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Assembly

# Research and Information Service Briefing Paper

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## State Aid

This Briefing Paper provides a general briefing on European State Aid rules. It explains the legislative background and gives some detail on what is, and what is not, permissible under those rules.

## 1. Introduction

An individual EU Member State, including its devolved institutions, may lawfully provide financial assistance to business if such assistance conforms with prevailing EU State Aid rules. Consequently, policy and legislation implementing such assistance must also comply.

As a result, State Aid considerations are frequently highlighted to committees of the Northern Ireland Assembly. Often, State Aid rules are cited as a reason why a particular policy proposal could not be pursued. In other instances, there are potentially far-reaching implications for the operations of Executive departments and for businesses.

For example, the level of selective financial assistance that *Invest NI* is able to provide to prospective investors has reduced from 2011 onwards. So that organisation's role could change somewhat – it may become more of an advisory body, for example.

This change to Northern Ireland's ability to incentivise foreign direct investment features strongly in the arguments for the devolution of corporation tax. With reduced financial assistance available, it has been argued that the Executive needs new and different economic development tools – in this case, the ability to reduce corporate taxation.<sup>1</sup>

There were also State Aid considerations in relation to another recent policy initiative – the Large Retail Levy that the Executive has introduced to fund the extension of the Small Business Rate Relief Scheme. In this instance the Department of Finance and Personnel took advice from the Attorney General's office and were advised that:

*...the Attorney General agrees with our assessment that there is no state aid involved in these measures, either in relation to the large shops levy or the extension of the small business rate relief scheme.<sup>2</sup>*

### Purpose of Briefing Paper

This paper provides general briefing on State Aid. Section 2 provides detail on the relevant European legislation and the definition of State Aid. It details the tests that are applied to determine whether there is State Aid provided by a particular measure. Section 3 explains the rationale that underpins the State Aid rules. Sections 4 and 5 describe circumstances in which State Aid is permitted, the process for approval and the means of legal challenge. Section 6 presents the consequences for Member States and businesses if the rules are broken.

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<sup>1</sup> ERGNI (2011) „The Case for Reduced Corporation Tax – A Supporting Update“ available online at: [http://ergni.org/reports/report\\_update\\_feb\\_2011.pdf](http://ergni.org/reports/report_update_feb_2011.pdf) (accessed 2 February 2012) (see page 8)

<sup>2</sup> Committee for Finance and Personnel, Official Report, 11 January 2012, available at: [http://www.niassembly.gov.uk/Documents/Official%20Reports/Finance\\_Personnel/120111\\_RatesAmendmentBillPreIntroductoryBriefing.pdf](http://www.niassembly.gov.uk/Documents/Official%20Reports/Finance_Personnel/120111_RatesAmendmentBillPreIntroductoryBriefing.pdf) (accessed 2 February 2012) (see page 16)

## 2. What is State Aid?

State Aid is a Member State's financial aid to business which meets all the criteria in Article 107(1) of the Treaty on the Functioning of the European Union. This article 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.<sup>3</sup>*

The Department of Enterprise, Trade and Investment's (DETI) European Support Unit describes State Aid as:

*...a specific term which relates to forms of assistance, from a public body, or publicly-funded body, or body under public sector control, given with the potential to distort competition and affect trade between member states of the European Union. The 'state aid rules' encompass various European regulations, frameworks, articles and guidelines. The European Commission governs Member States' compliance with these rules and must be notified of all schemes involving state aid. State aid granted without Commission approval is viewed as unlawful.<sup>4</sup>*

In determining whether or not a particular state intervention is State Aid, four key questions need to be considered.<sup>5</sup> These are detailed below. It should be noted that **all four** criteria must be met for a measure to be a State Aid.

### 1. Is the support granted by the state or through state resources?

This includes all public and private bodies controlled by the state. State resources include tax exemptions and also funds not permanently belonging to the state but which the state may direct, such as EU Structural Funds.

