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# **EC State Aids and Sectoral Aid to the Motor Vehicle Industry**

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# Abbreviations

a.M.	am Main
art.	Article(s)
Bd.	Band (volume)
Bull.	Bulletin
C(f)	Capacity after investment
C(i)	Capacity before investment
CEEC	Countries of Central and Eastern Europe
CFI	Court of First Instance
COM	Commission
DG	Directorate General
EBRD	European Bank for Reconstruction and Development
EC	European Community, Treaty Establishing the European Community of 25 March 1957 and the new version of 1 November 1993
ECJ	European Court of Justice
ECLR	European Competition Law Review
ECR	European Court of Justice Reports
ECSC	European Coal and Steel Community, Treaty Establishing the European Coal and Steel Community
ed.	Edition
eds.	Editors
EEA	European Economic Area
EFTA	European Free Trade Association
e.g.	<i>exemplum gratia</i> (for example)
EIB	European Investment Bank
et seq.	<i>et sequentes</i> (and the following)
EU	European Union
EUR	Euro, European Currency
f.	following (singular)
ff.	following (plural)
FFSA	Federation française des societer d'assurances
G/B/T/E	von der Groeben/Boeck/Thiesing/Ehlermann, <i>Kommentar zum EWG-Vertrag</i> , 4 <sup>th</sup> ed., 1991

gge	gross grant equivalent
ibid.	<i>ibidem</i> (the same)
i.e.	<i>id est</i> (what means)
mg. no.	marginal number
n.	note
nge	net grant equivalent
no.	number
O.J.	Official Journal (of the European Communities)
p.	page
pp.	pages
pt	point
RabelsZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht
R&D	Research and Development
SME	Small and Medium-sized Enterprise
TWD	Textilwerke Deggendorf
U.K.	United Kingdom
v	<i>versus</i> (against)

# I. Introduction

The control of State aid in the European Community is directly linked to the realisation of a system of undistorted competition as stipulated in Art. 3(g) EC Treaty. For this reason, State aid provisions must be functionally interpreted in light of this objective.<sup>1</sup> The stimuli provided by free competition are indispensable for an efficient allocation of resources. If these criteria are not applied, products will no longer be manufactured where conditions are most favourable, but in that member country which is willing to give the company the "biggest gift". However, such interference with the system may possibly be warranted where the market forces alone are only able to achieve the desired result very slowly or to an insufficient extent.

The EC Treaty stipulates the fundamental incompatibility of State aid with the common market (Art. 87(1) EC Treaty). However, the rule provided by Art. 87(1) EC Treaty is modified by numerous legal exceptions (Art. 87(2) EC Treaty) and by a broad scope of discretion on the part of the Commission in respect of further possible exemptions (Art. 87(3) EC Treaty). The provisions regarding exemptions as such have such substantial scope; economic aspects are taken into consideration as much as social or historical circumstances (Art. 87(2)(c) EC Treaty). The review of State aid and the imposition of sanctions on unlawful State aid are carried out by the European Commission (Art. 88 EC Treaty). Member States are obliged to notify the Commission in order to enable it to fulfil this function.

European competition law has always sought to control the granting of subsidies by Member States.<sup>2</sup> This leads to perceptible curtailment of the Member States' sovereignty and of the scope of their economic policies.<sup>3</sup> This is based on the consideration that an uncoordinated coexistence of national subsidies of varying intensity would deadlock the economic process of integration and its aim of achieving a homogeneous market.<sup>4</sup> Subsi-

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<sup>1</sup>NICOLAYSEN, p. 120.

<sup>2</sup>The early ban of State aid in Art. 4(c) ECSC, which is even stricter than the ban in Art. 87 EC Treaty. For the sobering legal reality in the ECSC, see BÖRNER/BULLINGER, pp. 197 ff.

<sup>3</sup>Thus also G/B/T/E-Wenig, Art. 87, mrg. no. 3.

<sup>4</sup>ZIPPEL, p. 4.

dies granted by individual member countries cause defensive subsidies to be introduced in other countries, thus resulting in a cumulation of measures which distort competition.<sup>5</sup> Moreover, State aid can be used as a protectionist instrument to favour domestic industries, to provide them with a competitive edge and to circumvent necessary structural adaptations by passing the difficulties on to competitors in other countries.<sup>6</sup> According to BÖRNER/BULLINGER, uncontrolled national State aid would transform the common market into a "finance ministers' wrestling match".<sup>7</sup> In addition, State aid review seeks to reduce budget deficits, thereby contributing to the objective of monetary union review. Furthermore, the Commission regards State aid as a means of reinforcing economic and social coherence between prosperous and less prosperous regions.<sup>8</sup>

Among undertakings, subsidies result in a "State aid mentality": companies that are in difficulty immediately turn to the government for help instead of tackling their problems with the use of their own resources under their own steam. This attitude is fostered in particular if competitors in other member countries receive or are entitled to State aid.<sup>9</sup> In general, however, it must be the task of the company itself to achieve financial results which enable it to create the prerequisites for its own equilibrium, and to raise the means for any structural adaptations it must carry out to counter market pressure.<sup>10</sup> In the Commission's view, only a small proportion of the macroeconomic gains expected from the completion of the single market would be achieved if industry's restructuring process were to be impeded by State aid.<sup>11</sup> Moreover, there is a danger that companies' choice of branch offices and production plants would be influenced by competition between national State aid offers. This leads to the so-called "Delaware effect": locations are no longer chosen on account of market factors but on the strength of government incentives expressed in the framework of tax and company law.<sup>12</sup> The Community has always considered such conditions to be incompatible

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<sup>5</sup>20<sup>th</sup> Report on Competition Policy, p. 143.

<sup>6</sup>12<sup>th</sup> Report on Competition Policy, p. 117.

<sup>7</sup>BÖRNER/BULLINGER, pp. 197 ff.

<sup>8</sup>21<sup>st</sup> Report on Competition Policy, p. 23.

<sup>9</sup>11<sup>th</sup> Report on Competition Policy, p. 123.

<sup>10</sup>Commission Decision of 27/11/1985, 3484/85/ECSC, O.J. 1985 No. L230/1.

<sup>11</sup>20<sup>th</sup> Report on Competition Policy, p. 143.

<sup>12</sup>TIMMERMANS, pp. 1 ff., 14.



with the principle of undistorted competition in the European market.<sup>13</sup> The Commission attributes increasing importance to State aid (mal)practices in member countries.<sup>14</sup> This is understandable if we keep in mind the extent of State aid granted within the European Union.

Subsequent to multilateral consultations, the Commission first published a report on State aid in 1988.<sup>15</sup> This report emphasizes that the Commission regards competition as the most important guarantor of the completion of the single market. In view of the latter objective, the Commission is pursuing a policy of strict State aid control in an effort to prevent the advantages to be expected from the integration of national economies from being placed in jeopardy.<sup>16</sup> It holds the view that in a more strongly integrated market, certain types of State aid will distort competition to a correspondingly greater extent.<sup>17</sup> In this context, the Commission, in 1993, described the surveillance of so-called sensitive sectors<sup>18</sup> as a task of highest priority.<sup>19</sup>

The Commission has developed strict standards for the control of State aid. These are partially laid down in the form of general principles and guidelines. The Commission has decided to convene regular biyearly multilateral meetings with State aid experts from all the member countries. These meetings are supposed to serve as a forum for the discussion of proposals regarding the design of general policy and for the formulation of State aid frameworks<sup>20</sup> in key sectors before such proposals are adopted by the Commission.

