Quickguides

EU State aid
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This Quickguide provides an overview of the EU State aid rules. In particular, it considers:

• Why State aid should be of interest to business
• The criteria for State aid
• Situations in which State aid will be unlikely to arise
• Exemptions
• Economic assessment
• Emergency measures
• Procedure
• Participation in State aid procedures
• Examples of State aid
• Practice advice to manage the risk

For further information on any of these areas please speak to one of the contacts listed on the final page of this Quickguide, or your usual Ashurst contact.

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EU State aid

1. Introduction

What are the State aid rules?
The EU State aid rules are designed to maintain a level playing field for businesses in Europe and to prevent the creation of "national champions" through State subsidies. EU State aid is an area of EU competition policy where the European Commission (the "Commission") has become increasingly active, using its powers to investigate and claw back subsidies unlawfully paid to public and private sector firms. State aid enforcement is an ongoing priority for the Commission as part of the Lisbon strategy for growth and jobs in Europe.

Why should State aid be of interest to business?
State aid law should be of interest to businesses in their capacity as:

- potential beneficiaries of State aid measures; or
- as competitors of firms receiving illegal State subsidies.

Typically, a careful assessment of State aid issues would be required, for example, in the context of a firm contemplating the purchase of a business from a Government body or an asset which has historically received State aid. In addition, the Commission's recent investigations into tax ruling practices of Member States, which led to a number of decisions and several appeals before the EU General Court, has created significant legal uncertainty for companies having received or seeking tax rulings from national tax administrations. Given the severe financial consequences attached to a finding of State aid in such cases, there is an increasing need for businesses to carry out State aid compatibility checks with respect to existing tax rulings, as well as any request for new rulings.

A failure to identify unlawfully paid State aid may result in lengthy Commission investigations and eventual repayment of State subsidies received plus interest. Businesses, particularly in countries where in general aid to industry is sparse, are becoming increasingly aware of their right to challenge unlawful subsidies paid to their overseas competitors in breach of the Treaty on the Functioning of the European Union (the "TFEU"). It is therefore critical for businesses to examine the possibility that State aid may arise in the context of their own transactions or for attacking any suspected unlawful State aid measures that competitors may receive that could distort fair competition.

2. The legal basis

The TFEU generally prevents EU Member States from granting financial assistance in a way that distorts competition and inter-state trade within the EU. The reason for this prohibition is to promote the maintenance of a level playing field for businesses within the EU. Article 107(1) TFEU provides that: "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".

3. The criteria for State aid

State aid consists of any transfer of State resources that favours one or more undertakings, resulting in a competitive advantage that could not have been obtained under normal market conditions. The aid

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1 At the time of writing, the Commission adopted final decisions in the Fiat (2015), Starbucks (2015), Apple (2016), Belgian Excess Profits (2016), Amazon (2017) and Engie (2018) cases.
does not necessarily need to be granted by the State itself. It may also be granted by a private or public intermediate body controlled by the State (including regional or local authorities, public banks and foundations or any other "emanation" of the State). In its 2016 notice on the "Notion of State aid", the Commission provides further guidance on the four cumulative conditions of State aid, summarised below.

**State aid is granted through State resources**

The requirement that State aid must be granted through State resources means that granting the aid must constitute some depletion of the State's resources, compared with what they would have been had the aid not been granted. Direct subsidies are the most obvious form of aid. However, aid can consist of the State foregoing revenue which it would otherwise receive, for example, such aid could take the form of a "shortfall" in tax and social security revenue due to exemptions or reductions in taxes or social security contributions granted by the Member State, or exemptions from the obligation to pay fines or other pecuniary penalties.

**State aid favours certain undertakings or the production of certain goods**

"Favouring" means conferring a financial benefit over and above what market forces would provide. The simple act of buying goods or lending money is not necessarily "favouring".

"Undertakings", for the purposes of State aid, are entities engaged in economic activity. This means that they operate in a market providing goods or services in competition with other market operators. The same entity may well be an undertaking for some of its activities and not for others. For example, a school might not be an undertaking when it teaches its pupils but may be one when it purchases textbooks and furniture.

