State Aid – Balance of competence review

1. Executive Summary

1.1. The Treaty on the Functioning of the European Union ("**TFEU**") confers exclusive competence on the European Union ("**EU**") for establishing the competition rules necessary for the functioning of the internal market; these include the State aid rules.

1.2. An important justification for the State aid rules is that competition and trade within the internal market would be unfairly distorted if goods or services which have the benefit of free movement can be subsidised by Member States.

1.3. The original Treaty of Rome prohibited the grant by Member States of State aid which distorts competition by favouring certain undertakings or the production of certain goods in so far as it affects trade between Member States. It conferred on the Commission the power to approve State aid in certain circumstances. These provisions have not changed substantively in subsequent Treaties.

1.4. The Court of Justice has given the Treaty provisions a wide interpretation. In particular it has set a low threshold for the requirement that the measure distorts competition and affects trade. It has also interpreted the concept of an undertaking to include any entity engaged in an economic activity.

1.5. The scope of application of the State aid provisions has increased as a result of changes in the development of the internal market and the political choices made by Member States. The liberalisation of trade in services and the increased role of the private sector in delivering services previously provided by the State have increased the range of services within the scope of the State aid rules.

1.6. Member States have competence in such matters as direct taxation, industrial policy, the environment, employment and social policy and health. However, their competence must be exercised in compliance with the State aid rules.

1.7. As Member States are subject to the prohibition on granting State aid and the power of the Commission to approve State aid, this gives the Commission a significant role in the way Member States act in areas within Member State competence.

1.8. There is little scope for the Council to increase its role in State aid matters since its powers are very limited. However Member States can seek to shape the development of State aid law by intervening in cases in the General Court and Court of Justice.

International context

1.9. Prohibition of State aids or State subsidies is common in international free trade agreements, as subsidies are viewed as undermining free trade. There are other international agreements which contain provisions on subsidies, including free trade agreements entered into by the EU. These are generally based on the World Trade Organisation ("**WTO**") Agreement on Subsidies and Countervailing Measures. The WTO Agreement on Subsidies and Countervailing Measures contains provisions on subsidies on goods which share similar objectives in certain respects to the State aid provisions in the TFEU, although there are many material differences in approach and practice. There are no equivalent provisions with respect to services in the WTO.

1.10. In contrast, the Agreement on the European Economic Area ("**EEA**") contains almost identical provisions to those in the TFEU because that Agreement, in effect, extends the internal market to Norway, Iceland and Liechtenstein. The EFTA Surveillance Authority and the EFTA Court apply the same interpretation of State aid as in the EU and the EFTA Surveillance Authority approves State aid on the same basis as the Commission.

2. The Nature of EU Competence and its relation to Member States' competence

2.1. Article 3(1)(c) of the TFEU states that the Union shall have exclusive competence for "the establishing of the competition rules necessary for the functioning of the internal market". These include the rules on State aid.

2.2. Member States have competence for such matters as industrial and employment policy, research and development, environmental policy and direct taxation. These competences must be exercised in accordance with EU law – including the rules on State aid. The purpose of this paper is to examine how the EU's competence in establishing State aid rules is exercised and interacts with Member State competences in practice.

3. Purpose and effect of the Treaty provisions

3.1. From the establishment of the common market it was recognised that a common market where goods and services have freedom of movement could not operate effectively unless there are provisions controlling the ability of Member States to grant subsidies. If businesses are able to compete at EU level, there needs to be a level playing field; competition and trade would be distorted if a Member State could grant aid that would benefit the producers of its own goods and services. The Treaty therefore contains a prohibition on Member States granting State aid.

3.2. The Treaty does however recognise that subsidies perform a valuable function where the objective they pursue can be justified despite the distortion of competition that might arise. The Treaty therefore contains provisions setting out the circumstances in which State aid can be approved.

3.3. The founding Member States decided that there should be a body independent of the Member States which should have the power to approve State aids. They gave that power to the European Commission.

3.4. In exercising its powers to approve State aid, the Commission takes into account the objectives of the EU set out in the Treaty. It also takes into account developments in priorities of the EU as set out in, for example, conclusions of the European Council.

3.5. The State aid rules do not require Member States to grant State aid or to have certain policies. These matters remain within the competence of Member States. However, the effect of the State aid rules is to restrict the way Member States exercise their competence.

3.6. The EU rules provide a regime to prevent State resources being used to confer an advantage on an economic entity operating in a market, where this would distort competition and affect trade between Member States, but also to permit aid to be granted in certain circumstances where the effect on competition and trade can be justified.

4. Outline of Treaty provisions

4.1. Article 3 TFEU provides that the Union has exclusive competence in certain areas, including the competition rules necessary for the functioning of the internal market. This exclusive competence reflects the rationale for the Treaty containing rules on State aid: in an area where goods and services have freedom of movement competition and trade would be distorted if a Member State could grant aid that benefits the producers of its own goods and services.

4.2. The State aid provisions are contained in Articles 107-109 of the TFEU. The provisions are structured as an initial general prohibition followed by power for the Commission to approve State aid in certain circumstances. They also contain procedural provisions, in particular an obligation on Member States to notify proposed aid to Commission before it is granted.

4.3. Article 107(1) contains a prohibition on Member States granting State aid. Recognising that sometimes aid can be justified, Article 107(2) and (3) confers power on the Commission to approve aid. This could be the case with aid to promote the development of areas where the standard of living is abnormally low or where there is serious underemployment, to promote a project of common European interest or to remedy a serious disturbance in the economy of a Member State. In other cases aid could be justified but only where this would not affect trading conditions to an extent contrary to the common interest.

4.4. Article 106(2) provides that compensation for the performance of a service of general economic interest can be justified in certain circumstances where the development of trade would not be affected to such an extent as would be contrary to the interests of the EU.

4.5. The structure of a prohibition coupled with a broad discretion on the Commission, especially to take into account the effect on competition and trade, has implications for the competence of Member States in two respects. First, the competence of a Member State is constrained because it must exercise its competence in accordance with EU law. Therefore, if the measure contains State aid it is prohibited, unless it is approved by the Commission. Second, the power of the Commission to approve State aid gives the Commission the ability to control the details of a measure proposed by a Member State.

4.6. The interplay between the competence of the EU and that of the Member States can be illustrated by an example. A Member State wants to amend its tax legislation to encourage small and medium sized enterprises to invest in more research and development. Direct taxation, industrial policy relating to small and medium sized enterprises and research and development are within the competence of Member States. However, since the measure contains State aid, the prohibition in Article 107(1) applies, the Member State must notify the proposed law to the Commission before it comes into force and the Commission has a broad discretion under Article 107(3) whether to approve it[1].

5. Other international commitments

5.1. As well as the EU rules on State aid, the UK, as a member of the WTO, is obliged to comply with the WTO agreements relating to subsidies.

[1] See Commission Decision N802/1999 UK R&D Tax Credit

5.2. The WTO agreements seek to reduce the barriers to international trade in goods. Recognising that subsidies could have a distortive effect on international trade by favouring the companies which receive them, the Member States of the WTO entered into the Agreement on Subsidies and Countervailing Measures which regulates subsidies to companies producing goods.

5.3. Therefore, even if the UK were not subject to the EU State aid rules, it would be subject to the rules in the WTO Agreement, which though not the same, share similar objectives.

5.4. The WTO Agreement and other international agreements containing provisions relating to subsidies are considered in Section 15.

6. Interpretation of the Treaty provisions by the Commission and the Court

The prohibition

6.1. Article 107(1) of the TFEU contains the general prohibition on the granting of State aid:

> "Save as otherwise provided in the Treaties, 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 internal market."

6.2. What is now Article 107(1) has been the subject of extensive interpretation by the Court of Justice. In considering this issue it is convenient to look at the elements of the Article:

- Aid is granted by a Member State or through State resources.
- The aid favours certain undertakings or the production of certain goods.
- The aid distorts or threatens to distort competition.
- The aid affects trade between Member States.

6.3. All four elements must be present for there to be State aid If one element is not present there is not State aid.

Aid is granted by the Member State or through State resources

Aid is wider than a subsidy

6.4. The State aid rules restrict interventions by the State in the form of financial support which can distort competition and affect trade. One of the earliest cases in which the Court of Justice considered what is meant by aid is Case 30/59 Steenkolenmijnen v High Authority, a case under the Treaty of Paris but relevant to the current TFEU. The Court said:

> "A subsidy is normally defined as a payment in cash or in kind, made in support of any undertaking, other than the payment by the purchaser or the consumer for the goods or services which it produces. An aid is a very similar concept with, however, emphasis on its purpose and seems especially devised for a particular objective which cannot normally be made without outside help. ***The concept of aid is nevertheless wider than that of a subsidy because it embraces not***

only positive benefits such as subsidies themselves but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without being subsidies in the strict sense of the word, are similar in character and have the same effect."

6.5. Thus from the outset the Court gave a wide meaning to the concept of aid.

Potentially even wider meaning rejected

6.6. In 1998 it appeared that the Court of Justice was giving an even wider meaning to the concept in Case 200/97 Ecotrade v Altifornie & Ferriere di Servola. The case concerned the Italian law on insolvency. The law contained provisions which were for the benefit of large undertakings which became insolvent. The Court held:

> "Application to an undertaking… of a system of the kind introduced by [the law] and derogating from the rules of ordinary insolvency, is to be regarded as giving rise to the grant of State aid… where it is established that the undertaking
>
> - has been permitted to continue trading in circumstances which it would not have been permitted to do so if the rules of ordinary law relating to insolvency had been applied or
>
> - has enjoyed one or more advantages, such as a State guarantee, a reduced rate of tax, exemption from the obligation to pay fines and other pecuniary penalties or waiver in practice of public debts wholly or in part, which could not have been claimed by another insolvent undertaking in connection with the application of the ordinary law relating to insolvency."

