition policy background, but must also be seen against the even broader and more fundamental principles of equal treatment and subsidiarity, embodied in Arts. 5, 12 and 13 of the Treaty. The structure of the State aid regime, as it has been developed by the administrative practice of the EC Commission and the Community courts, reflects both principles. At one extreme, it is obvious that a cash injection into a single company, if sufficiently large to fall within the scope of Community law at all, will potentially infringe the Community prohibition on State aid. At the other extreme, a low corporate tax burden, imposed by a Member State on all businesses operating within its jurisdiction, will not be caught by the State aid rules, despite its obviously much greater distorting effect on competitive conditions within the Community.

The rationale for this approach derives from the fact that the latter case is, in the relevant sense, non-discriminatory, because it applies equally to all undertakings operating within the relevant national borders. It also reflects the political reality, embodied in the principle of subsidiarity, that national decisions on taxation continue to be permitted under Community law, so that the correct unit of analysis from the perspective of Community law is the national rather than the Community legal and political order.

The conceptually interesting questions arise where national assistance (including its corporate tax policy) is *not* uniform in its application or operation, so that individual undertakings, groups of undertakings or industrial sectors, or particular geographical regions, are treated differently. In those circumstances, the principles of equal treatment and free competition pull in one direction, whereas the principle of subsidiarity pulls in the other. Resolution of this conflict requires more detailed consideration of the nature of a State aid under Community law (in particular whether tax advantages come within the potential scope of the Community rules). In substance, Arts. 87 to 89 embody a stringent regime of justification for discriminatory aid measures that fall within the scope of Community law by having an effect on trade between the Member States. The grounds of justification are specified in Arts. 87(2) and (3). The Commission has published guidelines to deal with many of the specific issues that arise.

The further introductory remark that should be made here is that the Community rules have two aspects, one substantive and one procedural. The State aid rules confer exceptionally wide powers on the EC Commission (only the rules under Article 86 – ex 90 – are comparable in their scope). The Commission, an administrative body, is empowered by these provisions to interfere with the political

choices of the national administrations in the management of their individual national economies. This is clearly a highly sensitive issue and has frequently raised concerns as to non-disclosure or lack of transparency (whether deliberate or inadvertent) between the Member States and the beneficiaries of State aid, particularly where aid is given to public undertakings.

The EC Treaty, and principles and rules made under the Treaty, have therefore adopted a stringent approach not only to the interpretation of the substantive rules but also to the procedural obligations imposed on the Member States by the Treaty (and specific rules have been introduced in respect of financial transparency).³ State aids can be rendered unlawful not only because they are ruled by the Community institutions to be incompatible with Community law as a matter of substance but also because they have been granted without proper scrutiny by the Commission in accordance with the Community rules.

The Community Provisions – Articles 87 to 89

Articles 87 to 89 of the EC Treaty form a comprehensive code in respect of the grant of State aids by Member States. Article 87(1) contains a basic prohibition on the grant of State aids:

“Save as otherwise provided in this Treaty, any aid granted by a Member State through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.”

However, Arts. 87(2) and 87(3) provide a derogation to the prohibition and allow certain aids that are deemed by the Treaty itself or considered by the EC Commission to be beneficial, for example to encourage investment in less developed regions, industry, research and development:

- Article 87(2) provides that certain types of state aids *shall* be compatible with the common market. Aids falling into one of these categories should still be notified to the Commission but the Commission has no discretion to refuse the grant of that aid provided that the relevant condition is satisfied.

³ See Commission Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings, 1980 OJ L195/35.

- Article 87(3) sets out a number of categories of aid that *may* be compatible with the common market. The Commission enjoys a wide discretion here, not only to determine whether the relevant criterion is satisfied but also, even where the provision applies, to decide whether in the exercise of its discretion the aid should be allowed.