The limitation of the prohibition of State aid to "certain" undertakings means that measures which apply generally to all undertakings in the relevant Member State will not amount to State aid. In order for the measure to be considered State aid it must be selective. Therefore, if a guarantee is only offered to specific undertakings, businesses based in a certain region or businesses that manufacture a certain product, it will be State aid. If a bank guarantee for liability to third parties is available to the entire economy it would be regarded as a "general measure" and would not be caught by the EU State aid framework because any business could take advantage of it.

**State aid distorts or threatens to distort competition**

In practice, once it is clear that aid has been given, it will usually be held to distort or threaten to distort competition. Since aid is only aid if it is received by undertakings who are operating in a market there will usually be the potential for distortion, regardless of the characteristics of the market.

**State aid affects trade between Member States**

"Affecting" trade means having an effect on potential, as well as existing, cross-border trade. Therefore, support to an undertaking, or class of undertakings, will nearly always be held to affect cross-border trade.

4. **Situations in which State aid will be unlikely to arise**

State aid is unlikely to arise in the following situations:

- Where the State is investing in an undertaking or attaching conditions to a sale in circumstances and on the basis on which a market investor would do so (the "market economy investor principle" or the "meip"), the investment is not considered to be State aid. The meip test is used to judge whether a public sector investment (equity, loan or guarantee) equates to the actions of a private investor and therefore does not confer an advantage (and so does not amount to State aid). The terms of the investment need not be the most commercially rewarding that would be available to an
arm's length investor who is only interested in maximising profit. However, the terms should be acceptable to a business, taking a long-term view of its investment. Concomitant private sector investments alongside public investments normally create a strong presumption that the meip is satisfied (i.e. that the public sector behaviour aligns with private sector behaviour).

- Compensation for the provision of services of general interest does not amount to State aid if the following conditions are met:
  - the beneficiary is chosen by virtue of an open and transparent tender procedure; and
  - compensation is not excessive (i.e. only meets the costs of the service) having regard to prevailing market conditions for the service in question.
- State guarantees will fulfil the meip test and not constitute aid where certain conditions are met. For one-off guarantees the conditions are:
  - the borrower is not in financial difficulty;
  - the borrower would theoretically be able to obtain a guarantee on market terms from the financial markets, without any State intervention;
  - the guarantee is linked to a specific financial transaction, is for a fixed maximum amount, does not cover more than 80 per cent of the outstanding loan or other financial obligation (except for bonds and similar instruments), and is not open-ended; and
  - the market price for the guarantee is paid.

5. Exemptions

The Commission is empowered\(^2\) to enact regulations (known as Block Exemption Regulations) providing for an automatic exemption, for certain types of aid from the general prohibition. There are currently two Block Exemption Regulations:

- the *de minimis* Regulation, which among other things exempts aid below €200,000 over a period of three years under certain conditions; and
- the General Block Exemption Regulation ("GBER"), revised in 2014 and in 2017, exempts from notification to the Commission several types of aid including:
  - regional aid;
  - aid to SMEs in the form of investment aid, operating aid and SMEs' access to finance;
  - aid for environmental protection;
  - aid for research and development and innovation;
  - training aid;
  - recruitment and employment aid for disadvantaged workers and workers with disabilities;
  - aid to make good the damage caused by certain natural disasters;
  - social aid for transport for residents of remote regions;
  - aid for broadband infrastructures;
  - aid for culture and heritage conservation;
  - aid for sport and multifunctional recreational infrastructures;
  - aid for local infrastructures;

– aid for regional airports; and,
– aid for ports.

In addition to general exemptions there are also a range of sector specific rules governing grants of aid to, for example: audiovisual production, deployment of broadband networks, public broadcasting, postal services, shipbuilding, steel sector, airports and airlines, maritime transport, rail and road transport services.

6. Economic assessment

The compatibility of State aid with the TFEU, if not de minimis or covered by the GBER, is assessed through the application of a so-called "balancing test". Essentially, this means that the compatibility of State aid will be assessed on a case-by-case basis through the application of a three-part test which examines the following questions:

• Is the aid measure aimed at a well-defined objective of common interest (such as growth, employment, cohesion, protection of the environment, and research and development)?