6.7. The first indent of the Court's judgement would give a very wide meaning to the concept of aid since the financial resources of the State were not involved. However, in Case C-379/98 PreussenElektra the Court rowed back from such a wide meaning. That case concerned a German law which required electricity suppliers to obtain a proportion of their electricity from renewable sources. This was an advantage to generators of renewable energy but no transfer of State funds was involved nor was there a reduction in the sums that would otherwise be payable to the State. The Court held there was no State aid. It said that only advantages granted directly or indirectly through State financial resources are to be considered as State aid. The approach in PreussenElektra, not that in Ecotrade, has been followed in later cases[2].

State resources can involve private resources channelled through a fund

6.8. A Commission Decision which illustrates the wide scope of the concept of State resources is the UK Renewables Obligation (N504/2000). It involves private resources paid to a fund. The system requires electricity suppliers to purchase a certain amount of "green certificates" from producers of green electricity. If, however, electricity suppliers do not have a sufficient amount of green certificates, they must pay a buyout price to a fund set up by the UK Government and managed by OFGEM, the industry regulator. The UK Government argued that the fund was not State resources, relying on the PreussenElektra case, but the Commission decided

[2] In contrast it appears that under the WTO rules there is no cost to Government requirement. This means that various Government mandated measures that do not impose a cost on the granting Government are nevertheless regarded as a subsidy in the WTO regime.

that it was because it was established by the State and was fed by contributions imposed by the State.

The aid favours certain undertakings or the production of certain goods

6.9. This element gives effect to the principle that State aid is concerned with preventing distortions of competition. The rules therefore apply:

- Only to entities carrying out an economic activity, and
- Where those entities receive an advantage which is not available generally.

6.10. There are two sub-elements here, favouring and undertaking.

Favouring

6.11. Undertakings are favoured if they receive an advantage not available to other undertakings. This will be the case, for example, where

- only one undertaking receives a benefit
- only undertakings in a specific region or sector receive a benefit
- where the advantage is available within the discretion of the grantor.

Wide interpretation of sector

6.12. The Commission has interpreted the concept of a sector very widely. In its Decision on the UK's R&D tax credit (N802/99) the Commission decided that a tax credit available to all small and medium sized enterprises was selective since it applied only to the sector of SMEs. It thus favoured a sector, viz SMEs, over other companies, viz large companies.

Market economy investor principle

6.13. Where the State invests in an undertaking on the same terms as a market investor would invest, the Court and the Commission have decided that the undertaking does not receive an advantage and therefore there is not State aid. However applying the market economy investor principle is not easy in practice. An example that illustrates the difficulty is Commission Decision C7/2007 concerning Royal Mail. As part of a refinancing of Royal Mail, the UK Government invested in Royal Mail on what it considered were market terms and it had a report by Deloittes that the investment was one that a market investor would make. However, the Commission took a different view and decided that the investment was not on market terms. The Commission therefore decided that the investment was State aid but approved it under what is now Article 107(3)(c).

6.14. The Commission and the Court have applied a similar principle where the State is a creditor and waives a debt due to it.

Taxation by regional authorities

6.15. There is no favouring if all undertakings within a Member State benefit from the assistance without distinction being made between them. For example, a tax benefit available to all companies is not State aid.

6.16. One area where the Commission has sought to widen the concept of favouring is where a body within a State below the level of the national government

has tax raising powers and adopts a lower rate of tax for undertakings within the jurisdiction of that body than is payable elsewhere in the Member State. In a line of cases the Commission has sought to restrict severely the power of authorities below the level of a Member State to adopt tax measures which have the effect that the level of tax within the jurisdiction of that authority may be less than in the rest of the State. The UK has sought to oppose this in the Court of Justice, so far successfully[3].

6.17. More generally, in Case C-106/09P Commission v Gibraltar and United Kingdom the Commission put forward an argument that would have challenged the Member States' competence in tax matters and would have opened the door to harmonisation by the Commission of direct taxation. In the event, the way that the Court dealt with the Commission's ground of appeal did not have such wide implications.

Meaning of undertaking

6.18. The classic definition of an undertaking is in Case 41/90 Hofner & Elser v Macraton. The Court of Justice said:

> "the concept of an undertaking, in the context of competition law, covers any entity engaged in an economic activity, regardless of the legal status of the entity or the way it is funded."

6.19. The legal status of the entity is not the determining factor; what counts is whether it is carrying out an economic activity. An economic activity consists in offering goods or services on a given market. It is the activity which counts, not the legal status of the entity. Thus charities[4], non-profit making organisations[5] and even part of the State[6] can be an undertaking. An entity may be an undertaking in respect of some of its activities but not others.

6.20. The dividing line between an economic activity and a non-economic activity is difficult to draw and an activity which is an economic activity in one Member State may not be in another. The concept is an evolving one linked in part to the political choices of each Member State. Some Member States have decided to transfer to undertakings certain tasks which in the past were traditionally carried out by the State. Some States may also create a market in an activity where one did not previously exist. In addition, there are often providers that are clearly undertakings because they operate on the basis of making profits whereas other providers do not.

6.21. It is often difficult to work out whether an undertaking is carrying out an economic activity. This can lead to uncertainty and member States notifying measures to the Commission to obtain legal certainty. This can result in an extension of EU competence. The difficulty in drawing a dividing line can be illustrated by three sectors.

Health services

6.22. An example is the provision of health care. In all Member States there are private providers of health care as well as public providers and the way health care is provided differs significantly from one Member State to another and changes over

[3] See Case C- 430/06 Cominidad Autonoma de la Rioja
[4] Commission Decision on Brighton West Pier Trust
[5] Cases 209/78 etc Van Landewyck v Commission Case C-244/94 FFSA
[6] Case 118/85 Commission v Italy

time. In the UK there are the NHS and private commercial providers. In other Member States health care providers offer their services for remuneration either directly from patients or from their insurance.

6.23. In Case C-205/03 FENIN the Court of Justice decided that management bodies of Spanish health services providing free medical services were not undertakings, although there are also commercial undertakings providing medical services[7]. This is because public hospitals are an integral part of a national health service and are almost entirely based on the principle of solidarity between citizens. The hospitals are funded from State resources and provide their services on the basis of universal coverage.

6.24. In contrast, in many other Member States hospitals offer their services for remuneration. In such systems there is a certain degree of competition between hospitals. Here, the provision of health care is not classified as non-economic and therefore falls within the State aid rules.

Social housing

6.25. The Irish Government notified a guarantee it was proposing to grant to obtain legal certainty. In its decision relating to the Irish Housing Finance Agency (Commission Decision N209/2001) the Commission considered whether funding advanced to local authorities to be used for public service purposes (ie the funding of the statutory social obligations of local authorities) was State aid. It decided that municipalities are active on the housing market and by offering cheaper housing conditions, through rent and construction loans, to certain consumers they are in competition with other operators in the housing market. They are therefore performing an economic activity. The Commission decided that the funding was State aid but went on to approve it.

6.26. As funding for social housing can be within scope of the State aid rules, the Commission has gained a degree of competence in this area.[8]

Infrastructure

Position of the Commission before 2008

6.27. Finance provided by the State for infrastructure is an example of how the effect of an element of what constitutes State aid (here favouring an undertaking) can change over time and broaden the scope of application of the State aid rules and hence the competence of the EU.

6.28. The change has been partly driven by the change in the way the State finances infrastructure projects. Until the end of the 1990s the provision of infrastructure was, as a general rule, considered not to fall within what is now Article 107 unless it benefitted a particular undertaking. An example is the Commission's Decision NN 109/98 Manchester Airport. Manchester Airport was owned by local authorities in the area. The local authorities lent money to the Airport at below market rates. A complaint was made to the Commission that this constituted State aid. The complaint was rejected by the Commission which said:

[7] For this reason the Advocate General took a different view from that of the Court
[8] See further paragraphs 11.17-11.22

> "The construction or enlargement of aviation infrastructure projects financed by the public sector represents a general measure of economic policy which cannot be controlled by the Commission under the State aid rules on State aid, in so far as it is aimed at meeting planning needs or implementing national transport policies. Nevertheless, since possible aid elements may result from the preferential treatment of specific companies when using the infrastructure, the validity of this general principle is subject to the condition that the infrastructure concerned is accessible to all users on the basis of objective and non-discriminatory criteria."

6.29. The Commission said that this approach stemmed from the consideration that access to air transport is of basic importance for the economic and social development of a region. It said that the situation of local authorities owning and financing airports was common across Europe and the Community itself was committed to co-financing of some airport infrastructure in the context of Trans-European Networks. No undertaking was therefore favoured.

6.30. The Commission established a principle that where infrastructure was made available to all users on a transparent and non-discriminatory basis, there might not be aid to the provider of the infrastructure. It applied this principle in a number of contexts, including ports, stadiums and R&D facilities. As a result, and consistent with the practice of the Commission, in a number of cases the Member States tended to consider that the financing of infrastructure is not subject to the State aid rules as it constitutes a public interest task and, if access is open and non-discriminatory, there is no specific advantage conferred on a beneficiary.

Position of the Commission after 2008

6.31. However, the Commission signalled a change in its practice in 2008. In a decision in July 2008 it decided that financing at below market rates provided to the operator of Leipzig Halle Airport for the construction of a runway was State aid. It referred to the examples of airport infrastructure built with private funds in other Member States, namely the airport in Ciudad Real (Spain), Terminal 5 at Heathrow Airport (United Kingdom) and the airports in Vienna (Austria) and Frankfurt-am-Main (Germany).