### 2. Does the support confer a selective advantage to an undertaking?

The State Aid rules only apply in respect of financial support to undertakings, that is to say any entity which is engaged in economic activity. If support is provided to an entity engaged in a non-economic activity, then it cannot be State Aid. Therefore, support given to individuals, through the social security system for example, would not be considered as State Aid.

<sup>3</sup> See <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008E107:EN:HTML>

<sup>4</sup> <http://www.detini.gov.uk/deti-euro-prog-index.htm>

<sup>5</sup> Department for Business, Innovation and Skills (2010) 'State Aid – a beginner's guide' available online at: <http://www.bis.gov.uk/assets/biscore/business-law/docs/s/11-1040-state-aid-guide> (accessed 24 January 2011) (see pages 1-2)

Economic activities are those which involve the placing of goods or services on a given market. It should be noted that it is not necessary for the goods or services to be supplied at a profit for them to be economic activities. Also, in determining whether an entity is an undertaking it is important to look at the *activity* and not the *form*. This means that public sector bodies and charities would be undertakings in respect of any economic activities that they undertake.

A benefit to an undertaking, granted for free or on favourable (non-commercial) terms, could be State Aid. This includes the direct transfer of resources, such as grants and soft loans, and also indirect assistance - for example, relief from charges that an undertaking normally has to bear, such as a tax exemption or the provision of services, loans, at a favourable rate. Support that targets particular businesses, locations, types of firm (for example SMEs or sectors) will be considered selective. By contrast; general tax measures such as business taxation, when applied equally to all undertakings fail this test and are not considered as State Aid.

### **3. Does the support distort or have the potential to distort competition?**

If the support strengthens the position of the beneficiary relative to other competitors then this criteria is likely to be met. The potential to distort competition does not have to be substantial or significant, and this criterion may apply to relatively small amounts of financial support and firms with little market share.

### **4. Does the support affect trade between Member States?**

The Commission's interpretation of this is broad - it is sufficient that a product or service is tradable between Member States, even if the recipient of support does not itself export to other EU markets.

### 3. Why have rules on State Aid?

Ultimately, unlawful State Aid is prohibited to protect consumers. The rationale is that providing assistance to one undertaking but not another (wherever it may be located) distorts competition. Those undertakings which receive assistance may be discouraged from innovating or from seeking other forms of competitive advantage. Also, the support of existing – possibly inefficient – undertakings might discourage new entrants to a market.

Those new entrants might otherwise offer a similar service to established undertakings but at lower cost. Or they might offer better products or services which would draw demand away from established undertakings. Either way, any intervention which could reduce price or quality competition between undertakings (both within and between EU Member States) has the potential to impact on consumers.

In summary, the reasons for controlling State Aid can be stated as:

- To avoid a subsidy 'race';
- To ensure a level playing field throughout the EU; and,
- To ensure competitiveness and encourage restructuring and innovation in industry.<sup>6</sup>

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<sup>6</sup> Presentation to State Aid Conference for Scottish Local Authorities (2007) available online at: [http://www.stateaidscotland.gov.uk/state\\_aid/files/Sheena%20Brown%20LA%20Presentation.ppt](http://www.stateaidscotland.gov.uk/state_aid/files/Sheena%20Brown%20LA%20Presentation.ppt) (accessed 26 January 2012)

## 4. When is State Aid allowed?

State Aid is not illegal in all circumstances. The European Commission may, as an exception permitted by the Treaty, formally approve aid measures within certain limits (depending on the size, sector and location of the beneficiary).<sup>7</sup>

Article 107(3) of the Treaty on the Functioning of the European Union provides that the following are deemed 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.*<sup>8</sup>

It is for the European Commission to decide whether or not a particular measure is compatible with the terms of the European Treaty. The Commission has considerable powers to monitor, control, and restrict the forms and levels of aid given by Member States to their industries.<sup>9</sup>

If a government department believes that a measure it intends to implement might constitute State Aid, it must notify the Commission and seek approval. Any State Aid measure must be approved **in advance** of implementation. Article 108(3) of the Treaty provides that the Commission should receive notification “*in sufficient time to enable it to submit its comments*”.<sup>10</sup>