• Is the measure designed to deliver the objective of common interest - that is, does the aid address a market failure or another objective?

• Are the distortions of competition and effect on trade limited, so that the overall balance is positive?

The balancing test is not a substitute for notification to the Commission. Instead it describes the approach applied by the Commission to aid that is notified. It should help any businesses contemplating potential aid to assess the strength of their case, and it can also help to suggest how an arrangement might be adjusted to take it out of the State aid framework altogether, or render it more likely to be accepted as compatible.

7. Emergency measures

State aid for rescuing and restructuring firms in difficulty

State aid to individual undertakings in financial difficulty is usually assessed under Article 107(3)(c) of the TFEU and specifically under the Commission Guidelines on State aid for rescuing and restructuring firms in difficulty. A company is in difficulty and entitled to aid when “without intervention by the State, it will almost certainly be condemned to going out of business in the short or medium term”.

Rescuing and restructuring aid can usually only be received once, the so-called “one time, last time” condition (in exceptional circumstances every ten years), and is subject to the following conditions:

• Rescue aid:
  – Rescue aid must consist of reversible liquidity support in the form of loans/loans guarantees with an interest rate at least comparable to those reserved for loans to healthy firms.
  – Aid must be limited to the minimum necessary and be reimbursed or come to an end within six months.

• Restructuring aid:
  – Grant of restructuring aid is conditional on the full implementation of a viable restructuring or liquidation plan (i.e. a scaling down of the business) which must be submitted to the Commission.
  – The beneficiary is expected to make a significant contribution to the restructuring plan from its own resources varying between 25-40 per cent.

• Aid to remedy a serious disturbance to an economy: under Article 107(3)(b) TFEU a Member State is allowed to grant emergency aid in order to remedy a “serious disturbance in the economy of a Member State”. In 2008, in light of the unprecedented scale of the financial crisis, the Commission

adopted a series of communications aimed at the financial sector on the basis of this provision. Since then, these rules have been regularly updated to adapt to the evolution of the crisis. In 2013 the Commission’s "Banking Communication" was adopted, which supplements the existing "crisis rules".

8. Procedure

Notification

Under the TFEU the Commission is responsible for keeping existing systems of aid under constant review and for establishing an appropriate procedure for investigating aid. The system of control which has been put in place requires Member States to notify their plans to grant or alter aid and to obtain the Commission’s authorisation before implementation. There is a standstill obligation meaning that Member States may not implement aid measures until they have been declared compatible with the TFEU. Member States are obliged to abolish illegal aid which is incompatible with the TFEU in order to re-establish the previously existing situation.

It is important to note that the procedures primarily involve a dialogue between the concerned Member State and the Commission. The aid recipient(s) and any complainants are not parties to the procedure. State aid control involves a two-step procedure:

- **Step 1**: preliminary examination of the notification.
- **Step 2**: if necessary, a formal investigation procedure.

In the first phase (step 1), the Commission has a two-month period from the date of the complete notification to decide whether to clear the aid or initiate a more detailed enquiry. If the Commission has doubts as to the compatibility of the aid with the TFEU it launches a formal investigation (step 2) which involves an in-depth enquiry which can last up to 18 months or more in complex cases. The Commission has discretion to clear the aid, to prohibit it, or to clear it subject to conditions, unless the EU Council of Ministers decides otherwise.

Simplified procedure

There is a simplified procedure for straightforward cases, pursuant to which it will adopt a short form "no aid" or "no objections" decision within 20 working days.

Code of Best Practice

The Code of Best Practice details how State aids procedures should be carried out in practice, in particular as regards their duration, transparency and predictability. It covers:

- pre-notification contacts between the Commission, the Member State and the beneficiary including "state of play" contacts;
- a system of "Mutually Agreed Planning" under which timeframes and priority treatment of cases may be agreed; and
- indicative timeframes and clear principles for the handling of complaints and contacts with third parties.