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<sup>13</sup>Case 730/79 *Philip Morris v Commission* [1980] ECR 2671: One of the main objectives of Article 87 is to prevent the displacement of industry caused by "bidding up" on investment projects through the machinery of aid.

<sup>14</sup>22<sup>nd</sup> and 23<sup>rd</sup> Reports on Competition Policy.

<sup>15</sup>18<sup>th</sup> Report on Competition Policy, p. 148.

<sup>16</sup>20<sup>th</sup> Report on Competition Policy, p. 144.

<sup>17</sup>23<sup>rd</sup> Report on Competition Policy, p. 15.

<sup>18</sup>Sensitive sectors include industries with chronic structural problems such as shipbuilding, steel, synthetic fibers, and the motor vehicle industry.

<sup>19</sup>Thus verbatim in the 23<sup>rd</sup> Report on Competition Policy, p. 15.

<sup>20</sup>Such Community frameworks exist for (among other industries) shipbuilding, textiles, synthetic fibers, the motor vehicle industry, for R&D, and for SMEs. The 1997 Community Framework for State Aid to the Motor Vehicle Industry will build the main part of the following discussion, see IV.

In addition, from its earliest case law, the European Court of Justice has expressed the conviction that subsidies run counter to the essential objectives of the Community since they enable economic activities to be called into life, to be maintained or encouraged which do not accord with the most rational distribution of production at the highest level of performance.

Within the outline of the first section of my investigation, the main focus is being directed towards the discussion about the general principles of EC State aids, whilst the most recent case law is clearly being emphasized. Further discussion is dedicated to the background and historical aspects related to sectoral aid. Above all, I would like to emphasize the fact that the main focus within the investigation is directed towards the main principles of State aid to the motor vehicle industry. Specific detail is provided on behalf of the 1997 Community framework for State aid to the motor vehicle industry. It is inevitable that the content of the texts provides a detailed description and explanation of the various inter-connections of the main topic and of all the various, specific aspects of sectoral aid, concerning the motor vehicle industry.

To support a student by writing his master thesis is time consuming, taking considerable skill and infinite patience. Thus, I would like to thank Professor Peter Gjörtler for his help in this regard.

## II. EC State Aids

### 1. Definition

The Treaty on European Union does not give an explicit definition of State aid. In the case law of the Commission and the ECJ it has been held to comprise any advantages granted directly or indirectly through state resources<sup>21</sup>. In order for a measure to constitute State aid, four cumulative conditions must be fulfilled.

#### 1.1. *Incompatibility with the Common Market*

Under Article 87(1) of the EC Treaty<sup>22</sup>, 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 is incompatible with the common market, in so far as it affects trade between Member States and save to the extent that the Treaty provides otherwise. The aim of Article 87 is to prevent trade between Member States from being affected by advantages given by the the public authorities which, in various forms, distort or threaten to distort competition by favouring certain undertakings or the production of certain goods.<sup>23</sup>

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<sup>21</sup>STEINER/WOODS, p. 198.

<sup>22</sup>JONES/SUFRIN, p. 70.

<sup>23</sup>E.g. Case T-14/96 *Bretagne Angleterre Irlande v Commission* [1999] ECR II-139, paragraph 71. In relation to the mechanics of applying the State aid rule, many older cases are no longer relevant because of legislative changes made in the procedures to be followed by the Community institutions. More specific, see HANCHER/SLOT/OTTERVANGER, *EC State Aids*, D'SA, *European Community Law on State Aid*, BAUDENBACHER, *A Brief Guide to European State Aid Law* and EVANS, *European Community Law of State Aid*. Specific chapters are devoted to State aids in BELLAMY/CHILD, *European Union Law of Competition* and RITTER/BRAUN/RAWLINSON, *European Competition Law: a practitioner's guide*. Articles on this subject appear from time to time in *European Competition Law Review* (see, for example, VAN CALSTER/GREENING, *The EC's State Aid and Tax*).

### 1.2. *Prohibition*

It is implicit in the fact that such aids are incompatible with the common market that they are prohibited.<sup>24</sup> The prohibition stems from a combination of the incompatibility of such aids with the common market and the obligations in Article 10 of the EC Treaty imposed on Member States to take all appropriate measures to ensure fulfilment of the obligations arising from the Treaty, to facilitate the achievement of the Community's tasks and to abstain from any measure that could jeopardise the attainment of the objectives of the Treaty.

### 1.3. *Direct Effect*

The prohibition implicit in Article 87(1) is not direct effect, that is, it cannot be relied upon in litigation before the courts of a Member State.<sup>25</sup> It operates within the procedural framework of Articles 87-89, which distinguishes between existing aid systems and new aids. Under Article 87(1), therefore, the grant of a State aid is not automatically contrary to the Treaty.<sup>26</sup> The prohibition on existing aid systems is intended to take effect when it has been put into concrete form by acts having general application adopted by the Council under Article 89 or by individual decisions adopted by the Commission under Article 88(2),<sup>27</sup> at which point reliance can be placed upon the prohibition in litigation before the courts of a Member State. Proposals to introduce new aid or alter existing ones (which amounts to the introduction of a new aid) are subject to the procedure envisaged in Article 88(3). That comprises a special prohibition on the implementation of the proposed aid pending the termination of the procedure, whether or not the aid is subsequently found to be incompatible with the common market.<sup>28</sup> That prohibition can be relied upon in litigation before the courts of a Member State.

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<sup>24</sup>E.g. Cases 6/69 and 11/69 *Commission v France* [1969] ECR 523.

<sup>25</sup>Case 77/72 *Capolongo v Maya* [1973] ECR 611, paragraphs 5-6. See also Case 74/76 *Iannelli v Meroni* [1977] ECR 557, paragraphs 11-12, Case 78/76 *Steinike & Weinlig v Germany* [1977] ECR 595, paragraphs 6-10.

<sup>26</sup>Case 323/82 *Intermills SA v Commission* [1984] ECR 3809, paragraph 32.

<sup>27</sup>Case 77/72 *Capolongo v Maya* [1973] ECR 611, paragraphs 6.

<sup>28</sup>Case 120/73 *Lorenz v Germany* [1973] ECR 1471, paragraphs 4-6.

Thus, "existing" aids<sup>29</sup> are not subject to any prohibition derived directly from the Treaty. They can be prohibited with prospective effect by the Community institutions (normally the Commission); but, until prohibited, the aid is not unlawful. The position of "new" State aids is somewhat different. Such aids have to be notified to the Commission before they are introduced. If they are introduced without notification, they are automatically unlawful; and private persons may rely upon their illegality before national courts. If they are notified to the Commission before their introduction, no adverse legal consequences for the State aid flows unless and until the Commission reaches an adverse decision.<sup>30</sup> Thus, upon notification to the Commission, a "new" State aid becomes an "existing" one.