6.32. The Decision was challenged in the General Court unsuccessfully. The public authorities referred to the previous practice of the Commission and argued that the concept of an 'undertaking' does not apply to regional airports, at least in regard to financing of airport infrastructure. The construction of such infrastructure is not an economic activity but is a part of transport policy, economic policy and regional policy. They also argued that a private investor would not make the investment because it could not be profitable.

6.33. In its judgement the Court recognised that the Commission had considered, in the past, that the construction of infrastructure projects represents a general measure of economic policy which cannot be controlled by the Commission under the Treaty rules on State aid. However, it said that there have been developments in the airports sector concerning, in particular, the organisation of the sector, and its economic and competitive situation. It said that the Commission must, when adopting a decision concerning the airports sector, take account of those developments and the interpretation by the Court of the meaning of undertaking and

their implications for the application of what is now Article 107 to the financing of infrastructure related to airport operations.

6.34. Following the judgement of the General Court in the Leipzig Halle case, the Commission takes the view that any type of infrastructure (excluding infrastructure related to security safety etc) that is commercially exploited is within the State aid rules. Only the financing of infrastructure which is not later commercially exploited and built in the interests of the general public is in principle excluded from the scope of the State aid rules. The Commission has defined the exclusion narrowly to include public roads and motorways that are not operated by a concessionaire and parks, playgrounds etc, open to the general public.

The aid distorts or threatens to distort competition

6.35. This element is included because the State aid rules are concerned with preventing distortions of competition.

6.36. It is difficult to demonstrate that there is no distortion of competition if aid favours an undertaking. In an opinion given in 1980 in Case 730/79 Philip Morris v Commission the Advocate General set a low threshold to be met. He said:

> "it is permissible… to start from the presumption that any public aid granted to an undertaking distorts competition- or threatens to distort it where the aid is only proposed and not yet granted- unless exceptional conditions exist (for example the total absence in the common market of products which are identical to and may be substituted for those manufactured by the recipient of the aid)."

6.37. In 2003 the UK Government argued that the proposed financial support for credit unions in Scotland did not constitute State aid because there would be no distortion of competition. It argued that credit unions are not in competition with banks and, instead, addressed a market failure. The Commission rejected that argument[9], noting that there exist commercial undertakings that provide loans and credit to low income people. As the support would not be available to these commercial loan providers, there would be a distortion of competition.

6.38. The limited distortion of competition because the aid addresses a market failure is taken into account by the Commission in deciding whether to approve State aid.

6.39. One situation where there is no distortion of competition is where the funding is provided to a monopoly. In Commission Decision N356/2002 Network Rail the Commission decided that there was no competition on the market for operating the national rail infrastructure except during the Railtrack era.

The aid affects trade between Member States

6.40. The reason for this element is that the justification for the EU having competence in respect of State aid is that State aid can affect trade between Member States and distort the internal market.

6.41. In the Philip Morris case the Court of Justice set a low threshold for satisfying this element. It said:

[9] Commission Decision N244/2003. The Commission approved the aid.

"When State financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade the latter must be regarded as affected by the aid."

6.42. It is, in practice, very difficult to show that there could no effect on trade between Member States in respect of goods. However, it may be possible to do so in respect of services. Some services are performed at a purely local level where people do not cross borders to receive or deliver them. However, many services have been brought within the State aid rules as a result of the liberalisation of services within the EU.

Effect of liberalisation

6.43. A case which illustrates the effect of liberalisation is Case C-280/00 Altmark. It concerned a public bus service licensed to operate only within the administrative district of Stendal in Germany. Bus services in Germany are largely liberalised which means that undertakings in other Member States could respond to the tender to provide the bus service. There could therefore be an effect on competition and trade[10].

Low threshold

6.44. In the Altmark case the Court of Justice said:

"[There] is no threshold or percentage below which it may be considered that trade between Member States is not affected. The relatively small amount of aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that trade between Member States might be affected."

6.45. A recent case which confirms the principle in the Philip Morris and Altmark case is Case C-494/06P Commission v Italy and WAM. The Court of Justice annulled the Commission's decision because of the inadequacy of the reasoning. However, it repeated its case law setting a low threshold for satisfying the elements distorting competition and affecting trade. It said that it is not necessary to demonstrate that the aid has a real effect on trade between Member States and that competition is actually being distorted, but only to examine whether that aid is liable to affect such trade and distort competition. With regard more specifically to the condition that trade between Member States is affected, the grant of aid by a Member State, in the form of a tax relief in that case, to some of its taxable persons must be regarded as likely to have an effect on trade and, consequently, as meeting that condition, where those persons perform an economic activity in the field of such trade or it is conceivable that they are in competition with operators established in other Member States. Furthermore when aid granted by a Member State strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade the latter must be regarded as influenced by that aid. In that regard the fact that an economic activity has been liberalised at Community level may serve to determine that the aid has a real or potential effect on competition and affects trade between Member States.

De minimis aid

[10] The case can be contrasted with Case 103/84 where the Court of Justice held that municipal transport undertakings were not within the State aid rules since they did not compete with each other and so there was no distortion of competition.

Commission regulation

6.46. The Commission has, however, accepted that very small amounts of aid do not generally distort competition or affect trade between Member States. In the De Minimis Regulation 1998/2006 the Commission sets out the level aid below which it considers that there is no effect on competition or trade. The present level is aid of up to €200,000 to any one undertaking over any period of 3 years. There are a number of exceptions and it does not include forms of aid for which the inherent amount of the aid cannot be calculated in advance and excludes aid to firms in difficulty.

6.47. There is a separate de minimis regulation relating to services of general economic interest. The Commission concluded that advantages granted to undertakings providing services of general economic interest may be deemed not to affect trade between Member States or distort competition may be different from the general de minimis ceiling. In addition, many activities qualifying as services of general economic activity have a limited territorial scope and therefore do not affect trade. The ceiling is set at €500,000 to any one undertaking over a 3 year period.

Small amounts of aid not covered by the De Minimis regulation

6.48. A case where a Member State argued that a measure did not affect trade between Member States is Case C-351/98 Spain v Commission. The case concerned an interest subsidy whose purpose was to facilitate the replacement of commercial vehicles belonging to natural persons, small and medium sized enterprises, regional public bodies and bodies providing local services.

6.49. The Spanish Government did not notify the measure to the Commission because it took the view that it did not contain State aid because, amongst other reasons, there was no effect on trade. The Commission accepted that there was no State aid to bodies providing local services or those granted to natural persons or SMEs for the purchase of vehicles where they pursue a business other than transport because there would be no effect on trade or they were not undertakings. However, it considered that all other aid awarded to natural persons or SMEs constituted State aid because there could be an effect on trade.

6.50. The amount of aid was below the de minimis limit but that exemption did not apply to transport. The Spanish Government argued that the Commission had not shown an effect on trade between Member States. It pointed out that the amount of transport cabotage was insignificant and that beneficiaries able to compete with carriers from other Member States represented a tiny proportion of the commercial vehicle fleet.

6.51. The Court rejected these arguments. Whilst recognising that a small amount of aid to an undertaking over a given period does not affect trade between Member States in particular economic sectors, it decided that, on the facts of this case and the nature of the transport market, there was an effect on competition and trade between Member States.

Appreciable effect on trade: difference between Articles 101 and 102 and Article 106

6.52. The effect on trade criterion is a jurisdiction criterion which defines the scope of application of EU competition law. It is included because EU law should apply only where there is an effect on trade between Member States. However, the case law of the Court of Justice on what is meant by an effect on competition has developed differently in the case of Article 107 on the one hand and Articles 101 (antitrust) and 102 (abuse of a dominant (position) on the other.

6.53. All three Articles refer to an activity affecting trade between Member States. However, in the context of Articles 101 and 102 the Court of Justice has introduced the concept of an appreciable effect on trade. For example, in Case 22/71 Beguelin the Court said that "in order to come within the prohibition of Article [101] the agreement must affect trade between Member States and the free play of competition to an appreciable extent". A substantial case law and practice has developed on what an appreciable effect means.

6.54. In contrast the Court of Justice has not referred to the need for an appreciable effect on trade in the context of State aid. In Case 102/87 France v Commission the Court said:

> "The relatively small amount of aid or the relatively small size of the undertaking which receives aid does not as such exclude the possibility that intra-Community trade might be affected."

6.55. Instead the Commission has developed the concept of de minimis aid. In its first Notice on de minimis aid in 1996 the Commission referred to an appreciable effect on trade. It said that "any financial assistance given by the State to one firm distorts or threatens to distort, to a greater or lesser extent, competition between that firm and its competitors which have received no such aid; but not all aid has an appreciable effect on trade and competition between Member States". It is on the basis of there being no appreciable effect on competition and trade between Member States in certain defined circumstances that de minimis aid is outside Article 107. However, the language of an appreciable effect on trade has not been used expressly since 1996 to justify de minims aid.

6.56. In contrast to cases under Article 101 (antitrust) and Article 102 (abuse of a dominant position) the assessment by the Commission whether there is a distortion of competition or effect on trade is very brief. This follows from the consistent case law of the Court of Justice going back to the Philip Morris case referred to above[11]. In that case Philip Morris argued that the Commission ought to have carried out an examination of the relevant market, similar to that required for the purposes of what are now Articles 101 and 102 and then examined the effect of the contested aid on that market. However, the Court rejected that contention. It is therefore not necessary for the Commission to conduct a thorough analysis of the relevant product and geographical markets as required under Articles 101 and 102.