<sup>7</sup> Department for Business, Innovation and Skills (2011) ‘State Aid – frequently asked questions’ available online at: <http://www.bis.gov.uk/assets/biscore/business-law/docs/s/11-864-state-aid-frequently-asked-questions> (accessed 24 January 2012) (see page 4)

<sup>8</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008E107:EN:HTML>

<sup>9</sup> Department for Business, Innovation and Skills (2011) ‘State Aid – frequently asked questions’ available online at: <http://www.bis.gov.uk/assets/biscore/business-law/docs/s/11-864-state-aid-frequently-asked-questions> (accessed 24 January 2012) (see page 4)

<sup>10</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008E108:EN:HTML> (accessed 2 February 2012)

## National Regional Aid

Of the exceptions permitted by the Treaty listed above, Article 107(3)(a) has arguably been the most important for Northern Ireland. A region's standard of living is interpreted as 'abnormally low' in the Commission's *Guidelines on National Regional Aid for 2007-2013* if it:

*...has a per capita gross domestic product (GDP), measured in purchasing power standards (PPS), of less than 75 % of the Community average.<sup>11</sup>*

State Aid **may** be granted by Member States to promote the economic development of certain disadvantaged areas without it being considered a distortion of competition or trade within the EU. This is called national regional aid. The Guidelines state that:

*National regional aid consists of aid for investment granted to large companies, or in certain limited circumstances, operating aid, which in both cases are targeted on specific regions in order to redress regional disparities. Increased levels of investment aid granted to small and medium-sized enterprises located within the disadvantaged regions over and above what is allowed in other areas are also considered as regional aid.<sup>12</sup>*

Northern Ireland qualified for national regional aid for 2007-13, and had previously benefitted from 2000-2006. On that basis, public funding - which would otherwise be prohibited - has been allowed to support investment and economic development in the region.

At present, Invest Northern Ireland can grant selective financial assistance (SFA) under Article 7 of the Industrial Development (Northern Ireland) Order 1982 (SI 1083 (N.I.15)).<sup>13</sup> Assistance may be given to projects likely to provide, maintain or safeguard employment in any part of Northern Ireland. SFA for individual projects is limited by ceilings imposed by EU rules on Gross grant equivalent (GGE). These aid ceilings are reduced from 2011 onwards as shown in the tables below for different sizes of enterprise.

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<sup>11</sup> European Commission (2006) 'Guidelines on National Regional Aid for 2007-2013' available online at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:054:0013:0044:EN:PDF> (accessed 26 January 2012) (see paragraph 16)

<sup>12</sup> European Commission (2006) 'Guidelines on National Regional Aid for 2007-2013' available online at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:054:0013:0044:EN:PDF> (accessed 26 January 2012) (see paragraph 1)

<sup>13</sup> Available online at: <http://www.legislation.gov.uk/nisi/1982/1083/article/7>

**(i) Aid Ceiling\* 1 Jan 2007 – 31 Dec 2010**

Area	Large	Medium	Small
All NI	30%	40%	50%

**(ii) Aid Ceiling\* 1 Jan 2011–31 Dec 2013**

Area	Large	Medium	Small
Inner Belfast	10%	20%	30%
Outer Belfast & Rest of NI	15%	25%	35%

Source: Invest NI<sup>14</sup>

A consultation by the UK Department for Business, Innovation and Skills (BIS) in July 2011 sought comments on, amongst other things, the removal of the **automatic** assisted area status of Northern Ireland. This suggested change is based on the perceived unfairness of the current situation that:

*...due to the political and economic situation at the time it was drafted, the [Industrial Development Act] mandated the automatic inclusion of 100% of the Northern Ireland population in the UK regional aid map (the current version of which covers 2007-2013). This has resulted in relatively prosperous areas of Northern Ireland being eligible for aid when less well-off areas in the rest of the UK (measured in terms of GDP per capita) have not.*<sup>15</sup>