Article 88(1) requires the Commission to monitor existing aids and to propose “appropriate measures required by the progressive development or by the functioning of the common market”. Article 88(2) introduces a three-stage procedure for decision-making by the Commission and Council: (i) to take decisions requiring the Member States to abolish or alter aid or aid schemes (ii) to refer cases of non-compliance to the Court of Justice of the European Communities and (iii) for the Council to grant a derogation on the application of a Member State.

Article 88(3) requires Member States to notify the Commission of the granting of new state aids, whether individual or in the form of schemes, or alterations to existing aids or aid schemes. This obligation to notify extends to all aids satisfying the criteria in Article 87(1), even if a Member State considers that the relevant measure falls outside Article 87(1) or that the aid is fully compatible with the common market. The last sentence of Article 88(3) is of particular importance, providing that “The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision”. This provision is directly enforceable in the national courts and can therefore lead to an obligation on the part of a Member State to recover aid even without a decision of the Commission finding the aid to be “incompatible with the common market” (though the national court must of course satisfy itself that the measure falls within the terms of Article 87(1) and that the procedural requirements of Article 88(3) have not been satisfied).⁴

The Concept of “Aid”

Article 87(1) applies to “any aid granted by a Member State or through State resources in any form”. The essence of an aid granted “by a State or through State resources” is that it is an advantage that places a burden on the public finances in the form of either expenditure or reduced revenue. The measure therefore entails some form of transfer, positive or negative, from the State to the recipient of the aid. The mere conferring of a commercial advantage by national legislation does not suffice if there is no such transfer: Case C-379/98 *PreussenElektra AG*, judgment of 13th

⁴ For details of this issue, see the Commission’s “Notice on cooperation between national courts and the Commission in the State aid field”, OJ 1995 C312/7.

March 2001, para. 58; Case 82/77 *Van Tiggele* [1978] ECR 25, paras. 24-5.

The EC Treaty does not provide a definition of “aid” but the words “any” and “in any form” have been taken literally and a very broad category of measures has been found to be caught by the concept of aid. As noted above, the procedural obligations in Article 88(3) apply not only to individual grants of aid but also to aid schemes and modifications of such schemes. In summary, “aid” is a broader concept than “subsidy” “because it embraces not only positive benefits ... but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which without their being subsidies in the strict sense of the word, are similar in character and have the same effect”: Case 30/59 *Limburg* [1961] ECR 1. The concept is to be applied not by reference to the cause or aim of a State measure but in relation to its effect: Case 173/73 *Italy v EC Commission* [1974] ECR 709, [1974] 2 CMLR 593. A benefit conferred on an undertaking without that undertaking giving anything in return amounts to an aid: Case 61/79 *Amministrazione delle Finanze dello Stato v Denkavit Italiana* [1980] ECR 1205.

In determining whether or not an advantage conferred on an undertaking is to be regarded as an “aid”, particularly but not only in cases of capital injections from State funds, it is frequently necessary to assess whether the relevant financial advantage has been granted by the State on realistic commercial terms. In assessing this question, the Commission will assess whether or not a “market investor”, i.e. a private sector operator, would have considered that the investment in question, and in particular the rate of commercial return, was commercially justified in all the prevailing circumstances: e.g. Case T-613/97 *Ufex v Commission*, judgment of 14th December 2000, paras. 68ff. Where it can be shown that the State is acting because the commercial sector would not intervene then there exists a presumption that an aid is being granted: *Intermills v EC Commission* Case 323/82 [1984] ECR 3809.

Although the factual context against which aid cases are assessed is frequently complex, no distinction is drawn in principle between positive or negative, or contingent and actual, benefits, all of which may confer a commercial advantage at the State’s expense and can therefore fall within the scope of the concept of “aid”. In particular, State guarantees will constitute aid whether or not the guarantees are called upon since the provision of a guarantee itself confers a commercial benefit by removing the element of risk that the undertaking would otherwise have to finance or insure against, transferring it to the State.⁵

⁵ The Commission has recently published a Notice on the application of Arts. 87 and 88 to State aid in the form of guarantees: 2000 OJ C71/7.

The Commission has published a specific notice on the application of the state aids rules to measures relating to direct business taxation.⁶ This notice aims to clarify when a tax measure is to be regarded as a State aid under Article 87(1). Tax measures likely to constitute a State aid will be where an advantage is conferred upon a specific beneficiary or category of beneficiaries of a tax rule. This may be provided in various ways through a reduction in a firm's tax burden, including a reduction in the tax base; a total or partial reduction in the amount of tax; deferment, cancellation or even special rescheduling of tax debt. Tax measures unlikely to constitute State aid include tax measures of a purely technical nature and measures pursuing general economic policy objectives through a reduction of the tax burden related to certain production costs, such as research and development.⁷

Discriminatory Effects

Article 87(1) requires that the aid's distorting effects on competition arise "by favouring certain undertakings or the production of certain goods". This requirement embodies the rationale described above that there should be an element of discrimination in the measures at issue, either in respect of specific undertakings or in respect of an industrial sector or region. Conversely, general measures of economic policy such as general tax reductions, currency devaluation or interest rate reductions, although they clearly benefit undertakings operating in the country concerned, are not considered to be State aids.

For example, in Case 173/73 *Italy v EC Commission* [1974] ECR 709, the Italian government introduced a law that had the effect of temporarily reducing social security contributions in respect of family allowances payable by employers in the textile industry. The Commission found that this measure, applying only to the textile industry and for a temporary period, constituted State aid. The Italian government had argued that the measure was aimed at restructuring the general system of social contributions in Italy. The ECJ upheld the Commission, finding that the alleged fiscal or social aim of a particular measure could not shield it from the application of Article 87. In this case the reduction of the rate afforded to employers in the textile industry was a measure intending to exempt those undertakings from the charges arising under the normal application of the social security system and there was no justification for the exemption on the basis of the

⁶ OJ 1998 C384/3.

⁷ See the Articles by James Flynn and Christopher Vajda QC for more details. For recent English cases, see *R v Customs and Excise, ex parte Lunn Poly and Bishopsgate Insurance Ltd* [1999] 1 CMLR 1357; *Professional Contractors Group Ltd. v Commissioners of Inland Revenue* [2001] EWHC Admin. 236, Burton J, 2nd April 2001.

nature or general scheme of the system.

On the other hand, the fact that some firms or sectors benefit in practice more than others does not necessarily mean the measures in question are caught by the State aid rules. For example measures designed to reduce the taxation of labour for all firms will have a relatively greater impact on labour intensive industries than on capital intensive industries, without constituting State aid.

Substantive Assessment of State Aid – Article 87(2) and (3)

As already stated, Article 87(2) identifies classes of aid that are deemed to be automatically compatible with the common market.⁸ They must be notified to the Commission, and are therefore subject to the procedural prohibition contained in Article 88(3), but the Commission's substantive powers are limited to confirming that the relevant derogation applies.

By contrast, under Article 88(3), the relevant conditions are merely necessary conditions for the exercise of the Commission's discretionary power to grant derogation.⁹ The Commission therefore inevitably enjoys a wide discretion, which is confirmed by the Court of Justice's approach to the process of judicial review in areas of complex economic assessment:

“The Commission's examination entails consideration and appreciation of complex economic facts and conditions. Since the Community judicature cannot substitute its own assessment of the facts, especially in the economic field, for that of the originator of such a decision, the Court must confine itself to checking that the rules on procedure and the statement of reasons have been complied with, that the facts

⁸ There are three such categories: non-discriminatory social assistance to individual consumers (Article 87(2)(a)); aid to make good damage from natural disasters or exceptional occurrences (Article 87(2)(b)); and aid to compensate areas adversely affected by the separation of Germany prior to reunification.

⁹ The five categories under Article 87(3) are: aid to promote economic development in areas of low standard of living or high unemployment (Article 87(3)(a)); aid to promote a major European project or to remedy a serious economic disturbance in a Member State (Article 87(3)(b)); aid “to facilitate the development of certain economic activities or of certain economic areas, where such aid does not affect trading conditions to an extent contrary to the common interest” (Article 87(3)(c)); aid “to promote culture and heritage conservation”, subject to the same proviso as (c) (Article 87(3)(d)); and finally “such other categories of aid as may be specified by decision of the Council acting by qualified majority on a proposal of the Commission”. The interpretation and application of these provisions is obviously extremely complex and cannot be dealt with in a short article of this kind.

are materially accurate and that there has been no manifest error of assessment or misuse of powers".¹⁰

However, the Commission's discretion is not unfettered, even in this area. Not only must its reasoning be founded on a credible market and factual analysis and a statement of reasons, but the Commission must be satisfied that the aid in question is "necessary" for the achievement of the relevant objective. In determining that question, the Commission will assess not only the economic, technical and policy issues that arise, but will also require that the proposed aid have a "compensatory justification". That means that the beneficiary of the aid, and therefore the grant of the aid to the relevant beneficiary, must make a contribution, over and above the effects of normal market forces, to the achievement of the Community objectives contained in the derogations of Article 87(3). In effect, there must be some form of causal link between the grant of the aid and the achievement of the relevant policy objective.¹¹

Specific Legislation, Notices and Guidelines

The Commission has adopted specific legislation and/or published sectoral guidelines in respect of a number of industrial sectors where aid is a recurrent feature: synthetic fibres, motor vehicles, shipbuilding, steel, coal, transport (road, rail and inland waterway, sea, maritime transport, aviation), agriculture, fisheries. Likewise, the Commission had adopted specific measures in respect of regional assistance schemes.¹²

Finally, the Commission has also published a number of guidelines on "horizontal" topics, i.e. issues that are not specific to particular economic sectors or to aid that is limited geographically in scope. These topics include a "de minimis" notice,¹³

¹⁰ Case T-288/97 *Regione autonoma Friuli Venezia Giulia*, judgment of 4th April 2001, para. 74, citing Case 730/79 *Philip Morris v Commission* [1980] ECR 2671, paras. 17 and 24, Case C-142/87 *Belgium v Commission "Tubemeuse"* [1990] ECR I-1433, para. 34, Case C-303/88 *Italy v Commission* [1991] ECR I-1433, para. 34, and Case T-149/95 *Ducros v Commission* [1997] ECR II-2031, para. 63.

¹¹ See Case T-188/97 *Agrana Zucker et al. v Commission*, judgment of 7th June 2001, para. 74, citing Case 730/79 *Philip Morris v Commission* [1980] ECR 2671, para. 17.

¹² See in particular the "Guidelines on National Regional Aid" 1998 OJ C74/9. Details of the numerous documents published by the Commission are outside the scope of a general survey of this kind but the Commission web address identified at fn. 2 gives a full list.

¹³ 1996 OJ C68/9.

research and development aid, environmental aid, rescue and restructuring aid, aid to small and medium sized enterprises, aid for employment and for training, and aid for undertakings in deprived urban areas, and a very recent communication on risk capital.¹⁴ Additionally, Council Regulation (EC) No. 994/1998¹⁵ delegated power to the Commission to adopt block exemption regulations for certain categories of State aids. Areas identified by Regulation 994/1998 for the adoption of block exemption regulations in the future are SMEs (small and medium sized enterprises), research and development, environmental protection, employment and training and regional aid. The Commission has very recently adopted Regulations in respect of training, “de minimis” aid, and SMEs.¹⁶

Procedure: Article 88 and Regulation (EC) No. 659/99

In 1999 the Council adopted Regulation (EC) No. 659/99,¹⁷ laying down specific rules on the procedure to be followed in the notification and monitoring of new and existing State aids. Prior to the entry into force of that Regulation, the procedural rules followed by the Commission pursuant to Article 88 were determined largely by the case law of the Court of Justice, in particular Case 120/73 *Lorenz* [1973] ECR 1471. That case law remains important, not only as relevant background for the interpretation of the Regulation but also because many cases actually before or potentially liable to come before the Court of Justice concern measures adopted before the entry into force of the Regulation.¹⁸

The primary obligation imposed on the Member States in respect of proposed aid is to notify all such measures to the Commission in advance of putting them into effect. The Commission considers a Member State to have failed in its obligation to notify where the process of putting aid into effect has been initiated. “Putting into effect” is deemed to be as soon as the legislative machinery has been set up enabling the aid to be granted, and not at the later stage of actually granting the aid itself.

¹⁴ Details of the various guidelines and notices are to be found at the web-page referred to at footnote 2 above.

¹⁵ 1998 OJ L142/1.

¹⁶ 2001 OJ L10/20, 30, 33.

¹⁷ 1999 OJ L83/1.

¹⁸ See, e.g., Case C-99/98 *Austria v Commission*, judgment of 15 February 2001. Paras. 28 to 33 summarize the relevant case law.

Article 4 of Regulation 659/99 provides that, once notified, the proposed aid is subject to a preliminary examination by the Commission and the Regulation sets out the procedure and timetable for this preliminary examination. Within two months of the notification the Commission must reach one of the following decisions:

- the notified measure does not constitute aid; or
- no doubts are raised as to the compatibility of the notified measure which is compatible with the common market; or
- doubts are raised as to compatibility and the Commission must initiate proceedings in accordance with Article 88(2).

If the Commission fails to comply with this timetable, the Member State must notify the Commission of its intention to put the notified scheme into effect, at which point the Commission must take one of the above decisions within 15 days, failing which the Member State is permitted to implement the aid scheme, which is then treated as an existing aid within the terms of Article 88(1).

The second form of decision is known as a “decision not to raise objections”: the Commission specifies which exception under the EC Treaty has been applied; the prohibition contained in Article 88(3) is lifted; and the aid is thereafter subject to monitoring by the Commission as an existing aid.

The third form of decision, known as a “decision to initiate the formal investigation procedure”, leads to a much more detailed examination. The formal investigation procedure requires the Commission to set out a preliminary assessment as to the aid character of the proposed measures and its doubts as to the compatibility with the common market. The Member State concerned and other interested parties may submit their comments to the Commission regarding its preliminary assessment. The Commission will then either authorise or refuse the grant of aid by way of a final decision (normally within 18 months of the opening of the procedure).¹⁹ At the end of the investigation procedure, the Commission will either authorise or refuse aid by way of a formal decision that:

- following modification by the Member State concerned, the notified measure does not constitute aid;

¹⁹

Article 7 governs this procedure, and provides for the possibility of a Member State calling on the Commission to reach a final decision within 2 months after the initial 18 months has expired: Article 7(7).

- following modification by the Member State concerned, doubts as to compatibility have been removed and the aid is compatible, a “positive decision”;
- conditions may be attached to a positive decision, subject to which an aid may be considered compatible, a “conditional decision”; or
- the notified aid is not compatible with the common market, a “negative decision”.

Where a negative decision is reached, the Commission must decide that the aid is not to be put into effect. Where the aid has been illegally granted (that is prior to notification or prior to a decision by the Commission, in breach of Article 87(3)) the Commission is given extensive powers to require the aid to be suspended or recovered.²⁰

Finally, the Commission frequently acts on the basis of complaints from competitors and other interested groups (for example, non-governmental organisations) that aid has been unlawfully granted. Articles 17ff. of Regulation 659/99 sets out a code for such cases, and Article 20 confers limited procedural rights on “interested parties”.²¹

²⁰ Article 1(f) of Regulation 659/99 defines aid granted in breach of Article 99(3) as “unlawful aid”. Arts. 10-15 set out a code to be followed by the Commission and the Member States for the recovery of such aid.

²¹ “Interested parties” are defined as “any Member State and any person, undertaking or association of undertakings whose interests might be affected by the granting of aid, in particular the beneficiary of the aid, competing undertakings and trade associations”. The web address at fn. 2 above includes reference to a Commission Guide to procedures in State aid cases, part VI of which summarises the Commission’s approach by reference to a 1989 notice, 1989 OJ C26/7.