

## EC State Aid Conference 2 November 2001

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### RECENT DEVELOPMENTS IN COMMISSION POLICY AND PRACTICE

As is the case in other fields of European law, Community state aid law develops in several ways. With more than 40 years' experience of state aid discipline, there is now an impressive body of **case law** from the European Courts and practice by the Commission in relation to the interpretation of Articles 87 and 88 of the Treaty. The Commission has also adopted a significant amount of so-called **soft law** in the form of Commission guidelines, notices and communications. The aim of this soft law is to make clear the policy that the Commission follows in its assessment of state aid measures under the Treaty. Nevertheless, there may be a need for even greater clarity concerning both (1) the criteria that the Commission applies when assessing the compatibility of an aid measure and (2) the criteria applied for assessing whether certain measures can be regarded as state aid or not.

The Commission in the mid-nineties modified its view on the desirability of **secondary legislation** in the form of Council regulations based on article 89 of the Treaty. Before the Commission was hesitant because some earlier proposals to the Council had not been adopted. This change of approach has resulted in the adoption of the *procedural regulation* and the enabling regulation, which enables the Commission to adopt *block exemptions* for certain types of horizontal aid (SME aid, training aid, employment aid, R&D aid, environmental aid, regional aid).

The main objective of the enabling regulation and the system of block exemptions was to simplify procedures for non-problematic types of aid and thereby free the Commission from a large number of notification procedures in routine cases. Hence, the primary aim was procedural reform *without* changing the substantive rules for assessment.

Notwithstanding the impressive body of case law and the Commission's soft law, the state aid articles of the Treaty continue to present challenging questions of interpretation. A good example is the recent judgment by the European Court of Justice in the *Preussen-Electra* case. This judgment deals with the concept of state aid and more precisely the question of whether a

legislative intervention in the market mechanism confers an advantage granted through state resources.

Today's conference will provide an excellent opportunity to explore many of the most significant recent developments of state aid law. I will focus on the recent trends in secondary legislation and Commission soft law.

Firstly, I will give an overview of the latest soft law adopted by the Commission and indicate the way in which it is evolving. I would highlight three developments. For traditional horizontal aid, as covered by the enabling regulation, the first block exemptions have been adopted for SME-aid, training aid and de minimis aid. However, block exemptions are not at this stage considered for all horizontal aid covered by the enabling regulation. Moreover, the enabling regulation does not cover all types of horizontal, regional or sectoral aid. I will give an overview of on going work within the Commission to update and revise its soft law. Moreover, I want to briefly explain how, in the recent past, new types of aid measures have emerged, which have been addressed by a new type of soft law. I am here thinking of the recent communication on state aid and risk capital.

Secondly, I will devote some time to the experiences so far of procedural reform. The procedural regulation entered into force in April 1999 and the first block exemptions have been applied since the beginning of this year. It will take time to fully understand the implications of the new rules and to explore the new elements of the procedural regulation. Nevertheless I want briefly to comment on experience so far.

## ***Recent developments of Commission soft law***

### ***Horizontal aid covered by the block exemptions***

The Commission's soft law has to a large extent been adopted in the field of "traditional" horizontal aid and it has provided criteria for the assessment of the compatibility of such aid. Therefore much of the soft law is covered by the enabling regulation and thus potentially by block exemptions.

However, the use of block exemptions is considered appropriate only when certain conditions are fulfilled. Firstly, the criteria that the Commission applies for judging compatibility should be well established and not in need of significant modifications. Secondly, the use of block exemptions requires that the compatibility criteria can be expressed very precisely in a legal text.

In line with this approach the content of the three block exemptions adopted to date (*training aid; SME-aid and de minimis*) follows the lines of existing

practice. They largely translate the criteria of the earlier guidelines into the more effective and reliable legal form of a regulation. With the introduction of the block exemptions the earlier guidelines for training and SME aid and the notice on de minimis were abolished. The new training aid and SME-aid regulations provide for notifications for larger amounts of aid, which the Commission intends to assess on the basis of the same criteria as provided in the regulations.

The conditions for the use of block exemptions means that they cannot be expected to cover all horizontal aid in the short term. The environmental aid guidelines are a case in point, concerning the two conditions for adopting block exemptions.

