Recent Developments in EC State Aid Law

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Why State Aid Law This Year?

• The short answer: Popular demand

• But more seriously:
  • State aid law is “coming of age” – more law, less politics
  • It affects hundreds of companies’ investment plans each year
  • Banks and financial markets have woken up to the risk
  • Tax and social security regimes turn out to be illegal…
  • With liberalisation of markets, State aid becomes a public policy tool

Last, we are in a recession: Mergers are down, State aid is up
A steady increase in cases

Source: 2001-2003 State Aid Scoreboards (European Commission)
Will you succeed?

Source: 2001-2003 State Aid Scoreboards (European Commission)
Total Aid in bn EUR
(less agriculture, transport and fisheries)

Source: Online State Aid Scoreboard (European Commission)
A Refresher:
Definition of State aid in Art. 87(1) EC

« [...] any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market. »
Art. 87(1) EC – The elements

1. **State aid in « any form whatsoever »:**
   - Tax breaks /relief from mandatory contributions
   - Sale or lease of shares, assets or public land on favorable terms
   - Grant of use to infrastructure, energy on preferential terms
   - Any State action that does not correspond to that which a private investor would have adopted

2. **« State resource »:**
   - resources/services from State
   - regional/local entities
   - State-owned companies where act *attributable* to public body (*Stardust*)
3. « Favouring a certain industry or undertaking »
   • « specificity » of measures
   • general measures are not State aid

4. Affecting trade between Member States
   • Effect on trade presumed for liberalised markets

5. « Distorts/threatens to distort competition»
   • potential distortion is sufficient
   • De minimis aid
Procedure and Outcomes

- Procedure
  - Notify or aid is illegal
  - “Standstill” obligation, but can be approved later (*Boussac*)

- Commission Decisions: Outcomes
  - Finding of no State aid
    - Measures meet private investor test / No effect on trade
  - Approval of aid (compatibility, but not legality - *Van Calster*; 24 Oct 2003)
  - Conditional approval
    - Obligation to restructure, reduce capacity, etc.
    - Where conditions are not satisfied: “Misuse of aid”
  - Negative decisions
    - Recovery of aid with interest / 10 year statute of limitation

- National Courts enforce the Standstill Obligation (*Ryanair*)
Five Issues

- **When is Government action not State aid?**
  The private investor test
- **Rescue and Restructuring Aid**
  Rescue aid; Restructuring aid, Compensatory measures, and distortion of competition
- **Public services and State aid**
  Compensation for public services obligations or State aid?
- **EU Enlargement**
  Effect of transitional regime on investments in Accession Countries
- **Procedural Issues**
  Merger control and State aid; Statute of limitations; Enforcement priorities
The Private Investor Test
The Private Investor Test -- Overview

- What would the hypothetical private investor have done?

- Why the Private Investor Test?
  - Non-discrimination: Art 87 may not prevent State ownership (Art 295)
  - Without test, the “standstill” obligation would paralyze commercial acts

- Principal questions that arise:
  - Which hypothetical investor? Indicators:
    1. Concomitance – other (private) investors at the same time?
    2. *Pari passu* – investing on same terms and in same proportion?
    3. But, are they all in same position? (*de novo* v. existing shareholders)
  - Financial difficulties? Presumption of aid
  - Test is applied *ex ante* / facts at the time of the investment
Issue 1: The Acceptable Rate of Return

- Business judgment rule (1993 Communication)
  - Government’s judgment: Is it a reasonable investment?
  - Supported by appropriate experts

- WestLB – “Average rate of return in banking sector”
  - Commission: investors will “at least” want average return
  - CFI: Average return is OK as analytical tool, but
  - Requires reasons why the average rate was chosen (not Credit Lyonnais)
  - Compare Alitalia – simple cross reference not good enough

- Why is average rate = minimum rate?
  - No private investor seeks average

- Is this about substituting the business judgment?
Issue 2: “Owner Effect”

- Shareholder with existing/controlling position acts differently from de novo/minority shareholder

- France Télécom – France argues that it announced:
  - Intent to subscribe to future share issue
  - Shareholder advance to tide the company over

- Question: Was it rational to help FT “time its market entry”?  
  - Commission seems to exclude “first step” / others were not willing
  - Controlling shareholder acts differently (that is the primary role)

- Preventing call on pre-existing guarantees by additional payment?
  - Bank Burgenland (170/247M€) / Linde – acting before foreseeable liability

- Would a private investor really do as the Commission?
Issue 3: Acquirer Liability

• Buying assets or shares – Are you responsible for past sins?
  • Banks – purchase by open tender process = seller keeps the benefit
  • Seleco – fair value opinion; “who assumed the risk in the price”

• When is it market price
  • Tenders and fair value opinions
  • Effect of allocation of liability in acquisition agreements?