6.57. In determining whether or not there is State aid within Article 107(1) the Commission does not consider the market share the undertaking has in the EU. For example, in a decision in 1987 the Commission rejected Germany's argument that, as the recipient of the aid accounted for only 0.03% of all trade within the European Community, any effect on trade would be minimal. This has been the consistent practice of the Commission and has been accepted by the Court of Justice. Indeed,

[11] See paragraph 6.36

it is irrelevant that the aided undertaking does not export its products. As the Court said in Case 102/87 France v Commission:

> "Where a Member State grants aid to an undertaking, domestic production may for that reason be maintained or increased with the result that… undertakings established in other Member States have less chance of exporting their products to the market in that State."

7. The power of the Commission to approve State aid

The exceptions in Article 107

7.1. Article 107(2) and (3) contain exceptions to the general prohibition by listing circumstances where aid that would otherwise be subject to the general prohibition shall or may be compatible with the internal market:

> "2. The following shall be compatible with the internal market:
>
> (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
>
> (b) aid to make good the damage caused by natural disasters or exceptional occurrences;
>
> (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.
>
> 3. The following may be considered to be compatible with the internal market:
>
> (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;
>
> (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
>
> (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
>
> (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;
>
> (e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission."

7.2. The basis on which the Commission now exercises its discretion is to apply a balancing test, balancing the positive and negative effects of the aid and considering

whether the distortion of competition and effect on trade is limited so that the overall balance is positive.

Approval of services of general economic interest

7.3. In addition to approval under Article 107(2) and (3), State aid for services of general economic interest can be approved by the Commission under Article 106(2). Article 106(2) provides:

> "Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union."

7.4. The provision effectively acts as a further exception to the general prohibition on state aid. The scope of this exception and the competence it affords to Member States is considered later in this note.[12] It has increased in importance in recent years.

8. Procedure and enforcement

8.1. Article 108 contains procedural and enforcement provisions and provides the Commission with competence to assess whether aid is compatible with the internal market.

Approving State aid under Articles 107(2) and (3) and 106(2)

8.2. Article 108 provides the Commission with the sole[13] competence to assess whether aid is compatible with the internal market by virtue of the exemptions contained Article 107(2) and (3) and Article 106(2).

Notification

8.3. Article 108(3) requires Member States to notify the Commission of plans to grant or alter aid before it is granted. Member States may not put proposed State aid measures into effect until the Commission has made a final decision on compatibility. This provision is fundamental to the operation of the State aid provisions.

8.4. If the Commission considers that any planned aid is not compatible with the internal market, it is required to initiate the formal investigation procedure without delay.

8.5. Article 108(3) has direct effect, which means that a person who considers that aid has been granted before it has been authorised by the Commission may bring an action in the national court. National courts enforce the obligation to notify, but are not, however, empowered themselves to approve any aid under Article 107(2) and 107(3) or Article 106(2).

Monitoring

[12] See Section 11

[13] The Council has very limited powers to approve State aid under Article 108(2). See paragraph 8.8.

8.6. The Commission also has an ongoing obligation to monitor State aid. Article 108(1) provides that the Commission shall, in cooperation with Member States, keep under constant review all systems of existing aid in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the internal market.

Enforcement

8.7. Article 108(2) applies where the Commission finds that aid granted by a Member State or through State resources is not compatible with the internal market, or that such aid is being misused. In those circumstances, after giving notice to the parties concerned to submit their comments, it shall decide that the State concerned shall abolish or alter such aid. The Member State is required to recover the aid from the recipient with interest. If the State concerned does not comply with the decision the Commission may refer the matter to the Court of Justice.

Power of Council to approve aid

8.8. Article 108(2) enables the Council to make a decision on aid in exceptional circumstances. On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered compatible with the internal market, in derogation from the provisions of Article 107 or from the regulations referred to in Article 109, if such a decision is justified by exceptional circumstances. The Court of Justice has clarified that the power cannot be used after the Commission has made a decision.

Rule-making

8.9. Article 109 enables the Council, on a proposal from the Commission and after consulting the European Parliament, to adopt regulations for the application of Articles 107 and 108 and which may in particular determine the categories of aid exempted from the prior notification procedure in Article 108(3).

8.10. The power has been used to adopt regulations governing the procedure that applies to State aid and to give the Commission power to adopt regulations exempting certain categories of aid from the obligation to notify proposed aid measures in advance. The exemption regulations themselves are made by the Commission. The Council, Parliament and Member States have no formal role in the how the Commission exercises the power conferred by the Council, although the Commission consults on draft regulations. This means that the conditions which need to be satisfied for a proposed measure to be exempt from prior notification are determined by the Commission without any control by the Council or Member States.

Challenges to Commission decisions

8.11. Article 263 enables decisions of the Commission relating to State aids to be challenged in the Court of Justice. A Member State has an absolute right to do so and a natural or legal person may do so where the decision is of direct and individual concern to that person. In addition, State aid cases frequently come before the Court on a preliminary reference from the national courts under Article 267 as a result of the requirement in Article 108(3) not to put an aid into effect until it has been approved by the Commission having direct effect.

9. Evolution of Treaty provisions

The Treaty of Paris

9.1. The Treaty of Paris of 1951 established the European Coal and Steel Community (the "**ECSC**"). This laid the foundations of a common market in coal and steel products, including as part of this control of state subsidies to coal and steel.

9.2. Article 4(c) of the Treaty of Paris provided that "all subsidies or aids granted by States" are incompatible with the common market for coal and steel and shall accordingly be abolished and prohibited within the Community. The High Authority and the Council established under the Treaty of Paris had power to authorise aid in certain circumstances. The ECSC Treaty expired on 22 July 2002 and the general state aid rules provided for in the EC Treaty applied from that date onwards.

The Spaak Report

9.3. In June 1955 the Member States of the ECSC set up an intergovernmental committee to provide a report on further economic integration chaired by Paul-Henri Spaak. The Spaak Report formed the basis of negotiations for the Treaty of Rome which established the common market. The report recommended the inclusion of provisions on aids granted by the Member States. It said that one of the essential guarantees which must be given to undertakings is that they should not be put at a disadvantage by artificial advantages benefitting their competitors.

The Treaty of Rome to the Treaty of Lisbon

9.4. The Treaty of Rome was in large part based on the recommendations in the Spaak Report. Articles 92 to 94 of the Treaty of Rome contained the provisions on State aid. Article 92 (now Article 107(1)) contained the prohibition on State aid.

9.5. No substantive changes have been made to this paragraph since the original Treaty of Rome. [14]

9.6. Article 92(2) (now Article 107(2)) provided certain categories of aid shall be compatible with the common market. No substantive changes have been made to this paragraph since the original Treaty of Rome[15].

9.7. Article 92(3) (now Article 107(3)) provided that certain categories of aid may be compatible with the common market. The Treaty on European Union (the Maastricht Treaty) added the further category of aid to promote culture and heritage conservation. The TFEU amended paragraph (a) by adding a further category of aid: "to promote the development of the regions referred to in Article 349[16], and to include at the end of the paragraph "in view of their structural, economic and social situation".

9.8. Article 93(1) to (3) (now Article 108) dealt with procedural matters and enforcement. Subsequent Treaties did not alter those provisions substantively. However the TFEU

[14] That paragraph has not changed since the original Treaty of Rome except that the Treaty on the Functioning of the European Union changed the reference to "this Treaty" to "the Treaties" and "the common market" to "the internal market".

[15] The only changes made to Article 92(2) by the TFEU are to change the reference to "the common market" to "the internal market" and to add a sentence at the end of indent (c) "Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.

[16] Guadeloupe, French Guiana, Martinique, Reunion, Saint Barthelemy, Saint Martin, the Azores, Madeira and the Canary Islands.

inserted a new provision into Article 108 making clear the Commission's power to make regulations relating to categories that the Council has determined may be exempted from the prior notification procedure.

9.9. Article 94 of the Treaty of Rome (now Article 109 of the TFEU) describes the legislative procedure for adopting Regulations. No substantive changes have been made to this paragraph since the original Treaty of Rome. The Maastricht Treaty inserted an obligation to consult the Parliament.

Non-treaty developments

9.10. It will be noted that no substantive changes have been made to the prohibition on State aid since the original Treaty of Rome. What constitutes State aid has not changed and only limited changes have been made to the Treaty provisions giving the Commission power to approve aid. However, since then significant changes have occurred in the development of the internal market, in particular increased liberalisation of services, and in the role of the State, in particular activities which were seen as functions of the State are now carried out by private sector entities. Also Member States have sought to achieve their political and economic policies in new and different ways. These developments have resulted in a much wider range of measures being within the State aid rules.

10. How the Commission approves State aid

10.1. Article 107(2) and (3) give the Commission power to approve aid[17]. Article 107(3) gives the Commission a broad discretion whether to approve the aid falling within the paragraph. The way the Commission exercises its discretion has developed over time.

Early cases

10.2. At first the Commission considered each case on its own merits. However in its 10th Report on Competition Policy (at point 213) the Commission stated that in view of the increasing number of aid proposals with which it had to deal, it would exercise its discretion not to raise objections to a proposed aid if that aid contains a compensatory justification. Such a justification would have to take the form of a contribution by the beneficiary of the aid, over and above the effects of the normal play of market forces to the achievement of the Community objectives contained in the derogation in Article 92(3)[18]. Thus distortions of competition were to be permitted, provided they were necessary to secure Community objectives.

10.3. The Commission was not, however, consistent in its application of the compensatory justification principle, in the sense that it did not always systematically indicate in its decisions allowing aid why in its view the normal play of market forces would not achieve the desired goal or what precisely the benefits of the proposed scheme to the Community would be.