The consultation closed on 2 November 2011 and at the time of writing was still awaiting a UK Government response. BIS officials have indicated that a consultation response should be issued by the end of February 2012.<sup>16</sup>

<sup>14</sup> Invest Northern Ireland 'Guidelines on NI's SFA Scheme' available online at: (see page 12)

<sup>15</sup> Department for Business, Innovation and Skills (2011) available online at: <http://www.bis.gov.uk/assets/biscore/economic-development/docs/c/11-1061-consultation-revision-of-industrial-development-act.pdf> (accessed 30 January 2012) (see page 7)

<sup>16</sup> Source: personal communication with BIS official

## 5. How does a Member State apply for approval of a measure?

As noted above, the European Commission may give approval for interventions that might be State Aid to go ahead. This power extends to the supervision of Member States' plans to alter existing State Aids, and to constantly reviewing all systems of aid.<sup>17</sup>

Under European law, once a Member State applies to the European Commission (by submitting a 'notification') a decision must be made within two months. The Commission may either approve at this stage, or decide to begin a formal investigation. A formal investigation will add at least another six months to the process.<sup>18</sup>

### Challenging the decisions of the European Commission

The decisions of the European Commission may be taken by Member States or businesses for review by the European Court of First Instance (CFI), with a possible appeal to the Court of Justice (ECJ) on points of law. The courts have the power to establish the legality of decisions on grounds such as a lack of legal competence; infringement of an essential procedural requirement; or, misuse of powers, for example.<sup>19</sup> If a decision by the Commission is found to be unlawful, it must take the necessary measures to comply with the judgment.

On 24 January 2012, the search facility on the European Court of Justice website listed 61 cases as pending in relation to state aids. This suggests it is an active and important area of European law.

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<sup>17</sup> Quigley, C (2009) 'European State Aid Law and Policy' (2 Edition), Oxford, Hart Publishing.(see page 355)

<sup>18</sup> Department for Business, Innovation and Skills (2011) 'State Aid – frequently asked questions' available online at: <http://www.bis.gov.uk/assets/biscore/business-law/docs/s/11-864-state-aid-frequently-asked-questions> (accessed 24 January 2012) (see page 5)

<sup>19</sup> Quigley, C (2009) 'European State Aid Law and Policy' (2 Edition), Oxford, Hart Publishing (see page 481)

## 6. What happens if a Member State breaks the rules?

State aid has direct effect in the Member States. This means that it is directly applicable without incorporating legislative actions from the Member States (which, for example, an EC Directive would require). In consequence, national courts are **obliged** to enforce the state aid provisions of the EC Treaty directly in any action on this issue.

Any aid paid unlawfully is subject to recovery, with interest, from the date it was granted. Aggrieved competitors may take their complaint about (suspected) illegal State Aid directly to the Commission. Member States are obliged to recover illegal aid if ordered to do so by the Commission even if the recovery of aid means that recipient companies go bankrupt.<sup>20</sup> In a recent example, the European Commission ordered Hungary to recover State Aid from the national airline Malév.<sup>21</sup> Examples from closer to home are provided in Boxes 1 and 2.

In addition aggrieved competitors may also take the recipient of unlawful aid to court in their own Member State to seek damages. In the words of BIS:

*The consequences for businesses if funding bodies get the State aid rules wrong can be severe.*<sup>22</sup>

### Box 1: The Aggregates Levy Relief Scheme

In August 2011, the European Commission published an invitation to submit comments in relation to a challenge to the Aggregates Levy Relief Scheme in Northern Ireland by The British Aggregates Association and two quarry companies from the Republic of Ireland.. This contained the following statement:

*...the Commission doubts whether the modified [Aggregates Levy Relief Scheme] applicable in Northern Ireland complies with the Treaty, in particular Article 110 of the TFEU. These doubts preclude the Commission from finding the measure compatible with the internal market at this stage.*<sup>23</sup>

In November 2011, the Assembly passed a motion that:

*That this Assembly recognises the imminent danger to the quarrying industry if the EU Commission decides to require a recovery of the aggregates levy rebate from 2004; and calls on the First Minister and deputy First Minister to make urgent representations to the EU president and the Chancellor of the Exchequer requesting that no recovery order is made.*<sup>24</sup>

<sup>20</sup> Department for Business, Innovation and Skills (2011) 'State Aid – frequently asked questions' available online at: <http://www.bis.gov.uk/assets/biscore/business-law/docs/s/11-864-state-aid-frequently-asked-questions> (accessed 24 January 2012) (see page 5)

<sup>21</sup> See press release 'State aid: Commission orders Hungary to recover incompatible state aid from national air carrier Malév' 9 January 2012, available online at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/7&format=HTML&aged=0&language=EN> (accessed 30 January 2012)

<sup>22</sup> Department for Business, Innovation and Skills (2011) 'State Aid – frequently asked questions' available online at: <http://www.bis.gov.uk/assets/biscore/business-law/docs/s/11-864-state-aid-frequently-asked-questions> (accessed 24 January 2012) (see page 5)

<sup>23</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2011:245:0010:0020:EN:PDF>

<sup>24</sup> Official Report 7 November 2011 <http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Reports-11-12/07-November-2011/>

**Box 2: Ryanair's legal battles with the European Commission<sup>25</sup>**

*On December 11, 2002, the European Commission announced the launch of an investigation into the 2001 agreement among Ryanair, the Brussels (Charleroi) airport and the government of the Walloon Region of Belgium, the owner of the airport, which enabled the Company to launch new routes and base up to four aircraft at Brussels (Charleroi). The European Commission's investigation was based on an anonymous complaint alleging that Ryanair's arrangements with Brussels (Charleroi) constituted illegal state aid.*

*The European Commission issued its decision on February 12, 2004. As regards the majority of the arrangements between Ryanair, the airport and the region, the European Commission found that although they constituted state aid, they were nevertheless compatible with the EC Treaty provisions and therefore did not require repayment. However, the European Commission also found that certain other arrangements did constitute illegal state aid and therefore ordered Ryanair to repay the amount of the benefit received in connection with those arrangements. On April 20, 2004, the Walloon Region wrote to Ryanair requesting repayment of such state aid, although it acknowledged that Ryanair could offset against the amount of such state aid certain costs incurred in relation to the establishment of the base, in accordance with the European Commission's decision. Ryanair made the requested repayment.*

*On May 25, 2004, Ryanair appealed the decision of the European Commission to the CFI, requesting the court to annul the decision because:*

- the European Commission infringed Article 253 of the EC Treaty by failing to provide adequate reasons for its decision; and*
- the European Commission misapplied Article 87 of the EC Treaty by failing to properly apply the Market Economy Investor Principle (MEIP), which generally holds that an investment made by a public entity that would have been made on the same basis by a private entity does not constitute state aid.*

*In March 2008, Ryanair had its hearing before the CFI, and in December 2008, the CFI annulled the European Commission's decision, and Ryanair was repaid the EUR4 million that the Commission had claimed was illegal state aid. The Belgian government has also withdrawn a separate EUR2.3 million action against Ryanair arising from the same transaction.*

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<sup>25</sup> Source: London Stock Exchange Aggregated Regulatory News Service (ARNS), July 26, 2011

## 7. Sources of further information

The European Commission's DG Competition publishes a weekly State Aid e-news (and archive back to 2006) which is available at:

[http://ec.europa.eu/competition/state\\_aid/newsletter/index.html](http://ec.europa.eu/competition/state_aid/newsletter/index.html)

Information on reform of state aid can be found at:

[http://ec.europa.eu/competition/state\\_aid/reform/reform.html](http://ec.europa.eu/competition/state_aid/reform/reform.html)

Details of the European Competition Forum 2012 can be found at:

[http://ec.europa.eu/competition/information/european\\_competition\\_forum\\_2012/index.html](http://ec.europa.eu/competition/information/european_competition_forum_2012/index.html)