

European Economic Law

Lesson 12

The Role of the State/Subsidies

Overview of the course

- I. Principles of European Economic Law – The Economic Constitution of the European Union and the Foundations of the Internal Market
- II. Fundamental Freedoms
- III. EU Competition Law
- IV. The Role of the State/Subsidies**
- V. Community Policies

- 1. Application of Competition Law to State Action (Art. 106 TFEU)
 - a) The State as an Undertaking
 - b) Art. 106 (1) TFEU
 - c) Art. 106 (2) TFEU
 - d) State Monopolies
 - e) Procedural Particularities
- 2. State Aids (Art. 107 et seq. TFEU)
("et seq." = "et sequentes" = and the following ones)

a) The State as an Undertaking

- Competition law applies to all **undertakings**.
- **Definition Undertaking:** Any entity engaged in an economic activity, that is, an activity consisting in offering goods or services on a given market, regardless of its legal status and the way in which it is financed
- ➔ Also the state, including all subdivisions, is subject to general competition law.
- ➔ But only as far as the states acts as undertaking (e.g. postal services, telecommunication, employment agencies, supply of water, gas and electricity)
- ➔ Competition law is not applicable to the exercise of public authority.

Social Security

- What about **social security**?
- ECJ, 22 January 2002 – *Cisal di Battistello*
 - In Italy, there is a system of compulsory insurance against accidents at work.
 - All employees have to be insured at the public body INAIL (Istituto nazionale per l'assicurazione contro gli infortuni sul lavoro).
 - Is this system of compulsory insurance compatible with European competition law?

ECJ – *Cisal di Battistello*

- Competition law only applies if INAIL is an "undertaking".
- INAIL offers services on the market of insurance against accidents at work.
- ECJ: "According to settled case-law, **Community law does not affect the power of the Member States to organise their social security systems.**"
- "However, as is clear from the case-law of the Court, the social aim of an insurance scheme is not in itself sufficient to preclude the activity in question from being classified as an economic activity [...]. In that regard, two other aspects deserve attention."

ECJ – *Cisal di Battistello*

- "In the **first place**, a number of elements tend to demonstrate that the insurance scheme in question in the main proceedings applies the **principle of solidarity**."
- "**The absence of any direct link between the contributions paid and the benefits granted** thus entails solidarity between better paid workers and those who, given their low earnings, would be deprived of proper social cover if such a link existed."

ECJ – *Cisal di Battistello*

- "In the **second place**, it is clear from the case-file that the activity of the INAIL, entrusted by law with management of the scheme in question, is subject to supervision by the State and that the amount of benefits and of contributions is, in the last resort, fixed by the State."
- "In summary, it is clear from the foregoing that the amount of benefits and the amount of contributions, which are two essential elements of the scheme managed by the INAIL, are subject to **supervision by the State** and that the **compulsory affiliation** which characterises such an insurance scheme is **essential for the financial balance of the scheme and for application of the principle of solidarity**, which means that benefits paid to insured persons are not strictly proportionate to the contributions paid by them."

ECJ – *Cisal di Battistello*

➔ "INAIL fulfils an **exclusively social function**. It follows that its activity is **not an economic activity** for the purposes of competition law and that this body does not therefore constitute an undertaking within the meaning of Articles 85 and 86 of the Treaty."

b) Art. 106 (1) TFEU

Art. 106 (1) TFEU

"In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 18 and Articles 101 to 109."

- ➔ - Art. 18 TFEU: prohibition of discriminations on grounds of nationality
- Art. 101 et seq.: General competition law
- Art. 107 et seq.: Aids granted by states

b) Art. 106 (1) TFEU

Public undertaking

An undertaking over which the public authorities directly or indirectly exercise dominant influence by virtue of their ownership, financial participation, or the rules which govern it. A dominant influence of public authorities is presumed in particular when they:

- a) hold the major part of the undertaking's subscribed capital,
- b) control the majority of the votes attached to shares issued by the undertaking or
- c) are in a position to appoint more than half of the members of the undertaking's administrative, managerial or supervisory body.