#### *1.4. Relationship Between the State Aid Rules and other Treaty Provisions*

Certain elements of a State aid scheme may contravene Treaty provisions other than the State aid rules. Where those elements of the aid scheme are so indissolubly linked to the objective and functioning of the aid itself that it is impossible to evaluate them separately, the State aid rules will alone apply. The effect of such elements on the compatibility or otherwise of the aid scheme, viewed as whole, is determined under the procedure laid down in Article 88. On the other hand, where it is possible to distinguish between those elements of the aid scheme which are necessary for the attainment of its objective, or for its proper functioning, and those which are not, the latter may be dealt with under the appropriate Treaty provisions and will not stand or fall depending upon whether or not the aid scheme in its entirety is prohibited under Article 87 or is compatible with the common market (from the perspective of the State aid rule).<sup>31</sup> Accordingly, a national court may find that a discrete part of a State aid scheme that infringes a Treaty provi-

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<sup>29</sup>Existing aids are aids that were or are already in existence when Article 87 came or comes into effect within a Member State (the end of the transitional period, in the case of the six original Member States; or the date specified in the relevant Act of Accession, in the case of other Member States), aids that have lawfully been brought into effect after Article 87 came into force in the Member State concerned, and aids that for any other reason are deemed to be existing aids: see, in particular, Council Regulation No. 659/1999 (O.J. 1999 No. L83/1), Article 1(b). See also, in that connexion, Case C-295/97 *Industrie Aeronautiche Meccaniche Rinaldo Piaggio SpA v International Factors Italia SpA and others* [1999] ECR I-3735, paragraphs 47-48.

<sup>30</sup>The procedure followed by the Commission is now to be found in Council Regulation No. 659/1999 (O.J. 1999 No. L83/1).

<sup>31</sup>Case 74/76 *Iannelli v Meroni* [1977] ECR 557, paragraph 14.

sion other than the State aid rules (such as the free movement of goods rules) is unlawful even though the national court cannot find that the entire aid scheme is unlawful under the State aid rules.<sup>32</sup>

## 2. The Concept of a State Aid

To be caught by the Treaty, a State aid must possess the following features: (a) it must be an "aid"; (b) it must be "granted by a Member State or through State resources"; (c) it must "distort or threaten to distort competition by favouring certain undertakings or the production of certain goods"; and (d) it must affect trade between Member States. Although the wording of Article 87(1) permits those features to be separated from one another, there is in practice a close relationship between them. For example, the requirement that there be an actual or threatened distortion of competition that takes the form of favouring undertakings or the production of certain goods (otherwise known as the "selectivity" of the aid) is commonly regarded as a necessary feature of the concept of a State aid and not simply as a consequence of a State aid (as defined) that renders it incompatible with the common market.<sup>33</sup>

### 2.1. Aid

"Aids" have been variously described as "benefits",<sup>34</sup> "gratuitous advantages";<sup>35</sup> "decisions of a Member States by which the latter, in pursuit of their own economic and social objectives, give by unilateral and auto-

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<sup>32</sup>*Iannelli v Meroni* (above), paragraph 16. The ability of the national court so to rule depends upon the circumstances; Case 18/84 *Commission v France* [1985] ECR 1339, paragraph 13; Case 103/84 *Commission v Italy* [1986] ECR 1759, paragraph 19; More specific, FERNÁNDEZ FARRERES, p. 149.

<sup>33</sup>Although the State aid regimes in the ECSC and EC Treaties are very different, they converge on the concept of a State aid; and the case law under either Treaty concerning that concept is transposable to the other Treaty (e.g. Cases T-129/95, T-2/96 and T-97/96 *Neue Maxhütte Stahlwerke GmbH v Commission* [1999] ECR II-17, paragraph 17). Accordingly, cases decided under the ECSC Treaty and concerning the concept of a State aid are here cited in relation to the concept of an aid under the EC Treaty. Judicial review decisions concerning the concept of a State aid is materially different from judicial review of decisions in the compatibility or otherwise of a State aid with the common market: Case T-95/94 *Sytraval & Brink's France v Commission* [1995] ECR II-2651, paragraph 54.

<sup>34</sup>Case 173/73 *Commission v Italy* [1974] ECR 709, paragraph 13.

mous decision, undertakings or other persons resources or procure for them advantages intended to encourage the attainment of the economic or social objectives sought";<sup>36</sup> "positive benefits, such as subsidies themselves, also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict meaning of the word, are similar in character and have the same effect";<sup>37</sup> and "an economic advantage which the recipient would not have obtained under normal market conditions".<sup>38</sup>

## 2.2. *Granted by the State or through State Resources*

The expression "aid" necessarily implies advantages granted directly or indirectly through State resources or constituting an additional charge for the State or for bodies designated or established by the State for that purpose.<sup>39</sup> The phrase "granted by the State or through State resources" makes it clear that it makes no difference whether the aid is granted directly by the State or by public or private bodies established or appointed by the State to administer the aid: in applying the State aid rules, regard must primarily be had to the effects of the aid on the undertakings or products favoured by it and not on the status of the institutions entrusted with the distribution and administration of the aid. Further, a measure adopted by public authority and favouring certain undertakings or products may still be an aid even if it is wholly or partially financed by contributions imposed by public authority and levied on the undertakings concerned.<sup>40</sup> Thus, a benefit may be an aid if it has been decided upon and financed by a public body, implemented subject to the approval of the public authorities, granted in the

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<sup>35</sup>Case 78/76 *Steinike & Weinlig v Germany Commission v Italy* [1977] ECR 595, paragraph 22.

<sup>36</sup>Case 61/79 *Amministrazione delle Finanze dello Stato v Denkavit* [1980] ECR 1205, paragraph 31.

<sup>37</sup>Case C-200/97 *Ecotrade v Altiforni e Ferriere di Sevola* [1998] ECR I-7907, paragraphs 34-35. Although that statement was made in the context of the ECSC Treaty, the judgement in fact emphasizes the conceptual similarity between aids under that Treaty and aids under the EC Treaty.

<sup>38</sup>Case C-39/94 *SFEI v La Poste* [1996] ECR I-3547, paragraph 60.

<sup>39</sup>Case C-200/97 *Ecotrade v Altiforni e Ferriere di Sevola* [1998] ECR I-7907.

<sup>40</sup>Case 78/76 *Steinike & Weinlig v Germany* [1977] ECR 595, paragraphs 21-22; Case 173/73 *Italy v Commission* [1974] ECR 709, paragraph 16.

same way as an ordinary State aid, and represented as being part of a package of measures that are accepted as being State aids.<sup>41</sup>

On the other hand, where an advantage is conferred by the State but it does not involve the employment of State resources, whether directly or indirectly, it is not a State aid.<sup>42</sup> In one case, the alleged State aid was a legal provision relieving a particular undertaking from a generally applicable obligation imposed on employers to recruit staff under employment contracts of indeterminate duration, as opposed to fixed term contracts. The legislation gave the favoured undertaking a flexibility not available to other undertakings operating in the same sector. Nonetheless, the advantage was not a State aid because it did not involve any direct or indirect transfer of State resources to the beneficiary.<sup>43</sup>

A direct transfer is simply a payment. Indirect transfers encompass situations where the State forgoes a payment to which it would otherwise be entitled, such as where it creates a tax exemption and thereby accepts a drop in tax revenue but does not employ its resources for the benefit of the favoured undertaking in any positive way;<sup>44</sup> and situations where the State provides funds to a person or body, enabling that person or body to release resources (whether the same or other resources) to an undertaking or for the production of certain goods.<sup>45</sup> In order to be a State aid, an advantage must therefore involve some additional burden for the State. If the advantage does not involve some additional burden, by comparison with the situation that would otherwise prevail, it may not be a State aid.<sup>46</sup>

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<sup>41</sup>Case 290/83 *Commission v France* [1985] ECR 439, paragraphs 14-15; Case 57/86 *Commission v Greece* [1988] ECR 2855.