• Commission still mulling over this one..
  • Wants Seleco scaled back (who benefits? continuing distortive effect?)
  • Circumvention concerns; but is bankruptcy law not the way to address?
  • But, arguing that very point in the WTO in antisubsidy cases
Does the Private Investor Test Need Fixing?

- *West LB* – The real question: Whose business judgment?
  - Member State investing? (1993 Communication)
  - Commission substituting its (“better”) judgment (*WestLB* & *FT*)
  - The Courts instead of the Commission?

- The CFI in *WestLB* and *Alitalia*
  - Reasoning and burden of proof
  - the CFI is pushing the Commission to the “battle of the experts”

- Where reasonable people differ: The investor’s judgment wins?
Rescue and Restructuring Aid -- The "Cancer" of EU State Aid
Rescue aid – Timing Issues

- Conditions for approving rescue aid (1999 Guidelines)
  - Remunerated guarantees and loans
  - Limited to the necessary amount
  - Limited duration (6-12 months) – extended for restructuring plan

- Urgency versus the standstill obligation
  - The timing of rescue difficult to reconcile with procedure
  - Effect of breaching standstill – illegality – the banks flee…
  - See France Telecom, British Energy, Alstom
Restructuring Aid: Conditions
Viability and “One-Time-Last-Time”

• « One-time-last-time principle »
  • New in the 1999 Guidelines
  • One restructuring within a 10 year period
  • Unless exceptional and unforeseeable circumstances

• Restructuring aid requires a restructuring plan
  • Long-term viability within reasonable timescale
  • Incentive for Commission to “second guess” on viability
Restructuring Aid: Conditions
Limiting distortion of competition

- **Minimum** amount of aid and **maximum** private contribution
  - What is « substantial » private contribution? (50%, 34%, 9.3%…)

- **Compensatory measures** to remedy distortion
  - **Theory:**
    - Aid shifts burden of structural adjustment to other producers
  - **Where (over-)capacity:**
    - Capacity closure (not sale)
    - Except if leads to monopoly or narrow oligopoly
  - **Recent practice:** Increased emphasis on compensatory measures
    - Also where no over-capacity (1999 Guidelines)
  - **Is this justified in light of limited market and distortion analysis?**
New Guidelines: Issues to be resolved

1. Commission’s review of viability should address:
   - coherence, reasonableness, sound method and approach of plan

2. Need for additional EC resources for assessment of the separate issues:
   - Viability of enterprise
   - Distortion and market analysis

3. A better distortion analysis?
   - Not simple overcapacity analysis (see Scoreboard)
   - Definition of «tolerable » degree of distortion

4. A more refined analysis of restructuring measures / remedies
   - Requiring “industrial” restructuring for a financial crisis (e.g., fraud)

5. Address the conflict between standstill and rescue measures
   - A block exemption, or a “fast-track” procedure?
Public Services and State Aid
Public Services and State aid

- Why care?
  - Postal services, banking, rail, bus transport, broadcasting...

- What are Services of General Economic Interest?
  - No definition in the EC Treaty (Art. 16 & 86)
  - Discretion of Member State
  - Increasing scrutiny, but scope of review limited to manifest error (TV2)

- Is compensation for carrying out the obligation “State aid”? 
  - Two approaches
    - Yes: State aid -- FFSA and SIC
    - No: Compensation -- Ferring and Altmark
  - Procedural consequences – notification and standstill obligation
Public Services and State aid

• What costs can be compensated?
  • Open Tender Procedures
  • Other means for establishing the compensation (*Altmark*)

1. Definition of public service mission imposed by public authority
2. Compensation not exceed net additional costs (w. reasonable profit)

3. *Ex ante* definition of cost parameters
4. Benchmarking (Efficiency Test)
   • “typical, well run company” – for each PSO? What market?
   • “adequately” equipped – “gold-plating” is not compensated?
Is *Altmark* irrelevant?