Environmental policy is a complex and dynamic policy field and the new *environmental aid guidelines*, which entered into force at the beginning of this year, incorporate many changes to the earlier guidelines. The 1994 environmental guidelines, although based on the "polluter pays" principle, accepted that total cost internalisation was not yet possible, and that aid could be necessary on a temporary basis. The approach of the new guidelines is that aid should no longer be used to make up for the absence of cost internalisation. Moreover, the new guidelines had to take into account that aid is granted more frequently in the energy sector. They also recognise that new types of measures, such as environmental taxes and guaranteed prices, are increasingly used. A flexible approach has been adopted for tax derogations. This form of operating aid is allowed for 10 years for enterprises that have signed voluntary agreements on environmental protection. For enterprises that have not signed such agreements, it is required that they continue to pay a significant part of the taxes in question.

The Commission is also in the process of revising the *employment aid* guidelines and the *research and development* guidelines. The Commission has already adopted a draft block exemption regulation for aid for job creation. At this stage, however, it is not envisaged that the block exemption route will be followed for the renewal of the research and development aid guidelines.

### ***Regional investment aid for large projects and to the "sensitive sectors"***

The Commission is currently undertaking work on the renewal of the *multisectoral framework*, which sets out the criteria for assessing aid to large regional investment projects. This framework, which was adopted for a trial period of three years (1998-2001), aims at limiting the amount of regional

aid to large investment projects.<sup>1</sup> The system is based on a modulation of the regional aid intensities normally allowed for investment in the specific region. According to the multisectoral framework, the maximum aid allowed is dependent on the capacity situation of the sector; the capital/labour ratio of the investment; and the number of indirect jobs created by the investment.

The multisectoral framework has not proved to be very effective in achieving its objective of limiting aid to large projects. For this reason, the Commission is in the process of discussing with Member States the need for major reform. The aim is simplification and to ensure an effective limitation of the aid authorised for large-scale projects.

This ongoing review of the multisectoral framework also includes a reassessment of the specific *sectoral rules* for steel, synthetic fibres and the automotive industry.<sup>2</sup> These sectoral rules currently set out various criteria for approving investment aid. The car framework, for example, requires mobility of an investment project as proof of the necessity of the aid and normally requires a cost-benefit analysis to determine the maximum aid allowed. The Commission would like to integrate these special sectoral rules into the new multisectoral framework, as was the case for the textile sector, when the current multisectoral framework was adopted. However, in integrating the specific sectoral rules into the more widely applicable text it is possible to apply stricter criteria to state aid to sectors in structural overcapacity, than would be the case for large projects in other sectors.

### ***Risk capital***

State aid discipline must be able to respond to developments in the markets and changes in Member States' policy priorities. This may be possible without major changes to the basic approach, as has been the case in the field of environmental aid. Recently, however, the traditional approach has been problematic in dealing with some measures aiming to promote risk capital. In order to clarify its policy for assessing risk capital measures<sup>3</sup>, the Commission has responded with a new type of soft law.

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<sup>1</sup> The framework applies to investment projects meeting one of the following criteria: (1) total aid amount is at least EURO 50 million or (2) the total project cost is at least 50 million EURO and the cumulative aid intensity is at least 50 % of the regional aid ceiling in the area concerned, and aid for job created or safeguarded amounts to at least 40 000 EURO.

<sup>2</sup> ECSC steel products are currently covered by the ECSC Treaty and the steel aid Code. This Treaty expires in July 2002 and these products will then be covered by the EC Treaty and its state aid rules. The Commission intends to continue the strict approach concerning state aid to the sector. The steel aid Code includes inter alia a prohibition of regional aid as well as rescue and restructuring aid.

<sup>3</sup> State aid and risk capital OJ C235, 21.8.2001

Before turning to the communication on state aid and risk capital, a few words about the background. In the late nineties the Commission was confronted with a new type of measures that Member States wanted to introduce, notably in the context of the European structural funds. This was at the time when the European Council underlined the importance of the "new economy" and many papers comparing the venture capital markets in Europe and the US pleaded for measures to encourage the development of European risk capital markets in order to reach levels comparable to those in the US. The state aid rules were regarded as an obstacle to this development, because many of the envisaged measures did not fit into the traditional approach. Hence, it was difficult for the Commission to assess and to authorise such measures.