<sup>42</sup>E.g. Case 82/77 *Openbaar Ministerie v van Tiggele* [1978] ECR 25, paragraphs 24-25 (fixing of minimum retail prices); Cases 213-215/81 *Norddeutsche Vieh- und Fleischkontor v BALM* [1982] ECR 3583, paragraphs 22-23 (allocation of tariff quota opened by a Council Regulation – the levy waived was part of the Community's own resources, not State resources).

<sup>43</sup>Case C-52/97, C-53/97 and 54/97 *Viscido v Ente Poste Italiano* [1998] ECR I-2629, paragraphs 12-16.

<sup>44</sup>The tax concession at issue in Case C-156/98 *Germany v Commission* (Opinion of Advocate General Saggio, paragraph 30).

<sup>45</sup>E.g. Case C-308/88 *Italy v Commission* [1991] ECR I-1433, paragraph 11-14.

<sup>46</sup>Case C-200/97 *Ecotrade v Altiforni e Ferriere di Servolo* [1998] ECR I-7907, paragraph 43.



### 2.3. *The Form of an Aid*

State aids can take all manner of forms. For example: preferential discount rates in respect of export credits;<sup>47</sup> tax incentives for investments;<sup>48</sup> reductions in employers' social security contributions;<sup>49</sup> a straightforward payment of money (as in the case of subsidy);<sup>50</sup> investment in the capital of an undertaking;<sup>51</sup> the giving of a guarantee;<sup>52</sup> purchasing goods or services from the favoured undertaking in the absence of any, or any sufficient, demand for them or at an overvalue.<sup>53</sup> A tax concession or tax exemption that reduces the undertaking's liability towards the State;<sup>54</sup> aid for research and development;<sup>55</sup> a deferral of performance of an obligation to pay money to the State.<sup>56</sup>

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<sup>47</sup>Cases 6 and 11/69 *Commission v France* [1969] ECR 523; Commission's Notice on the application of the State aid rules to short term export credit insurance, O.J. 1997 No. C281/4.

<sup>48</sup>Case 70/72 *Commission v Germany* [1973] ECR 813.

<sup>49</sup>Case 173/73 *Italy v Commission* [1974] ECR 709; Case C-251/97 *France v Commission* [1999] ECR I-6639. On employment aids generally, see the Commission's Notices in O.J. 1995 No. C334/4 and O.J. 1997 No. C1/10.

<sup>50</sup>In the context of the State aid provisions of the ECSC Treaty, it has been held that: "A subsidy is normally defined as a payment by the purchaser or consumer for the goods or services which it produces. An aid is a very similar concept, which, however, places emphasis on its purpose and seems especially devised for a particular objective which cannot normally be achieved without outside help." Case 30/59 *Steenkolenmijnen v High Authority* [1961] ECR 1 at 19. A subsidy is an aid even if it is granted because of some particular burden imposed by the State upon the recipient (in casu the performance of a public service obligation): Case T-46/97 *Sociedade Independente de Comunicacao v Commission*, 10 May 2000, paragraphs 77-85.

<sup>51</sup>E.g. Case C-142/87 *Belgium v Commission* [1990] ECR I-959, paragraphs 25-26. The Commission has published guidelines on rescue and restructuring aid: see O.J. 1999 No. C288/2.

<sup>52</sup>See in particular the Commission Notice on the application of the State aid rules to guarantees (O.J. 2000 No. C71/14).

<sup>53</sup>Case T-14/96 *Bretagne Angleterre Irlande v Commission* [1999] ECR II-139, paragraphs 71-76.

<sup>54</sup>E.g. Case C-387/92 *Banco de Credito Industrial v Ayuntamiento de Valencia* [1994] ECR I-887, paragraphs 13-14; Case T-106/95 *FFSA v Commission* [1997] ECR II-229; Case C-6/97 *Italy v Commission* [1999] ECR I-2981. See also the Commission Notice on the application of the State aid rules to direct taxation (O.J. 1998 No. C284/3).

<sup>55</sup>See the Commission's Communication published in O.J. 1996 No. C45/3.

<sup>56</sup>Case T-67/94 *Ladbroke Racing Ltd. v Commission* [1998] ECR II-1, upheld on appeal in Case C-83/98 *France v Ladbroke Racing Ltd. and another*, 16 May 2000. But compare Case C-342/96 *Spain v Commission* [1999] ECR I-2459.

However, the form taken by an aid is not relevant.<sup>57</sup> The intention of the Treaty is to cast a broad net and, more particularly, to bring within the concept of a State aid caught by the Treaty anything that has all the features of a State aid irrespective of its "form".<sup>58</sup>

#### 2.4. *The Private Investor Test*

An advantage accorded by the State will not be classified as a State aid if it is no different from what the favoured undertaking could have got from private sector sources under normal market conditions.<sup>59</sup> That principle, often referred to as "the private investor test", originated in cases involving investments in the capital of an undertaking or the grant of loans to an undertaking, where the transaction was (or was said to be) in terms of its form and appearance identical to a standard commercial transaction. The ECJ was not prepared to accept that the Member States, or State bodies, were prevented by the Treaty from entering into ordinary commercial transactions of that sort. On the other hand, it did take the view that such transactions could be objectionable if a private sector investor (or lender, or whatever) would not have entered into the transaction at all (usually because of the perilous state of the recipient undertaking) or if the terms available from the private sector would have been different (that is, less favourable). In either event, the recipient undertaking would be getting from the State something that it would not otherwise have got, and it was therefore legitimate to conclude that a State aid was involved.<sup>60</sup>

When applying the private investor test, it is necessary to take a private sector comparison that is as close as possible to the transaction effected by

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<sup>57</sup>Article 87(1) refers to "aids...in any form whatsoever". See, for example, Case 323/82 *Inter Mills SA v Commission* [1984] ECR 3809, paragraph 31.

<sup>58</sup>Accordingly, there is no room in the Treaty for the concept of a "measure having equivalent effect to a State aid": Case 290/83 *Commission v France* [1985] ECR 439.

<sup>59</sup>E.g. Case C-39/94 *SFEI v La Poste* [1996] ECR I-3547, paragraph 60.