European Commission, Glossary to European Communities, 2002

b) Art. 106 (1) TFEU

Privileged undertakings: Undertakings to which Member States grant special or exclusive rights

- **Exclusive rights:** e.g. state monopolies
 - public utilities
 - agency with a monopoly over the provision of recruitment services
 - monopoly to organize dock works in a harbour
- **Special rights:** Not one, but several undertakings are granted a privilege.
- ➔ In the past, many state monopolies have been abolished. Often, the former state monopolist today stands in competition with private companies (see the example of telecommunications).

b) Art. 106 (1) TFEU

- EU competition law does not only apply to the behaviour of public or privileged undertakings, but also to competition-related acts of Member States themselves.
- Member States may not adopt measures encouraging undertakings to conclude cartels (Art. 101 TFEU) or to abuse a dominant position (Art. 102 TFEU).
- In every case, it has to be established if the (public or privileged) undertaking is responsible for a competition law violation, or if it is the State.

b) Art. 106 (1) TFEU

Three possibilities:

1. Autonomous decision of the public or privileged enterprise:
 - ➔ direct application of Art. 101, 102 TFEU
2. The enterprise is forced by the state to behave in an anti-competitive manner (by legislation or administrative decisions):
 - ➔ Art. 106 (1) TFEU in combination with Art. 101, 102 TFEU
 - ➔ The enterprise is not responsible ("state action defence")
3. The anti-competitive behaviour of the undertaking is "state-induced" (as opposed to "state-imposed"):
 - ➔ Both consequences (1 and 2) apply: the enterprise *and* the state are responsible.

b) Art. 106 (1) TFEU

An example: European Commission, 20 March 2001 – Deutsche Post AG

- According to the findings of the European Commission, *Deutsche Post* (a public undertaking) used revenues from the letter-mail monopoly to practice a below-costs strategy on parcel services (directed against the competitor UPS).
- ➔ Such cross-subsidizing constitutes an abuse (exclusionary conduct) in the sense of Art. 102 TFEU.
- ➔ *Deutsche Post* was not forced by the state to engage in such a strategy: There is autonomous behaviour of the public undertaking.
- ➔ An authorization of the tariffs by the regulatory authority would not have taken away the responsibility of the enterprise. Only an obligation of the state to do so would give rise to the "state action defence".

c) Art. 106 (2) TFEU

Art. 106 (2) TFEU

"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 this Treaty, 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 Community."

c) Art. 106 (2) TFEU

Art. 14 TFEU

"Without prejudice to Article 4 of the Treaty on European Union or to Articles 93, 106 and 107 of this treaty, and given the 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."

c) Art. 106 (2) TFEU

Services of general economic interest

Services of an economic nature, the provision of which can be considered to be in the general interest. For example, basic, publicly accessible supply of energy, telecommunication, postal services, transport, water and waste-disposal services. The Member States are primarily responsible for defining what they regard as services of general economic interest on the basis of the specific features of the activities concerned. However, their definitions are subject to the Commission's control for manifest errors where Member States specifically entrust undertakings within the meaning of Article 106 (2) TFEU with services of general economic interest. The precise definition of the particular task assigned to the entrusted undertaking is an important element for assessing whether, and to what extent, it is justified for the State to grant exclusive rights or funds to that undertaking in order to ensure the fulfilment of the task.

European Commission, Glossary to European Communities, 2002

c) Art. 106 (2) TFEU

- Services of general economic interest ("public service"):
 - energy
 - telecommunication
 - postal services
 - transport
 - water
 - waste-disposal services

- Revenue-producing monopolies: no practical importance. According to the dominant opinion, it is not allowed to discriminate in order to generate public revenues.

c) Art. 106 (2) TFEU

- Art. 106 (2) TFEU is interpreted narrowly: The competition rules only stand back if the application of the competition rules "obstruct" the performance of the public service task.

- Therefore it is not sufficient, that the public service task is complicated: Its performance has to be prevented.

- **Example for a successful Art. 106 (2) defence:**
 The interest in having a nation-wide network of postal services.
 Postal operators may be obliged to provide a minimum service over the whole territory of the country, i.e. densely *and* scarcely populated areas. Newcomers may be prevented from "cherry picking" without infringing competition rules.

d) State Monopolies

- **Art. 345 TFEU:** "The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership."
 - ➔ In principle, Member States are free to organize certain activities in the public or in the private sphere.
 - ➔ Member States may choose to stay owners of public utilities (gas, electricity, post, telecommunications etc.).