The traditional approach to state aid control is reflected in a set of principles and assumptions, embodied both explicitly and implicitly in the Commission's soft law. They include *inter alia* the following:

- (1) state aid is granted for a specific purpose, which can be expressed concretely in the form of the *eligible costs* for achieving that purpose;
- (2) state aid measures that are not in the form of grants must be given an *aid value* in order to assess compatibility;
- (3) the compatibility of an aid measure primarily depends on the aid intensity, which is measured in grant equivalents (aid in relation to the "eligible" costs).

Additionally, it is often implicit in the traditional approach that :

- (4) aid is granted to the entity benefiting from the aid.

These elements of the traditional approach posed problems for risk capital measures, which are normally in the form of capital injections that are not provided for a specific purpose and cannot be measured in grant equivalents.

The compatibility criteria in the risk capital paper differs from those of traditional guidelines. The paper strongly underlines the need to establish the presence of a *market failure* as a criterion for authorising aid. The criteria provided for assessing compatibility in the Communication are:

- a "safe harbour" for transactions below certain levels (EURO 1 million in Article 87(1)(a) -regions; 750 000; 500 000 in other regions);<sup>4</sup>

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<sup>4</sup> The justification given is that for small transactions the argument that market failure exists through high transaction costs is more persuasive.

- above these levels there is a need to prove market failure ; the aid must be proportionate to the market failure ; and must minimise distortion; and
- additional compatibility criteria are expressed as "positive" and "negative" elements to be taken into account.

The experience with this new type of approach will be interesting. On the one hand, it clearly allows for more flexibility than the traditional guidelines. On the other hand, though, transparency and predictability cannot be as high as for soft law based on the traditional approach.

I want to underline that the risk capital paper does not mean that the traditional approach has been modified. In its risk capital paper, the Commission confirms its belief that there are, in general, good reasons for the "eligible costs" approach, which provides certainty, predictability and a basis for limiting aid and for ensuring equal treatment. The Commission also underlines the risk that a departure from the traditional approach entails the risk of accepting operating aid, which is considered as one of the most distortive types of aid.

### ***Scope of the state aid rules***

More difficult than to judge the compatibility of state aid is often to assess whether specific measures constitute state aid. This is also reflected in the topics chosen for this conference. The first topic of the programme is indeed the *definition of aid*.

The interpretation of the criteria for qualifying a measure as state aid has mainly developed through Commission practice and the case law of the Courts. Nevertheless there is some soft law that primarily focuses on this issue, rather than on the criteria for compatibility of aid measures. The most recent guidelines are the notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees and the notice on state aid and direct business taxation.

The *notice on guarantees* underlines that the risk associated with a state guarantee should normally be remunerated by an appropriate premium. Thus, even if no payments are ever made by the State under a guarantee, there may nevertheless be a State aid under article 87. The notice explains that the aid beneficiary is usually the borrower, who can obtain better financial terms for a loan than those available for him on the financial markets without the guarantee. It is, however, recognised that it can, in certain circumstances, be the *lender* that benefits from the aid since the guarantee provides it with a higher rating at the capital markets and thus cheaper funding costs. In this context, you will be aware that the

Commission has recently taken some landmark decisions concerning guarantees to German public banks.

The notice lists some conditions, the fulfilment of which ensures that public guarantee schemes and individual public guarantees do not constitute aid. The conditions aim at ensuring that the terms of the guarantees are in conformity with market conditions. Guidance is also given for assessing the aid intensity of guarantees. In this way, the compatibility can be assessed according to the specific rules concerning the compatibility of aid for horizontal, regional and sectoral objectives.

The *notice on direct business taxation* provides guidance on the sometimes difficult issue of whether a fiscal measure constitutes aid, or whether it is to be regarded as a general measure. Tax measures which are effectively open to all economic agents operating within one Member State are general measures and do not fall under articles 87 and 88 of the Treaty. The notice clarifies the selectivity criterion and also explains under which conditions the selective nature of a measure may be justified by "the nature or general scheme of the system".

