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# STATE AID ACTION PLAN

# CBI'S RESPONSE TO THE COMMISSION'S CONSULTATION

# 14 September 2005

## SUMMARY OF CBI'S RESPONSE

The effective control of state aid is an essential underpinning of the EU's drive for competitiveness. The development of world-class companies should be competition-led not dependent on government hand-outs. In its role as gate-keeper the Commission must address new challenges to ensure a level playing field for business and eliminate distortive state aid.

The CBI believes the five main priorities for the Commission are;

- Focussing its resources on the large distortive state aids, often associated with restructuring politically sensitive companies, and streamlining reviews of small schemes. The exemption limit for small amounts of state aid has not been increased for many years and should go up to 250,000€, spread over 3 years.

- Recovering the one third of illegal state aid which is at present outstanding by increased transparency and better processes. Recovery is the only deterrrent to the granting of unlawful aid.

- Enhancing third party rights to aid enforcement.

- Greater emphasis on economic analysis in presenting and reviewing state aid cases.

- Simplifying the present rules and exemptions.

## Introduction

The CBI welcomes the Commission's proposals for a comprehensive reform of state aid policy. State subsidies have the capacity to distort competition between firms, both within the same Member State and in different Member States. National governments, by funding and assisting domestic enterprises, can create and reinforce substantial barriers to competition and trade. Subsidies encourage inefficiencies, by shielding firms from market forces, and in the longer term are detrimental to consumers through higher prices and a lower quality of goods and services. An effective competition policy must, therefore, alongside rules relating to mergers, cartels and dominance, lay down strict controls on state aids to businesses.

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In the last few years, the Commission has achieved significant reforms in Article 81/82 enforcement and in merger control. As a result of modernisation, it has streamlined its enforcement in relation to cartels and restrictive practices. It is now time for the Commission to turn its attentions to the modernisation of state aid policy, particularly in light of the renewed commitments by the Member States in the Lisbon Council.

There has been talk in the past of state aid reform which has not come to anything because of pressure from some Member States. We believe it is essential that the Commission, having now created the momentum for state aid reform, continues to provide the leadership and drive to see these proposals through.

## Challenges

There are substantial problems in the current implementation of the state aid rules under Article 87 of the Treaty:

1. The Commission's interpretation of state aid under Article 87 is often highly formalistic and academic, paying little attention to the real impact of state aids on the market.

2. A large part of the Commission's resources are tied up with the investigation of small, local aid schemes which have little or no distortive effect, rather than with the tackling of major subsidies to large enterprises, which have a more serious impact on competition and trade.

3. In recent years, both the Commission and the Court have expanded the definition of state aid to cover a wide range of State interventions. This has increased the need for precautionary notifications of schemes which have no real anti-competitive effects. A case in point (in the UK) is the Commission's attitude towards grants to social or voluntary enterprises engaged in public sector services. Again, this represents a distraction from the need to tackle large, unlawful payments of subsidies to major enterprises.

4. There is a lack of consistency and predictability in the treatment of state aid, contributing to legal uncertainty on the part of investors and aid recipients, for example in major transport and energy infrastructure schemes.

5. The application of the rules is unnecessarily complex. The Commission has developed a plethora of guidelines, working papers, and communications, dealing with various types of sectoral or horizontal schemes, which can make it difficult to ascertain how the rules are applied in particular circumstances.

6. Negative decisions by the Commission, requiring the repayment of unlawfully granted state aid, are not consistently enforced against the Member States. A significant proportion of unlawful state aid is never recovered from the recipient. This in turn undermines the deterrent effect of the state aid prohibition in Article 87.

7. The Commission's willingness, in a number of well-publicised individual cases, to approve large sums of state aid for restructuring purposes actively encourages Member State governments to subsidise national champions.

8. There is often a danger that political influences are brought to bear in state aid decisions, particularly where other DGs are involved in the assessment of state aid.

9. There is a lack of clarity about the role of third parties, which have no formal rights as such in bringing complaints to the Commission – in contrast to third party rights in other areas of competition policy.

10. There are substantial barriers in the bringing of state aid challenges in the domestic courts.

We therefore strongly support the proposals for a reassessment of state aid policies and procedures to achieve the key objectives set out in the Lisbon Strategy.