<sup>60</sup>E.g. Case 234/84 *Belgium v Commission* [1986] ECR 2263, paragraphs 14-15; Case 40/85 *Belgium v Commission* [1986] ECR 2321, paragraph 20; Case C-303/88 *Italy v Commission* [1991] ECR I-1433, paragraphs 20-24; Case C-305/89 *Italy v Commission* [1991] ECR I-1603, paragraph 19; Cases C-278/92, C-279/92 and C-280/92 *Spain v Commission* [1994] ECR I-4103, paragraph 21; Case T-358/94 *Air France v Commission* [1996] ECR II-2109, paragraph 70. The principle can be traced back to the Advocate General's Opinions in Case 84/82 *Germany v*

the State (or a State body) that is suspected of being a State aid and a comparator that is as close as possible to the person granting the aid in terms of the funds available. The private investor against whom the action of the State (or State body in question) is to be compared is not a particular person (such as a particular, or a typical, private sector investor in the Member State in question); nor is it an ideal or theoretical investor. Instead, it is a hypothetical reasonable investor applying ordinary commercial criteria and operating under normal market conditions.<sup>61</sup>

It is not necessarily the case that the hypothetical private investor would seek a profit in the short term because private investors may well be guided by the prospect of profitability in the longer term; but the general principle of the test is to determine whether or not the transaction would or could have been entered into with a private sector counterparty envisaging making a return on the transaction (or at least minimising losses) and leaving aside any consideration of the social, regional, sectoral or other policy considerations that typically motivate the State (or State bodies).<sup>62</sup>

The comparison with a private sector investor is not, however, exact in all respects. For example, a private sector operator might bear the losses of a subsidiary out of a desire to protect the image of the group or in order to carry out an orderly redirection of the group's activities. Such considerations must be left out of account when considering whether or not an advantage granted by the State (or a State body) is a State aid. The private investor test is focused rather more on the question whether or not the transaction that is alleged to be a State aid is ultimately going to be, or is expected to be, profitable.<sup>63</sup>

In that connection, many investments made by prudent private sector investors involve some risk and, despite the existence of an intention that the investment shall bring a commercial return within a reasonable period, it

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*Commission* [1984] ECR 1451 and Cases 296 and 318/82 *Netherlands and Leeuwarder Papierfabrik v Commission* [1985] ECR 809.

<sup>61</sup>LASOK, p. 4-9.

<sup>62</sup>Cases T-129/95, T-2/96 and T-97/96 *Neue Maxhuetten Stahlwerke and others v Commission* [1996] ECR II-17, paragraphs 104-140 (in particular, paragraph 132).

may turn out that no return can be made or that the investment is simply lost in whole or in part. The private investor test therefore involves a comparison with an hypothetical judgmental decision; and it is entirely possible that different private sector investors, acting reasonably and in accordance with commercial criteria under normal market conditions, could take different views of the sense in making a particular investment and of the acceptability of the terms under which a particular investment was or would be made. Possibly for that reason, the private investor test is often applied in the cases in a negative rather than a positive sense: it is regarded as crucial that the prospect of receiving an appropriate return on the advantage granted was simply disregarded; or that the circumstances were such that no private investor operating under normal market conditions would have done what the grantor of the alleged State aid did; or that no private investor operating under normal market conditions would have taken into account the considerations advanced to justify the alleged State aid.<sup>64</sup> On the other hand, it would seem that, if the prospect of receiving a return did motivate the action of the grantor of the alleged State aid and the action taken fell within the range of possible decisions that a private sector investor might make, acting reasonably on the basis of commercial considerations and under normal market conditions, then the alleged State aid cannot be considered to be a State aid.<sup>65</sup>

## 2.5. *Relevance of Purpose*

An advantage granted by the State (or a State body) is not excused from being a State aid merely because it serves some particular purpose or policy.<sup>66</sup> The cultural, social or other aims of the advantage in question, but

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<sup>63</sup>Case C-303/88 *Italy v Commission* [1991] ECR I-1433, paragraphs 21-22; Cases T-129/95, T-2/96 and T-97/96 *Neue Maxhütte Stahlwerke and others v Commission* [1996] ECR II-17, paragraphs 123-128.

<sup>64</sup>Case C-303/88 *Italy v Commission* [1991] ECR I-1433, paragraphs 22 and 24; Cases T-129/95, T-2/96 and T-97/96 *Neue Maxhütte Stahlwerke and others v Commission* [1996] ECR II-17, paragraphs 116-121 and 124.

<sup>65</sup>LASOK, p. 4-11.

<sup>66</sup>One of the early pronouncements on Article 87(1) was that it applied to "decisions of Member States by which the latter, in pursuit of their own economic and social objectives, give by unilateral and autonomous decisions, undertakings or other persons resources or procure for them advantages intended to encourage the attainment of the economic or social objectives sought": Case 61/79 *Amministrazione delle Finanze dello Stato v Denkavit* [1980] ECR 1205, paragraph 31. Thus, the existence of a purpose or objective served by a benefit granted by the

defined it in relation to its effects. The aims of the advantage in question, but defines it in relation to its effects. The aims of the advantage may be relevant when the Commission, in exercise of its power of constant review under Article 88 of the Treaty, rules on the compatibility with the common market of a measure already categorised as State aid and verifies whether that measure falls within the derogations provided for by Article 87(2) and (3).<sup>67</sup> Equally, where a particular advantage granted by the State is objectively justified on commercial grounds (and is not, for that reason, a State aid), the fact that it also furthers a particular political aim does not turn into a State aid.<sup>68</sup>

It does not follow from the lack of relevance of the purpose of an alleged State aid that the legal or economic context must be ignored. In one case, it was held that a preferential gas tariff benefiting a particular class of undertakings might not be a State aid if it were demonstrated that the tariff was objectively justified by economic reasons such as the need to resist competition on the same market from other sources of energy, the price of which was competitive.<sup>69</sup> In another case, the argument that a system of special administration for insolvent undertakings gave rise to a State aid merely because the application of the system would produce a loss of tax revenue for the State (since insolvent undertakings to which the system applied would be sheltered from claims and the running of interest on their debts would be suspended) was rejected on the ground that that consequence was an inherent feature of any statutory system laying down a framework for relations between an insolvent undertaking and the general body of creditors.<sup>70</sup> In general terms, where a practice is justified objectively on commercial grounds, it is not a State aid irrespective of the existence of some other motive for its adoption.<sup>71</sup>

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State (otherwise than in return for something of equivalent value supplied by the undertaking receiving the benefit) is indicative of the benefit being a State aid rather than a reason for deciding that it is not one.

<sup>67</sup>Case 173/73 *Italy v Commission* [1974] ECR 709, paragraphs 12-13; Case T-14/96 *Bretagne Angleterre Irlande v Commission* [1999] ECR I-723, paragraph 79.

<sup>68</sup>Case C-56/93 *Belgium v Commission* [1996] ECR I-723, paragraph 79.

<sup>69</sup>Case 67, 68 and 70/85 *Van der Kooy v Commission* [1988] ECR 219, paragraph 30; Case C-56/93 *Belgium v Commission* [1996] ECR I-723, paragraphs 10, 20.

<sup>70</sup>Case C-200/97 *Ecotrade v Altiforni e Ferriere di Servola* [1988] ECR I-7907, paragraph 36.

Accordingly, the broad wording of Article 87(1) does not signify that all advantages granted by a State, whether financed through State resources or not, constitute aid but is intended merely to bring within that definition both advantages which are granted directly by the State and those granted by a public or private body designated or established by the State.<sup>72</sup>

### 3. Effect on Competition

In order to be incompatible with the common market, a State aid must distort or threaten to distort competition by favouring certain undertakings or the production of certain goods. Thus, there must be some causal connection between the State aid and the effect on competition.<sup>73</sup> The analysis of the consequences of a State aid must take account of foreseeable changes in competitive conditions and alter over time.<sup>74</sup>

#### 3.1. *Distortion or Threatened Distortion of Competition*<sup>75</sup>

As in the case of the competition rule applicable to undertakings, it is not necessary for there to be evidence of an actual effect on competition; it is sufficient if the State aid is capable of distorting competition.<sup>76</sup>

#### 3.2. *Favouring Certain Undertakings or the Production of Certain Goods*

The requirement that a State aid favour "certain" undertakings or the production of "certain" goods, otherwise known as the "selectivity" of the aid, is one of the defining features of a State aid.<sup>77</sup> "Selectivity" means that the aid is essentially discriminatory in nature because it benefits particular undertakings or the production of particular goods. For example, a general measure affecting the national economy (such as, before Member States join the

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<sup>71</sup>Case C-56/93 *Belgium v Commission* [1996] ECR I-723, paragraph 79.