You might be aware that the Commission in July of this year opened procedures on a package of tax measures, which are also being looked at by the Council group on harmful tax competition. There is indeed a link between these two projects. Already in 1997 when the Code of Conduct on harmful business taxation was agreed, the Commission committed itself to the strict application of state aid rules. The package of July concerns 15 tax provisions in 12 Member States and mainly focuses on preferential tax arrangements granted to multinational companies or to companies active in the insurance and financial sectors. In assessing the pending cases, the Commission is basing itself on the guidance given in the notice on direct business taxation.

Difficult issues about the scope of the state aid rules also arise in the field of *indirect taxation*. One problem is linked to the fact that the incidence of indirect tax measures is not always clear. If the consumer benefits from a derogation from value added tax there might not be any benefit to an undertaking and therefore no state aid. It may also be difficult to judge whether derogations to an indirect tax can be considered to be part of the logic of the tax system. This question appears, in practice, to be much more difficult to judge for indirect than for direct taxation. The Commission has, in recent practice, been confronted with this issue in the context of new environmental taxes in Member States.

An important discussion today centers around public services and rules concerning services of general economic interest. The Commission has set

out its general policy in this area in two Communications on "Services of General Interest in Europe" in 1996 and September 2000.<sup>5</sup> These Communications play an essential role in clarifying the dividing line between state aid and government activities that are not state aid.

Member States have been insisting on further clarification of this dividing line. The Commission has recently responded in a Communication including a report to the Laeken European Council. In the report the Commission announces Community guidelines for state aid granted for services of general economic interest in 2002.<sup>6</sup>

## ***Procedural reform***

### ***The procedural regulation***

The procedural regulation codifies, for the first time, state aid procedures in one single binding text. The regulation clarifies the four different procedures used depending on the type of aid: (1) *notified aid*, (2) *unlawful (unnotified) aid*, (3) *misuse of aid* and (4) *existing aid schemes*. Already this clarification of the different types of aid procedures is contributing to increased transparency and legal certainty as far as state aid procedures are concerned. After the adoption of the block exemptions a new category of aid has emerged, which is *block exempted aid*.

An important objective of the procedural regulation was to strengthen the controlling powers of the Commission. In this respect, the provisions of the regulation that reinforce the notification obligation and the standstill clause of the Treaty are of particular interest. The Treaty provides an obligation to notify all plans to grant aid and the standstill clause prohibits the Member State from putting aid into effect until the Commission has authorised it. Many of the new procedural rules can contribute to the respect of these cornerstones of state aid control. However, the procedural regulation has not changed the fact that the Commission has no real sanctions for the non-respect of the notification obligation. The rules on unnotified aid simply aim to restore the competitive situation *ex ante* before unlawful aid was granted.

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<sup>5</sup> OJ C 281, 26.9.1996 and OJ C 17, 19.1.2001.

<sup>6</sup> In a second phase the Commission will, if and to the extent it is justified by the experience gained with the application of the guidelines, adopt a block exemption for certain aid granted in the area of services of general economic interest. See COM(2001) 598. The Commission is also finalising a communication on state aid and public broadcasting.



I would like to comment on the following key aspects of state aid procedures in the light of the new regulation:

- (1) speeding up Commission procedures;
- (2) ensuring that Commission decisions are based on correct and complete information;
- (3) restoring the ex ante competitive situation when unnotified aid has been granted;
- (4) monitoring and control of compliance with Commission decisions.

(1) *Speeding up Commission procedures.* The Commission is often criticised for the lengthiness of state aid procedures. It is, indeed, true that the examination of state aid cases can sometimes take a very long time. It is, however, important to stress that the problems are of a different nature for notified and unnotified aid.

When an aid is *notified* to the Commission, the Member State concerned normally has a clear interest in speeding up the Commission decision and is ready to co-operate. Legal time limits for Commission decisions can, in such a situation be effective in speeding up procedures. Indeed the procedural regulation reinforces the two month time limit for the Commission to conclude the initial investigation procedure. It clarifies the so called Lorenz-procedure that the Member State can make use of. If no decision has been taken within the two month time limit, the Member State may put the notified measure into effect, after giving prior notice to the Commission.