Guidelines and frameworks

10.4. From about 1971 the Commission started setting out how it would exercise its discretion in more detail. Sometimes this was in the form a letter or communication to the Member States or a framework or by setting out what it had done in its annual

[17] Article 107(2) and (3) are set out in paragraph 7.1
[18] Now Article 107(3)

report on competition policy. Sometimes those statements related to a specific sector, such as synthetic fibres, and sometimes they were of horizontal application, for example aid for aid for research and development. In the mid-1990s the Commission adopted guidelines in a number of areas in order to increase transparency and consistency in its decision making practice and to make explicit the different types of aid and their objectives which would normally be approved by the Commission. In 1995 and 1996 it adopted guidelines setting out how it would exercise its discretion to approve aid relating to rescue and restructuring of firms in difficulty, aid to employment, aid to undertakings in deprived urban areas, aid to small and medium sized enterprises and aid for R&D. It also issued a further notice on de minimis aid.

10.5. The Council adopted a Regulation in 1998 enabling the Commission to adopt block exemption regulations in areas where it has gained sufficient experience to approve State aid measures without the need for prior notification to the Commission[19]

Monti proposals

10.6. There were a number of reforms of the Commission's practice in subsequent years. In 2004 the then Commissioner for competition, Mario Monti, proposed a framework for lesser amounts of aid and a framework for aid with limited effects on competition. Neither was adopted. Some commentators thought that all kinds of aid distort competition and therefore should not be encouraged. On the other hand, others thought that the plan involved a lot of hassle with no practical benefit.

10.7. One reform that was made was to improve procedures. The Commission adopted Regulation 794/2004 providing for standard notification forms, a simplified procedure for small increases in aid covered by schemes and annual reporting to the Commission by Member States.

Kroes State Aid Action Plan

10.8. His successor, Nellie Kroes, had more success. In 2005 the Commission adopted a State Aid Action Plan with the objective of ensuring that Member States have a clear, comprehensive and predictable framework, so that they can provide State aid which contributes to cohesion, competitiveness and high quality public services. The purpose of the Plan was to use the State aid rules to contribute to the Lisbon Strategy by focussing aid on improving the competitiveness of EU industry and creating more sustainable jobs, on ensuring social and regional cohesion and improving public services. The Plan also aimed to rationalise and streamline procedures, so that the rules are clearer and less aid has to be notified, and to accelerate decision making.

10.9. Following the adoption of the State Aid Action Plan by the Commission a number of the instruments setting out how the Commission would approve aid were amended. In addition the Commission adopted a notice on a simplified procedure and a Best Practice Code on the conduct of State aid control procedures. They aimed at improving the effectiveness, transparency and predictability of State aid procedures at each step of an investigation, thereby fostering voluntary co-operation between the Commission and Member States.

[19] See paragraphs 10.12-10.18

2012 Reform Package

10.10. In 2012 the Commission set out a further programme of State aid reform with three objectives:

- Foster growth in a strengthened, dynamic and competitive internal market
- Focus enforcement on cases with the biggest impact on the internal market
- Streamlined rules and faster decisions.

10.11. As part of this the Council adopted a new Enabling Regulation on 22 July 2013. It introduced new categories of aid that the Commission may decide to exempt from the obligation of prior notification by means of block exemption regulations. So far as procedures are concerned the Council adopted a new Procedural Regulation intended to improve the handling of complaints, leading to a swifter, more predictable and more transparent investigation of complaints. It also provides for new tools for gathering information directly from market participants and for conducting sector inquiries with the objective of enabling the Commission to obtain all necessary information to adopt well-reasoned decisions. The objective is for the Commission to adopt faster and better decisions.

Block exemption regulations

10.12. The purpose of block exemption regulations is to reduce the number of notifications to enable the Commission to focus on the most important cases where distortions of competition are most significant. They also enable public authorities to grant "good" aid without prior notification to the Commission, saving Member States time and resources.

10.13. The Commission exempts aid by means of a block exemption regulation where it has gained sufficient experience that aid which meets the conditions set out in the regulation is clearly compatible and does not give rise to a significant distortion of competition or effect on trade.

10.14. An aid measure which meets all the conditions contained in a block exemption regulation is exempted from the obligation to notify the Commission and not to be put into effect by the Member State until the Commission has given its decision. The Member States are required to provide a short report to the Commission which can then seek further information from the Member State.

10.15. The power was first used to enable the Commission to adopt block exemption regulations in 1998. It enabled the Commission to adopt block exemption regulations in respect of aid for:

- Small and medium sized enterprises
- Research and development
- Environmental protection, employment and training
- Regional aid
- De minimis.

10.16. The current Regulation includes the following types of aid:

- Aid to SMEs: aid for investment in plant and for hiring additional workers, aid in the form of risk capital, innovation aid and aid contributing to intellectual property rights costs

- Social aid: aid to employ disabled and disadvantaged workers
- Regional aid: in assisted areas, aid for newly created start-ups
- Environmental aid: a number of aid measures favouring environmental protection or tackling climate change, aid promoting investment in energy saving or investments in renewable energy sources and aid in the form of tax reductions
- Aid for women entrepreneurship: measures in favour of childcare and parent care costs and supporting small enterprises owned and run by women
- Aid for R&D and innovation: aid for certain R&D projects and measures supporting newly established innovation companies.

10.17. The Regulation does not apply in a number of cases; in particular it does not apply to firms in difficulty. The Regulation sets out detailed conditions which must be complied with and sets a threshold where aid to individual companies above a certain limit is outside the scope of the Regulation and must be notified to the Commission.

10.18. As part of the objective of enabling the Commission to focus on cases with the biggest impact on competition and trade, on 22 July 2013 the Council adopted a further regulation extending the power of the Commission to adopt block exemption regulations in respect of aid for:

- Innovation
- Culture
- Natural disasters
- Sport
- Certain broadband infrastructure
- Other infrastructure
- Social aid for transport to remote regions and certain agriculture, forestry and fisheries issues.

The legal status of guidelines

10.19. The legal status of guidelines has been considered by the Court of Justice in a number of cases. The Court has recognised that the Commission has the power to adopt such instruments as guidelines and frameworks setting out how it will exercise its discretion. It has said that such instruments have no legislative force. However, the Commission is bound by them in so far as their provisions do not depart from the proper application of the rules in the Treaty.

10.20. In Case C-75/05P Germany v Kronofrance an issue arose in relation to the Multisectoral Framework, an instrument setting out how the Commission exercises its discretion relating to major investments in regions. The Court said:

> "59 It is true, as the appellants submit, that, in the application of Article [107(3)], the Commission enjoys wide discretion, the exercise of which involves complex economic and social assessments which must be made in a Community context…
>
> 60 However, it should be pointed out that, in adopting rules of conduct and announcing by publishing them that they will henceforth apply to the cases to which they relate, the Commission imposes a limit on the exercise of its aforementioned discretion and cannot depart from those rules under pain of being

found, where appropriate, to be in breach of general principles of law, such as equal treatment or the protection of legitimate expectations…

61 Thus, in the specific area of State aid, the Court has already had occasion to stress that the Commission is bound by the guidelines and notices that it issues, inasmuch as they do not depart from the rules in the Treaty and are accepted by the Member State…

65 In that respect, although the Commission is bound by the guidelines and notices that it issues in the field of State aid, that is so only to the extent that those texts do not depart from the proper application of the rules in the Treaty, since the texts cannot be interpreted in a way which reduces the scope of Articles [107 and 108] or which contravenes the aims of those articles…"

10.21. The question has been raised whether it is legitimate for the Commission to reject proposals that fall within the scope of a set of guidelines but do not meet their terms. As the Court said in paragraph 60 of its judgement in Germany v Kronofrance the Commission cannot depart from the rules it has adopted where this would result in it being in breach of the general principles of law, such as equal treatment or the protection of legitimate expectations. In the light of the Court's reference to the principles of equal treatment and legitimate expectation, it is rarely going to be possible for the Commission to approve a proposal which falls within the scope of a set of guidelines but does not meet its terms.

10.22. The result of this case law is that it appears at times that the Commission has gone out of its way to decide that a measure does not contain aid because otherwise it would fall foul of the principle in the Rescue and Restructuring Guidelines that further restructuring aid should not be given within 10 years of a previous grant of rescue or restructuring aid.

No relevant guidelines or framework

10.23. The fact that a measure does not fall within the scope of guidelines issued by the Commission does not mean that the Commission cannot approve the aid. It is still possible for the Commission to approve the aid directly under the Treaty itself. For example, aid to the Nuclear Decommissioning Authority was approved under Article 107(3)(c) itself because there were no guidelines covering the aid in question. There are guidelines on aid for environmental protection. This does not mean that the Commission cannot approve aid that has an environmental objective but is not within the scope of the environmental guidelines.

Checks and balances

10.24. The Treaty confers the discretion whether or not to approve aid under Article 107(3) on the Commission. It does not give a role to the Member States when the Commission is deciding how to exercise its discretion in individual cases or when adopting guidelines. However, it is the practice of the Commission to issue drafts of proposed guidelines and to consult on them and the Member States and other interested parties can make representations to the Commission. However, the decision whether to adopt them and in what form is a matter for the Commission. Neither the Member States nor the Council has a formal role.

10.25. Member States, recipients of aid and other interested parties are able to comment where the Commission opens a formal investigation into aid measures.

The Commission opens a formal investigation when it has doubts whether the proposed aid is compatible with the internal market. The grantor of the aid, other Member States and interested parties are given the opportunity to comment. A number of commentators have criticised the fact that this process is too much a dialogue between the Member State granting the aid and the Commission and does not give enough scope to the recipient of the aid and competitors to have an input.

11. Services of general economic interest

What are services of general economic interest?

11.1. Services of general economic interest (SGEIs) raise particular competence issues. SGEIs are services of an economic nature that public authorities identify as being of particular importance to citizens but which are not supplied by market forces alone, or at least not to the extent and under conditions required by society. Their provision may therefore require public intervention.