- Many public service operators cannot meet the four tests
  - The payments (and contracts) are illegal; Recovery?
  - Drown DG Comp with thousands of notifications?
- How to resolve?
  - A preview in the *TVE* decision (15 October 2003)
    - TVE fails the four *Altmark* tests, so payments are State aid
    - But because under “net additional costs” – compatible under Art. 86(2)
    - What happened to the efficiency test? Or is there one in Art. 86(2)?
- Will we see an Article 86(3) Directive?
  - Solving the notification and illegality problem of the Member States
  - “Good governance” (public efficiency) principles of *Altmark*
  - Transitional regime: Efficiency and *ex ante* testing after 2-3 years?
EU Enlargement and State Aid
EU Enlargement and State aid

- State aid at the centre of the Accession Treaty
  - Recent market economies with tradition of government intervention
  - Significant element of State ownership remains
  - Structural and social adjustments have been (and continue to be) significant
  - Much plant and infrastructure is uncompetitive; only attractive to investment if free of past debt
  - Foreign investments in recent years were often driven by tax breaks
  - No supra-national State aid control before accession
  - Commission expects 40% increase in State aid work as a result of the 10 new Member States
State aid in the New Member States

- Pre-accession State aid control based on « Europe Agreements »
  - Adaptation of national laws to EU rules
  - Introduction of national State aid control (national agency)
  - Commission has no direct competence, but verifies enforcement of _acquis communautaire_ (information exchange and consultation)

- Problem: Uneven enforcement = Past aid could _not_ be grandfathered

- The Solution: Accession Treaty reverses « Existing aid » presumption
  - Normally pre-accession aid is “existing” aid
  - Aid authorized by the Commission / Statute of Limitation / Lorenz
  - “Existing aid” qualification prevents ex post recovery
Accession Treaty

- Specific rules for «existing aid»
  - State aid granted prior to 10 December 1994
  - Aid approved by a two-tier review and listed in Annex IV
    - Approved by national government + no EC objection
    - Dual approval as above + modified Annex IV
    - Normal investigation procedure post-Accession

- Two special transitional arrangements
  - Restructuring of certain steel and shipbuilding industries
    - Set maximum aid amounts, capacity reductions, monitoring obligations
  - Amendment and phase-out of incompatible schemes
    - tax, environmental and investment legislation
  - Grandfathered benefits generally end with merger/acquisition
The After-Enlargement Risks?

• The aid is not listed as “existing aid” in the Accession Annex
  • Aid is “new” aid and should be notified
  • Third party complaint/investigation by Commission
  • Risk of negative decision with recovery (10 years)
  • National court can order recovery

• Non-compliance with transitional arrangements
  • Programme amendments = misuse
  • Incompatibility and recovery decision

• Increasing number of complaints

• First cases starting to appear
Procedural Issues
Procedural Issues

- New Enforcement Unit
  - Recovery even if appeal
  - Injunction against recovery (*Ilmenau*)

- Statute of Limitations for Recovery of Aid
  - 10 years back from interrupting act
  - Simple letter interrupts the period of limitation (*Scott Paper*)
  - Letter must specify the unlawful aid

- Interest on Recovery
  - Compound Interest Notice
  - Reference Rates
Procedural Issues

• Merger Control and State Aid Enforcement
  • *Matra* doctrine – merger control in State aid decisions
    • State aid compatibility if no breach of Arts. 81 & 82
    • Confirmed in *SIDE*
  • *RJB Mining* – State aid control in merger decisions
    • Commission must examine:
      • The “Supposed” aid, where
      • There is an “inherent” link between aid and merger
      • And determine increase in “financial and commercial strength”
    • Applied in several cases
      • *Deutsche Post/DHL* – Aid to acquirer, not a privatisation
      • CFI - *BaByliss v Commission* – not between private parties?
The Coming of Age of State Aid Law?

- LASA and LET testing for compatibility “quick look”?
- Whose business judgment in private investor cases?
- Better market assessment and distortion analysis in rescue and restructuring cases
- Art 86(3) Directive to solve *Altmark* problem? But with efficiency test?