However, the problem is, in practice, that the two month time period can only start to run from the receipt of a *complete* notification. If notifications are incomplete the Commission will request additional information and a new two months period starts to run from the receipt of that information. The regulation reinforces the position of a Member State, which considers that the Commission is requesting too much information. To this end it provides for the possibility for a Member State to declare that it considers the notification complete and to request the Commission to take a decision. At this stage it appears that Member States have not actively tried to explore this option.

The regulation also provides for the possibility for the Commission to consider a notification withdrawn if the Member State does not provide complete information. This option has so far only been used in a few cases by the Commission. This must be seen in the context that the Commission has no real interest in speeding up procedures in cases of notified aid. As

long as the standstill clause is respected no distortion of competition has occurred.

In practice the most important contribution to speeding up the initial first phase procedure for notified aid could result from the adoption of a standard notification form on the basis of article 27 of the procedural regulation. The form can help to clarify, in detail, the information necessary for the assessment.

The regulation also provides for a time limit of 18 months for closing the investigation procedure by a final decision. This cannot be expected to have considerable incentive effect on the Commission to conclude an examination of notified aid. The 18 months time limit is simply too long. However, recent practice in car cases shows that it has taken the Commission a minimum of five months to close an investigation procedure.

The procedural regulation does not provide for any time limits for unnotified aid. In these cases the Member States have not often requested the Commission to take a rapid decision. For the Commission the problem is in practice to receive sufficient information to base its decision on.

(2) *Ensuring complete and correct information.* The problem of ensuring complete information is, again, of a very different nature, depending on whether aid is notified or non-notified. A notification form should solve most problems for notified cases of traditional aid. The experience with the notification form of the multisectoral framework are in this respect rather encouraging. Such a form will have to allow for adaptations for different types of aid reflecting the different types of information required.

In cases of unnotified aid, the Member State might not, for obvious reasons, be very eager to provide information to the Commission. The procedural regulation, therefore, provides for an *information injunction*, which aims to ensure that the Commission receives the necessary information to deal with such cases. The consequence of an information injunction is that the Commission is entitled to take a decision on the information available if the Member State does not provide the information requested.

The potential for strengthening the information basis by information injunctions remains to be confirmed. The Commission has increased the use of such injunctions in recent practice. However, it is not clear that this has resulted in a significant improvement in the information provided by Member States. The main effect appears to be that the Commission is in a better legal position in taking decisions on the basis of incomplete information.

(3) *Restoring the ex ante competitive situation.* Ensuring that aid which has been unlawfully granted is *reimbursed* in an efficient manner is crucial for the credibility of a state aid discipline which is based on a notification obligation and a standstill clause.

The first thing to note is that the regulation empowers the Commission to take some provisional measures as soon as it learns about plans to grant unnotified aid. The Commission can issue a *suspension injunction* to suspend the unlawful aid until the Commission has decided on the compatibility ; and a *provisional recovery injunction* under certain conditions. In some cases the Commission has made use of a suspension injunction. However, the recovery injunction has not so far been used. The conditions are restrictive and in practice the Commission does not have enough information at this early stage.

The procedural regulation introduced some new elements concerning reimbursement of illegal aid. It has transformed the earlier *option* to request recovery, into an *obligation* on the Commission to order recovery when taking a negative decision on unlawful aid.<sup>7</sup> However, even before the adoption of the procedural regulation, the practice of DG Competition was to systematically order recovery when taking final negative decisions. The Commission also required interest to be paid from the award of the aid until its effective reimbursement. Therefore the procedural regulation mainly confirmed existing practice.

The most important thing is that the recovery decision is *executed* in an efficient way. In this respect the procedural regulation provides that recovery shall be effected without delay and in accordance with the procedures under the national law of the Member State concerned, *provided that they allow the immediate and effective execution of the Commission's decision.* In the event of a procedure before national courts, the procedural regulation provides that a Member State is obliged to take all necessary steps which are available in their respective legal systems, including provisional measures, without prejudice to Community law.