**Prioritisation**

The CBI is concerned that a large part of the Commission's workload focuses on relatively small, domestic aid schemes. There is an urgent need to re-focus the Commission's priorities, to concentrate on the challenging of substantial grants and subsidies having significant cross-border effects.

Under the Treaty, Member States are required to notify all aid for prior assessment by the Commission. Furthermore, only the Commission can authorise state aid under Article 87(2) and (3). We recognise that a system of *prior* control places a major burden on the Commission, and that the Commission cannot (unless the Treaty is amended) delegate or decentralise its functions.

However, notwithstanding the Commission's exclusive jurisdiction under the Treaty to assess notified state aid, there are a number of measures which would enable the Commission to concentrate and focus its resources on the more important aid schemes:

(a) There is a case for increasing the ceiling for de minimis aid under the block exemption. The current level of €100,000 has remained unchanged for several years and we propose should be increased to €250,000, spread over three years. Small amounts of state aid are highly unlikely to significantly distort competition or intra-Community trade. However, as we argue below, the increase in the de minimis ceiling should be accompanied by greater transparency, through publication of all de minimis aid. This would enable third parties to monitor de minimis aid provided to competitors, and to challenge abuses of the block exemption system. The Commission should also have the right to withdraw the block exemption in individual cases where there is evidence of significant anti-competitive effects (similar to the Commission's powers under Article 81 block exemption regulations).

(b) The Commission should re-introduce "fast tracking" for smaller, domestic aid schemes to achieve the principal objectives of the draft LASA and LET notices. There are clearly many notifications which, although they may technically involve state aid within the meaning of Article 87, do not raise significant competition issues at a European level. These do not require the same level of assessment as, for example, major restructuring aids. The CBI would support proposals which enable schemes with limited competition and trade effects to be dealt with on an expedited basis.

(c) A large part of the Commission's work load is taken up with third party complaints. As we indicate below, third parties have a vital role to plan in providing information to the Commission regarding unnotified state aid, and in demonstrating the effects of notified state aid in a particular market. However, the Commission should prioritise its handling of complaints, concentrating on those relating to larger schemes which can have European-wide effects. The Commission similarly prioritises competition law complaints, concentrating on those which have a significant Community dimension. Third party complaints which do not raise significant competition and trade concerns should be dealt with in the courts.

**Recovery of illegal state aid**

The state aid roadmap rightly highlights the need to improve recovery of unlawfully granted state aid. There is widespread concern that many negative decisions are simply ignored by Member State governments, and that a significant proportion of unlawful aid is never recovered from the recipient firm.

It is essential to the integrity of the state aid regime that there is proper and effective enforcement of state aid rules. The principal incentive for Member States to notify state aid is the risk that unnotified aid may need to be recovered. If recovery is effectively being ignored, there will be no effective deterrent to Member States to prevent further breaches of the rules.

The Commission therefore has to take more seriously the monitoring and enforcement of recovery decisions against Member States:

(a) There should be an expanded enforcement team within DG Competition, charged with reviewing the way in which Member States follow up negative decisions.

(b) There should be a greater willingness on the part of the Commission to have recourse to infringement proceedings under Articles 226 and 228, where the Member States does not take reasonable steps to recover aid.

(c) The Commission could undertake periodic reviews of the extent to which individual Member States have complied with recovery decisions. Infringement proceedings could be taken where the evidence indicates that Member States are simply failing to implement decisions across the board.

(d) In order to improve transparency, the Commission should publish, as part of the state aid scoreboard, details regarding the progress of the implementation of recovery decisions. This could increase the pressure on Member States to take the necessary steps to recover unlawful aid.

(e) The CBI would support the introduction of further investigatory powers on the part of the Commission when investigating Member State governance. However, the Procedural Regulation already provides the Commission with significant powers, eg. in relation to on-site monitoring. What appears to be lacking is the willingness to invoke these against Member States.

(f) A new Remedies Directive (referred to below) could clarify the Member State's ability to recover aid in the national courts, under its own national procedures. This would remove the potential for recipient firms to raise arguments to thwart recovery, eg. on grounds of legitimate expectation or legal certainty. Such a Directive could also provide for third parties to challenge Member State governments which fail to recover state aid.

## Enhancing third parties' rights

In relation to Article 81/82 enforcement and merger control, third parties have an invaluable role to play in the Commission's assessment of transactions. In consequence, the rights of third parties have been clearly established and defined, for example in terms of rights to hearings, access to file, etc.