11.2. There is no definition of SGEIs in the Treaty. However, it is generally accepted that SGEIs cover a wide range. They can vary from large commercial services to the entire population at affordable conditions, such as postal services, security of energy supply, electronic communication services, public broadcasting or public transport, to a wide range of social services such as the care of elderly or disabled people. They will fall outside the State aid rules if they are not performed by an undertaking or there is no distortion of competition or effect on trade between Member States. Otherwise they potentially fall within the State aid rules.

11.3. Frequently the Member States have conflicting policy objectives amongst themselves. Some Member States will want an SGEI to have greater protection whilst others will want it to be subject to the competition rules.

Article 106(2)

11.4. The special position of SGEIs was recognised in the original Treaty of Rome. That provision, Article 90(2), is now Article 106(2). The only changes reflect the new terminology such as substituting the Union for the common market. Article 106(2) provides:

> "Undertakings entrusted with the operation of services of general economic interest…shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union."

11.5. Article 106(3) enables the Commission to address appropriate directives and decisions to the Member States to ensure the application of this provision.

11.6. The Article is thus providing that undertakings entrusted with an SGEI are subject to, inter alia, the State rules except in so far as the application of those rules does not obstruct the performance of the task assigned to them. But trade must not be affected to an extent contrary to the interests of the Union. It provides a basis for the Commission to approve State aid in addition to the grounds in Article 107(2) and (3).

The Treaty of Amsterdam

11.7. In the late 1990s the Commission adopted a more interventionist approach to support for SGEIs. The approach had the effect of requiring a wide range of SGEIs to be notified to the Commission. The Member States were very concerned at this development and inserted a new provision into the Treaty by the Treaty of Amsterdam in 1997. That recognised the special place of SGEIs. The provision, now Article 14 of the TFEU, provides:

> "Without prejudice to Article 4 of the Treaty on European Union or to Articles 93, 106 and 107 of this Treaty, and given the special place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Union and the Member States, each within their respective powers and within the scope of application of the Treaties, shall take care that such services operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfil their missions. The European Parliament and Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services."

The Altmark Judgement

11.8. The issue of whether compensation for the performance of an SGEI or public service obligation is State aid and thus subject to control by the Commission arose in a number of cases before the Court of Justice around the same time. Six Member States intervened in Case C-280/00 Altmark in the Court of Justice to limit the support that would need to be notified to the Commission, whilst in the case of the UK not taking SGEIs completely outside the State aid rules. The judgement of the Court in that case set out the conditions that need to be met for support by a Member State to an SGEI not to constitute State aid. Those conditions are:

- The undertaking must have a clearly defined public service obligation,
- The parameters on the basis of which compensation is granted for the performance of the public service obligation must be established in advance in a clear and transparent manner,
- The compensation must not exceed what is necessary to cover all or part of the cost incurred in the discharge of the public service obligation, plus a reasonable profit, and
- The undertaking to perform the public service obligation should be chosen by a public procurement which would allow for the selection of the tenderer capable of providing the service at the least cost to the community or, if not, the level of compensation should not exceed that which would be required by a typical well-run undertaking providing the service.

Legislation adopted by the Commission

11.9. Article 14 TFEU provides that it is for a Member State to decide whether a service is a service of general economic interest. However, this is not an unfettered power because it is subject to control by the Commission and the Court of Justice. The Member States have a wide discretion in defining a SGEI and the power of the

Commission is to check for manifest error. The Parliament and the Council has not yet exercised the power to adopt regulations under the last sentence of Article 14.

11.10. However, the Commission adopted a package of measures at the end of 2011 on SGEIs consisting of a Communication and three legal instruments:

- a decision, which provides that public service compensation, below certain amounts and fulfilling certain conditions, can be considered compatible with Article 106(2) TFEU, and therefore exempt from the obligation of ex ante notification to the Commission under Article 108
- a Framework outlining the Commission's approach to cases falling outside the scope of the Decision and therefore subject to the notification obligation and Commission assessment and approval
- an amended Directive on transparency of financial relations between Member States and public undertakings.

11.11. The first and third instruments were adopted under Article 106(3) which enables the Commission to adopt legislation; there is no involvement of the Council or Parliament. The Communication and Framework were adopted under the general powers of the Commission.

11.12. The Communication gives information on what the Commission considers falls within the concept of a SGEI. It is based on the case law of the Court of Justice, for example, Case 179/90 Porto di Genova where the Court said that SGEIs exhibit special characteristics as compared to those of other economic activities and Case C-205/99 Anair where the Court said that a public service obligation cannot be satisfactorily provided by the market under conditions, such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest, as defined by the State.

Control of Member States' discretion

11.13. In Case T-106/95 FFSA the Court said that "in the absence of Community rules governing the matter, the Commission has no power to take a position on the organisation and scale of the public service tasks … or on the expediency of political choices made in this regard by the competent national authorities, provided that the aid in question does not benefit the activities pursued in competitive sectors or exceed what is necessary to enable the undertaking concerned to perform the particular task assigned to it."

11.14. In Case T-289/03 BUPA and others v Commission[20] the General Court followed the case law of the Court of Justice on the discretion of Member States to define a SGEI and confirmed that the control of the Commission and the Court over Member States in determining SGEIs is limited to ascertaining whether there is a manifest error of assessment. BUPA, which objected to an Irish measure being accepted by the Commission as an SGEI, sought to extend the competence of the Commission over that of Member States. BUPA, which competes with undertakings receiving State aid, claimed that the concept of SGEI is a concept of Community law which is strict and objective in nature and compliance with which is subject to unlimited control by the Community institutions and not capable of being delegated

[20] Note that this was a challenge brought by an undertaking challenging a positive decision of the Commission deciding that State aid by the Irish government was compatible with the internal market.

to the national authorities. It argued that, although the Member States have a certain latitude as to the manner in which they propose to ensure and regulate the provision of an SGEI, the determination of the SGEI depends on a set of objective criteria, such as the universality of the service and its compulsory nature, the presence of which must be verified by the institutions.

11.15. The General Court rejected those arguments. It said:

> "165 It must be made clear that in Community law and for the purposes of applying the EC Treaty competition rules, there is no clear and precise regulatory definition of the concept of an SGEI mission and no established legal concept definitively fixing the conditions that must be satisfied before a Member State can properly invoke the existence and protection of an SGEI mission, either within the meaning of the first *Altmark* condition or within the meaning of Article [106(2) TFEU].
>
> 166 As regards competence to determine the nature and scope of an SGEI mission within the meaning of the Treaty, and also the degree of control that the Community institutions must exercise in that context, it follows from paragraph 22 of the Communication on SGEIs … and from the case-law of the Court of First Instance that Member States have a wide discretion to define what they regard as SGEIs and that the definition of such services by a Member State can be questioned by the Commission only in the event of manifest error ...
>
> 167 That prerogative of the Member State concerning the definition of SGEIs is confirmed by the absence of any competence specially attributed to the Commission and by the absence of a precise and complete definition of the concept of SGEI in Community law. The determination of the nature and scope of an SGEI mission in specific spheres of action which either do not fall within the powers of the Community, within the meaning of the first paragraph of Article [2 TFEU], or are based on only limited or shared Community competence, within the meaning of the second paragraph of that article, remains, in principle, within the competence of the Member States. As the defendant and Ireland maintain, the health sector falls almost exclusively within the competence of the Member States. In that sector, the Community can engage, under Article [168(1) and (5) TFEU], only in action which is not legally binding, while fully respecting the responsibilities of the Member States for the organisation and provision of health services and medical care. It follows that the determination of SGEI obligations in this context also falls primarily within the competence of the Member States. That division of powers is also reflected, generally, in Article [14TFEU] which provides that, given the place occupied by SGEIs in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member States, each within their respective powers and within the scope of application of the Treaty, are to take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions."

Commission scrutiny

11.16. Although the control by the Commission and the Court over Member States' competence is limited to manifest error, the Commission scrutinises the way Member States exercise that competence. Two cases can usefully be compared. In Case 172/80 Zuchner the Court of Justice decided that the transfer of funds by

banks from one Member State to another was not capable of being an SGEI. However, in its Decision N514/2001 the Commission decided that the Universal Banking Service being set up by the Post Office could be an SGEI since it offered specially designed accounts which were easily available all over the country to those most vulnerable in society. These were loss making and therefore not offered by banks.

11.17. Another example where the Commission has scrutinised how a Member State defines an SGEI is the area of social housing.

11.18. As mentioned in paragraph 6.25, the Commission had decided that the financial support being provided by the Irish authorities for social housing by municipalities contained State aid but approved it under what is now Article 106 as an SGEI. In addition, the Block Exemption Decision relating to SGEIs approves compensation for the provision of services of general economic interest as regards compensation for the provision of services of general economic interest meeting social needs as regards social housing. However, since bodies providing social housing fall within the scope of Article 107 as undertakings, the Commission has a role in determining what aid is acceptable.

11.19. This can raise the issue of the boundary of a Member State's competence to determine the scope of the service of general economic interest and the power of the Commission. In its Decision N642/2009 the Commission in effect required the Netherlands to change the range of activities that fall within the SGEI. The Commission had expressed doubt about the compatibility of the Dutch social housing support with the State aid rules. It considered that it had the power to do so on the basis that there had been a possible manifest error by the Dutch authorities. Following negotiations between the Commission and the Dutch Government the Dutch Government agreed with the Commission what the scope of the SGEI should be and the Commission then approved the aid under Article 106(2) as compensation for an SGEI.

11.20. It is significant that the Commission did not accept that the original scope of the activities of the housing corporations concerned was an SGEI. The Dutch authorities were required to amend it to meet the objections of the Commission. Two other aspects of the Decision are worth mentioning. First, the Commission received a large number of complaints by private landlords that the benefit received by the housing corporations should not be approved. Second, in two cases the decision was challenged in the General Court. In Case T-202/10 housing corporations challenged the decision on the ground that the Commission was abusing its powers as it required a new definition of social housing from the Dutch Government.