The Commission's practice in following-up recovery decisions has certainly been strengthened in the last two years. Clear rules and new internal reporting practices have been established for the follow-up by DG Competition. In case a Member State refuses to comply with the recovery decision, the Commission will systematically refer the case to the Court of Justice. Normally, however, the Member States co-operate with the

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<sup>7</sup> The exceptions, that rarely apply are if recovery would be contrary to a general principle of Community law and the 10 year limitation.

Commission to ensure recovery according to national procedures. They normally take the steps which are available in their respective legal orders in the event of a procedure before national Courts. The problem is that the national procedures are very slow. So far the potential provided by the procedural regulation to put into question the primacy of national procedures that do not allow for immediate and effective execution has not been explored by the Commission.

From any point of view it is clear that relying on national procedures for recovering aid creates an effectively unequal treatment between Member States.

In some cases, circumvention of a forthcoming recovery decision has been tried by the creation of new legal entities to take over the assets of the undertaking subject to the recovery decision. The Commission has in recent practice been vigilant in reacting to such transactions and it has extended the recovery obligation to the new legal entity taking over assets. I would, however, like to underline that this only applies in clear situations of circumvention.

(4) Efficient *monitoring* of compliance with the Commission decisions is an important element of a credible state aid control system. The procedural regulation introduced a new element in this respect by providing for on-site monitoring visits to the aid beneficiary in cases where serious doubts exist about compliance with a Commission decision. This new provision has not yet been used in practice. However, similar monitoring has already been normal practice in some cases of aid to the sensitive sectors. The Commission cannot, therefore, be expected to have any hesitations in using the new provision, should there be doubts about the compliance with Commission decisions.

Finally, I would like to note that procedural questions obviously remain to be clarified that are not solved by the procedural regulation. Therefore the jurisprudence will continue to play a significant role.

### ***Block exemptions***

The system of block exemptions removes the notification obligation for state aid covered by the exemptions with the aim to free Commission resources from routine cases. It also relieves Member States from the administrative burden of notification and allows them to award aid without a standstill period.

At this stage the possibilities provided by the enabling regulation to remove the notification obligation by use block exemptions has not been fully used.

It has not proved to be that easy to translate Commission's soft law into legally precise texts.

The success of the block exemptions heavily depends on the efficiency of the monitoring and control system that has been introduced. Member States have to provide to the Commission summaries of exempted aid schemes and individual aid awards, with a view to publication in the Official Journal. They are also required to record and compile all information on the exempted aid and to supply the Commission with annual reports.

I would like in this context to stress that interested parties have a significant role to play in ensuring compliance with the block exemptions through the national courts, due to the direct applicability of the block exemption regulations. Upon action brought against such aid, it will be up to national courts to judge whether the conditions of a block exemption regulation are fulfilled.

### ***Further modernisation of the state aid discipline***

The key objectives of the modernisation project, that has so far resulted in the procedural regulation and the block exemptions, continue to guide the state aid policy of the Commission. Further efforts will be made to increase transparency and efficiency of procedures and to focus resources on the most distortive types of State aid. The experiences with the procedural regulation and the block exemptions provide a basis to build on.

Increased ***transparency*** is not only pursued by clarifying the Commission practice in soft law and adopting secondary law on the basis of Article 89. The Commission has put into place a *state aid register* and a *scoreboard* to increase transparency about the cases decided by the Commission and the state aid policy of Member States. These instruments will be further developed.

Increased transparency, also at the national level, should contribute to activate the role of national Courts in state aid control. They have an important role to play not only in the context of the block exemptions but more broadly in reinforcing the standstill clause of the Treaty. Competitors should become more vigilant in bringing cases before the national Courts. In an enlarged Community with many more Member States the enforcement of state aid law must become, to a larger extent than it is today, a shared responsibility of the Commission and the national Courts.

At the same time as the Commission pursues its modernisation project Member States are currently discussing their national state aid policies in the Council. As part of the so called Lisbon agenda the European Council has underlined the objectives to reduce and to reorient state aid from

undesirable objectives to desirable ones. Discussions are foreseen in the Council, during the Belgian Presidency, to examine how these objectives have been followed-up by Member States.