It is anomalous that similar rights have not been acknowledged or recognised in the area of state aid enforcement. Third parties have a crucial role to play in the challenging of large state aid schemes, both in alerting the Commission to unnotified aid, and also in providing an understanding of the effects of the aid in the relevant market.

The CBI would like to see much greater involvement of third parties in state aid enforcement:

(a) The Commission should publish a brief notice in the OJEC of every state aid notification. This could be along the lines of the notice published for every merger notification received under the EC Merger Regulation. Third parties should be given an opportunity – say within ten days – to submit comments. At present, the Commission only publishes third party notices at the beginning of the Article 88(2) procedure – but (as in the case of mergers) there may be many significant "Phase 1" cases where third party input is important for the Commission's evaluation of the aid.

(b) The Commission is strongly encouraged to consult more widely with third parties before taking state aid decisions. In Article 81/82 and merger cases by contrast, the Commission frequently sends out questionnaires to third parties.

(c) The Commission should also recognise the role of third parties in its decision making. Currently, the Procedural Regulation provides no rights to third parties whatsoever (beyond the ability to submit a complaint). In appropriate cases, complainants should have the right to a hearing or to review non-confidential versions of documents submitted by the parties under investigation. This would be no different to the procedures under Article 81/82 and merger control.

## Economic approach

We fully endorse the proposals for a "refined economic approach" in state aid enforcement. In Article 81 and 82 enforcement, the Commission focuses on the economic significance of anti-competitive behaviour, and a similar approach is required in state aid enforcement.
It must be recognised that, unlike in relation to Articles 81 and 82, there is no "significance" or "appreciability" test in relation to state aid. The ECJ has indicated that even small amounts of state aid, which have no visible distorting effect on the markets, are in principle capable of being caught by Article 87.

Nonetheless, an economic approach to state aid enforcement is a pre-requisite to improving state aid enforcement. Article 87 applies to state aid which, inter alia, distorts competition and affects intra-Community trade. The Commission needs to focus far more on aids which have a serious effect on the market. Effects, rather than form, based economic analysis, such as the Commission has in recent years moved towards in its guidance on the application of Article 81, has a fundamental role to play in the assessment of state aid.

There is also a need for a much more rigorous approach in defining inter-state trade effects. A number of recent decisions (e.g. *Brighton pier; Dorston swimming pool*) have involved state aids which have no real effects on trade, and where any concerns regarding trade distortions are entirely academic. Decisions of this nature encourage Member States to notify on a precautionary basis schemes which have no real European dimension. This represents a patent waste of scarce resources, which could be better deployed in tackling major rescue and restructuring packages. The Commission therefore must introduce far greater rigour in its analysis of trade effects.

In our view, the notification form submitted by Member State should require more detailed economic analysis (for example, a description of the market affected, and market shares) than is currently required. The Commission could grant "waivers" in relation to straightforward cases, as in the case of mergers.

As discussed below, the Commission should give detailed consideration to economic evidence provided by third parties, since they are often in the best position to explain the effects of state aid in a given market.

**Simplification**

The CBI agrees with proposals to simplify and consolidate EU state aid rules. Over the last few years, the Commission has developed a substantial amount of "soft" law through guidelines and communications., some of which have overlapping effects. Many businesses find it extremely difficult to understand how the Commission will assess a particular aid scheme, particularly where both horizontal and sectoral guidelines may apply.

We would support the introduction of a single, consolidated block exemption. We would also urge the Commission to consider similar consolidation in relation to its guidelines to make clear how guidelines (for example, in relation to risk capital and environmental protection) inter-relate.

The CBI would not be in favour of any significant extension to the current block exemption regime which presently covers de minimis, training, SME and employment aid. Any new areas of exemption should be closely examined on their merits. Possibly, there may be a case for widening block exemptions in relation to aid for SMEs.

The CBI also emphasises the need to retain and enforce the cumulation rules in the current block exemptions.

There should also be greater transparency when Member States use the block exemptions to grant funds. Member States should be required to publish a register of all block-exempted aid schemes, so that these can be reviewed and monitored by affected third parties. Abuses can then be challenged, either by a complaint to the Commission, or in the Courts. As stated above, the Commission should also retain the right to withdraw a block exemption if specific anti-competitive concerns arise.

## Litigation

The Commission points out in the state aid roadmap that Article 88(3) has direct effect, and enables litigants to challenge state aid before national courts. We welcome the launch of a study into the role of national courts in protecting third party rights.

As explained above, the Commission should concentrate on complaints which raise significant competition issues at a European level; complaints regarding less significant schemes could be dealt with in the national courts.

In practice, however, a litigant seeking to challenge state aid in the domestic courts faces substantial hurdles. Many of these are identified in the AEA study for the Commission in 1998 ("Application of EC State Aid Law by the Member State Courts"). These include: uncertainties regarding the available remedies under domestic legal systems; the limited knowledge of national judges and courts in this area; and a lack of transparency regarding local procedural rules. There has been little change to the position over the last few years.

In the area of EU public procurement law, the adoption of a "Remedies Directive" provided for a harmonisation of rights and remedies in the national courts for dealing with breaches of the procurement rules. As a consequence, a litigant seeking to challenge the award of a discriminatory competitive tender process has the option not only of a complaint to the Commission, but also of seeking an injunction to stop the award of the contract or damages once the contract has been awarded. The introduction of national remedies has given rise to a significant number of cases in the national courts, and this provides in turn a deterrent to public authorities from infringing the rights of bidders for major contracts. We believe the Commission should consider the adoption of a similar directive, to provide harmonised remedies including injunctive relief and damages, in the Member State courts in cases of unnotified state aid. This would provide a clear and transparent set of rules throughout the EU to facilitate third party claims in the courts.

We would emphasise, however, that the principal means of enforcement remains with the Commission. Litigation in the national courts cannot replace strong, effective action at a European level.

## Role of independent authorities

The Commission has floated the idea of involving national authorities in state aid enforcement.

It goes without saying that state aid enforcement cannot be decentralised in the same way as cartel or merger enforcement. The grant of un-notified state aid involves a breach by the relevant Member State government. It requires a central, independent body to take enforcement decisions.

We accept that there may be some role for national authorities to play in aspects of state aid control, for example in assisting the Commission with the detection and recovery of unlawful aid. However, the national body would have to be completely independent of the State executive in order to carry out these tasks. In many Member States, competition authorities and audit bodies have been set up and are funded by government, and it is questionable whether they are sufficient distinct from the executive to carry out a genuinely independent role.

That said, there may be some scope for involving national audit bodies in the monitoring of state aid as part of their general audit functions. They could, for example, be required to inform the Commission of any evidence of state aid which emerges from the auditing of a public sector body, or report on the steps taken by the government to recover unlawful, un-notified aid.

## Procedures

The CBI supports the Commission's proposals for improvements in some of its procedures, including the preparation of "best practices guidelines", more predictable timelines, and higher transparency by providing more information on the internet. Recently the Commission has introduced a number of improvements to its procedures, such as introducing a cut-off for finalising an application, and we support these reform efforts.The Commission should in particular implement some of the practices which have been developed in relation to merger notifications, in particular the practice of pre-merger discussions in order to improve the quality of notifications and prevent incomplete notifications.

The CBI also believes that DG Competition should have an exclusive remit to deal with state aids, and that the involvement of other DGs (energy, transport, etc.) should be limited.

## Guidelines

The Commission is also proposing a review of its various guidelines, e.g. in relation to rescue and restructuring aids, the communication on public sector broadcasting, and the notice on direct business taxation.

We will not deal here with these individual policy notices; the CBI would welcome the opportunity to submit comments as individual policies are put out to consultation.

## Innovation

Finally, the CBI notes the Commission's intention to make innovation a key priority within the state aid reforms.

CBI members would be concerned if the Commission is proposing a relaxation of the current state aid regime in relation to innovation and R&D. The term "innovation" is extremely wide, and can cover many different forms of commercial activity. The abiding principle should remain that state aid for innovation should only be allowed where: (i) there is a clear market failure on the part of the private sector to invest in a particular technology, know how, etc; and (ii) the funding of innovation will not significantly distort competition with the recipient firms' competitors. It is essential that the Commission continues to scrutinise all state aid schemes designed to encourage innovation.

There may well be a case for governments to grant subsidies to encourage new technology start-ups or stimulate technological developments by SMEs. Again, a market failure must be shown before State intervention can be justified. However, grants to large enterprises are a different matter. These will require very careful review of the underlying impact on competition.