11.21. In Case T-201/11 private landlords argued that the decision by the Commission would obstruct the commercial housing market and should be annulled. In both cases the Court decided that the applicants did not have standing to bring the actions.

11.22. Although the Block Exemption Decision relating to SGEIs approves aid for social housing, it would be open to private landlords to challenge a Member State's definition of the scope of the SGEI on the ground that it went beyond meeting social needs as regards social housing. It could do so by complaining to the Commission or by an action in the national court. The recitals to the Decision seem to give a narrow definition to social housing. Recital (11) refers to "undertakings in charge of

social services, including the provision of social housing for disadvantaged citizens or socially less advantaged groups, who due to solvency constraints are unable to obtain housing at market conditions".

12. Do the procedural rules increase EU competence?

12.1. Article 108(3) requires Member States to notify measures containing State aid to the Commission before they are put into effect. This has the benefit for Member States that they can obtain certainty that the measure either does not contain State aid or, if it does, that it will be approved by the Commission.

12.2. However, this procedure may have the effect of increasing EU competence for two reasons:

- The consequences that flow from a breach of the obligation to notify the Commission, and
- It enables the Commission to establish a policy on the State aid it will approve.

12.3. If a Member State puts a measure containing State aid into effect before it has been approved by the Commission, an action can be brought in the national court for breach of Article 108(3)[21]. The national court is required to give a remedy even if the Commission would have approved the aid or, indeed, does approve it[22]. Since a Member State which fails to comply with the obligation to notify the Commission is acting in breach of the Treaty, it is arguable that agreements it enters into, such as a guarantee, may be unenforceable.

12.4. As a result, Member States often notify proposed measures to the Commission for reasons of legal certainty even if they consider that the measure does not contain State aid. For example, the Irish Government notified the guarantee it proposed to grant in respect of the borrowings of the Housing Finance Agency[23] although it considered that the guarantee did not contain State aid to obtain legal certainty about the legality of the guarantee for the potential creditor of the HFA. In the event, the Commission decided that municipalities providing social housing are performing an economic activity and are therefore undertakings within the scope of the State aid rules.

12.5. The fact that the Commission has the discretion to grant approval has led it to adopt an extensive body of soft law explaining how it will exercise its discretion. The practical effect is to enable it to have a significant role in shaping measures adopted by Member States in areas where Member States have competence, such as the environment, research and development and SGEIs.

13. Control of EU competence

Greater role for the Council

13.1. The Council has very limited powers in relation to State aid. What is State aid is set out in the Treaty itself in Article 107(1) and the power to approve State aid is conferred on the Commission. The Council cannot therefore amend these provisions or adopt legislation derogating from them.

[21] Case C-354/90 FNCE v France
[22] Case C-199/06 CELF
[23] Commission Decision N209/2001. See paragraph 6.25

13.2. At present it has some limited powers. Under Article 107(3)(e) it may by means of a decision on a proposal from the Commission specify other categories of aid which may be compatible with the internal market. The scope of this provision has not been tested. It was used in the past for the instruments governing aid to shipbuilding. This was on the basis that the other provisions of the Article could not have formed a legal basis for the authorisation of shipbuilding aids, as measures foreseen in them included production aids, which could not be regarded as facilitating development under paragraph (c). Similarly Council Decision of 10 December 2010 on State aid to facilitate the closure of uncompetitive coal mines was adopted under this provision because none of the other paragraphs in Article 107(3) could be used. Again paragraph (c) could not be used because the aid did not facilitate the development of certain activities.

13.3. Article 108(2) enables the Council to decide that aid which a State is planning to grant is compatible with the internal market in derogation from Article 107 if such a decision is justified in exceptional circumstances. It applies if no decision has been made by the Commission. The Council acts unanimously. There is no requirement for a proposal from the Commission. The provision has rarely been used. In Case C-110/02 Commission v Council the Court emphasised that it could be used only in exceptional circumstances. The Advocate General in his opinion explained the purpose of the Treaty provisions of securing the effective and impartial control of State aids. He said that the Commission is better suited to the task of overseeing the activities of the Member States than the Council, which comprises their representatives.

13.4. Article 109 enables the Council, on a proposal from the Commission and after consulting the European Parliament, to make appropriate regulations for the application of Articles 107 and 108 and which may in particular determine the conditions in which Article 108(3) shall apply and the categories of aid exempted from this procedure. The Article has been used to adopt the Procedural Regulation and to give the Commission power to adopt block exemption regulations. The Article is potentially wider than the way in which it has been used so far. However, its scope is not clear. It could arguably be used to give the Council greater control of the provisions included in block exemption regulations. It could not be used to amend the Treaty provisions or to adopt provisions inconsistent with them.

13.5. In 1980 an issue arose as to the scope of the Commission's power to make legislation under what is now Article 106(3). As well as containing provisions relating to SGEIs, it states that Member States shall not enact any measure relating to public undertakings contrary to the rules contained in the Treaty, in particular the rules on competition. In Cases 188-190/80 the UK and a number of other Member States[24] challenged the power of the Commission to adopt legislation under Article 90(3) (now Article 106(3)) establishing a monitoring and surveillance measure designed to ensure transparency of State aid granted to public undertakings by Member States.

13.6. The Member States unsuccessfully argued that the Commission had no such power and that any legislation should be adopted by the Council under Article 94 (now Article 109). The Court rejected their arguments. It accepted that the Council could have adopted legislation under Article 94 but this did not prevent the Commission adopting legislation under Article 90(3) impinging upon the specific sphere of aids within Article 90.

[24] In contrast the Netherlands and Germany intervened in support of the Commission

13.7. Article 14 TFEU enables the Parliament and the Council to adopt regulations relating to SGEIs. The power has not yet been exercised. The most recent legislative package was adopted by the Commission.

13.8. The European Council has a role in setting the direction of the European Union. Article 15 of the Treaty on European Union states that the European Council shall provide the Union with the necessary impetus for its development and shall define the general political directions and policies thereof. Conclusions have often included paragraphs concerned with State aid[25]

14. Challenges and interventions in the Court of Justice

Challenges to Commission decisions

14.1. The Court of Justice has had a major role in developing the Treaty rules on State aid, in particular the scope of what is State aid within Article 107(1). The UK can seek to influence the development of EU competence in State aid by challenging decisions of the Commission and by intervening in cases.

14.2. The UK Government has the power to challenge decisions of the Commission addressed to it. In addition, as a Member State it has the power to challenge decisions addressed to other Member States and to intervene in cases in the Court of Justice relating to aid granted by Member States or where the Commission has refused to grant approval or has ordered the recovery of aid unlawfully paid. It can also intervene in preliminary references to the Court of Justice from national courts raising State aid issues.

14.3. A challenge to a Commission decision can be brought on the grounds of lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers. In the context of State aids this means that a challenge could be brought for a number of reasons. The first is that a measure the Commission has decided contains State aid does not, in the view of the challenger, do so. This is on the ground that the Commission has competence to act only if the measure contains State aid. This is a question of law. It is more difficult to challenge a refusal of the Commission to approve aid. This is because, except in the limited cases falling within Article 107(2), the Commission has a discretion whether or not to approve the aid. It may be possible to do so if the decision is not properly reasoned or the Commission has breached a procedural requirement, for example by not giving the Government sufficient opportunity to make representations.

14.4. So far as the power to challenge a decision of the Commission addressed to the UK, this power has been rarely exercised, often because, whilst disagreeing with the Commission's assessment that the measure contains State aid, the Commission has approved it., In Case C-279/08P Commission v Netherlands the Court held that a Member State could challenge a decision where the Member State considered that the measure did not contain State aid even if the Commission had approved the aid. However, despite this clarification of the power to challenge a decision, the appetite to do so will depend on the importance of the general principle involved. Often the process of securing a positive Commission decision will have involved a great deal of effort and a challenge is going to be resource intensive.

[25] For example, the Laeken European Council in 2001 contained conclusions on SGEIs.

Intervention in cases before the Court of Justice

14.5. The ability to intervene can arise in two situations. The first is where a Member State or natural or legal person challenges a decision of the Commission. On occasion the UK has intervened in a challenge brought by a UK company where the Commission has approved aid to one of its competitors. An early example is Case T-184/97 BP v Commission where the UK intervened in support of BP's challenge to a decision of the Commission approving aid to one of its competitors.

14.6. Another example is Case C-205/03 FENIN. The case was a challenge to a Commission decision concerning health service providers in Spain and whether they were undertakings. The hospitals provided care which was free at the point of delivery. The implications for the NHS were clear then.

14.7. The second situation is where there is a preliminary reference to the Court of Justice from the national court. There have been a number of examples where the UK has intervened where important UK policy objectives were clearly involved. It is often very difficult to be able to discover whether a case from the courts of another country involve a point of relevance to the UK. Little information is given in the notice the Court publishes in the Official Journal. It is also often difficult to understand how something arising in another Member State can be relevant to the UK. Two examples of cases where the implications for the UK were clear were Altmark and Rioja.

14.8. Case C-280/00 Altmark, a reference from a German court, concerned the circumstances in which compensation paid to an undertaking for the performance of a service of general economic interest would be State aid and should therefore be notified to the Commission before it is granted. The UK's interest in the case was clear and the UK presented arguments to protect the ability of UK companies to compete in other Member States.

14.9. Case C-430/06 Comunidad Autonoma de la Rioja, a reference from a Spanish court, concerned the powers of an autonomous region to tax at a different rate to that applying elsewhere in Spain. The case and, in particular the arguments being put forward by the Commission, had implications for the devolution policy of the UK Government, in particular whether a devolved administration could tax at a different level to the national level.