<sup>72</sup>Case C-52/97 *Viscido v Ente Poste Italiane* [1998] ECR I-2629, paragraph 12-16 and paragraph 16 of the Opinion of Advocate General Jacobs.

<sup>73</sup>Case 40/75 *Société des Produits Bertrand SA v Commission* [1976] ECR 1.

<sup>74</sup>Cases T-132/96 and T-143/96 *Freistaat Sachsen and others v Commission*, 15 December 1999, paragraphs 211-218.

<sup>75</sup>EVANS/MARTIN, pp. 79-111.

<sup>76</sup>E.g. Cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98 and T-23/98 *Alzetta Mauro and others v Commission*, 15 June 2000, paragraphs 76-82.

Euro-zone, devaluation of the national currency) would not be regarded as a State aid, because of its lack of selectivity, even though it might also be beneficial to national exporters. On the other hand, a preferential discount rate for exports is a State aid, even if applied to all domestic products, because it is of direct benefit to individual exporters.<sup>78</sup>

For the purpose of determining whether or not an aid is "selective", the status of the undertakings or manufacturers benefiting from the alleged aid as public or private undertakings is irrelevant:<sup>79</sup> hence, a benefit is selective even if it favours either certain goods produced by public sector undertakings or certain goods produced by private sector undertakings (or certain goods produced by a mixture of the two). An aid is selective even if the number of recipients is, for some reason, indeterminate (in the sense of uncounted or difficult to count), as long as the class of recipients is defined in such a way as to exclude other undertakings.<sup>80</sup> It seems arguable that a form of assistance may also be "selective" even if it benefits all undertakings or all goods in a particular Member State: the "selectivity" arises from the fact that the assistance is not extended to all undertakings or all goods in the Community.

### 3.3. *De minimis*

Different views have been expressed as to whether or not a *de minimis* rule applies in the context of State aid.<sup>81</sup> It has been suggested by an Advocate

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<sup>77</sup>Case C-200/97 *Ecotrade v Altiforni e Ferriere di Servola* [1988] ECR I-7907, paragraph 40.

<sup>78</sup>Cases 6/69 and 11/69 *Commission v France* [1969] ECR 523, paragraphs 20-21; Case 173/73 *Italy v Commission* [1974] ECR 709, paragraph 19.

<sup>79</sup>Case 78/76 *Steinike & Weinlig v Germany* [1977] ECR 595, paragraphs 17-18.

<sup>80</sup>Case C-156/98 *Germany v Commission* (pending), where a tax concession made available to beneficiaries was indeterminate (Opinion of Advocate General Saggio, paragraph 31). Case C-75/97 *Belgium v Commission* [1999] ECR I-3671, paragraphs 23-31; Case C-256/97 *Demenagements-Manutention Transport SA* [1999] ECR I-3913, paragraphs 27-30; Case C-295/97 *Industrie Aeronautiche e Meccaniche Rinaldo Piaggio SpA v International Factors Italia SpA and others* [1999] ECR I-3735, paragraphs 37-43.

<sup>81</sup>In principle, the question whether or not there is a *de minimis* rule divided into two parts: is there such a rule in relation to the required effect on competition; and is there such a rule in relation to the required effect on trade between Member States? In practice, little attention is paid to the difference between effect on competition and effect on trade between Member States. Accordingly, both aspects of the *de minimis* question will be considered here. There is no *de minimis* rule in the State aid provisions of the ECSC Treaty because those provisions do not require a

General that the effect of a State aid must be significant for it to be incompatible with the common market.<sup>82</sup> On the other hand, all attempts to rely on *de minimis* before the Community courts have so far been unsuccessful. That may be due to the fact that, hitherto, the *de minimis* argument has been based upon the relatively small size of the aid or the relatively small size of the recipient rather than upon the relatively small extent of the actual effect of the aid.<sup>83</sup> Even a relatively small amount of aid can have a significant effect where competition in the relevant market is strong.<sup>84</sup> It has also been held that the capacity of a State aid to strengthen an undertaking's competitive position is assessed by reference to the advantage given to the recipient and not by reference to the operating results of the undertaking's competitors,<sup>85</sup> which excluded another basis for describing the effect of a State aid as being *de minimis*.

The Commission is empowered to introduce a *de minimis* rule by means of a regulation.<sup>86</sup> Instead, it has issued a notice on the *de minimis* rule for State aid that is, at the least, indicative of the extent to which a new State aid must be notified to the Commission before it is brought into effect. Under the Commission's notice, the *de minimis* rule applies to the extent that all the aid granted to a particular undertaking (or for the production of particular goods), excluding export aid, does not exceed, in the aggregate,

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State aid to distort competition in order to be prohibited: Cases T-129/95, T-2/96 and T-97/96 *Neue Maxhuetten Stahlwerke GmbH and another v Commission* [1999] ECR II-17, paragraph 147.

<sup>82</sup>Case C-142/87 *Belgium v Commission* [1990] ECR I-959 at 1001.

<sup>83</sup>Case C-142/87 *Belgium v Commission* [1990] ECR I-959, paragraph 43 of the judgement; Case T-14/96 *Bretagne Angleterre Irlande v Commission* [1999] ECR I-139, paragraphs 77-78; Case C-156/98 *Germany v Commission* (pending), Opinion of Advocate General Saggio, paragraph 33. In Cases T-129/95, T-2/96 and T-97/96 *Neue Maxhuetten Stahlwerke and others v Commission* [1999] ECR II-17, paragraph 147, the CFI concluded that the State aid rules in the ECSC Treaty did not embody a *de minimis* rule because there was no requirement that a State aid should distort or threaten to distort competition. On the basis, it could be inferred *en contrario* that the requirement of an effect on competition in the EC State aid rules does indicate that those rules embody a *de minimis* rule.

<sup>84</sup>Case 259/85 *France v Commission* [1987] ECR 4393, paragraph 24; Cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98 and T-23/98 *Alzetta Mauro and others v Commission*, 15<sup>th</sup> June 2000, paragraphs 84-87.

<sup>85</sup>Case T-14/96 *Bretagne Angleterre Irlande v Commission* [1999] ECR I-139, paragraphs 77-78.

<sup>86</sup>Council Regulation No. 994/98 (O.J. 1998 No. L142/1), Article 2. The Regulation therefore implies that a *de minimis* rule is contained within Article 87 and Article 88 of the Treaty. If that were not the case, the Council would not have the power to empower the Commission to define such a rule.