- **But:** Commission and ECJ have given strict requirements, providing for equality of treatment of public and private undertakings ("competitive neutrality").
 - ➔ level playing field

d) State Monopolies

- The existence of state monopolies itself has become under legal scrutiny.
- ECJ, 30 April 1974 – *Sacchi*:
 - ➔ State monopolies are admissible.
- ECJ, 19 March 1991 – *Telecommunications terminals equipment*
 - ➔ State monopolies may infringe the fundamental freedoms (or the competition rules). In absence of a justification, they have to be abolished.

d) State Monopolies

"The grant by a Member State of exclusive importation and marketing rights in the telecommunications terminals sector is capable of restricting intra-Community trade and therefore constitutes a measure having an effect equivalent to a quantitative restriction within the meaning of Article 30 of the Treaty. In the first place, the existence of such rights deprives traders without such rights of the opportunity of having their products purchased by consumers, and secondly the diversity and technical nature of the products in that sector are such that there is no certainty that the holder of exclusive rights can offer the entire range of models available on the market, inform customers about the state and operation of all the terminals and guarantee their quality. Accordingly, Article 2 of Directive 88/301 rightly requires such rights to be withdrawn, whilst Article 3 sets limits thereto which are imposed by the requirements of safety, protection of networks and interworking of equipment."

d) State Monopolies

- The "automatic abuse" theory: Where a public monopoly is not capable of satisfying the demand for a certain good, the grant of the exclusive right infringes Art. 106 (1) and Art. 102 lit. b TFEU.
- ➔ See the case concerning the German monopoly for recruitment activities.

d) State Monopolies

➤ **ECJ, 23 April 1991 – Höfner and Elser**

"A Member State is in breach of the prohibition contained in those two provisions [sc. Art. 106 (1) and 102 TFEU] only if the undertaking in question, merely by exercising the exclusive right granted to it, cannot avoid abusing its dominant position. [...]"

A Member State creates a situation in which the provision of a service is limited when the undertaking to which it grants an exclusive right extending to executive recruitment activities is manifestly not in a position to satisfy the demand prevailing on the market for activities of that kind and when the effective pursuit of such activities by private companies is rendered impossible by the maintenance in force of a statutory provision under which such activities are prohibited and non-observance of that prohibition renders the contracts concerned void."

d) State Monopolies

➤ Another reason for the illegality of a state monopoly is the "extension of the monopoly without objective justification" (see ECJ, 13 December 1991 – RTT).

➔ An obligation to unbundle may be the consequence, e.g. of a network (telecommunications, energy) and the use of that network.

d) State Monopolies

Unbundling

Separation of the various components of production, distribution and service in order to introduce greater elements of competition to these segments of an industry. 'Functional unbundling' requires monopolistic utilities to provide access to (part of) their distribution or service network, in exchange for an access fee. 'Structural unbundling' makes complete vertical separation necessary and obliges monopolistic utilities to divest their production, their distribution or their service assets.

d) State Monopolies

European Commission, 7 October 2008 – Slovenská Pošta

- An amendment to Slovakia's postal legislation extended the monopoly of the incumbent (*Slovenská Pošta*) to hybrid mail services (which previously were open to private competitors).
- Competitors are prevented from continuing their activity.
- *hybrid mail services*: content is electronically transferred to an operator who prints, envelopes and delivers the letters.
- The amendment infringes Art. 102 in conjunction with Art. 106 TFEU: extension of a dominant position.
- No Art. 106 (2) TFEU defence: It cannot be shown that the extension of the monopoly is necessary to finance the universal postal service.

d) State Monopolies

- Some criticize the stringent requirements to the legality of state monopolies.
Craig/de Burca, p. 1079: "This comes perilously close to regarding the grant of exclusivity as abusive *per se*."
- On the other hand, EU law has helped to launch reforms which – on the level of Member States – apparently were difficult to achieve.

e) Procedural Particularities

Art. 106 (3) TFEU

"The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States."

- ➔ In the system of the treaty, the power of the European Commission under Art. 106 (3) TFEU is unique. Normally the competence to adopt directives is with the European Parliament and the Council (Art. 294 TFEU).