Consequences of unlawful State aid

The Commission or a national court (the latter following an action brought by a third party) may recover unlawfully granted aid from the recipient. Interest will be charged on the aid. Any promise by the State to cover the repayment or interest will not only be unlawful and invalid but will also in itself constitute aid.
9. Participation in State aid procedures

Any legal or natural person may trigger an investigation by lodging a complaint concerning alleged unlawful State aid with the Commission. The Commission also invites interested parties to submit comments (via a notice in the Official Journal of the EU) when it has doubts as to the compatibility of a proposed aid measure and opens a formal investigation procedure.

Third party rights are however, in practice, poorly protected in State aid proceedings with the consequence that they may take only a limited part in the Commission’s initial assessment (increased if the Commission opens an in-depth investigation). However, third parties may play a major role in the appeal process of any State aid decision before the European Courts in Luxembourg. While the Commission stage of a complex State aid case could easily take up to two years (or more) if an in-depth investigation is launched, a Court appeal action would typically add at least four years to the period of legal uncertainty. It can be seen, therefore, that third parties can materially add to the period of legal uncertainty in State aid cases.

Any person or entity who has suffered loss because illegal State aid has been granted may bring an action for damages in a national court. With its "Enforcement Notice" the Commission aims to encourage private enforcement at the national level and, in practice, given poor third party complainant rights before the Commission, there is increasing evidence that this will often be the most effective means of enforcing third party rights.

10. Examples of State aid

Types of arrangement that require close scrutiny

None of the following is necessarily unlawful State aid but the presence of such arrangements should alert the participants to the possibility that aid is being granted:

- public sector equity injections;
- disposals of State-owned assets on highly favourable terms or without a tender process;
- State involvement in loans on favourable terms, reduced interest rates and interest payment holidays;
- State involvement in guarantees against liabilities or losses;
- fiscal measures such as relief from a tax which would otherwise be payable, if not applicable to all companies;
- public sector support to rescue or restructure firms in financial difficulty; and
- public service schemes under which certain undertakings have been entrusted with the operation of services of general economic interest.

Less obvious forms of potential State aid

Less obvious forms of State aid include the following:

- government assistance to a public enterprise preparing for privatisation;
- legislation that protects or guarantees market share; and
- public-private partnerships and other contracts not open to competitive tendering.

These examples of aid measures all involve an element of favourable treatment conferred upon the recipient of the aid.
Tax rulings
Since June 2013, the tax ruling practices of Member States are under close scrutiny. The function of a tax ruling is to establish in advance the application of the ordinary tax system to a particular case in view of its specific facts and circumstances. However, the Commission considers that a tax ruling may confer a selective advantage upon the concerned taxpayer, where it results in a lowering of that addressee's tax liability in the Member State as compared to companies in a similar factual and legal situation. Since 2015, the Commission has adopted negative decisions in several cases involving specific tax payers (including the "Apple" case where the Commission ordered Ireland to recover a record 13 billion euros from Irish based entities of the group) and also adopted a decision in a case involving a Member State scheme (the "Belgian excess profits" case).

11. Practical advice to manage the risk

- Identify the relevant industrial sector for the aid. There are many specialist sectoral state aid regimes: currently and most obviously those for financial institutions, but note also those now available for the real economy generally and those for maritime and rail transport, ports and airports, among others.

- Identify the basic context for the aid assessment:
  - are you a would-be beneficiary?
  - are you in a mergers and acquisitions/risk assessment scenario?
  - are you a complainant?

- Is the aid automatically exempted? For example, a bank under one of the national rescue schemes or because the aid is *de minimis* or covered by a block exemption or other sectoral rules.

- Can you argue that the measure is not aid?
  - for example, it matches the actions of a market economy investor; or
  - it fulfils the criteria for a public interest service.

- If the aid is not automatically cleared, identify the appropriate clearance mechanism and assess the prospects of the need for notification for the aid package.

- The State aid process is a dialogue between the Member State and the Commission. A beneficiary and its advisers will need to push hard to ensure appropriate representation.

- The beneficiary has a clear interest in ensuring that the State aid procedures are followed, since the liability to repay with interest rests solely with the beneficiary.

- State aid authorisation is handled solely by the Commission in Brussels. Seek specialist advice early and note that the process is susceptible to high quality advocacy, political pressure and lobbying.
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