EUR 100'000 over a three year period beginning when the first of the aid in question is granted.<sup>87</sup> The Commission of the European Communities has recently adopted the regulation on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid.<sup>88</sup>

#### 4. Effect on Inter-State Trade

The required effect upon inter-State trade is in principle no different from the effect required in the context of the competition rules applicable to undertakings. The question of the application of a *de minimis* rule is considered above, in connection with the required effect on competition. Where State financial assistance strengthens the position of an undertaking vis-à-vis other undertakings competing in intra-Community trade, the assistance must be regarded as affecting trade between Member States.<sup>89</sup> Aid granted to an undertaking that does not export its products to other Member States is such as to affect trade between Member States where producers in other Member States compete with the recipient of the aid because, as a result of the assistance, domestic production may be maintained or increased in the face of competition from producers in other Member States, reducing the opportunities for those producers to export to the State concerned.<sup>90</sup> Where the primary effect of the aid is to make investment in the undertakings benefiting from the aid more attractive, there may be an effect on inter-State trade because, in principle, investment in every undertaking established in another Member State that does not benefit from the aid is possible only under less favourable conditions.<sup>91</sup>

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<sup>87</sup>O.J. 1996 No. C68/9; O.J. 2000 No. C89/7.

<sup>88</sup>Council Regulation No. 69/2001 (O.J. 2001 No. L10/30).

<sup>89</sup>Case 730/79 *Philip Morris v Commission* [1980] ECR 2671, paragraphs 11; Case C-75/97 *Belgium v Commission* [1999] ECR I-3671, paragraphs 49-53.

<sup>90</sup>Case 102/87 *France v Commission* [1988] ECR 4067, paragraph 19; Case C-303/88 *Italy v Commission* [1991] ECR I-1433, paragraph 27.

<sup>91</sup>Case C-156/98 *Germany v Commission* (pending), Opinion of Advocate General Saggio, paragraphs 29 and 31.

## 5. State Aids Compatible with the Common Market

There are two classes of State aid that are compatible with the common market: (i) State aids covered by the opening words of Article 87(1) ("Save as otherwise provided in this Treaty") – the "saving clause"; and (ii) State aids declared to be compatible with the common market by Article 87(2).

### 5.1. *The Saving Clause*

The saving clause relates in particular to the special provisions in the Treaty concerning agriculture and transport.

### 5.2. *Article 87(2)*

Three categories of State aid are deemed by the Treaty to be compatible with the common market and are therefore not prohibited: (i) aids having a social character, granted to individual consumers, provided that the aid is granted without discrimination related to the origin of the products concerned; (ii) aids to make good damage caused by natural disasters or exceptional occurrences; and (iii) aids granted to the economy of certain areas of the former Federal Republic of Germany affected by the division of Germany, insofar as such aid is required in order to compensate for the economic disadvantages caused by the post-war division of Germany. As grounds for derogating from a general rule of incompatibility with the common market, those grounds must be strictly construed.<sup>92</sup> The Commission exercises a discretionary power when deciding whether or not one of those grounds applies; and the degree of judicial intervention in the exercise of that power is limited.<sup>93</sup>

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<sup>92</sup>Cases T-132/96 and T-143/96 *Freistaat Sachsen and others v Commission*, 15 December 1999, paragraph 132.

<sup>93</sup>In many cases, the ECJ or CFI has contented itself with saying that the person challenging the assessment made had not shown that the decision-maker (usually the Commission) had overstepped the limits to its discretion: see, for example, Cases T-132/96 and T-143/96 *Freistaat Sachsen and others v Commission*, 15 December 1999, paragraph 148.

### 5.3. *Aids Having a Social Character*

Such aids comprise such things as grants to the indigent to enable them to buy fuel or other comforts. Such aids are permitted on the condition that particular products are not favoured by reference to their origin. Hence, it is possible for such an aid to favour one type of product over another (such as gas heating rather than electricity for domestic use); but it is not permissible for the aid to favour (for example) gas produced in one Member State at the expense of gas produced in another. Individual consumers must be the immediate recipients of the aid. If the immediate recipients of the aid are other persons, the aid cannot be regarded as compatible with the common market on this ground.<sup>94</sup>

### 5.4. *Natural Disasters and Exceptional Occurrences*

Aid may be granted to alleviate hardship and to finance the reconstruction of an industrial plant that has been destroyed as a result of a natural disaster or an exceptional occurrence; but neither event justifies aid for general development of the industries or regions affected by natural disaster or an exceptional occurrence.<sup>95</sup>

### 5.5. *Aids Compensating for the Division of Germany*<sup>96</sup>

Despite the reunification of Germany, the justification for special treatment of certain areas of Germany affected by the post-war division of the country has not disappeared as yet. However, aid to the economy of those areas is justified only to the extent that they have suffered from the existence of the former frontier between the Federal Republic and the Democratic Republic, such as through geographical isolation, the interruption of communications or the loss of access to markets.<sup>97</sup>

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<sup>94</sup>Case 52/76 *Benedetti v Munari Fratelli SAS* [1977] ECR 163 (wheat bought with State funds at the intervention price was resold at a lower price for milling, resulting in a reduced price for bread; but the aid subsidised directly the milling industry rather than individual consumers).

<sup>95</sup>E.g. Case C-364/90 *Italy v Commission* [1993] ECR I-2097. See also Commission Decision 91/175 concerning aid to assist certain areas of the Mezzogiorno affected by natural disasters (O.J. 1991 No. L86/23).

<sup>96</sup>SCHÜTZ, p. 203; MÜLLER-GRAFF, pp. 37-65.

## 6. Aids that may Be Exempted From Prohibition

Five categories of State aid may be exempted from prohibition: (i) aids to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; (ii) aids 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; (iii) aids 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 public interest; (iv) aids to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest; and (v) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.<sup>98</sup> As grounds for derogating from a general rule of incompatibility with the common market, those grounds must be strictly construed.<sup>99</sup>

The exercise of the discretion to exempt aids falling within one of those categories involves economic and social assessments which must be made in a Community context.<sup>100</sup> In making its assessment, the Commission is entitled to require a compensatory justification for the aid, that is, a contribution by the recipient of the aid to the achievement of the objectives of the Community, as set out in Article 87(3), over and above the effects of the normal play of market forces.<sup>101</sup> However, the breadth of the discretion is such that there is only a limited degree of judicial intervention in decisions to exempt an aid.<sup>102</sup>

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<sup>97</sup>Cases T-132/96 and T-143/96 *Freistaat Sachsen and others v Commission*, 15 December 1999, paragraphs 129-131 and 134-137.

<sup>98</sup>Article 87(3) of the Treaty.

<sup>99</sup>E.g. Cases T-132/96 and T-143/96 *Freistaat Sachsen and others v Commission*, 15 December 1999, paragraph 167.

<sup>100</sup>Case 730/79 *Philip Morris Holland BV v Commission* [1980] ECR 2671, paragraph 24; Case C-303/88 *Italy v Commission* [1991] ECR I-1433, paragraph 34.

<sup>101</sup>Case 730/79 *Philip Morris Holland BV v Commission* [1980] ECR 2671, paragraph 26 of the judgement and paragraph 6 of the Opinion of Advocate General Capotorti; Case C-75/97 *Belgium v Commission* [1999] ECR I-3671, paragraphs 55-58.

<sup>102</sup>Cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98 and T-23/98 *Alzetta Mauro and others v Commission*, 15 June 2000, paragraph 130, where the grounds on which the courts will interfere with such an exercise of discretion were listed as being: breach of procedural rule; failure to give reasons; material error of fact; manifest error of appreciation; and misuse of power.

