The Coming of Age of EC State Aid Law: A Review of the Principal Developments in 2002 and 2003

Marc Hansen, Anne van Ysendyck, Susanne Zühlke *

A. Introduction

State aid has for a long time been the “poor relative” of European competition law. Much of state aid law enforcement was (and still is) viewed as politically motivated, with unclear standards being applied to situations where national government policies are at stake. Because of this government involvement, many companies have also been reluctant to bring cases as this was viewed as inviting “retribution” from the Member States affected.

Since the mid-1990s, this picture has gradually changed. State aid control is now as significant as classic antitrust enforcement and merger control. Today, the Commission reviews close to a thousand state aid cases each year. Many recipients of state aid have had to submit to lengthy investigations and some have gone bankrupt following recovery of illegal aid. Companies have discovered that a social contribution or tax regime that provided certain benefits fell to be regarded as state aid, and are now reorganising operations as benefits cease. Competitors are also increasingly willing to come forward to complain about market distorting subsidies, in particular as liberalisation has left state aid as the last resort of Member State intervention. Last, and this is of great significance, financial institutions and purchasers of businesses are increasingly aware of the risks inherent in dealing with companies that have received state aid. All of this, together with high profile disputes such as Alstom, France Télécom, British Energy or WestLB, has contributed to an increased awareness of state aid issues.

Also, over the past decade, the enforcement priorities have gradually shifted. While policing loans and capital injections in failed companies remains a priority because such aids are viewed as the “cancer” of state aid, enforcement is increasingly also focused on measures that have an indirect, but substantial, impact on competition. The emphasis on compensation for public services, tax measures, social contributions and “fake” R&D programmes are examples of this policy.

The article is intended to provide an update on the practice of the Commission and EC courts in the areas of state aid law that are of most practical importance to practitioners. While the article does not include a basic overview of the state aid rules, it does, where relevant,

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* Marc Hansen is a partner, Anne van Ysendyck and Susanne Zühlke are associates, in the London and Brussels offices of Latham & Watkins. An earlier version of this article was delivered at the IBC Advanced EC Competition Law Conference in November 2003 in Brussels. It includes relevant material until December 31, 2003. The authors wish to thank Henrik March, European Commission, for comments on previous drafts of this article. All views expressed, as well as errors and omissions are, however, the sole responsibility of the authors. For full disclosure, it is noted that the authors have been involved in the following cases referred to in the paper: Brittany Ferries (n.13 below); P&O v Commission (n.13 below); Bank Burgenland (n.43 below); RJB Mining v Commission (n.2–93 below); Saarbergwerke (n.2–92 below); Addinol (n.87 below); KataLeuna (n.2–1 below). © 2003, Hansen, van Ysendyck & Zühlke. Note: For technical reasons footnotes are numbered 1–n. The article covers developments until January 31, 2004.

1 The article is based in part on articles and books previously published by the authors, including: Hansen, van Ysendyck and Zühlke, Public Services Obligations and EC State Aid Rules, Global Counsel 2002; van Ysendyck in Schröter/Jakob/Mederer, Kommentar zum Europäischen Wettbewerbsrecht; Hansen, van Ysendyck and Zühlke, Altmark Trans: European Court of Justice Outlines Conditions for Public Services Compensation, PLC Competition Law Service; van Ysendyck and Zühlke, RIW Kommentar zu Altmark, RIW 2003, 717; Zühlke, Durchgriffshaftung im Europäischen Beschleunigung, EWS 2003, 61 (concerning the state aid liability of buyers of assets); Hansen a.o.; Attacke Tax Distortions, Global Counsel, April 2000; Hansen a.o., European State Aid Control as a Business Tool, The European Antitrust Review (1999).

2 As background, it is recalled that there are five elements to finding state aid: European Court practice defines state aid in the sense of Art. 87(1) EC as: (i) a measure that confers a benefit or advantage, (ii) which is granted by or under instruction of the state and involves state resources, (iii) which favours certain undertakings (often referred to as “selectivity” or “specificity”), (iv) which distorts or threatens to distort competition, and (v) which affects trade between the Member States. Aid must be notified to the Commission before it is granted (the “stand-still” obligation) and the Commission has exclusive competence to find compatibility of aid measures. The Commission applies Arts 87 and 88 through a variety of guidelines, framework programmes, and “block exemptions”.

give sufficient background as to the applicable procedural and substantive rules so as to allow also the uninitiated reader to benefit from the overview.

The article reviews the principal developments since January 2002 in six selected areas. Obviously, not all developments can be reviewed and the choice of the most important developments necessarily involves a subjective element. The following areas are reviewed:

- the private investor test or: when is government action not state aid?
- rescue and restructuring aid
- state aid and compensation for public services
- taxation measures
- issues relating to EU enlargement in 2004
- procedural issues

Last, in the conclusion we examine the outlook for the future of the EU state aid regime, and in particular the recent announcements of Commissioner Monti in regard to future enforcement priorities and a new approach currently under development. The latter should facilitate the approval of certain categories of aid measures considered as having only a limited distortive effect (i) because of their limited amount (LASA — limited amount of state aid) or (ii) because of the sector involved which is characterised by limited trade between Member States (LET — limited effect on trade).

B. The Private Investor Test

The private investor test applies to any state measure that provides a benefit to a (private or public) company. The test is applied to all types of state measures, including government capital injections, loans granted by the state, sales of government assets and privatisations, the grant of state guarantees for obligations of enterprises, and waivers of debt by the state.

The private investor test is an “arm’s length” test and is the basic economic tool for determining whether a state measure is to be considered as a “market” investment, or whether such measure involves the grant of state aid that has the potential to distort competition. The test follows from the principle of equal treatment of public and private property ownership contained in Art.295 EC: Member States are permitted to invest and take part in commercial operations in a competitive market, provided that they seek to earn a “normal” market return.

The test is often criticised as inadequate or as impracticable. This is due to the major inherent limitation in the test: The state is different from any hypothetical private investor. It has theoretically almost unlimited resources and thus a better credit rating than most private investors. The profitability analysis of a state is thus necessarily based on different parameters. Similarly, in particular when dealing with the very largest government investments in industry, there is often no private investor that could have taken the place of the government. The comparison of the state to a private investor therefore remains theoretical.

The private investor test is a centre-piece of EC state aid law in so far as, without this test, the stand-still

3 There are a number of other recent developments that are each of interest, but cannot be covered in within the scope of this paper. In terms of practical impact, the most important of such developments are: (i) the adoption of, and first practical experiences with block exemption regulations; (ii) the coming changes to the regional aid maps in 2006; (iii) the replacement of sectoral rules by the Multisectoral Framework for Large Investment Projects; and (iv) the expiration of the ECSC Treaty on July 23, 2002 including transitional rules regarding application of the EC Treaty rules to the coal and steel sectors, in particular the phasing out of the sui generis restructuring aid rules.

4 Also referred to as the market economy investor test or the informed private investor test.

5 This includes measures from central, regional or local government, financial institutions or other national, regional or industrial agencies funded from state resources or over which central, regional or local governments exercise a dominant influence.

6 The private investor test does not, by its very nature, apply but owned indirectly by the state (e.g. a capital injection or a write-off of a loan by a state owned company) can also be state aid, if that measure can be imputed to the state, e.g. the state owned company acted under instructions of a public authority; see Case C-482/99 France v Commission (Starlight Marine) [2002] E.C.R. I-4397, at paras [52]–[57].
obligation of Art.88(3) EC would apply to all commercial activities by the state.8 This would affect a wide variety of measures, ranging from purchases or sales of land or assets, to contracts for services. This could partially paralyse the Member State’s economies.

Some of the issues concerning the application of the private investor test were recently the subject of judgments by the European Courts9 or decisions of the Commission.10 These cases show that the private investor test applies in a variety of situations:

- the decision and judgment in WestLB finding that the contribution of certain assets to WestLB by the government majority shareholder contained state aid in so far as the contribution was not remunerated at the average rate of return in the German banking industry.11
- This judgment will have an impact not only on a number of public German banks already hard-hit by the impending withdrawal of public guarantees,12 but also generally on asset contributions by public majority shareholders;
- investigations into business strategies and financing models of ferry operator Brittany Ferries (under appeal), Deutsche Post (under appeal) and Ryanair (pending)13;
- various pending cases, where the Commission has considered state measures to be rescue and restructuring aid rather than the commercial or portfolio investments they were claimed to be, including in France Télécom14;
- A “private investor benchmark” is also being developed to deal with the issue of whether compensation for public service obligations contains state aid.15 The Court in Altmark suggests that public service funding (outside of a public tender) only escapes state aid control where the costs that are being compensated do not exceed those of a company that is “typical, well run and equipped [to perform] the service”. The Court thus considers that a public service provider should be measured against other (private) operators, much in the same way public investments are judged with the private investor test.16

This section (i) describes the main criteria for applying the private investor test; (ii) examines recent cases applying the test, and (iii) highlights some of the policy concerns for the future.

1. The Private Investor Test—The Principal Criteria for Assessment

Originally, the private investor test was developed in the 1980s for the assessment of public authorities’ holdings in the light of EU state aid law.17 The concept was developed further in 1993 in a Commission communication relating to the application of state aid law to public companies in the manufacturing sector.18 It has since been applied in a substantial number of cases.

The private investor test compares the conditions at which state funding is made available to a company to the conditions that would have been acceptable to a

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8 Art.88(3) EC provides that the Member State cannot grant aid before it has been notified to and authorised by the Commission. See also Art.5 of Council Reg.659/1999 laying down detailed rules for the application of Art.93 of the EC Treaty, [1999] O.J. L83/1 (“Procedural Regulation”).
11 Joined Cases T–228/99 and T–233/99 WestLB et al. v Commission (WestLB) judgment of March 6, 2003 (not yet reported). This judgment annuls Commission Decision of July 8, 1999, [2000] O.J. L150/1; See also Case C–209/00 Commission v Germany judgment of December 12, 2002 (not yet reported), relating to infringement proceedings against Germany for failure to implement.
comparable private investor operating under market conditions at the same time and in comparable circumstances. A state measure does not contain aid in the sense of Art. 87(1) EC if it meets this test. If, however, a private (hypothetical) reference investor would not have taken such a decision, then the measure contains state aid. The aid can be the full value of the benefit, or a portion thereof where a private investor would have made the same decision but on different, economically less favorable conditions for the beneficiary (for example at a higher interest rate for a loan, requiring a premium for a guarantee, a dividend payment for an increase in the state equity position or a higher sales price in the case of a privatisation or sale of land or assets).

Which hypothetical private investor serves as the benchmark?

It is clear that private investors react differently to risk, depending on their own legal and economic circumstances and the type and context of the investment.

The European Court of Justice (“ECJ”) has for instance recognised that there is a distinction between long and short-term investments. While short-term investments are expected to focus on the immediate price in the case of a privatisation or sale of land or assets, long-term investments are expected to focus on the immediate increase in the state equity position or a higher sales price at a higher interest rate for a loan, requiring a premium for a guarantee, a dividend payment for an increase in the state equity position or a higher sales price in the case of a privatisation or sale of land or assets.

The Commission also accepts that minority holdings involve different commercial considerations from those present where an investor is a majority shareholder. The Commission further recognises that a distinction can be drawn between new investments and increases in existing investments since a private investor may more easily accept a temporarily lower return on investment when increasing (or maintaining) an existing investment, in particular where the later investment is intended to preserve the earlier investment (also called the “owner-effect”). In certain instances a group of companies benefiting from aid may be viewed as a “single economic unit”, and the reference investor may be inside or outside the group.

When private investors invest at the same time (concomitance) and under the same conditions (pari passu) as the state, the Commission is generally willing to accept that the state has invested on market terms.

This alone, however, may not be enough to prove that market terms prevailed. The Commission takes account of all relevant economic and legal facts in its comparative analysis, and has for instance found that concomitance is not sufficient where the situation of the public lender/investor was substantially different from that of the private investors.

Absent concomitance of a similarly situated investor, or a public benchmark (which may be available in the case of a loan where the borrower may be rated by the financial markets), it is very difficult to ascertain what terms a private investor would have accepted as priorities and objectives of investors vary. The test is particularly difficult to apply to enterprises that are wholly-owned by the state. Finding the appropriate (hypothetical) reference investor and determining the conditions under which it would have acted becomes the central problem.

Financial difficulties of the receiving company—Is an investment always state aid?

Where public funding (including a loan or guarantee) is provided to a company in financial difficulties, the

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19 See WestLB, Joined Cases T–228/99 and T–233/99, op. cit. n.11, at para.[245] “[…] whether, in similar circumstances, a private investor operating in normal conditions of a market economy (‘a private investor’) of a comparable size to that of the bodies operating in the public sector could have been prompted to make the capital contributions in question […] . In particular, the relevant question is whether a private investor would have entered into the transaction in question on the same terms and, if not, on which terms he might have done so […] .”


22 WestLB, Commission Decision, op. cit. n.11, at para.[171]; 1993 Communication, see above, n.18, para.30.

23 See 2 below.

24 Case 323/82 Intermills SA v Commission (Intermills) [1984] E.C.R. 3809; see also Brittany Ferries, op. cit. n.13, at paras [188]–[189] and [211].


26 e.g. Philip Holzmann, Commission Decision of May 8, 2001, [2001] O.J. L248/46, at para.[73], where the Commission distinguishes between the situation of the public bank KfW which participates under the same apparent terms in the restructuring of the company Philipp Holzmann as private banks. Based on the economic context of KfW’s participation, the Commission concluded, however, that KfW’s unsecured loan constitutes state aid since it was the only bank that was not already a creditor of the company before it decided to participate.
Commission considers that this is state aid.\textsuperscript{27} The Commission thus considers that any measure that benefits a company in difficulties should be notified,\textsuperscript{28} regardless the conditions under which the state decides to act. This reasoning was reportedly applied to the decision of the French Government to participate in a capital increase of Alstom.

One may question whether the Commission presumption is justified as it would seem to disregard the individual circumstances and places the government investor in a different position than a private investor (which may well consider that the most rational conduct is to restore lost capital, waive debt, or convert debt into equity). The application of the presumption is discussed in greater detail below.

**The ex-ante assessment—The facts available at the time of the investment**

The private investor analysis must be applied to the facts as they existed at the time when the state made the definitive decision to commit funds. The Commission assesses whether, at the time of the investment and on the basis of the information then available (including past and forecast market developments),\textsuperscript{29} a private investor would have taken the same decision. This applies both to the assessment of proposed aid measures (that is in connection with a notification) and to the subsequent assessment (for example a decision on non-notified aid).\textsuperscript{30} In order to show that the conduct of the state is representative of rational conduct by a private investor, seller, or lender, public authorities will often offer evidence in the form of opinions by economic experts or business strategy consultants in the case of equity contributions, commercial banks in the case of loans, or investment banks in the case of privatisations.

These will opine as to whether at the time of the investment, a private investor would have acted in the same manner as the public authority.

The Commission cannot apply the private investor test “ex post”; that is by looking at the facts as they developed after the decision to commit the funds.\textsuperscript{31} This is apparently the case even if the effect of the measure is immediate and was foreseen to have such effect, such as where international rating agencies immediately recognise the improved prospects for the business after the announcement of a government investment.\textsuperscript{32} It would, however, appear that the de facto success of a given investment would provide a very strong indication that the original investment decision was based on reasonable expectations and was thus in line with market conditions. A decision to the contrary would imply that the actual commercial success is a result of chance. While this cannot be excluded, the Commission should be required to provide strong evidence to sustain such a finding.

2. The Private Investor Test—Recent Developments and Clarification of Practice

Several recent Court and Commission cases have contributed to develop further certain aspects of the private investor test.

**What constitutes an acceptable rate of return?**

In principle, the Commission recognises that the state has a wide margin of discretion when assessing whether a given investment conforms to market conditions. Within that margin of discretion, the exercise of judgment by the public investor has to be respected.\textsuperscript{33} The Member State will often bring expert evidence to support this judgment.\textsuperscript{34} However, it is not clear that the Commission always respects the judgment of the Member State, or whether the Courts enforce it.

The Commission has, for instance, used the reference to an “average rate of return of the relevant sector” to determine the appropriate rate of return for the capital injected in the WestLB case. In that case, the Land

\textsuperscript{27} “[T]here is State aid where fresh capital is contributed in circumstances that would not be acceptable to a private investor operating under normal market economy conditions. This is the case (i) where the financial position of the company, and particularly the structure and volume of its debt is such that a normal return (in dividends or capital gains) cannot be expected within a reasonable time from the capital invested”, 1984 Communication, n.17 under section 3.3.

\textsuperscript{28} Community guidelines on state aid for rescue and restructuring firms in difficulty, [1999] O.J. C288/2, para.17, (“Rescue & Restructuring Guidelines” or “1999 Guidelines”), where the Commission states that there is a presumption that a state measure, contributed to a company in difficulties, contains state aid; 1984 Communication, Section 4.3.

\textsuperscript{29} See Stardust, Case C–482/99, op. cit. n.5, at paras [61], [71] and [81].

\textsuperscript{30} WestLB, Case T–228/99, op. cit. n.11, at para.[246] “[T]he comparison between the conduct of public and private investors must be made by reference to the attitude which a private investor would have had at the time of the transaction in question, having regard to the available information and foreseeable developments at that time”.

\textsuperscript{31} See Stardust, Case C–482/99, op. cit. n.5, at paras [68]–[81]; WestLB, Case T–228/99, op. cit. n.11, at para.[246]; see also WestLB, Commission Decision of July 8, 1999, op. cit. n.11, at para.[163].

\textsuperscript{32} France Télécom; Invitation to submit comments, para.[94], op. cit. n.14.

\textsuperscript{33} See 1993 Communication, op. cit. n.18, at para.[27].

\textsuperscript{34} See, e.g. Brittany Ferries where specialised ship financiers opined on the acceptable rate of return, op. cit. n.13, at para.[53]; or Saarbergwerke, where a major international investment bank opined on the fair value of the enterprise and different assets being privatised, Commission Decision of May 7, 2002, [2002] O.J. L203/52, at para.[17].
Nordrhein Westfalen (majority shareholder) transferred the assets of a public institution (Wohnungsbauförderungsanstalt—WfA) to the Westdeutsche Landesbank (WestLB). The law that provides for the transfer of the WfA also requires that WestLB pay, in the event of a profit, an annual return of 0.6 per cent after tax in respect of the part of the WfA capital that guaranteed the transactions of WestLB (that is counted for capital adequacy purposes). In the course of the procedure, the Commission determined an (unspecified) average rate of return in the banking sector and compared that rate to the remuneration actually paid by WestLB.

By doing so, the Commission effectively ruled out any margin of discretion for the public shareholder in the determination of the appropriate rate of return for its investment. The CFI, when reviewing the Commission decision, does not analyse this issue as clearly as one could have desired. On one hand, it accepts the possibility of using an average return for the sector as an “analytical tool” for the determination whether a state measure involves state aid; on the other, it stresses that all relevant factors should be taken into consideration. It is unclear how such “other” factors can be duly taken into consideration when it is acceptable to find that the average rate of return is apparently the minimum rate the hypothetical private investor would have accepted.

In WestLB, the Court of First Instance (“CFI”) in the end annulled the Commission Decision on a point that may provide an answer to this question at a later stage in the proceeding: the Commission had not provided adequate reasons for choosing the appropriate minimum rate of return (which in this case was the “average” rate of return in the sector). It is possible that the Commission when elaborating on the reasoning will see fit to explain why the average rate was the minimum acceptable rate of return, and how this is reconcilable with placing the public investor on an equal footing with private investors, not all of whom realise an “average rate of return” on each and every investment.

The “owner effect”?
The Commission recognises in its 1993 Communication the existence of what is referred to as the “owner effect”. According to this principle, an existing shareholder with a substantial existing, perhaps controlling, investment in an enterprise may act differently from a minority or de novo investor.

The March 2003 notice opening the investigation into the proposed recapitalisation of France Télécom provides an interesting example of the Commission’s approach to the principle of “owner effect”. To simplify, the Notice states that the French State (majority owner of France Télécom) announced (i) that it would subscribe to a planned capital increase pari passu with private investors, and, (ii) that it would grant, through a government controlled investment vehicle, a shareholder advance in an amount equal to the planned share subscription by the state. From the press, it appears that this announcement was preceded by the announcement of new management and a new business plan. The Government’s announcement of the intention to subscribe to the share issue and to extend a shareholder advance, together with an asset divestiture plan, in turn allowed France Télécom to obtain better credit ratings from major international credit rating agencies and, it would appear, attract major institutional investors for a series of bond issues that were then being contemplated. This resolved the “cash crunch” experienced at the time.

The French Government explained that this conduct was entirely the norm for a controlling shareholder. A controlling shareholder can be expected to announce whether it will subscribe to its proportionate share of a capital increase and to make the shareholder advances that are required to allow the company to choose the right moment to approach the capital markets with a share issue. In sum, the announcement of the (possible) shareholder advance merely allowed the French Government to protect the value of its equity holding in France Télécom by allowing France Télécom to improve its credit rating so as to enable it to seek additional debt financing on international capital markets.

This raises the following question: does the conduct of the French State amount to state aid, or would a private (controlling) shareholder not also have announced its intention to subscribe to the future share issue and, if necessary, granted a shareholder advance until such time as the share issue could be launched on the international capital markets on acceptable terms?

In the letter to France opening the investigation, the

35 WestLB, Case T–228/99, op. cit. n.11, at paras [247]–[258]; The CFI states at para.[258] that “[. . . ] use by the Commission of a minimum return corresponding to the average return in the sector concerned as an analytical tool, used in the course of considering all factors relevant to the case before it, does not infringe Art.87(1) EC”.
36 WestLB, Case T–228/99, op. cit. n.11, at para.[404].
Commission seems to suggest that the principle of concomitance excludes that the controlling shareholder takes “the first step”.

In this regard, the Commission relies heavily on statements in the file that no “other” investor was willing to commit funds when France announced its intention to take up its share in the planned capital increase. Thus, the Commission seems (at least in the opening notice) to ignore the French argument that a controlling shareholder must necessarily act differently from “other” shareholders.

The Commission may, of course, take comfort in the recent judgment in WestLB. In that case the CFI considered that a private investor “will seek to achieve the maximum reasonable return on his investment [...] even where he is investing in an undertaking of which he is already a shareholder”. This statement on its face seems to exclude the “owner-effect”, but could also be seen as explaining what the French Government actually did in the France Télécom case: it was the shareholder advance that allowed France Télécom to “time” its share issue and thereby permitted the shareholder to maximise its return.

Anticipating liability by a fresh investment

There are several recent cases that consider whether a public authority that has a pre-existing exposure (that may result in liability) can make (additional) investments to prevent such liability from being asserted.

In the Linde case the court found that the existing exposure of a public entity to a loss-making contractual obligation, justifies committing additional funds in order to reduce future losses. While the facts of the case were unusual (the additional funds were granted to a third party to release the government from its liability), the principle should apply equally where the existing and new investments are in the same company.

In Bank Burgenland, the state (here Land Burgenland, the majority shareholder) guaranteed certain debt in order to protect Bank Burgenland from insolvency proceedings. In the event of insolvency, the state would have been liable for all of Bank Burgenland’s engagements on the basis of a pre-existing general guarantee which protected all creditors of the bank. Exposure in the event of insolvency would by far have exceeded the supplementary limited guarantees.

However, in the decision to open a formal investigation, the Commission concluded that the state guaranteed the losses “too early”, since Bank Burgenland was not insolvent (yet). The Commission considered that because the state was not obliged to cover losses at the time the guarantee was granted, the guarantee constituted an advantage in the sense of Art.87(1) EC. In reaching this conclusion, the Commission ignores that the state would have been liable for a substantially higher debt had it allowed Bank Burgenland to declare insolvency. Above all, in similar conditions a private guarantor mindful of limiting future exposure would likely have granted the limited (additional) guarantees that were required to keep the bank afloat. The new guarantees did not increase overall exposure, and by not giving the guarantees, the guarantor would have increased substantially the likelihood of larger claims.

Privatisations and asset sales by the state—Acquirer liability for past state aid?

The ECJ recently ruled in the first of a series of pending cases on whether an acquirer of assets is liable for recovery of illegal aid that was granted to the seller prior to the acquisition. The Commission had maintained public authorities were significantly lower than the aggregated losses the BvS would have suffered if it had continued to perform the supply agreement until its expiry.


44 The Commission had decided in some cases that the acquirer of assets of a former state aid recipient is liable for recovery of illegal aid that was granted to the seller prior to the acquisition.

The Commission had maintained...
that the parties sought to circumvent a Commission decision ordering recovery of aid from the seller. It also considered, that since the assets had been bought with illegal state aid, this illegal state aid continued to distort competition. In *Seleco*, the ECJ held that liability will depend on the price paid for the assets: if the acquirer pays a market price, it does *not* receive any advantage through the transaction which could be considered as state aid and can thus *not* be considered as liable for the repayment of the aid granted to the seller.

Accordingly, the risk of a transfer of liabilities for illegal aid can in principle be avoided by acquiring assets/shares at a market price. The market price can be determined by reference to an independent valuation, but given uncertainties involved in relying on expert opinions (and the Commission’s tendency to advance contrary expert opinion), it may be preferable to seek to have the market price determined through an auction or tender process. The *Seleco* doctrine would also seem to have implications for the drafting of acquisition agreements. This is, however, outside of the scope of this paper.

Several other cases involving similar issues are pending before the ECJ and the CFI. In *SMI*, Advocate General Tizzano maintained the ECJ’s approach in *Seleco* and recommended annulment of the Commission decision relating to *SMI* on the same grounds.

Last, benchmarking against “private investors” also arises in connection with the assessment of whether public services compensation is to be deemed state aid. This is discussed below in Section D.

### 3. Future Application of the Private Investor Test

As discussed above, the state is necessarily different from any hypothetical private investor. The first case where the CFI expressly addressed this issue and thus actually recognises the fundamental difference between a public and a private investor is *WestLB*. In that judgment, the CFI reiterated that the private investor test has its origin in the principle of equal treatment of public and private undertakings and that the principle of equal treatment prohibits that like cases are treated differently.

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authority. Of course, the Commission must control that judgment, and may require the Member State (and the beneficiary) to justify the investment decision. This will require evidence and economic analysis. The Commission’s role is to verify whether the judgment of the Member State was based on incorrect data, unsound economic principles, or business methods that are not in use among private investors. If this is the task of the Commission, it seems difficult to believe that it could reach the conclusion (as it did in WestLB) that the government should have pursued “the average rate of return” in the industry. No private investor would have used the average rate as its benchmark—it would know too well that business is a combination of high and low yield opportunities and that both are required to survive and prosper.

Of course, where the Commission determines that the business judgment was based on incorrect facts or unsound analysis, it must proceed to a compatibility analysis. In this area, the Commission has a wider role since the policy objectives inherent in the state aid rules play a significant role. So far, the Courts have refrained from adding a “third” business judgment to the equation and have accorded the Commission a wide margin of appreciation in the application of the private investor test. It is submitted that it is in particular not appropriate to simply take the results of its own experts analysis and replace the business judgment of the Member State. This is in particular relevant in light of the extensive use of experts in private investor cases (see among others WestLB decision and the recent press announcement on the Commission hiring an expert for the assessment of the France Télécom). Also, in many cases it will not be possible to show that the public authority based itself on a particular reasoning, profit objective, or success prediction. The Member State should still be able to bring evidence that in light of the facts available at the time the decision made sense as a business judgment.

Even then, as will be examined below, the role arguably does not extend to making what are in essence business judgments [such as the assessment of viability; see below].

See Case T–296/97 Alitalia v Commission [2000] E.C.R. II–3871, at para.[105]; “... When the Commission adopts a measure involving such a complex economic appraisal, it enjoys a wide discretion and judicial review of that measure, even though it is in principle a comprehensive review as to whether a measure falls within the scope of Art.[87(1) EC] [...], is limited to verifying whether the Commission complied with the relevant rules governing procedure and the statement of reasons, whether the facts on which the contested finding was based have been accurately stated, and whether there has been any manifest error of assessment or a misuse of power [...]. In particular, the Court is not entitled to substitute its own economic assessment for that of the author of the decision”; see also Case C–111/99 P (Order) Lech-Stahlwerke GmbH v Commission [2001] E.C.R. I–727, at paras [28]–[32]; see also Case C–323/00/P (Order) DSG Donnemayer Stahlgesellschaft mbH v Commission [2002] E.C.R. I–3919, at paras [42]–[47]. However, the ECJ examined the application of the private investor test by the Commission in Stardust, Case C–482/99, op. cit. n.5.


57 See, e.g. Guidelines on national regional aid, [1998] O.J. C74, regional aid is strictly tied to investments, with the minor exception of regional aid granted in Art.87(3)(a) EC regions, see ibid. at 4.15. Aid found compatible under Art.86(2) is, at least in principle, not distortive as it should not spill-over into areas that are not “reserved”. The reality is, however, often different (see Section D below).

As opposed to, e.g. aid granted for special purposes, such as investments, research and development, training, employment, etc.

C. Rescue and Restructuring Aid

Rescue and restructuring aid is typically granted in a situation of acute financial distress where state funding is often the last resort to keep the beneficiary from going into administration. Rescue and restructuring aid has substantial political and social implications, in particular where industrial leadership aspirations and thousands of jobs are at stake, Alstom and British Energy being recent high profile examples.

It is arguably in the assessment of rescue and restructuring aid that it is clearest that state aid control is a “branch” of EC competition law. Rescue and restructuring aid can be said to be more distorting of competition than other forms of state aid. Contrary to most other bases for authorising state aid, rescue and restructuring aid covers ongoing operating expenses of a company. State intervention that keeps an enterprise afloat submitted that this wide margin of appreciation does not go so far as to allow the Commission to substitute its own judgment for that of the public investor. In WestLB and in Alitalia, the CFI seems to deal with this as a matter of burden of proof and reasoning: Perhaps the requirement of better reasoning will lead to better analysis of the business opportunities and risks, which in turn may show that in any investment situation the opinion of reasonable investors (and experts) may differ. If so, the Commission should be encouraged not to choose its own judgment over that of the investor.
and active in the market almost always has a severe impact on competitors that do not benefit from state support. This is particularly true where the beneficiary of the aid is experiencing cash flow difficulties and the aid can contribute to, for example, a price war. Precise analysis of the relevant market and the market power of the beneficiary enterprise is therefore key, maybe more so than in any other area of state aid law, to understanding the remedies that will protect competitors.

It is this need for balancing all of these concerns that led the Commission in 1994 and 1999 to issue detailed rules on rescue and restructuring aid. However, as recent cases have shown, the current Rescue and Restructuring Guidelines of 1999 (the “1999 Guidelines”) are increasingly under strain. The 1999 Guidelines will expire in October 2004, and the Commission published a draft for new guidelines in January 2004.

In the recent past, the Community Courts have annulled several Commission Decisions on restructuring aid whether they prohibited or authorised the grant of aid. This highlights the difficulty in finding the right solution in these cases. There are also a number of interesting actions pending, most notably the actions brought by Greenpeace and DRAX against rescue aid for British Energy.

After briefly highlighting some of the major recent and mostly pending cases, we will focus on three main issues: (i) rescue measures, (ii) restructuring measures and (iii) the outlook for the ongoing review of the 1999 Guidelines.

1. Overview of Recent Rescue and Restructuring Cases

One remarkable development is the extent to which rescue and restructuring aid is no longer the preserve of traditional heavy manufacturing, such as coal and maybe shipbuilding. Increasingly, rescue and restructuring aid is being granted to “new economy” companies. Major cases of the past two years included:

- aid to telecoms companies, such as MobilCom and France Télécom;
- the manufacturing sector, such as rescue aid for the French manufacturer of high speed trains and turbines Alstom, French computer manufacturer Bull, German aerospace company Fairchild Dornier and for Grundig, the German based electronics producer;
- transport industries have been at the centre of restructuring efforts, including the ongoing monitoring of the restructuring of Greek Olympic Airways and Italy’s Alitalia, aid for Air Lib, the French airline that was spun off at the time of the Swissair reorganisation, rescue aid for German LTU, as well as the restructuring aid decisions in the maritime transport field with respect to Société Nationale Corse Maritime (SNCM) and Brittany Ferries;
- the banking sector also saw a number of cases, including a substantial package in favor of German Bankgesellschaft Berlin and alleged restructuring


60 1999 Guidelines, section 7.2, para.97, op. cit. n.28.


aid to Bank Burgenland, a regional Austrian bank; and
- the energy sector had its problems with aid to the restructuring of the nuclear liabilities of British Energy, and the Commission opened an investigation into the Dutch nuclear power provider, AVR.

Aid to the coal industry, and a number of shipbuilding cases, which is assessed under separate rules will not be addressed here.

2. Rescue aid

Rescue measures are by their very nature inevitably granted in circumstances of extreme urgency: They are designed to keep a company in business for a limited period of time during which its future (restructuring or liquidation) can be assessed.71

Timing—procedural issues

Rescue and restructuring aid is applied following the normal procedural regime set out in Council Regulation No.659/99.72 Because of the inherent urgency in such matters, two issues arise:

- Is the urgency of rescue measures reconcilable with the stand-still obligation of Art.88(3) EC?
- What are the powers of the Commission to enforce the stand-still obligation in such a situation?

Practical and legal effects of violating the stand-still obligation. Rescue measures need to be implemented quickly; they are generally envisaged in the context of a rapidly deteriorating financial situation and impending insolvency. Since a Commission investigation takes at least a couple of months, rescue measures are often implemented before they are approved by (or even notified to) the Commission.73 This violation of the stand-still obligation is of substantial concern for financial institutions which provide funding backed by State guarantees or investors that co-invest with the State. If the State rescue measures are not approved, the private parties are exposed to the entire credit or investment risk on their own. As government guarantees or state investment promises increasingly evaporate, it is likely that financial institutions in particular will either demand a higher remuneration (making recovery for the troubled company more difficult), or simply deny funding. Similar considerations apply to equity investors.

What powers does the Commission have to enforce the stand-still obligation? This has been the subject of much public discussion in the Alstom case. The most effective solution has been dismissed by the Court in the early years of state aid control: the Commission cannot reject a proposal to pay aid simply because it has been implemented prior to notification or approval.74 This deprived the Commission of what would have been formidable powers. So what other enforcement powers does the Commission have at its disposal?

In Alstom, the Commission threatened to issue an injunction against France for failure to comply with the stand-still obligation.75 Had France still not complied, the Commission could then have pursued infringement proceedings under Art.88(2) EC.76 While Art.88(2) EC dispenses with the obligation to send a “reasoned opinion” to the Member State concerned, the procedure is still very complex and could last several years.77

The Commission has yet to follow through with a full
enforcement procedure. This is possibly because in cases where the restructuring aid is ultimately approved, the process appears futile. Most (large) restructuring investigations are completed within a period of two and a half years from opening of the inquiry. As a result, the proceedings issued by the Commission to ensure compliance with the stand-still obligation of Art.88(3), would have become moot by reason of a final decision on the underlying case. The Commission’s powers to enforce the stand-still obligation for rescue aid are thus limited in practice.

Competitors are, however, in a better position. Competitors can seek recourse directly in the national courts, which are required to enforce the stand-still obligation. In the past, competitors have only rarely taken this route. As, however, the Commission’s resources in state aid enforcement are increasingly stretched and competitors have realised the limitations in the Commission’s powers to enforce Art.88(3) EC, such direct court actions have become increasingly frequent. This trend may be reinforced by a recent ECJ judgment which appears to further strengthen competitors’ rights. In Van Calster, the ECJ held that the Commission’s approval of aid cannot have retroactive effect. This means that aid measures which were implemented prior to a compatibility finding by the Commission remain illegal as regards the period preceding the approval decision.

**Conditions for approval of rescue aid**

According to the 1999 Guidelines, rescue aid must: (i) be in the form of remunerated guarantees and loans, (ii) limited to the amount strictly necessary to keep the stricken enterprise in business, (iii) restricted in duration and (iv) serve to alleviate a social crisis without adverse spillover effects on other Member States. In practice, the latter criterion is generally fulfilled and the main issues are the form and the duration of rescue aid:

Rescue aid must be granted in the form of repayable loans and guarantees. Experience has shown this requirement to be over-simplistic in complex restructuring scenarios. In British Energy, the Commission approved loans and deposits by the government (which served as collateral for British Energy’s trading and non-trading (regulatory) counterparties). In Alstom, the Commission allowed the use of convertible bonds (having rejected an outright capital increase). The convertibility of the bonds was made subject to approval of the resulting equity investment as restructuring aid. The measure in Alstom was therefore a hybrid form of loan during the restructuring phase. In practice, the wording of the Guidelines is thus stretched to allow a variety of measures.

According to the Guidelines, rescue funding may not be in effect for more than 6 to 12 months. The Commission generally authorises the aid for a period of six months, with a possibility for extension in exceptional circumstances. The rescue funding is intended to give the company the time to prepare a coherent restructuring plan (or to prepare its liquidation). Thereafter, the funding must either be withdrawn or justified as restructuring aid.

In practice, the Commission allows rescue measures to continue for a longer period where a proposed
restructuring plan is under consideration (see for instance Bankgesellschaft Berlin).83

If the rescue measures are not brought to an end after their term (usually 12 months), the measures become illegal aid and may, in the case of government guarantees, become unenforceable. Similarly, for loans, the Commission may order the recovery of the principal with interest.84 At that point, competitors can also petition national courts to declare the rescue measures illegal and thereby prevent the illegal aid from having effects.

Recurring rescue aid?

There has recently been some discussion whether rescue aid can be granted more than once.85 The 1999 Guidelines provide86 that rescue aid is a “one-off operation” and that repeated rescues “cannot be allowed”. The Commission has stated this principle in several decisions,87 but Commission practice shows that this principle is not applied rigorously.88 However, rather than focusing on whether rescue aid is granted subject to the “one-time-last-time” principle (see below on restructuring aid), it would seem more meaningful and consistent with the structure of the 1999 Guidelines to ensure that there is an organic link between rescue aid and a subsequent restructuring plan and for that rescue funding is not granted without “strings attached”.89

Draft 2004 Guidelines on “urgency aid”

In the recently released DG Competition consultation document (Draft 2004 Guidelines), the Commission services propose to replace the concept of rescue aid with that of “urgency aid”. Urgency aid would be approved under a simplified and expedited procedure if the amount does not exceed €10 million.90 Under the proposals, a recipient of urgency aid would be permitted to take measures of a structural type. DG Competition proposes that urgency aid would be found compatible where the following conditions are met91: (i) urgency aid must comply with the “one-time-last-time” principle; (ii) the notification of urgency aid must be accompanied by a commitment by the Member State to communicate within six months a restructuring plan, a liquidation plan, or proof that the urgency measure has been reimbursed in full or the guarantee terminated; and (iii) the urgency aid does not exceed an amount determined according to a formula set out in the Draft 2004 Guidelines. It is likely that the conditions for approval of urgency aid will evolve during the consultation process on new rescue (now “urgency”) and restructuring aid guidelines.

3. Restructuring aid

The core conditions for approving restructuring aid under the 1999 Guidelines are (i) a restructuring aid can only be granted once within a 10 year period (the “one-time-last-time” principle) and (ii) the requirement of a coherent restructuring plan which (a) ensures the return to viability in the foreseeable future and (b) limits as far as possible the distortion of competition that would result from the grant of state aid. The prevention of distortion is achieved by requiring (iii) that the aid be limited to the absolute minimum, requiring “own investment” from private sources, and by requiring the aid recipient to reduce capacity or otherwise alter its commercial activities (referred to as “compensatory measures”). Last, timing of the aid in relation to the existence of an “approvable” restructuring plan can raise specific issues.

The “one-time-last-time” principle

The “one-time-last-time” principle92 seriously limits the ability of Member States to support perennially loss making businesses. Because of the statute of limitations,93 one-time-last-time in effect means that restructuring aid can be granted only every 10 years. This requirement was introduced in the 1999 Guidelines to remedy issues identified in early practice.

While the obvious purpose of the one-time-last-time principle is laudable (to ensure that companies are not kept afloat by successive aid measures), the principle is both unduly rigorous and, in practice, unduly restrictive. The principle forces Member States (and beneficiaries) to anticipate all events in the operation of a

83 Bankgesellschaft, op. cit. n.68. It is not immediately clear how the requirement of limited duration of rescue measures was applied to the issuance of convertible bonds in the Alstom case. According to press reports, the bonds were issued with a 30 year maturity, see Alstom, op. cit. n.56.
84 Bull, op. cit. n.65, at para.[68].
85 Ibid, at para.[60]; see also Interview with Mario Monti, Financial Times, September 21, 2003.
86 In para.25.
88 Addinol, op. cit. n.87; and Crédit Lyonnais, Commission Decision of May 20, 1998, op. cit. n.68.
89 See Interview with Mario Monti, Financial Times, September 21, 2003, op. cit. n.85, in which the danger of “no strings” rescue loans is identified as an issue, in particular, where a restructuring drags on for years.
90 See Draft 2004 Guidelines, op. cit. n.61, section 3.2.2.
91 Ibid. para.37.
92 This concept existed already in a slightly more obscure wording under 3.2.2. (i) in the 1994 Guidelines where it is stated that “like rescue aid, aid for restructuring should [. . . ] normally only need to be granted once”.
93 Art.15 of the Procedural Regulation, op. cit. n.8.
business over a future 10 year period. Not all events can, however, be predicted, in particular events such as the September 11, 2001 terrorist attacks or the subsequent SARS crisis that severely affected the airline industry. The 1999 Guidelines therefore provide for an exception to the “one-time-last-time principle” in case of exceptional and unforeseeable circumstances for which the company is not responsible.94 This principle is retained in the recently released proposal for new guidelines.

The restructuring plan, the measure of viability and the “battle of the experts”

The 1999 Guidelines require that the restructuring ensures that the company return to long-term viability. This should be done on the basis of a coherent set of measures (which must include internal measures) that must ensure that the company will be able to cover its costs in the long run. Furthermore, such a restructuring plan must take into account and remedy the problems that led the company into financial difficulties in the first place.

The restoration of long term viability has to be achieved on a “reasonable timescale”. The Commission case law demonstrates that there is no “golden rule” in terms of minimum or maximum time a restructuring can take: the length depends on factors such as the sector in question, the reasons that led to the difficulties of the company, the size of the company. It is not unusual to see restructuring plans that run for more than five years, but the Commission has recently indicated that it intends to set tighter targets for completion of a restructuring.95

Restructuring plans are complex financial and business plans which are (generally) developed (or reviewed) by management consultants, accountants, and experts in business economics relevant to the industrial sector affected. Where the company in difficulties prepares its own restructuring plan, the Commission will generally direct the Member State to have it assessed by external experts. The Commission may also retain its own experts to review the restructuring plan, in particular in the case of complex restructurings involving large amounts of state aid.96

As a practical matter, this “battle of the experts” is unequal—typically the experts retained by the Member State or the beneficiary have worked for a considerable amount of time with the enterprise in question and have often deployed large teams of sophisticated experts in many countries to assess what business plans would render the company viable. On its side, the Commission must review the proposed measures within limited time and relying on experts which it has selected (mostly) on the basis of a fixed and often low price tender. As a result, the Commission often receives summary or inconclusive advice from its own consultants and is left in the unenviable position of having to take a decision in which it explains why it has not followed its own advisors.97

Recent experience with complex restructuring cases suggests that the Commission should devote additional resources to the business economic assessment of restructuring plans (analysis of financial viability and options for restructuring the business). This would direct the Commission’s efforts to what is its proper role: the review of the restructuring plan to ensure its internal coherence, accuracy in terms of financial and accounting methodology, and reasonableness in terms of conclusions. This would in turn reduce the incentive for the Commission to engage in what is not its remit: second guessing the business judgments of the management of commercial enterprises.98

The restructuring plan must ensure that the distortive effect of the aid is limited

The second element of a restructuring plan has two requirements: (a) The amount of aid must be limited to the absolute minimum necessary and must be accompanied by “substantial private contribution”; and (b) the company must foresee (and implement) compensatory measures to limit the effect of the state aid on competition.

(a) The limitation on the amount of aid and the requirement of a “substantial” participation of private financing in the restructuring costs. This part of the test can be compared to the “indispensability” requirement in Art.81(3)—the amount of aid granted by the state must be as little as required to achieve the acknowledged benefits of the state aid.

94 This should not only encompass natural disasters or accidents that may hit an aid beneficiary, but also macro-economic events, see, under the 1994 Guidelines.
95 See Interview with Mario Monti, Financial Times, September 21, 2003, op. cit. n.85.
96 Alstom and British Energy, both op. cit. n.56; or under the 1994 Guidelines; Crédit Lyonnais, op. cit. n.68 GAN, Commission Decision of July 30, 1997 [1998] O.J. L78/1; Brittany Ferries, op. cit. n.13.
97 See, e.g. Brittany Ferries, op. cit. n.13, para.234.
98 Note here that the creation of the Office of the Chief Economist does not seem to address this concern in that the in-house economists at DG Competition are generally advising on industrial economics. While this is very relevant to the issue of distortion of competition (see (iii) below), this generally requires different skill sets and practical experience from the evaluation of restructuring plans and viability of businesses based on future pro-forma accounts.
The requirement that the state aid be limited to the strict minimum is intuitive, but raises an interesting issue of timing in particular in cases where the Commission’s assessment of the restructuring aid continues over a period of years. In such cases, the Commission will sometimes require the aid to be paid in installments and will evaluate at each juncture in the plan whether the company is implementing the plan correctly. In such cases, the Commission is effectively led to conduct a continuing assessment of the “necessity” of each “tranche” of aid as the restructuring plan is progressively implemented, and may decide to limit the amount of aid to that which is necessary in light of the facts at the time of the decision. While such an “ex post” analysis is proscribed in the case of the private investor test (see Section B), it is not uncommon in the case of restructuring aid analysis. On its face this is reasonable (because it limits the aid to the bare minimum), but such an approach can lead to disastrous results if combined with the “one-time-last-time” principle. By removing part of the aid anticipated in a restructuring plan, the Commission may deny the company the “safety cushion” required to weather a future financial squeeze during the 10 years before another restructuring plan can be considered.

As regards the level of private participation in the overall restructuring costs, the Commission appears to have accepted various solutions, depending on the amounts of aid involved and the type of restructuring measures. The Court of First Instance has for example considered a private participation at slightly under 50 per cent of the overall costs as “not manifestly insufficient” and the Commission has accepted even far lower private share of restructuring costs. The Draft 2004 Guidelines would, if adopted, introduce minimum levels of contributions to the restructuring costs which have to be made by the beneficiaries. In the proposals, the amount of the minimum contribution depends on the size of the beneficiary enterprise and must be made from own resources and free of aid.

99 See, e.g. Brittany Ferries, op. cit. n.13, at para.[288] and n.116.
1 The Commission considered as insufficient an investor contribution of 9.3 per cent of the overall restructuring costs, see Addinol, op. cit. n.87; as sufficient an investor contribution of 34 per cent, see KataLeuna, Commission decision of February 13, 2001 [2001] O.J. L245/26.
2 See Draft 2004 Guidelines, op. cit. n.61, at para.54. The Draft Guidelines foresee a contribution of at least 25 per cent if the beneficiary is a small enterprise (which can be lowered to 20 per cent under exceptional circumstances) and 40 per cent if the beneficiary is a medium-size company (which can be lowered to 35 per cent under exceptional circumstances). The contribution to be made by large undertakings will be assessed on a case-by-case basis, but should generally be at least 50 per cent.

(b) Capacity reductions and limitations on production—Distortion of competition analysis. It is the requirement that the distortive effects of any restructuring aid be measured in relation to the market, that shows the “competition law heritage” of Art.87 EC. The concern stated in the 1999 Guidelines is that aid in restructuring cases shifts the burden of structural adjustment to producers other than the enterprise in difficulty.

The Guidelines therefore require “compensatory measures”. The imposition of such measures in individual cases is tied to a simplistic distinction in the 1999 Guidelines between markets with and without overcapacity. Where the markets at an EEA level suffer from structural overcapacity, the restructuring plan must foresee capacity reductions. Where no such structural overcapacity is present, the Commission may require such capacity reductions. In recent practice, the Commission generally requires compensatory measures, or attaches obligations as a condition to clearing aid. Such obligations may take the form of a requirement that the Member State not to grant other aid, or enjoin the recipient from acting as a price leader.

Where capacity reductions are required, the 1999 Guidelines make it clear that the closure of obsolete production capacity will not satisfy this requirement because such closure is not considered as reducing the distortive effect of the aid. The same applies to the sale of production capacity to competitors, since the capacity would then remain in the market (and the aid to the seller would distort competition). The reduction of personnel alone is also excluded.

The nature and extent of compensatory measures depends on an analysis of the (product and geographic) markets affected. The 1999 Guidelines list a number of factors that must be considered. Where the market has structural overcapacity, the capacity reduction must take account of the market position of the beneficiary and the likely impact of the aid on competition. Where the market does not have overcapacity, compensatory measures are designed to mitigate the potentially distortive effects of the aid and the Commission will take account of the “state of the market”, and in particular the “level of growth and the extent to which demand is met”.

3 See generally 1999 Guidelines, op. cit. n.28, at paras 35–39 and 42. Note that the Member State may be required to open its market to other Community operators as a condition for approving aid. See also Draft 2004 Guidelines, op.cit. n.61, at para.36.
The market analysis required under the 1999 Guidelines is therefore, on its face, far more demanding than previously, and in particular requires a precise definition and assessment of the markets that will be affected by the aid. To that end, the 1999 Guidelines require that a market study be communicated together with the restructuring plan. The Commission increasingly retains experts for such assessment when high amounts of aid are involved, but the market analysis in state aid cases still lags considerably behind that applied, for example, in merger cases.

A related weakness in the approach is that the distortion analysis in Commission decisions is often cursory. There is no coherent approach to what constitutes distortion, or to the levels of distortion acceptable. The focus seems mainly to be on the remedies to distortion, that is, the “compensatory measures” discussed above. Because the courts generally assume that aid distorts competition, the Commission’s analysis of distortion is often cursory, even in restructuring cases. However, determining efficient remedies also requires a more determined analysis than is presently conducted. If one were to determine more precisely the distortive effects of a particular aid it may become apparent that other measures could protect competitors better than off-the-shelf capacity reductions. Perhaps the suggestions that the Commission move to “LASA” and “LET” testing will also remedy this weakness to some extent (see Section H below), but the recent proposals do not seem to signal a shift towards a more rigorous distortion analysis.

The Commission recognises that an absolute requirement to reduce capacity would have perverse effects. In practice, it therefore relaxes this requirement where a reduction in capacity would lead to a substantial lessening of competition in the market affected. This was recently applied to justify decisions not requiring (further) reductions in capacity where such reduction could have altered the market structure by creating a narrow oligopoly or even a monopoly.

Similarly, but less recognised, is that a requirement of a substantial reduction of capacity is not always reconcilable with the objective of ensuring the long term viability of the restructured company. This shows that a difficult balance has to be found between the two concepts: compensating for the distortions caused by the aid and the necessity to ensure long term viability.

4. Rescue and restructuring cases: Issues to be resolved

The preceding discussion suggests a lack of clarity on a number of issues. This will require reflection and resolution to ensure legal certainty in the application of state aid law to rescue and restructuring situations:

- The first issue is a variant on that discussed above in regard to the private investor test. In restructuring cases, the Member State seeks approval of aid and submits a rescue and/or restructuring proposal. The Commission’s remit is to apply the rescue and restructuring guidelines and to ensure that the Member State would not grant aid above and beyond what those rules permit. In that context, is it appropriate, as would seem to happen, that the Commission essentially substitutes its own business judgment as to viability for that of the enterprise? Should the Commission be making the judgment as to which business activities should be shed as “compensatory measures”? If in the end the enterprise fails to recover, will the company’s management not have been implementing the Commission’s business plan at the expense of national taxpayers?

It is submitted that the more appropriate exercise of the Commission’s powers would be to review the

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5 See 1999 Guidelines, paras 32, 37, and Annex I.
6 Due to the increasing impact of economic analysis and expertise in the assessment of state aids, the job description for the economic expert retained by DG COMPETITION included assessment of economic aspects in the field of state aid cases. Contrary to the financial and business model analysis required when assessing the restructuring plan and the viability of a restructured enterprise, the market analysis required for the distortion test under the 1999 Guidelines is substantially similar to that applied in merger control and Art.81–82 cases.
7 In general, the distortive effect of the aid is presumed and the Commission does not attempt to quantify it with the exception of certain cases in the banking sector. In Crédit Lyonnais and Banco di Napoli, the Commission stated that it was possible to estimate the theoretical distortion of competition caused by the aid granted in form of capital increases or aid with a similar effect. This was based on the existing solvency constraint in the banking sector which establishes a direct relationship between a bank’s capital and the commitments it is authorised to make. See, Crédit Lyonnais, Commission Decision of May 20, 1998, op. cit. n.68, at para.[10.5.a]; Banco di Napoli, Commission Decision of July 29, 1998 [1999] O.J. L116/36, at para.[5.4].
9 See state aid scoreboard, op. cit. n.61, table on p.18.
10 See Draft 2004 Guidelines, op. cit. n.61, paras 49–53.
11 1999 Guidelines, at para.38; see also Brittany Ferries, op. cit. n.13, at para.[258]. See also Kneissl Dachstein v Commission, op. cit. n.2–4, at paras [60] and [97]; Draft 2004 Guidelines, op. cit. n.61, at para.50.
restructuring plan for coherence and reasonableness, and to verify that the financial and accounting approach and methods used are sound.

- The assessment of restructuring aid deserves thorough viability analysis, market assessment, and distortion analysis. The complexity of the different concepts that are involved in the assessment of restructuring aid suggest that there is a need for more Commission resources in terms of experts that have the (very different) skills required to deal with the separate issues of (i) the assessment of the financial and business viability of a restructuring plan and (ii) the market impact in terms of distortion caused by the aid and the recommended compensatory measures or other remedies.

- The distortion and market impact analysis remains to be refined and needs to move away from the “over capacity test”. In addition, the Commission should define objectives of the distortion analysis and explain, how the test is applied. What are the parameters that should be used and what is the “tolerable” degree of distortion that should be achieved by compensation measures?

- There also seems to be a need for a more refined analysis of the appropriate restructuring measures. In some instances the financial and economic situation of a company can be addressed through a “financial restructuring”, without the need to carry out an “industrial activities restructuring”. This can be the case either because the company has already adapted its structure to new market developments, or because the acute financial situation is due to particular circumstances such as fraud or a significant loss on financial markets. Requiring a company that is structurally sound to shed business activities, just to approve a “financial restructuring” makes limited sense.

- Last, the timing issue in relation to rescue measures should be tackled. One solution may be to adopt a block exemption regulation for rescue measures, or a specific “fast track” procedure. This would help reduce the problem of rescue measures being implemented prior to any notification or approval. The recently released proposal for new guidelines appears to address this issue through the simplified procedure. Whether the proposed guidelines will be adopted and how they would operate remains to be seen.

D. Compensation for Public Services

EU regulation of Member State national public service obligations (generally referred to as “Services of General Economic Interest”) has been undergoing substantial development in recent years. One issue results from the compensation paid to public service operators (for example, the payment a bus operator receives from a municipality to operate a certain bus route that would otherwise be loss-making): The interplay between EC state aid law 13 and public service obligations (exempted from the competition rules of the Treaty by Art.86(2)).

The principal aim of state aid rules when applied to public service obligations is to address two sets of issues: (i) the manner and extent to which a Member State can compensate an operator for the cost of carrying out public service obligations; (ii) how to avoid aid “over-spills” between the area of the public service obligation and other areas of economic activity.

Even if the Community Courts have provided some “safe harbors”, the Commission frequently finds that the service for which compensation is granted does not qualify as a service of general economic interest, or that compensation is excessive. In such cases, the service provider faces the risk of a substantial recovery order, potentially covering compensation payments that occurred up to 10 years before a case was initiated. Such sums can be significant as seen recently in Deutsche Post where the recovery order was for €572 million. Recently, the Commission has examined public service obligations and compensation schemes in economic sectors such as banking, media, transport, and postal and logistics services.

This section seeks to address some of the issues raised by the interface of state aid and public service rules, in particular the following three questions: (i) what qualifies as services of general economic interest; (ii) must the Commission approve of compensation before it is paid; and (iii) what costs can be compensated?

This paper does not consider the issues that arise in relation to assessment of distortion of competition caused by aid to companies that have both public service and competitive activities. 14

13 Arts 87 and 88.
14 This section is based on a series of previously published articles, see Hansen, van Ysendyck and Zühlke, “Public Services Obligations and EC State Aid Rules” Global Counsel 2002: see also by same authors, “Altmark Trans: European Court of Justice Outlines Conditions for Public Services Compensation” http://competition.practicallaw.com/A32061 and van Ysendyck and Zühlke, “RIW Kommentar zu Altmark” RIW 2003, 717. An important aspect of state aid analysis that has not been covered in this paper is the assessment of distortion of competition. The element of distortion is particularly difficult to assess where a
1. What are Services of General Economic Interest? 16

The EC Treaty does not contain a definition of services of general economic interest. 16 The Member States’ traditions in this regard differ considerably due to historical, political and economic circumstances, and absent harmonisation the principle of subsidiarity gives the Member States some freedom to define the “public service remit”. The definition of the remit is subject to review only for manifest errors.

In order to allow the courts or the Commission to assess the definition of the public service remit, the public service remit is involved because the compensation amount is not state aid and cannot, as a legal matter, cause distortion within the sense of Art.87(1) EC. Particular issues arise in relation to costs that are shared between the public service activity and a “competitive” activity (such where the same buildings, delivery vans or even brand advertising are used for, or benefit, both areas of activity). Similarly, in the German Landesbanken cases (including the WestLB case, op. cit. n.11 and 12) the “balance sheet effects” were considered. The unlimited guarantee to the public service operations reduced borrowing costs of the competitive operations. Accounting segregation between public service activities and “competitive activities” (see Art.2(d) of the Transparency Directive; op. cit. n.5) should deal with many such issues in the future, but where disputes arise it may be expected that the allocation and depreciation principles applied by the public service operator will be carefully scrutinised and challenged.

Similar issues arise where the distortive effects are in an upstream or downstream market. One example is broadcasting where the distortive effects must be measured, e.g. on the market for sports and film rights. Even if the public service compensation is not legally state aid, must the amount that can be allocated to acquire broadcasting rights be measured against some market standard? If not, the unlimited funds of public service broadcasters will result in a significant distortion of markets that are unrelated to the actual public service remit. If the state aid provisions of the Treaty are to have any meaning (and generally the Community Courts do give them meaning), the Commission will undoubtedly have to develop new tools to deal with these issues.

15 Public services are also referred to as services of general economic interest. The relevant legal rules include: Arts 16, 86(2) and 73 EC. The Commission has set out its concept of services of general economic interest in Communications published in [1996] O.J. C281/3 and [2001] O.J. C17. Sector-specific rules are contained in the rules relating to the liberalisation of certain markets, such as telecommunications, energy, in the rules relating to the air transport sector, the maritime sector, broadcasting. The Commission has also published Reports to the Councils in Laeken COM (2001) 598 of October 17, 2001 and in Seville COM(2002) 636 of November 27, 2002. The yearly Competition Policy Report also frequently contains a section dedicated to the recent developments in this area of the law.

16 See Arts 16 and 86 EC. One observes that in its recent Green Paper on Services of General Interest (COM (2003) 270 final of May 21, 2003) the Commission attempts to take a more proactive approach in defining the public services remit. Whether the Commission will succeed in taking a more central role is tied to Art. III–6 of the draft Constitution, which will give the Commission, acting with the Council and the Parliament, powers to decide on the scope of public service remits. The Commission gets a broader right of initiative in this regard, the definition will apparently continue to rest in the hands of the Member States. Community Courts require the Member States to clearly define the public service mission in an act of a public authority (for example a legislative Act). The Commission is increasingly scrutinising such definitions as shown in recent cases in the areas of banking, broadcasting, maritime transport, urban and medical transport, and postal services provide ample evidence of this. So far, the Commission has largely respected the Member States’ freedom to define services of general economic interest under Art.86 EC.

There have, however, been cases where the Commission has not accepted that obligations were public service obligations. This was decided for instance with regard to advertising sales activities in the recent Art.88(3) letter to Denmark in TV2.17

Also excluded from the scope of services of general interest are “non-market services”. As a general matter, EC competition and internal market rules do not apply to such services. Examples of non-market services are, for instance, supervision of the air space, national education, and compulsory basic social security schemes.18 Other examples are organisations that do not engage in commercial or industrial activity, such as trade unions, political parties, religious organisations, consumer associations, and so on.

2. Are compensation amounts deemed to be state aid?

The Commission’s competence to approve aid requires a preliminary finding that a given measure constitutes state aid within the meaning of Art.87 EC. This has been the subject of some debate as regards amounts paid as compensation for public service obligations. The critical issue is whether such compensation confers a “benefit” to the provider of the respective services.19

17 See TV2 Denmark, Invitation to submit comments [2003] O.J. C59/2, at para.[58] (available only in Danish).
19 Another issue which is beyond the scope of this paper is whether revenues on public services that exceed costs must be paid back to the state. The key issue here is, whether such revenues can be considered to come back from state resources. Some commentators have argued that the (compulsory) license fees paid by private customers are not state funding (PreussenElektro doctrine, Case 379–98 PreussenElektro AG v Schleswag AG [2001] E.C.R. I–2099, Preliminary Ruling) see, e.g. Koenig and Haratsch, “Public Service Broadcasting in Germany”, [2003] EstAL 569 at p.571. In the case of license fees for broadcasting the Commission’s position continues to be that such fees come from state resources, see, e.g. TV2 Denmark, op. cit. n.17, paras [45] and [46]. See also: Commission decision
“State aid” or “compensation” approaches?
The Community Courts and the Commission have applied two different approaches to determine whether compensation for public service obligations is State aid within the meaning of Art.87 EC:

- **State aid approach.** The Court of First Instance (CFI) found in the FFSA and SIC cases that all funds provided from state resources are state aid, irrespective of the purpose for which they are paid. As such, compensation for services of general economic interests must be justified under Art.87(2), (3) or Art.86(2) EC.

- **Compensation approach.** In the Ferring case, and most recently in Altmark, the European Court of Justice (ECJ) rejected this view and held that compensation, which does not exceed the additional net costs incurred to fulfill the public service obligation, does not constitute a benefit within the meaning of Art.87 EC.

Current law is therefore that compensation for public service obligations does not constitute state aid, as long as it does not exceed the additional net cost of providing such service. The choice between the “compensation approach” and the “state aid approach” has two important procedural consequences:

**Notification.** If compensation for services of general economic interest does not constitute aid, then such compensation need not be notified to the European Commission in advance of payments. This complicates enforcement of state aid rules, but the Commission can examine excessive compensation either of its own motion, or on the complaint by a competitor. This solution, while administratively efficient (Member States do not wait for Commission approval), leaves service providers subject to legal and financial uncertainty.

**Stand-still obligation.** If compensation amounts are not deemed to qualify as state aid, the stand-still obligation under Art.88(3) EC does not apply. This removes the risk of national courts ordering (temporary) recovery for violation of the stand-still obligation.

While the procedural consequences are thus significant, the substantive outcome is in principle the same under the state aid and the compensation approaches.

For public service operators and their competitors, the practical impact of the different analysis is primarily that the Commission’s powers of control are more immediately exercised. After Altmark it seems unlikely that the Court will again revert to the state aid approach. The Court confirmed its approach in the most recent case, Enirisorse, where it found that neither the public services remit nor the compensation mechanism had been sufficiently defined, and that the compensation paid to a port services provider therefore contained state aid. In another recent case, Gemo, Advocate General Jacobs had expressed the view that the compensation approach was not necessarily suitable for all cases. Jacobs distinguished between (i) cases where the compensation was a *quid pro quo* for public service obligations that had been defined by the Member State and (ii) instances where the link between the public service obligation and the state measure is less clear. For the former category, the “compensation approach” would be appropriate, while the “state aid approach” (and the attendant *ex ante* control of the Commission) would be more appropriate for the latter category. The Court in Gemo did not find it necessary to address this point since it found that the public financing mechanism contained state aid.

22 However, one view is that the stand-still obligation does not apply to compensation amounts, because under Art.86(2) EC compensation for cost is compatible with the common market. Thus, under the state aid approach, compensation for service of general economic interest is state aid, but considered compatible under Art.86(2) EC. Compensation amounts above the actual costs require an assessment under Art.87(2) or (3) EC. By comparison, under the compensation approach, compensation that corresponds to the cost of providing the service is not deemed state aid at all. Compensation in excess of the actual cost is assessed under Art.87(2) and (3) EC as under the state aid approach.

24 The recent decision in Van Calster (op. cit. n.73) does, however, suggest that there may be situations where the two approaches may lead to a different substantive outcome. Because a compatibility finding does not cure illegality *ab initio* (from implementation of a scheme) and parties against whom unlawful levies have been made can then reclaim such levies *ex post*, it would seem that a number of non-notified state funding schemes could be at risk for the past even where a compatibility finding is later made. This could be of particular concern for instance in the public service broadcasting industry where licensee fee payors (households) might be entitled to reclaim license fees for any period up to a compatibility finding. Only if the licensee fee funding is found to never have been state aid (compensation approach) could such an outcome be avoided.
in favor of the users of the public service. The issue of whether there were aid elements in the compensation paid to the public service providers was thus left open.\footnote{Gemo, Case C–126/01, Opinion of Advocate General Jacobs, April 30, 2003, at paras [117]–[132], see in particular para.[125] on reconciling the judgments of the Court. Case C–126/01 Ministre de l’Economie et Gemo SA (Gemo) judgment of November 30, 2003 (not yet published).} The distinction drawn by Advocate General Jacobs in Gemo therefore remains open to be argued in future cases.

3. What costs can be compensated after Altmark?

As before Altmark, the proper amount of compensation may either be established by way of a public tender or by other means.

**Open tender procedures**

One way to address the amount of the compensation is to require that public service contracts be subject to open public tenders. The Commission has a preference for open tender procedures in sectors where multiple bidders can offer the same service.\footnote{See Commission 2001 Notice on Services of General Interest, op. cit. n.15, at para.26.} Such a procedural solution may well ensure that compensation amounts are economically appropriate, relieving the Commission of the need for a detailed investigation of the scope of the public service remit, as well as an examination of the related costs, revenues and compensation.

Open tender procedures may not be appropriate in all circumstances. In the postal and broadcasting sectors there may be one provider which for historical or political reasons is preferred or best suited to provide the service. Equally, in the maritime (and possible rail) transport sectors experience has shown that it may be inefficient to employ an open tender procedure because of the need for continuous services and substantial long-term investments that may not be recouped in an efficient manner through even the most advanced multi-year tender procedures.

**Other means for establishing the amount of public service compensation**

Absent an open, transparent and unconditional bidding procedure and unless the amount of compensation is clearly below costs, the determination of the costs related to the public service obligation and the appropriate amount of compensation will involve a number of difficult issues.\footnote{The Commission 2001 Notice on Services of General Interest, op. cit. n.15, sets out the basic principle that compensation may not “exceed the net extra costs of the particular task entrusted to the undertaking.” (at para.26). Note, however, that the compensation for the public service is often granted in ways other than straight forward grants. Calculating the actual benefit of a tax measure, state loans or guarantees involves other issues. In some cases, the state aid measure may also be indirect. Following a recent change in the Dutch copyright law, a public service broadcaster launched an on-demand music service the legality of which was the subject of much debate and several litigation threats. It was argued that public service broadcasters have been able and willing to take greater risks than private broadcasters as regards copyright infringement because damage awards “resulting from” public service activities will simply be offset by higher compensation amounts. This has the effect of enabling the public service broadcaster to test new business models before their private counterparts and may constitute a benefit on its own.}

In Altmark, the Court of Justice set out four conditions for determining whether compensation would fall outside the definition of state aid as set out in Art.87(1) EC. Each of these conditions must be satisfied for the state funding to escape state aid control.\footnote{From the way the Court described the conditions it would appear that the first three conditions apply also to situations where the public service compensation is determined by tender (see above). While this has always been clear for the first condition and makes sense for the third condition, it seems surprising that the “not exceed the reasonable costs” criterion would apply to the tender situation.}

Two of the conditions have long been part of the public services analysis:

- first, public services obligations (such as public broadcasting, certain postal services, port services, waste disposal or public transport) must be clearly defined and imposed by public authorities;
- second, compensation may not exceed the net additional costs for providing the service. This means in particular that income from the service must be set-off against costs and compensation may include a reasonable profit.

The Court seems, however, to chart new territory with two of its conditions:

- “Ex ante” definition of parameters. The Court holds that the parameters for compensation must be set objectively and transparently at the outset of a public services relationship. This means that a public service provider must ensure that all compensable cost factors are identified and budgeted for before assuming the obligation.

This appears to go beyond the current practice which focuses on the costs incurred and allows for retroactive

\footnote{From the way the Court described the conditions it would appear that the first three conditions apply also to situations where the public service compensation is determined by tender (see above). While this has always been clear for the first condition and makes sense for the third condition, it seems surprising that the “not exceed the reasonable costs” criterion would apply to the tender situation.}
adjustment of compensation. In Ferring, for instance, there was no clear nexus between specific tax benefits and projected costs, and the Court appeared to find it sufficient that tax benefits did not exceed the actual costs. The more restrictive Altmark approach was, however, applied in the recent judgment in Enirisorse, where the State funding for port services was not established on the basis of projected costs and therefore was found to contain state aid. 30 The test set out by the ECJ also raises the issue whether public service providers who “beat” agreed projections must forego the resulting profit because under the remaining conditions they may not receive compensation that exceeds actual costs. This may set the wrong incentives.

**Benchmarking.** The second new condition seems to go even further. If compensation is not determined through an open, public and unconditional bid, the level of compensation must be determined “on the basis of an analysis of the costs which a typical undertaking, well run and adequately [equipped] so as to be able to meet the necessary public service requirements, would have incurred discharging those obligations, taking account of the relevant receipts revenues and a reasonable profit [. . . ]”.

Until now, service providers had to show that the costs were necessary for providing the service and that they had, in fact, incurred the costs. Now it seems that, for compensation to escape state aid control, the “necessity” of the compensation for the obligation 31 will be determined by benchmarking the operations of the public service provider against a new and vague market oriented standard. This raises a number of questions: What is “a typical well run company”? In an industry with many companies providing the same services, does “typical” mean an average cost measure for the industry? Against whom does one benchmark when, as is often the case for public services, there is no company that offers comparable services, or at least not in the same (local) market? Does this test allow use of a benchmark company in another Member State? Even where the benchmark company is not operating in the same geographic market? When assessing a company that has several distinct public service obligations, does the test require benchmarking of the costs against each of the public service obligations? If so, does this imply that bundling of public service obligations becomes more difficult to manage as no public service provider can be equally efficient in providing each service? How would such a test apply to a public service broadcaster which is required to carry party political programs, children’s programming, local news, sports and educational content (several separate public services or a “package”).

Last, the judgment requires that the Art. 87(1) EC analysis include an assessment of whether the public service provider has adequate equipment for the execution of the public service obligation. This presumably means not only that one cannot benchmark against a low cost competitor who is unlikely to satisfy quality requirements because of under-investment (for example no adequate back-up resources if buses fail), but also that where the public service provider has over-invested and “gold-plated” its operations as compared with the average competitor, such over investment cannot be compensated without falling under state aid scrutiny. This could have a significant impact on former state monopolies that may be saddled with excessive production assets (or have chosen to over invest because of traditions in the public sector).

4. **Is Altmark irrelevant?**

A first reading of Altmark would lead to the conclusion that where the Commission or a competitor can prove that a public service provider was inefficient by comparison to “the typical well run” company, or “over-equipped” for providing a given public service, any compensation for costs representing such inefficiencies will be considered state aid and must be assessed as such. It seems implicit in the Altmark reasoning that in most cases, such state aid would be deemed operating aid and would therefore be unlikely to meet the conditions for approval, and would be subject to retroactive recovery if already paid out.

The Commission seems, however, to have reached a very different conclusion. The first post-Altmark decisions already indicate the new approach. In three decisions adopted on October 15, 2003 relating to compensation for Italian, Portuguese and Spanish broadcasters, 32 the Commission notes that the compensation paid to the Spanish broadcaster TVE did not meet the Altmark conditions and that therefore the compensation fell within Art. 87(1) EC and had to be assessed as state aid. Nonetheless, the Commission proceeds to find (without much ado in the press release

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30 See Enirisorse, Case C–34–38/01 op. cit n.2–25.
31 See, however, the pending case involving TV2 Denmark, op. cit. n.2–17, at para.[76], where the Commission invokes para.58 of the Communication from the Commission on the application of state aid rules to public service broadcasting ([2001] O.J. C320/5) and indicates that price dumping of advertising (on a commercial market) should be determined by benchmarking against an efficient operator. This is an application of the benchmarking test to determine “spill-over” from the activities that the subject of the public service obligation.
32 Not yet published; see Press Release IP/03/1399.
at least) that, in so far as the compensation does not exceed the net additional costs of the service, it is justified under Art.86(2) EC. 33

To the external observer the Commission appears to have reversed its practice again in an apparent desire to dispose of the Altmark judgment. It now accepts that compensation may fall under the state aid rules, but it again applies the pre-Ferring approach to approve under Art.86(2) EC any payments up to the “net additional costs” threshold. It would be interesting to see, whether the Court of Justice would share this interpretation of Altmark, in particular in so far as it renders meaningless the requirements of Altmark as regards “pre-set parameters” and “benchmarking”.

The Commission’s approach in the first cases may be motivated by the potentially significant impact of the Altmark judgment. The Commission seems to see Altmark as a decision requiring the Member States to ensure “good governance”—that is to ensure that taxpayer money is not spent on subsidising inefficient public service operators. In that sense, the judgment was a “warning shot” to the Member States. Commission and Member State officials have indicated that there are likely thousands of public service operators in the EU that operate under conditions that do not satisfy the four conditions of Altmark, and each operator would have immediately been at risk of a court injunction finding the aid illegal. With regard to those public service obligations that could be said to comply with the four Altmark criteria, the picture was equally grim. The application of Altmark would likely lead to an avalanche of notifications under Art.88(3), thereby placing Commission state aid enforcement under severe strains.

It remains to be seen whether the Commission will take the next logical step and adopt a Directive or other measure under Art.86(3) EC providing for a “block exemption” of all state aid up to the net additional costs threshold. Such a legislative measure, if adopted before Art.III–6 of the proposed Constitution applies, could resolve the issue of public service compensation for the past and the future, and limit scrutiny to the net cost component. The legislative measure could in particular be a way for the Commission to allow the Member States a limited transitional period to implement the “ex ante” and “benchmarking” requirements of Altmark. The Commission could thus ensure effective state aid enforcement in the future, reflect in the Art.86 context the “good governance” objectives set by the Court, and provide legal certainty all in one instrument. Failure to address the “good governance” principles of Altmark in an Art.86(3) measure would arguably constitute an ultra vires exercise of Commission powers insofar as the “Community interest” test in Art.86 does not seem compatible with state funding of activities that have been found to be inefficient in an assessment under Art.87(1).

E. Member State taxation and EU state aid control

1. Taxation and State aid issues—Background

Tax systems focus not only on generating revenue, they also have the function of creating incentives for certain behavior or discouraging unwanted activities. In addition, tax measures often have an element of “selectivity”. Because of limitations on scope, complex exceptions, and grounds for qualification or disqualification, tax laws result in some companies being subject to taxation and others not. Because taxation is to a significant extent not harmonised at EU level, this is in particular so when comparing similarly situated companies in different EU Member States. Because of these features, tax measures are not only very suitable as tools for European government industrial policies, but such measures are capable of distorting trade between the Member States.

In 1998, the Commission set out its state aid policy on tax measures in a notice. 34 In this notice, the Commission made it clear that it would carefully assess tax measures and that it would not tolerate illegal state aid contained in national tax systems. In 1999, the “Primarolo Group” reported to the Council with a study of Member State’s tax systems that identified 66 “harmful tax measures”. 35 Based on this report, the Commission initiated a number of state aid investigations, most of

33 The same approach was taken with regard to French TV stations France 2 and France 3, Commission Decision of December 10, 2003, Commission Press Release IP/03/1686.


which were concluded in the course of 2002–2003.\(^{36}\) Maybe the best known of these investigations, and that which has the most impact for multinational companies, is the controversy surrounding “co-ordination centers” in Belgium.\(^{37}\)

This Section briefly summarises two recent cases, and in that context examines (i) some procedural issues that are particular to state aid cases involving taxation measures, and (ii) the principal substantive legal issues in such cases. This article does not examine the possible grounds for finding compatibility of tax measures under the EC State aid rules, in particular rules on aid to R&D, investments or regional development.\(^{38}\)

2. Recent Cases—Issues and Analysis

In general, tax measures contain state aid when: (i) there is a benefit to a company or group of companies; (ii) this benefit is selective, that is it does not apply equally to all taxpayers concerned; and (iii) there is no justification inherent in the tax system for excluding a given company or group of companies from taxation.\(^{\text{39}}\) Tax measures almost certainly contain state aid in cases where the state waives a tax obligation that would otherwise be due by an individual company.\(^{40}\) More complicated issues result from tax measures that either apply only to a certain group of companies, or do not apply to certain companies. Two recent cases deserve particular attention:

- the cases concerning co-ordination centers, in particular in Belgium, Germany and Luxembourg\(^{41}\); and
- the pending German Road Toll case.\(^{42}\)

The co-ordination centre cases

The co-ordination centre cases gave rise to significant procedural issues as a result of the need to deflect the substantial economic (and political) impact of a finding of illegal state aid. Two aspects of these cases are of particular interest: (i) the Commission decision to limit the scope of its ruling to the future by applying the principle of legitimate expectations; and (ii) the subsequent Council intervention under Art.88(2) EC to allow application of the Belgian scheme for a longer period than allowed by the Commission.\(^{43}\)

Co-ordination centres are special purpose subsidiaries of multi-national companies. The creation of a co-ordination center is generally entirely tax driven: certain types of financing activities, if conducted through a co-ordination centre, will benefit from more lenient tax treatment than would otherwise be the case. In the mid-1980s, the Commission had concluded that at least some of the legislation creating these tax rules did not contain state aid. However, after the Primarolo Report labeled such tax structures as “harmful”, a Commission investigation that concluded in 2003 found that tax benefits for co-ordination centres in various Member States contain state aid. It also found that these benefits could not be justified under state aid rules.\(^{44}\)

As regards the Belgian scheme, the Commission was required to limit the decision to future effects. By approving the Belgian law in 1987 the Commission had given the Belgian scheme the status of “existing aid” in terms of EU state aid law.\(^{45}\) As a result, the Commission could not adopt a decision that involved retrospective recovery, and therefore directed the Belgian Government to amend the scheme prospectively from the date of the Decision and to phase out existing benefits by December 31, 2005.\(^{46}\)

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39 See Commission notice on the application of the state aid rules to measures relating to direct business taxation, \textit{op. cit.} n.2–34 at para.9 et seq.

40 See for instance \textit{British Energy}, \textit{op. cit.} n.56. A potential exception that comes to mind is an insolvency or restructuring of a debt type of situation, where the state would waive some of its tax due in order to secure a higher rate of actual payment; see also \textit{France Télécom}, \textit{op. cit.} n.14 (business tax regime).


42 \textit{German Road Toll}, Invitation to submit comments [2003] O.J. C202/5.

43 See n.2–41.

44 \textit{ibid.}

45 See \textit{Belgian co-ordination centres}, Commission Decision, \textit{op. cit.} n.2–37, at paras [70]–[73]. The concept of existing aid is discussed in detail below in Section F.

46 See \textit{Belgian co-ordination centres}, Commission Decision, \textit{op. cit.} n.136, at para.[123].
The equivalent schemes of other Member States which had not been notified and approved could not benefit from the principle of existing aid. Nonetheless, in a rare application of the principle of legitimate expectations, the Commission found that, also for these schemes, it would be inappropriate to make a finding of retroactive recovery. Accordingly, it required only prospective amendments.47

Even with these concessions the Member States had serious reservations about the Commission Decision to use Art.87 to curtail the freedom of Member States in the area of taxation. The Belgian Government therefore sought and obtained in July 2003 the extraordinary application of Art.88(2) EC to override the Commission decision and to extend until 2010 the phase-out for the Belgian co-ordination center scheme.48

**German Road Toll**

The recent opening of a formal investigation into the German road toll scheme raises the issue whether a provision that allows for an offsetting of fuel tax against road toll contains state aid.49 The proposed toll will be charged to heavy vehicles on the basis of kilometres driven on German highways. The toll scheme will be operated through an elaborate satellite-controlled system which tracks the vehicles. Passenger cars will not be subject to the toll. The road toll is intended to generate revenues for the maintenance of Germany’s highway infrastructure and other public roads.

Separately from the proposed road toll scheme, Germany (as other EU Member States) also charges tax on fuel at the time of purchase. The purpose of this tax is (at least partially) the same as that of the road toll: It is meant to generate revenues for the construction and maintenance of public roads. The road toll scheme allows heavy vehicle owners to offset fuel tax paid against road toll and thus lowers the total tax burden.

The question that arises is whether this “off set” provision results in a benefit to those that pay both taxes as compared to those who only pay either fuel tax or the road toll. The Commission investigation seems to be based on the concern that foreign heavy vehicles will be subject to both fuel tax (paid in another Member State) and the full road toll paid in Germany, whereas only German heavy vehicles will benefit from the offset mechanism which reduces the overall fiscal burden (an alleged de facto discrimination in the application of the tax reduction). It is unclear that this indirect effect of the toll scheme (where the foreign vehicles have the option of buying fuel in Germany) is sufficient to meet the requirement of “selectivity” in Art.87(1).

Even admitting that the Road Toll case is not a case of “tax competition” as was the Belgian Co-ordination Centre case, the Commission decision to investigate the proposed road tax scheme seems again to interfere with the ability of the Member States to adopt public policy measures and finance these through taxation. While the dispute seems mundane (in a sense, the German scheme is a variation on the “polluter pays” principle), it has a potentially serious impact on tax policy (and in other factual circumstances possibly on the network of bilateral double taxation treaties that bind the EU Member States): Must deductions from tax originate in the same Member State as the original tax receipts?50

Because EU tax harmonisation requires unanimity in the European Council, and Member States are naturally protective of tax revenues, the Commission has had little luck in convincing the Member States to harmonise tax regimes. Now it would seem that the Commission may be using the competition rules of the Treaty to achieve what it could not achieve in the Council. One may question whether this is sound policy and whether by effectively forcing the Council into more Art.88(2) EC decisions, the Commission is not at risk of undermining the competition rules by tainting them with political expediency.51

**F. State aid in the new Member States**

The accession of ten new countries from May 1, 2004 will lead to a substantial increase in population in the EU (to over 450 million) and complexity of business activities; an enterprise will have to deal with 25 different legal systems.52 EU enlargement, above all, represents a significant expansion of the “common

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48 See Belgian co-ordination centres, Council Decision, op. cit. n.2–37.
49 German Road Toll, op. cit. n.2–37.
50 This issue should not be confused with the freedom of establishment issues under Art.43 EC that have been considered in several tax cases, see, e.g. Case C–324/00 Lankhorst-Hoborst GmbH v Finanzamt Steinfurt [2002] E.C.R. I–11779.
51 Meanwhile, the decision raises also the interesting question of whether Germany would violate the stand-still obligation if it implemented the road toll scheme while the investigation is pending. It is recalled that the stand-still obligation only applies if the measure contains state aid.
52 Cyprus, Czech Republic, Estonia, Hungary, Malta, Latvia, Lithuania, Poland, Portugal, Slovakia and Slovenia; the Accession Treaty has been signed by all current EU Member States and the 10 accession countries on April 16, 2003. It still has to be ratified in every new Member State. However, under public international law, parties are under an obligation not to obstruct the purpose of the Treaty (See Art.18 Vienna Convention on the Law of Treaties). In the meantime, necessary popular referenda required for ratification have been concluded positively on the Treaty.
market” and with it an extension of EU laws, and including EC competition law.

At a practical level, enterprises will in particular be affected by the application of EC state aid rules to the new Member States. Eight of the 10 new Member States have fairly recently become market economies and each of the accession countries have gone through heavy structural adjustments in the 1990s. In almost all the countries, the public sector remains an important stakeholder in industry and has a substantial impact on the national economy.

In connection with the accession negotiations, the Commission and the existing EU Member States responded to this pre-existing situation by requiring a complex set of transitional arrangements and specific rules for the application of the concept of “existing aid” to pre-accession aid measures in the new Member States. These rules are contained in the Accession Treaty.53 Whereas the volume of state aid in the existing Member States has started to decrease in part because of enhanced enforcement, Commissioner Monti recently predicted that enlargement alone was likely to increase the workload of DG Competition in the area of state aid control by more than 40 per cent. This increased enforcement alone indicates the risks involved.

This Section provides an overview of the application of EC state aid law in the new Member States before and after accession, and the main risks for investors and enterprises.

1. Pre-Accession State Aid Control

Prior to accession, each accession country was required, under the terms of Europe Agreements,54 to adopt and implement national state aid legislation and to establish a national authority responsible for state aid control.55 Up to May 2004, state aid control in the accession countries is thus ensured by a national agency applying national rules.

Thus, under the pre-accession rules, the Commission had no direct competence in the territories of the candidate countries, but was merely limited to examining the actions of the national agencies on the basis of

the (limited) information and consultation mechanisms put in place by the Europe Agreements.56 Contrary to what applied to Austria, Finland and Sweden prior to their accession, there was no supra-national enforcement entity such as the EFTA Surveillance Authority. This meant that the national enforcement authorities experienced considerable pressure from their Governments to ensure that necessary foreign investments could be attracted through privatisations of, and debt-forgiveness for, previously loss making state companies (for example, Polish and Czech Steel industries), by tax breaks, or other investment incentives. Because legislation put in place to attract foreign investment was the subject of varying degrees of state aid control, the Commission and current EU Member States considered that it would not be possible to operate on a presumption that all aid granted prior to accession was compatible with the common market, even if approved by the relevant national agency.

2. “Existing aid” and Annex IV of the Accession Treaty

The state aid rules of the Accession Treaty are almost entirely based on the application of the distinction in EC state aid law between “existing aid” and “new aid”. Under EC law, a measure is “existing aid”, when (i) it existed prior to entry into force of the Treaty and has not been changed materially in the interim57; (ii) it has been authorised by the Commission or Council or is deemed so authorised58; or (iii) it has been paid prior to expiry of the 10-year statute of limitations set out in Art.15 of the Procedural Regulation. The Commission can modify a measure that is existing aid only with effect for the future by using what is referred to as “appropriate measures”59; it cannot order the recovery of existing aid. All other aid is “new aid” and must be notified to and approved by the Commission before it is granted.60 If the Commission finds that a new aid measure has been paid prior to approval and cannot be

53 See n.2–52, the Accession Treaty does not provide for any transitional regime for Estonia and Latvia.
54 Europe Agreements are bilateral framework agreements between the EU and each candidate country and establish a legal framework for the adaptation of the national legislation to EU legislation and the acquis communautaire.
56 This was ensured by means of regular reports on state aid programmes and individual aid measures to be communicated to the Commission. Even though it was lacking formal intervention powers, the Commission could require additional information and (indirectly) the amendment of the measures to ensure compliance with EU state aid rules. See Written Question by Joachim Wuermeling [2003] O.J. C52E/6.
57 See Procedural Regulation, op. cit. n.8, Art.1.
58 See Procedural Regulation, op. cit. n.8, Art.4(6). Aid is deemed authorised where the Commission has not taken a decision within two months of its notification.
59 Procedural Regulation, op. cit. n.8, Art.19.
60 See general description of Arts 87 and 88 EC in n.2 above.
approved, it can order retroactive recovery of such illegal aid up to 10 years in arrears.61

It follows from the above legal principles that absent any specific provisions in the Accession Treaty, all aid granted in the new Member States prior to accession would have qualified as “existing aid”, and state aid control by the Commission would have been limited to adopting “appropriate measures” with effect for the future. The issue of how to apply the “existing aid” principle was one of the key issues in the accession negotiations: How best ensure legal certainty for aid principles?62

The result of the accession negotiations was to reverse the presumption that is implicit in the “existing aid” principle. All state aid granted in the new Member States prior to accession is considered “new aid”, unless it was specifically qualified as “existing aid” in Annex IV to the Accession Treaty.63 A measure was included in Annex IV if it satisfied two conditions: (i) the measure had been reviewed and approved by the national state aid control authorities, and (ii) the Commission did not object to the measure in the framework of the information and consultation mechanisms put in place by the Europe Agreements.64 Annex IV was closed in November 2002.65

Four categories of aid are dealt with outside of this two-tier review system:

- aid measures subject to specific transitional arrangements (see below);
- aid measures in the agricultural sector which are subject to a separate regime; and
- aid measures in the transport sector.

Of these four exceptions, the first is clear and provides for “blanket approval” of pre-1994 aid, and the third and fourth raise a number of complex issues that are outside the scope of this paper. The further discussion below is therefore limited to the exception for specific transitional arrangements.

3. Other Transitional Arrangements

The Accession Treaty contains specific transitional arrangements for certain steel and shipbuilding enterprises, and for tax, environmental and aid programs that pre-date November 2002. The aid allowed by these transitional regimes is deemed compatible under the terms of the Accession Treaty, subject to implementation verified by the Commission.

Steel and shipbuilding. During the accession negotiations it became clear that several countries had industrial sectors in need of significant restructuring. Certain of these were in the category of industries for which current EU state aid rules no longer allow any restructuring aid, because the existing Member States have already completed a significant restructuring of these industries.67

The Accession Treaty therefore puts in place a special transitional state aid regime for the steel industry in Poland68 and the Czech Republic69 and shipbuilding in Malta.70 These transitional arrangements apply to each of the industries concerned, set maximum state aid amounts, and impose capacity reductions and limitations with specific references to the individual restructuring plans of each company concerned. To ensure compliance, the arrangements foresee complex and strict information and monitoring obligations. Aid

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61 Procedural Regulation, Art.15, op. cit. n.8; see also Section G below on the 10-year limitation period and the recent “compound interest” notice.


63 See Annex IV, Ch.3 of the Accession Treaty.

64 Idem.

65 For the interim period between November 2002 and May 1, 2004, a specific transitional procedure has been established which is based on the same principle of a two-tier review. To be considered as “existing aid”, measures have to be approved by the national agency and the Commission must not raise any objection as to the compatibility of the aid with the common market. It is foreseen that a second “existing aid” list for measures granted during the interim period will be integrated into the Accession Treaty after accession.

66 The reason for this date is that on December 9, 1994 the Council of Essen stated the importance of a tight system of the control of state aid in the new Member States. The EU therefore based the accession negotiations on the assumption that businesses in the new Member States have been on notice that state funds might become subject to Commission state aid control since at least the Council of Essen. (Conclusions of the Essen European Council of December 9, 1994, see Council Press Release of December 9, 1994, Press Release No.300/94; http://
granted in breach of any of the conditions foreseen in the transitional arrangements (and therefore the specific restructuring plans) is considered as incompatible with the Common Market and subject to recovery.

State aid through tax, environmental and investment schemes. Some of the Accession Countries maintain aid programs which are incompatible with EU law. Most of the aid programs are of a fiscal nature intended to attract investment or facilitate the transfer of SME from state to private ownership (tax credits, tax holidays for investors, and off-shore regimes), others are environmental aid schemes or specific investment aid schemes.

Under the transitional arrangements, these programs will have to be amended or phased out as provided for. Until the schemes are terminated, the Commission will be verifying that the programmes are applied strictly. Some of the rules foresee that the benefits of such programmes will terminate in the event of an acquisition or a merger.

4. The “after-enlargement”—Risks for existing and future investments?

After May 2004, the EU state aid rules will apply fully in the new Member States. The only “past aid” that will be exempted from Commission review will be aid listed as “existing aid” in the Accession Treaty ("two-tier" review and listing in Annex IV), or granted in accordance with the specific transitional regimes. All other aid (whether granted in 1995 or in 2004) may contain “new aid” which falls under the notification and stand-still obligation of Art.88(3) EC. Such aid can only be approved by the Commission, and failing approval is subject to recovery. However, in cases where the national state aid control rules of a new Member State prior to accession do not contain a provision equivalent to Art.88(3) EC, the recovery of such “new aid” does not appear to be possible. Aid cannot be qualified as “illegal” unless the relevant national rules contain a (notification and) stand-still obligation, the violation of which renders aid illegal.

However, it is worthwhile noting that with regard to aid granted to a number of Czech banks between 1994 and 1998 the Commission has come to the conclusion that the relevant measures will not be “applicable after accession” and are thus beyond the Commission’s remit. The Commission consequently closed the case. This may soften the potentially harsh effects of the existing aid/new aid distinction. Recent months have shown that competitors are increasingly filing complaints with the Commission alleging illegality of aid grants in past years. Many of these cases were, for one or another reason, not considered during the accession negotiations (possibly because the early experience of the negotiations indicated that the Community would not have agreed to grandfather the measures either through Annex IV, or through a transitional arrangement). The Commission thus announced an investigation concerning aid which the Czech Government planned to grant to ironworks Trinecke Zelezarny as this aid was not included in the restructuring concept negotiated and approved by the Commission.

Also, it would appear that economic pressures have led in particular certain accession countries to defer phase-outs and amendments required by the transitional arrangements on corporate tax breaks. As the Commission gains exclusive competence to review state aid measures, national action will not protect against a recovery order.

The uncertainty and risks identified above are particularly acute, because starting in May 2004, in addition to the prospect of a Commission investigation, beneficiaries of prima facie illegal aid are also at risk of an injunction by a national court, either seeking provisional recovery or to stop future payments of illegal aid. Particularly relevant to Eastern Europe because of the substantial number of privatisations and acquisitions in recent years, is that under certain circumstances a recovery order may be addressed to a purchaser of a company or business which benefited from aid prior to

72 e.g. corporate tax benefits in Hungary, Annex X under Section 6, 1.(a)(i), “In the event of a merger, acquisition or any similar event which involves the beneficiary of a tax benefit granted under the aforementioned legislation and falling under this para.(i), the benefit from corporate tax shall be discontinued.” An almost identical wording can be found for fiscal schemes in Malta, Annex XI, Section 6, under 2.(a)(i).
73 See 3. above.
74 Measure notified by the Czech government in favor of Komercni Banka and Ceska Sporitelna, Commission Press Release IP/03/1751, December 19, 2003. The banks were owned by the Czech Government at the time and have been sold to French Société Générale and Austrian Erste Bank respectively. These are the first 2 out of 16 notified cases. See also Česká Sparitelma, Commission Press Release January 28, 2004, IP/04/115.
75 Thus, the Commission only last month announced an investigation concerning aid which the Czech Government planned to grant to ironworks Trinecke Zelezarny since this aid was not included in the restructuring concept negotiated and approved by the Commission (see “Polish steel industry brace for private future” Financial Times, October 6, 2003; “Czech Trinecke ironworks in state aid probe” Reuters on May 28, 2003. Similar issues appear to have arisen for the Czech banking sector: “Czechs feel heat over bank bailouts” Financial Times, October 22, 2003.
the transfer of the business. Similarly, purchasers are well-advised to carefully study any terms that attach to restructuring plans that apply to acquired businesses. Any deviation from or amendments to an individual restructuring plan submitted to the Commission (for example, by the grant of additional aid or non-compliance with capacity limitations) will be considered as a breach of the transitional regime and could lead to the aid becoming unlawful (and non-approvable) “new aid” that may be subject to a recovery order by the Commission.

G. Recent Developments in EU State Aid Procedure

The increased importance placed on state aid enforcement has also led the Commission to review the procedural lacunae of EC state aid law so as to enable the Commission to adopt decisions that have the appropriate dissuasive effect and are enforced effectively.

The preceding sections of this paper have already touched on some of the most significant developments of a procedural nature, including the reliance on the “legitimate expectations” principle in the Belgian Coordination Centre case, the Council resorting to Art.88(2) in this case, the reliance on Art.82(2) and (3) to resolve the issues following the judgment in Altmark, and the extensive use of the procedural “existing aid” rules to deal with the state aid issues that arise in conjunction with EU enlargement in May 2004. There are a number of additional cases and policy initiatives that are worth mentioning to complete the overview of recent developments.

1. The Commission’s State Aid Modernisation Package

While not as extensive as current modernisation efforts in the fields of merger control and antitrust, the Commission in late 2003 announced a limited reform of its approach to state aid enforcement. The latest initiative was announced by Commissioner Monti and Director-General Lowe in a series of public speeches in December 2003 and has, apparently, three main elements: (i) the introduction of a “significant impact test” that will enable the Commission to prioritise its enforcement efforts on those cases of state aid that are potentially most distortive of competition; (ii) a draft implementing regulation and a notice on compound interest; and (iii) an increase in enforcement resources, in particular DG Competition personnel.

**Significant impact test**

In order to allow the Commission to focus its limited administrative resources on the effective control of state aid cases that have the greatest potential of distorting competition, DG Competition is currently working on two legal instruments that would allow for a simplified procedure for evaluating certain cases which are unlikely to have a significant impact on competition. The Commissioner and the Director-General have stressed that the simplified procedures do not imply that the aid concerned falls outside of the prohibition of Art.87(1), nor do the procedures exempt such aid from the notification and stand still obligations of Art.88(3) EC. The proposals would merely provide for an expedited and simplified clearance.

The two tests would apply in parallel. The first test relies on the “limited amount of state aid” involved (LASA), while the second could be used to assess larger amounts of aid, but which are a limited enforcement priority because of the “limited effect on trade” within the Community (LET).

**Limited amount of state aid—LASA.** Under the first approach, relatively small amounts of aid could be considered compatible with the common market under Art.87(3)(c) EC where certain conditions are met. Based on the published versions of public pronouncements by the Commissioner and the Director-General, the LASA test for expedited clearance would be met in *inter alia* the following situations: (i) the aid should be linked to the achievement of important Community objectives, such as promotion of R&D, protection of the environment, creation of new and better employment, promotion of training and promotion of SMEs; (ii) the maximum aid intensity should not exceed a threshold of currently 30 per cent; (iii) the maximum amount of aid to a single company should be limited to €1 million within a three year period; (iv) each Member State would be subject to a maximum of amount of aid that could be granted under the expedited procedure; and (v) certain safeguards would be introduced to ensure that the aid granted under the expedited procedure is not abused.

77 Seleco et al, op. cit. n.45.
78 See in particular the speeches of Mario Monti and Philip Lowe at a conference held by the British Chamber of Commerce on December 1, 2003. The text of these speeches is available on the Commission’s website.
79 This approach thus differs from the one taken with respect to aid that falls under the *de minimis* threshold of €100,000 within a period of three years and which is exempted from notification.
Limited effect on trade—LET. The second test seeks to identify certain measures that do not have a substantial adverse impact on trade within the Community. The test therefore applies only to selected economic activities that by their nature are unlikely to produce significant cross-border effects. DG Competition has announced that it intends to publish a list of economic activities for which state aid may be subject to the expedited LET test. In addition, DG Competition has indicated that aid can be judged under the expedited LET test if it satisfies the following four criteria: (i) the aid must be linked to expenses directly incurred in carrying out the activities concerned (operating aid); (ii) the aid must not exceed €3 million per year and per company; (iii) the aid must be awarded through a scheme that is open to all companies willing to carry out the identified activities, or must be awarded through a tender procedure; and (iv) transparency must be ensured.

While simplifying, and in particular shortening, the state aid procedure at least for those state aid cases which are supposed to have a limited distortive effect is to be welcomed, it is not clear whether these tests will work satisfactorily in all cases. Of greatest concern is whether the Commission will wish to address through the LET test some of the difficulties seen in the public service area, in particular as regards amounts which do not qualify for a compatibility finding under Art.86 EC. While an expedited LET procedure would allow notified aid to be dealt with quickly and efficiently, it would not resolve historic issues, in particular as regards illegality of aid prior to a compatibility decision. Nor would an expedited procedure seem appropriate for dealing with the complex economic assessments that are required by law under the Altmark jurisprudence, in particular as regards efficiency of the recipient enterprise. Last, the success of the LASA and LET initiatives will depend to a large extent on the procedural improvements the Commission has in mind for dealing with such cases. Proposals in this regard will likely be published in the course of 2004.

Draft Implementing Regulation

The Commission has recently published a draft implementing regulation on its website. This regulation is based on Art.27 of the Procedural Regulation. It introduces inter alia mandatory notification forms, lays down details of the notification procedure, the form and content of annual reports, the calculation of time-limits, the calculation of interest rates. This draft regulation is currently subject to Member States comments.

The Commission has also recently set out new rules on interest payments in a notice on compound interest in recovery decisions, which is apparently to be incorporated into the new Regulation. Under this notice, it expects Member States to recover compound interest on the amount of illegal state aid. This notice raises particular issues for countries where national legislation prohibits compounded interest (such as Italy and Germany). Undoubtedly, the Commission will require the Member States to recover compound interest from aid beneficiaries, but it is possible that this will leave acquirers of an undertaking that received aid without full recourse to a seller (as a court could find that a contractual indemnification clause providing that the seller remains responsible for state aid liabilities cannot provide for compound interest inter partes).

Dedicated enforcement staff in DG Competition

Finally, the Commission has created a new unit, staffed with four officials, whose stated objective it is to intensify the enforcement of recovery decisions. This unit will monitor the implementation of existing Commission decisions, will develop the Commission’s enforcement rules as well as ensure a consistent enforcement policy of the Commission.

Some of this increased emphasis on enforcement can already be seen in practice. The Commission is currently pursuing at least seven infringement proceedings, Bull being the most prominent of those.

2. Development of state aid procedure in the European Courts

Statute of limitation applicable to recovery decisions

A recent judgment also provides some insight into the scope of the Commission’s enforcement powers: In Scott SA, the Court of First Instance confirmed that the

80 See Section D above.
81 See, e.g. the issues raised at n.2–24 above.
83 Commission communication on the interest rates to be applied when aid granted unlawfully is being recovered [2003] O.J. C110/21.
84 Mr van der Wee has been appointed to head this unit.
85 See the following actions against Germany for failure to execute its decision to recover incompatible state aid from WestLB (Case C–209/00 Commission v Federal Republic of Germany); Belgium for failure to execute Commission decision on Maribel tax measures; France in relation to Bull (See, e.g. Agence Europe, “Commission prepares to go to court over Bull” September 27, 2003; and “EU Antitrust Chief Sues France Over Its Bailout of Groupe Bull” Wall Street Journal Europe, October 2, 2003; “Brussels sues France over illegal state aid” The Guardian, October 2, 2003).
limitation period provided for in Art.15 of the Procedure Regulation is applicable to aid granted before the coming into force of the Procedural Regulation. More importantly, the Court held that a simple letter sent by the Commission to the Member State constitutes a measure interrupting the 10-year limitation period.86 This makes it fairly easy for the Commission to interrupt the (already long) limitation period and thus preserve its powers to intervene against a given state aid measure.

The Commission letter (or Commission act, such as a decision) can, however, only interrupt the period of limitation if it refers to the illegal measure in question.87 The Court of First Instance is expected to rule on the “specificity” of the interrupting act in another pending case before the Court of First Instance. In that case, the applicant maintains that any Commission letter in relation to the beneficiary would lead to the interruption of the limitation period with regard to all potential illegal aid measures, even if they are not specified or even referred to in the letter.88

Interim measures
The CFI granted in Technische Glaswerke Ilmenau what appears to be the first interim measure in a state aid case. The President of the Court found that the applicant had proven the required elements (i) prima facie foundation of the claim and (ii) urgency. The President accordingly suspended enforcement of the decision for the duration of the proceedings.89 This order is important in so far as it addresses the difficulty of the national judge suspending a recovery order on grounds of the underlying illegality of the Commission decision.

3. Compatibility of Antitrust, Merger Control and State Aid Decisions

Finally, it is worth noting the continuing uncertainty as to whether the various decisions of the Commission in the area of competition law must take into account infringements of all competition rules, or only those that are the subject of the particular decision.

Merger control law considerations in state aid decisions
In Matra I and Matra II, the Courts stated that, although the procedures under Art.81 et seq. and 87 et seq. EC are independent procedures, the Commission is under an obligation to ensure that these provisions are applied consistently. In this case, the Commission services investigated at the same time a joint venture agreement notified for negative clearance under Art.81(3) EC and the compatibility of state aid notified in favor of the same joint venture. The state aid decision finding compatibility was taken only three days after the publication of a notice by the Commission in which the Commission made public that it intended to grant a negative clearance concerning the joint venture agreement. The Courts concluded that, in such a situation, the Commission can take a decision on the compatibility of the planned aid “provided that it has formed the conviction, with sufficient probability”, that the [operation] is not in breach of Art.81 and 82 EC.90 In other words when adopting a state aid decision, the Commission must consider the competition law aspects. This doctrine of “consistency” applied to state aid decisions was further strengthened by the judgment in SIDE in which the CFI held that “the Commission has not succeeded in showing that it was in a position to arrive at a firm view, based on economic analysis [. . . ] that the recipient of the aid was not in contravention of Arts [81] and [82]”.91

The Matra doctrine, while raising a number of issues that are outside the scope of this paper, is generally accepted as a logical consequence of the substantive rules. Aid granted to a joint venture that is ultimately found to be in breach of Art.81 (and thus is illegal) cannot be considered as compatible. Such aid would thus have to be recovered.

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86 Case T–366/00 Scott SA v Commission, judgment of April 10, 2003 (not yet reported), at para.[60]; and Case T–369/00 Département du Loiret v Commission, judgment of April 10, 2003 (not yet reported).
87 Art.15 of the Procedural Regulation, op. cit. n.8, provides that “Any action taken by the Commission or by a Member State, acting at the request of the Commission, with regard to the unlawful aid shall interrupt the limitation period” (emphasis added).
State aid law considerations in merger control decisions

In RJB Mining v Commission, the Court appears to have put the Matra doctrine “on its head”: that is, applied a similar logic to merger control proceedings. The case involved a situation where the Commission approved a merger while competitors were questioning whether there was a State aid element in the purchase price that benefited the acquiring party. The State aid issue was not addressed in the Commission Decision approving the merger.\(^92\) The CFI annulled this Decision on the grounds that:

although the Commission was not required to assess the legality of the supposed aid, namely the aid inherent in the merger in a formal preliminary decision [. . . ], it could not, in its analysis of the competitive situation under Art.66(2) of the ECSC Treaty, refrain from assessing whether, and if so to what extent, the financial and thus the commercial strength of the merged entity was strengthened by the financial support provided by that supposed aid.\(^93\) (emphasis added)

In the judgment the CFI essentially requires the Commission to examine the effect of state aid in a merger where (i) there is a claim (“supposed”) that there are state aid law aspects in a merger, and (ii) there is an “inherent” link between the state aid and the merger. In such a case, the Commission must examine (iii) whether, and to what extent, the aid increases by the “financial and thus the commercial strength” of the merged entity.

The new RJB Mining doctrine was applied in a string of cases in 2001 to 2002.\(^94\) From what appears in the published decisions, the Commission’s practice is less than entirely clear on any of the three elements of the RJB Mining test. The Commission does not seem to be testing whether the state aid claim is sustainable, and seems disinclined to identify a link between the state aid and the merger. Although interestingly in Deutsche Post/DHL the Commission was considering the impact of aid to the acquirer, not the aid “inherent” in the transaction. Last, and perhaps most importantly, the Commission has not so far developed a test for assessing the effect of the aid (increase in the “financial and thus the commercial strength”) in a sense that is relevant to the merger decision.

Many observers have taken the view that the RJB Doctrine is flawed. Not only is it questionable for the Commission to use merger control (involving private parties) as a remedy to enforce state aid law (involving Member States). The doctrine is also impractical because of the strict procedural time limits in cases under the Merger Control Regulation which cannot be respected if a full state aid investigation is required.\(^95\) Last, the doctrine seems devoid of purpose in so far as it resolves no real problem: If in the context of the state aid proceeding the “supposed” aid is either found (i) not to be state aid, or (ii) is found incompatible and recovered, no analysis of the “supposed aid” was required in the merger decision. Only if the aid is deemed compatible, would there seem to be an issue and then it would seem that the Matra doctrine would require the Commission to consider the strengthening of the competitive position in the state aid decision.

The very existence of the RJB Mining doctrine highlights the need for being aware of state aid risks when advising on merger control. One may, however, express the hope that the Community Courts in the future will resist the temptation to further develop this “holistic” doctrine of consistency between very different Commission acts. The recent judgment in BaByliss v Commission suggests that there are limits to the doctrine.\(^96\)

H. Conclusion

This paper has examined a number of concerns and issues in relation to six areas of application of EC state aid law. These concerns and issues will take on greater importance as the volume of state aid cases increases substantially in coming years.

\(^95\) Note that the RJB Mining case involved a merger assessment under the now defunct Art.66(2) of the ECSC Treaty where no such time-limits applied.\(^96\) Case T–114/02 BaByliss v Commission, judgment of April 3, 2003 (not yet reported). In that case the CFI seemed to limit the “inherent” link test of RJB Mining by finding that, while there could be such a link in a privatisation case, there was no such link in a case involving two private parties (para.[441]). It is interesting to note that a similar issue of substantive consistency between Commission decisions based on different competition rules, but the same facts, is raised in a pending case before the Court of First Instance. In Case T–206/01 P&O European Ferries v Commission [(2001) O.J. C331/22] the applicant argues that the market definition used for the distortion analysis in a decision approving restructuring aid is not compatible with a decision under Art.81(3) approving a joint venture. While the argument is interesting, it seems misplaced in the context given that the two market definitions are not incompatible, but one is merely more detailed in its analysis of one-way substitutability than was required of the other.
the state aid workload of DG Competition by 40 per cent, the current state of the economy and employment concerns increasingly lead Governments to rescue actions, competitiveness concerns are an incentive for more aggressive application of the R&D aid rules, and the recent judgment of the Court in Altmark raises the prospect of thousands of state aid notifications relating to local or regional public service contracts for urban transport, waste disposal, and so on.

Not all these cases will have substantial impact on the common market. The new approach presented by Commissioner Monti and referred to in the press recently\(^97\) should make it possible for the Commission to deal more efficiently with state aid cases that are not considered as distorting competition to an extent that is incompatible with the common market. The notion, as expressed, is that the Commission should be able, in its compatibility analysis, to operate with a presumption of legality where certain thresholds are not exceeded.

This would be the case either: (i) because of a “limited amount of state aid” (LASA) granted for certain projects (which is derived from the de minimis concept but applied to the compatibility analysis); or (ii) because the sector, in which they are granted, involves only to a very limited extent trade between member states (“limited effect on trade”; LET).

This more efficient enforcement will not, however, remedy on its own the more fundamental issues identified in the paper. Part of the “coming of age” of state aid law will require the Commission to seriously address in particular the following issues that are increasingly apparent from the practice of the last couple of years:

- The Commission will need to address the battle of opinions and whose business judgment prevails in private investor cases. The Treaty gives the Commission the power to judge whether that business judgment was based on recognised business and accounting principles and was reasonable in the circumstances. This can ensure effective control without the need for the Commission to substitute its own business judgment for that of the investor.
- Even with LASA and LET tests, the Commission will need to enhance both market analysis and distortion assessment in restructuring cases. Perhaps this is implicit in the acknowledgment in the recently released State Aid Scoreboard that compensatory measures will need to be reviewed to deal with the issue of distortion. However, the draft 2004 Guidelines suggest that the Commission did not resist the temptation to seek cover behind the presumption of distortion.
- Similarly, resolving the public service issue cannot be done by pushing the Altmark judgment aside. Legislative measures under Art.86(3) may be the appropriate means to allow Member States the time to adapt public service contracts to the “ex ante” and benchmarking requirements of Altmark, but the Commission cannot, without violating the “Community interest” test in Art.86, just disregard the “good governance” principles which the Court appears to have imposed on the Member States through that judgment.
- Last, the Council Decision to act under Art.88(3) EC to override the Commission decision in the Belgian Co-ordination Centre case should be a wake up call. Where the Commission tries to use the state aid rules to do what it has not been able to do with harmonisation proposals, the Council is likely to assert its powers. If politics replace the legal judgment, industry will cease to have faith in state aid enforcement as a branch of competition law. This will be a disservice to the development of EU law.

\(^97\) See Monti, “EU Commission to Focus on Major State Aid Cases” Dow Jones International of October 17, 2003.