2. State Aid

- Enterprises should compete on an equal footing.
- State aid may confer selective advantages to certain enterprises thus distorting competition and affecting trade between Member States.
- ➔ Necessity of state aid control in the internal market.
- See Art. 107 – 109 TFEU
- Numerous regulations and communications

2. State Aid

Art. 107 (1) TFEU

"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."

2. State Aid

1. "any aid ... in any form whatsoever": transfer of state resources or any other economic advantage
payment, tax exemption, interest rate rebate, loan guarantee, accelerated depreciation allowances, buying or renting state-owned land below market price, privileged access to infrastructure
Examples: EDF; public banks in Germany enjoyed an unlimited state guarantee.
2. "granted by a Member State or through State resources"
national, regional, local authorities; public banks; public foundations, etc.

2. State Aid

3. "distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods"
 - selectivity as opposed to general measures (e.g. nation- and sector-wide fiscal measures)
4. "affects trade between Member States"
 - A potential effect is sufficient.


Example

ECJ, 5 March 2009, C-222/07 – *UTECA v. Administración General del Estado*

- Spanish legislation requires television operators to earmark 5 % of their revenue for the funding of certain films, 60 % of that funding being reserved for films in an official language of Spain (Spanish, Basque, Catalan, Galician).
- **ECJ:**
 - It is not an advantage granted directly by the state.
 - The advantage is the result of general legislation applicable to all television operators, whether public or private.
 - ➔ The measure does not constitute state aid in favour of the cinematographic industry.

State Aid and Public Enterprises

- Public enterprises must neither be favoured nor penalized ("principle of neutrality"):
- **MEIP: Market Economy Investor Principle**
- ➔ If a rational private investor would not have injected new capital, public funding is state aid (see CFI, Case 358/94 – *Air France*, ECR 1996, II-2109; CFI, 15 December 2009, T-156/04 – *EDF/Commission*).
- **But:** Certain public measures only relieve public enterprises from structural disadvantages (e.g. public service obligations).



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State Aid and Public Enterprises

ECJ, C-280/00 – *Altmark Trans*, ECR 2003, I-7747:
No favourable competitive position of an enterprise, if four conditions are met:

1. First, the recipient undertaking must actually have public service obligations to discharge and the obligations must be clearly defined.
2. The parameters on the basis of which the compensation will be calculated must be established in advance in an objective and transparent manner.
3. The compensation must not exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations
4. If no public procurement procedure took place, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately equipped, would have incurred.


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Exceptions

- Art. 107 (2) TFEU ("shall be compatible")
- Art. 107 (3) TFEU ("may be considered to be compatible")
 - lit. c being the most important one
- ➔ Balancing of the positive and the negative effects of aid
- ➔ Aid must be necessary and proportionate to achieve a recognized goal.
 - environmental protection, R&D, regional aid

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Procedure

- Art. 108 TFEU: Procedure
 - The Commission is in charge
 - In "exceptional circumstances", the Council may grant an exceptional permission.
 - Art. 108 (3) TFEU: Member States have to inform the Commission in advance.
 - If not, the Commission may adopt an interim decision and fix a deadline.
 - After expiration, the aid may be assessed under the information available.
- Unlawful aid has to be recovered by the Member State in question. Only exception: recovery is "absolutely impossible".

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State Aid in the Times of Crisis

Craig/de Búrca, 4th edition, p. 1095: "The second limb of this Article concerning serious disturbance to the economy of a Member State [sc. Art. 87 (3) lit. b EC] will only rarely be used, since the economic problem must afflict the whole of the national economy." (!)

European Commission

- Communication from the Commission - Temporary framework for State aid measures to support access to finance in the current financial and economic crisis (17 December 2008, as amended on 25 February 2009);
- Communication from the Commission - The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (25 October 2008).



State Aid in the Times of Crisis

- n. 53 of that text:
 - "The Commission has taken appropriate steps to ensure the swift adoption of decisions upon complete notification, if necessary within 24 hours and over a weekend."
- **rescue aid:** temporary assistance to keep an ailing firm afloat
 - after *six months*: restructuring or liquidation plan
 - "one time, last time"
- **restructuring aid:**
 - restoration of long-term viability
 - compensatory measures: reduction of overcapacities
 - significant contribution of aid beneficiaries (50 % in case of large firms)
 - "one time, last time"