15. International agreements containing State aid provisions

The European Economic Area Agreement

15.1. The EEA Agreement is an agreement between the EU Member States and the EFTA States, Iceland, Norway and Liechtenstein. One of its principal objectives is to bring all those States together in a single market, the internal market. As a consequence it contains State aid provisions which are very similar to those in the EU. The substantive provisions are a prohibition on State aid which is in similar terms to Article 107(1) TFEU with a power to approve State aid similar to Article 107(2) and (3).

15.2. Article 61(1)of the EEA Agreement provides:

> "Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States 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 Contracting Parties, be incompatible with the functioning of this Agreement."

15.3. The EFTA States established an EFTA Surveillance Authority with powers similar to those of the European Commission. The proposed aid measures must be notified to the EFTA Surveillance Authority. The EFTA Surveillance Authority has the power to approve State aid under Article 61(2) and (3). Those grounds are similar to Article 107(2) and (3) but do not include a power to approve aid for the promotion of culture or heritage conservation.

15.4. Protocol 27 to the EEA Agreement refers to the objective of ensuring a uniform implementation, application and interpretation of the rules on State aid throughout the territory of the Contracting Parties, that is of the EU Member States and the EFTA States. The EFTA Surveillance Authority adopts guidelines and block exemption regulations in the same terms as those adopted by the European Commission.

15.5. In assessing whether a measure contains State aid the EFTA Surveillance Authority applies the same principles as the EU. It often refers to judgements of the European Court. In deciding whether to approve aid the Authority applies the same principles as the Commission. It frequently refers to decisions of the Commission that are relevant.

15.6. The rights of action and remedies derived from the general principles of EU law would not apply if the UK were a party to the EEA Agreement but not a Member State of the EU. For example, the obligation not to put a measure containing State aid into effect until the Commission has made a decision would not have direct effect and so would not form the basis of an action against the grantor of the aid in a UK court. Instead, the UK principles of administrative law would apply. Similarly the remedies derived from EU law would not apply, such as the right to damages for a serious breach of EU law and the greater scope of injunctive relief. UK law remedies would apply instead.

Stabilisation and Association Agreements

15.7. Stabilisation and Association Agreements between the EU and countries of Eastern Europe contain provisions on State aid. Typically they contain a prohibition on State aid, require the country to establish an independent monitoring authority and for that authority to apply the same criteria as to what is an aid and what should be approved as apply in the EU

Switzerland

15.8. Article 23 of the Agreement between the European Community and the Swiss Confederation provides that any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the proper functioning of the Agreement in so far as they affect trade between the Community and Switzerland.

15.9. There is no requirement on Switzerland to establish an independent monitoring authority. There is a procedure if a Contracting Party considers that a practice is incompatible with the Agreement and safeguarding measures can be taken.

WTO Agreement

15.10. The rules established by the WTO Agreements are relevant in two respects. First, the EU is itself bound by those rules. Second, even if the EU were to cease to have competence for State aid, the UK, as a party to the WTO, would be bound by the rules.

The Agreement on Subsidies and Countervailing Measures

15.11. The WTO Agreements include the Agreement on Subsidies and Countervailing Measures. This defines what is meant by a subsidy and sets out which subsidies are prohibited and which are actionable and the remedies. It applies only to goods.

15.12. The definition of a subsidy is similar to that of a State aid in the EU although there are a number of differences. The disciplines sets out in the Agreement only apply to specific subsidies, that is a subsidy that is available only to an enterprise, industry, group of enterprises or group of industries in the country that gives the subsidy. This is similar to, but in some cases different from, the requirement in the EU that the aid favours certain undertakings or the production of certain goods.

15.13. Prohibited subsidies are subsidies that require recipients to meet certain export targets, or to use domestic goods instead of imported goods. They are prohibited because they are specifically designed to distort international trade, and are therefore likely to hurt other countries' trade. They can be challenged in the WTO dispute settlement procedure where they are handled under an accelerated timetable. If the dispute settlement procedure confirms that the subsidy is prohibited, it must be withdrawn immediately. Otherwise, the complaining country can take counter measures. If domestic producers are hurt by imports of subsidized products, countervailing duty can be imposed.

15.14. In the case of actionable subsidies the complaining country has to show that the subsidy has an adverse effect on its interests. Otherwise the subsidy is permitted. The agreement defines three types of damage they can cause. One country's subsidies can hurt a domestic industry in an importing country. They can hurt rival exporters from another country when the two compete in third markets. And domestic subsidies in one country can hurt exporters trying to compete in the subsidising country's domestic market. If the Dispute Settlement Body rules that the subsidy does have an adverse effect, the subsidy must be withdrawn or its adverse effect must be removed. Again, if domestic producers are hurt by imports of subsidised products, countervailing duty can be imposed.

15.15. There is no provision similar to Article 107(2) or (3) which enables the Commission to approve subsidies which meet certain objectives. In addition, there is no obligation of, or procedure for, prior notification to a body that has the power to approve the subsidy. A country that considers that another country has granted a prohibited or actionable subsidy can take countervailing measures or invoke the disputes procedure to seek withdrawal of the subsidy against the country which has granted the subsidy.

15.16. There is no body similar to the Commission with the power to initiate action to enforce the Agreement or set out what subsidies are permitted by the Agreement. The latter is achieved by building a precedent of decisions of the bodies tasked with dispute settlement.

The General Agreement on Trade in Services

15.17. The Agreement on Subsidies and Countervailing Measures applies only to goods. There are no equivalent provisions for subsidies to services. Article XV of the General Agreement on Trade in Services simply provides:

> "1. Members recognize that, in certain circumstances, subsidies may have distortive effects on trade in services. Members shall enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade-distortive effects. The negotiations shall also address the appropriateness of countervailing procedures. Such negotiations shall recognize the role of subsidies in relation to the development programmes of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area. For the purpose of such negotiations, Members shall exchange information concerning all subsidies related to trade in services that they provide to their domestic service suppliers.
>
> 2. Any Member which considers that it is adversely affected by a subsidy of another Member may request consultations with that Member on such matters. Such requests shall be accorded sympathetic consideration."

15.18. No negotiations have been concluded. Thus, the only course open to a Member State of the WTO is to request consultation with the Member State providing the subsidy. The latter State is then required to accord it sympathetic consideration.

Differences between the regime in the WTO and EU

15.19. The substantive scope of the WTO regime is less well developed than that in the EU. As the case law of the WTO develops the extent of the differences and similarities will become clearer. However, it is possible to identify the principal differences between the two regimes. The principal differences between the subsidies regime in the WTO and the EU are as follows.

- The WTO Agreement on Subsidies and Countervailing Measures applies only to subsidies in respect of goods. The regime in relation to services provides only for consultation.
- There is no organisation in the WTO equivalent to the Commission in the EU.
- The definition of a subsidy in the WTO is similar to that of State aid in the EU. However, it is arguably wider in certain respects than that in the EU. As a result of the case law, such as PreussenElektra[26], State aid only exists where the measure entails a direct or indirect transfer of State resources to certain undertakings. In contrast, there is no similar cost to Government requirement in the WTO, with the result that various measures mandated by Government may nonetheless be regarded as subsidies.
- In other respects it is narrower. In Case C-351/98 Spain v Commission[27] the Court of Justice appears to have accepted that the subsidy in that case would not be considered a subsidy under the Agreement on Subsidies and Countervailing Measures[28].
- The subsidies that are permitted are not as clearly expressed as in the EU. In the WTO all measures meeting the definition of a subsidy are in principle actionable where they produce adverse trade effects. Whether they do is

[26] See paragraph 6.7
[27] See paragraph 6.48
[28] Paragraph 44 of the judgement

decided after the event in the event of a challenge. In the EU there is a body of rules based on Treaty provisions and instruments adopted by the Commission setting out what State aids are permitted.

- In the WTO there is no requirement to obtain approval before a subsidy is granted whereas in the EU, if a measure contains State aid it cannot be put into effect until the Commission has granted approval.
- In the WTO there is no body charged with enforcing the subsidy rules whereas in the EU the Commission has this role.
- In the WTO an action is brought by a Member State against another Member State. In contrast an interested person, such as a competitor can complain to the Commission or, where the State aid has been granted without the approval of the Commission, bring an action in the national court of the Member State granting the aid against the grantor of the aid.
- The remedies are different. In the EU the usual remedy is to require the recipient of the aid to repay it with interest. In addition, if an action is brought in the national court a complainant, such as a competitor can seek damages if it can show that it has suffered loss as a result of the unlawful grant of aid. In the WTO the recipient is not always required to repay the aid. Instead, one remedy is for the State which considers another has granted an actionable subsidy to impose countervailing measures.
- Most complaints of a breach of the State aid rules are made by competitors in the same country as the recipient of the aid. In the WTO a State takes measures if its companies are affected by subsidies granted by another State. This reduces considerably the number of subsidies which are challenged.
- As with the position with the EEA, the general principles of EU law relating to rights of action and remedies would not apply if the UK were a Member State of the WTO but not a Member State of the EU[29]

16. Conclusion

16.1. The TFEU confers exclusive competence on the EU for establishing State aid rules. The Treaty provisions have not changed fundamentally since the original Treaty of Rome. However the scope of activities covered by them has increased, particularly in the area of services.

16.2. This increase is largely the result of two factors. The first is the increased liberalisation of services in the internal market. The second is the change in the way services are provided, in particular the increased role of the private sector in the delivery of services that were previously provided by the State.

16.3. While Member States have competence in such matters as direct taxation, industrial policy, the environment, employment and social policy and health, such competence is limited in practice by the requirement to exercise such competence in accordance with the State aid rules.

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[29] See paragraph 15.6