### 6.1. Aids to Promote Economic Development of Deprived Areas

This category covers regional aids. The qualifying conditions for the approval of such aids are that the region to be benefited suffers from an abnormally low standard of living or serious underemployment. Both conditions are assessed by reference to the position in the Community as a whole rather than the position in the Member State of which the region in question forms a part.<sup>103</sup> The Commission has published guidance on aid for large investment projects.<sup>104</sup>

### 6.2. Aids for Important Projects or to Remedy Serious Disturbances

A project is not of common European interest unless it forms part of a transnational European programme supported jointly by a number of governments of the Member States or arises from concerted action by a number of Member States to combat a common threat, such as environmental pollution.<sup>105</sup> The "serious disturbance" referred to is a disturbance in the entire national economy of a Member State.<sup>106</sup> Whether or not there is a "serious" disturbance in the economy of a Member State that would justify exemption from the prohibition on State aids is to be determined by reference to conditions in the Community; if other Member States are in a worse situation, a disturbance in the economy of one particular Member State cannot be said to be "serious".<sup>107</sup>

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To those should be added error of law (for example, where the Commission mistakenly construes one of the grounds of exemption as applying to a certain situation when, properly construed, it does not). In Cases T-132/96 and T-143/96 *Freistaat Sachsen and others v Commission*, 15 December 1999, paragraph 169, the CFI added that the courts cannot substitute their own assessments for those of the Commission.

<sup>103</sup>Thus, in Case 730/79 *Philip Morris Holland BV v Commission* [1980] ECR 2671, the ECJ upheld a Commission decision not to approve a Dutch aid scheme because, although it would have benefited a region of the Netherlands whose unemployment rate was higher and *per capita* income lower than the average in the country, conditions in that region were still better than the average in the Community.

<sup>104</sup>O.J. 1998 No. C107/7.

<sup>105</sup>Cases 62 and 72/87 *Executif Regional Wallon and Glaverbel v Commission* [1988] ECR 1573, paragraph 22.

<sup>106</sup>Cases T-132/96 and T-143/96 *Freistaat Sachsen and others v Commission*, 15 December 1999, paragraph 167-168.

<sup>107</sup>Case 730/79 *Philip Morris Holland BV v Commission* [1980] ECR 2671, paragraph 25.

### 6.3. *Aids for the Development of Economic Activities or Areas*

Aids falling within this category can be applied to individual regions of a Member State or specific economic sectors. The key concept, so far as such aid is concerned, is that of "development".<sup>108</sup> Aid merely to save a bankrupt or moribund undertaking or to save jobs will not be exempted under this category.<sup>109</sup> On the other hand, the settlement of an undertaking's existing debts, in order to ensure its survival (which is ordinarily prohibited), does not necessarily affect trading conditions to an extent contrary to the common interest where it is accompanied by a restructuring plan.<sup>110</sup> Even if an aid facilitates development, it will not be exempted if it would adversely affect trading conditions contrary to the common interest.<sup>111</sup> That may arise if the aid, even if beneficial in itself, is financed by a method that would adversely affect trading conditions contrary to the common interest, such as by adversely affecting competitors of the undertakings benefiting from the aid.<sup>112</sup>

### 6.4. *Aids to Promote Culture and Heritage Conservation*

Such aids cannot be exempted if they affect trading conditions and competition to an extent that is contrary to the common interest.<sup>113</sup>

### 6.5. *Other Categories*

The Council is empowered to exempt categories of aid by decision. The main category comprises aid to the shipbuilding industry. The Council in turn has empowered the Commission to declare by regulation that the following categories of State aid are compatible with the common market under conditions that the Commission is to define: aid in favour of small and

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<sup>108</sup>BLUMANN, pp. 84-86.

<sup>109</sup>Case 84/82 *Germany v Commission* [1984] ECR 1451 at 1505 (Advocate General Slynn).

<sup>110</sup>Case 323/82 *Intermills SA v Commission* [1984] ECR 3809, paragraph 39; Cases T-126/96 and T-127/96 *Breda Fucine Meridionali and another v Commission* [1998] ECR II-3437, paragraphs 98-102 and the cases cited there.

<sup>111</sup>Essentially the same condition appears in the last sentence of Article 86(2) of the Treaty.

<sup>112</sup>Case 47/69 *France v Commission* [1970] ECR 487 at 496.

<sup>113</sup>Art. 87(3) lit. d of the Treaty.

medium-sized enterprises; research and development; environmental protection; employment and training; aid that complies with the map approved by the Commission for each Member State for the grant of regional aid.<sup>114</sup> The Commission has published a framework for training aid and regulations on the application of Articles 87 and 88 of the EC Treaty to training aid and aid to small and medium-sized enterprises.<sup>115</sup>

## 7. Procedural Rules

Article 88 of the EC Treaty contains rudimentary rules for supervising and dealing with State aids. Those rules were intended to be supplemented by more detailed rules to be adopted by the Council under Article 89.<sup>116</sup> In the event, no rules were adopted by the Council and the gap was progressively filled by various decisions of the ECJ. In 1998, the Council adopted a regulation empowering the Commission to declare certain categories of aid to be compatible with the common market and to define a *de minimis* rule for State aids, laying down the procedure to be followed to that end.<sup>117</sup> In 1999, the Council eventually adopted a body of procedural rules applying more generally to the supervision of State aids that, in its essentials, reflects the case law that had grown up in the meantime.<sup>118</sup>

### 7.1. Procedural Regulation

The Regulation No. 659/1999 aims at increasing transparency and legal certainty by the codification and clarification of the procedural rules developed through the Commission's practice and the jurisprudence of the Court of Justice. The regulation deals in particular with the following matters: notification, standstill (suspension of the effects of a notified aid), preliminary evaluation, requests for information, hearing, decisions, interim measures, recovery of unlawful aids, reporting obligations, monitoring powers, co-operation with national independent supervisory bodies and third party rights.

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<sup>114</sup>Council Regulation No. 994/98 (O.J. 1998 No. L142/1), Article 1(1).

<sup>115</sup>O.J. 1998 No. C343/10, O.J. 2000 No. C89/8 and 15.

<sup>116</sup>ROUAM, p. 108, HANCHER, pp. 134-150.

<sup>117</sup>See II.3.3., Council Regulation No. 994/98 (O.J. 1998 No. L142/1), Council Regulation No. 69/2001 (O.J. 2001 No. L 10/30).

<sup>118</sup>Council Regulation No. 659/1999 (O.J. 1999 No. L83/1).

## 7.2. Notification

According to Article 88(1) of the Treaty, the Commission must keep all existing State aids under constant review, including those authorised by the Commission, due to increasing integration and the changing environment of the Community.<sup>119</sup> Any plans to grant or alter aid prohibited under Article 87(1) and not authorised under Article 87(2) or a de minimis facility<sup>120</sup> or any general aid scheme or guideline of the Commission have to be notified to the Commission according to Article 88(3).<sup>121</sup> Notification shall take place in due time, i.e. at least two months or, as the case may be, 30 days before the projected entry into force, and no payments shall be made in violation of Article 88(3).<sup>122</sup> Questionnaires specify the information which the Commission deems necessary for examining aids.<sup>123</sup> The Commission considers a notification compulsory even where the exceptions under Article 87(2) are fulfilled.<sup>124</sup> Failure to notify can lead to an action by the Commission under Article 226<sup>125</sup> or by individuals before national requesting the recovery of the illegal aid.<sup>126</sup>

## 7.3. