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Position paper on State aid reform

1. INTRODUCTION

We welcome the opportunity to comment on the State Aid Action Plan "Less and better targeted State aid: a road map for state aid reform 2005-2009" which outlines the main aspects of the upcoming general reform of European State aid control. We fully subscribe to the Commission's objective to reform and modernise State aid control. In our view the most significant challenges facing the Commission are *(i)* the need to take into account the reality of economic globalisation when redefining the substance of State aid policy towards "less and better targeted aid"; and *(ii)* the need to make the procedures of State aid control more efficient and transparent.

2. "LESS AND BETTER TARGETED AID" IN A GLOBAL ECONOMY

Reduction in the general level of aid

The State Aid Action Plan is set in the context of the overall Lisbon Strategy, aimed at promoting job growth, innovation, sustainable development etc. Its recurring theme is "Less and better targeted aid". The proposed reform will basically entail a reduction of the overall level of aid, in combination with a redeployment of aid for certain horizontal objectives such as R&D (see, for example, para. 14 and 18).

Aid for activities that are distant from the market, for example fundamental research, will be exempted more easily because the incentive provided by the aid is expected to be higher as the activity is further removed from the market. This principle was already introduced by the Community R&D framework. The intention of the State Aid Action Plan is evidently to apply it more rigidly.

The reform also involves steep cuts in regional aid. The State Aid Action Plan announces sparing use of regional investment aid to large firms, and suggests that regional State aid should concentrate on the least-developed regions (para. 42). It further questions whether "regional bonuses" provided for in currently existing documents on horizontal aid should be maintained (para. 43). Furthermore, it proposes integration of the "Multisectoral Framework on regional aid for large investment projects 2002" (which has already led to drastic cuts in aid for large investment projects), into the Guidelines on regional aid (para. 41). Finally, the draft Guidelines on national regional State aid for 2007-2013, which were published on 15 July 2005, reduce the permissible aid intensities.

International location competition

The proposed approach will result in a significant reduction in "general investment subsidies". As law firms we are often involved in international investment projects. This experience may instruct the debate in the EU.

The objective of the EU State aid rules is to avoid distortion of competition between Member States. This avoids a so-called "subsidy spiral"[1], when two or more Member States are trying to attract a particular investment project to their territory, or a specific part thereof. Today, however, investors will often weigh up locations inside the EU against locations outside the EU. The incentives that EU Member States can give to those investors are restricted by EU State aid law. Third countries, however, do not have comparable rules. Companies that choose to invest in the United States, Asia or elsewhere outside the EU, are therefore often granted advantages that EU Member States may no longer be able to grant following the reform of EU State aid policy. For instance, third countries will grant advantages to attract facilities designed solely for production, in particular in the high-tech sector. In the EU, however, the proposed reform could make it impossible to grant such incentives. In cases of location competition between an EU Member State and a third country, the EU may therefore find itself at a "home-made disadvantage". In this context it is also important to note that the currently existing WTO rules on subsidies are not an effective tool to restrict the "subsidy spiral" in location competition involving non-EU countries.

Of course, there may be sound reasons of economic policy that justify the Commission's proposed approach of "less and better targeted aid", even in a context of increasing globalisation. Furthermore, subsidies are of course not the only element that may make a location outside the EU more attractive than a location inside the EU. Nevertheless, we think it would be wrong to ignore the international context when considering this aspect of the reform of EU State aid policy.

More frequent use of Article 87 (3)(b) EC could provide a solution

In our view, Article 87(3)(b) EC could provide a solution to address the problem of the "home-made disadvantage" in cases of international location competition between an EU Member State and a third country. Article 87(3)(b) EC allows State aid to be declared compatible with the Common Market if it is used to promote the execution of an important project of common European interest. Although this provision provides a specific legal basis for promoting key

[1] See, for example, Multisectoral Framework on regional aid for large investment projects, OJ 2002 C 70/8, para. 15.

industries, it has rarely been used in practice and it seems that the Commission has confined the notion of "important project of common European interest" to cross-border programmes.[2] In our view, however, nothing prevents a broader interpretation of this notion, or its use in cases of international location competition for investment in, for instance, key industries (biotechnology, IT, etc.).

The State Aid Action Plan itself seems to support the idea of approving more aid under Art. 87(3)(b) EC. It refers to aid that fulfils *"clearly defined objectives of common interest"* (para. 10), or R&D aid for important research projects of common European interest (para. 27) as being permissible aid. Commissioner Neelie Kroes also emphasised this matter in her speech at the UK Presidency Seminar on State aid:

> *"...State aid which benefits the European economy, aid which therefore could – and should – be compatible because it is in the common interest."*[3]

In the interest of legal certainty, however, it would be useful explicitly to clarify the use of Article 87(3)(b) EC as a legal basis for aid to investment projects in a context of international location competition.

Consolidating the rules

On a number of occasions the Commission has announced new guidelines, communications or a general block exemption or modification of existing regulations (e.g. para. 25, 27, 35). Clear rules and guidance are certainly welcomed. We wonder to what extent it would be possible to consolidate, or at least integrate as communications, the state aid rules in various areas. The proposed general block exemption seems a first step in that direction.

In general we welcome the 'clear state aid rules' discussed in para. 47. This is proposed in the framework of PPP projects, which is probably a good example of an area where the Commission's guidance would be welcome. However, apart from general guidance, it could in some instances be helpful if the Commission could explain in more detail in individual decisions why a particular measure or structure constitutes state aid in a particular project, and not in another. We do not wish

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2 Generally, Article 87 (3) (b) EC has been used to fund projects in the energy and aviation sector or projects which were aimed at R&D or environmental protection.

3 Commissioner Neelie Kroes at the UK Presidency Seminar on State aid, "The State Aid Action Plan – Delivering Less and Better Targeted Aid", SPEECH/05/440, p. 3. See also p. 4.

to question the Commission's conclusions, nor to underestimate the fact that cases need to be assessed on their specific facts, but rather to illustrate that for those not involved in the file, certain distinctions can be difficult to assess on the face of the decision. The result can be increased uncertainty and unnecessary state aid filings.

3. MODERNISING THE PRACTICES AND PROCEDURES OF STATE AID

Quality and completeness of notification, co-operation from Member States

The Commission is considering issuing best practice guidelines on the procedure for State aid control. One important issue is to provide for more predictable timeframes. In order to achieve this objective, the Commission will, *inter alia*, encourage higher quality and more complete notifications. The Commission will request that Member States provide complete information within a certain period (para. 50), and it will apply sanctions if Member States fail to comply. One of the proposed sanctions for violation of the notification deadline is to adopt a negative decision (para. 58).

We welcome the Commission's resolve to speed up the duration of notification proceedings. In the past, the long duration of proceedings has often proved to be a hurdle to a timely realisation of a project. However, we think it would be disproportionate to refuse approval of an aid, merely because of alleged incompleteness of Member State input. We see no reason why Member State cooperation could not be sought in exactly the same way as cooperation from private undertakings is sought in the antitrust and merger area, *i.e.* through financial penalties.

In addition, whilst it is probably true that information contained in notification forms is not always complete and exhaustive, there is no reason why requests for additional information or meetings to clarify points must lead to restarting the two month period from the point when such information is received. This means that the repeated use of questions can lead to a long decision-making period. Again, we understand that many state aid files may involve complex economic assessment. However, the experience of using requests for information under the Merger Control Regulation shows that shorter delays (both for the Commission and for the notifying parties) are possible in complex economic cases.

Transparency and access to information for private parties

It is important that the Commission increases transparency and improves the information available to private parties during the notification/investigation phase (paras 50 and 58). The limited

information, if any, that is currently made available by the Commission during the first phase investigation creates major difficulties both for beneficiaries of State aid and potential complainants.

Recipients of aid will take decisions of great financial significance on the basis that aid was declared compatible with the Common Market. In our experience, however, there is much variation between the Member State governments in the extent to which they involve aid recipients in the notification procedure. Some Member States rely heavily on the intended recipient to provide information and assist with submissions. Other Member States refuse even to grant the intended recipient access to key submissions, making it impossible for the recipient to assess the quality and completeness of the notification. However, if an approval decision is made on the basis of incorrect or incomplete information provided by the Member State, it is the recipient who risks having to pay back the aid. It is therefore generally in the interest of the recipient to ensure that the Commission is fully informed. In that context, increasing the procedural rights of recipients of aid, even in phase 1, will improve the legal certainty of the aid recipient, while also contributing significantly to the quality of the notifications.

For potential complainants, the position is particularly difficult because they will normally receive no information at all from the Member States granting the aid and they have no procedural rights in a phase 1 procedure. That would not necessarily be problematic if the Commission were to open a phase 2 investigation in all controversial cases. In practice, however, that is not always the case. On any analysis, a complainant should be given access to the documentation on which the Commission has based a phase 1 Decision, after the Commission has taken its Decision. Of course any potential access to the file has to be balanced with the aid recipient's right to confidentiality. It is essential, therefore, that business secrets and other confidential information of the aid recipient is removed before a complainant is given access to the file.

In one recent case our request, on behalf of a complainant, to have access to a third party report which formed the basis of a decision to approve an aid, was not granted. On enquiring about the Commission's reasons for refusing access to the key document in question, we were informed that access could not be granted until after the expiry of the 2 month period for appeal of the decision to the Court of First Instance. In our view, this approach is legally unacceptable.

Independent authorities and national courts

At paragraphs 51 and 55-56, the Commission proposes the increased involvement of independent authorities in Member States and national judges.

In our view there are two key issues with regard to involvement of independent authorities in the Member States. First it will probably be more difficult to create truly independent national authorities in the area of State aid than in the area of anti-trust. Second, it may be more difficult to ensure consistency in the application of the EU State aid rules across the 25 Member States than in the case of anti-trust. With regard to independence, the difference between anti-trust and State aid control is somewhat obvious. In antitrust, the Member State regulatory authorities have similar interests to those of the Commission. In State aid, the Community interest is often in conflict with that of the Member State granting the aid. With regard to the issue of consistency across the Member States, we think the "cultural differences" between the Member States are markedly bigger in the area of State aid than in the area of anti-trust. In our view, therefore, the Commission should tread carefully when considering the option of decentralisation.

With regard to an increased involvement of national courts, we refer to a comment by Judge David Edward from the European Court of Justice, speaking at a State aid conference in Oxford in 2002:

> "*There is a tendency in the Commission ... to see the reference back to national law and national courts as the panacea for its problems. 'Do not ask us to do it, leave it to the national courts and the national legal systems'. I have to say that that is not a universal panacea.*" [4]

We agree with Judge Edward. We do not suggest that national courts would somehow be incapable of handling State aid matters. In fact, our experience demonstrates that the national courts clearly are capable of adjudicating such cases. However, there exist very substantial differences between the legal systems of the Member States and the way in which they operate. In some Member States the courts are already overburdened by a very heavy case load. Adding complex State aid litigation to that case load is unlikely to result in better enforcement of State aid rules. Too much emphasis on national courts may also result in distortions between Member States because courts in some Member States have the means to work more effectively than in other Member States. Here too, therefore, the Commission should tread carefully when considering decentralisation.

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[4] D. Edward, "Conclusions and Reflections" in Seminar on the Application of the European Community Rules on State aid to State Guarantees (Held at all Souls College, University of Oxford), Special Supplement to Butterworths Journal of International Banking and Financing Law, January 2002, p. 67-68.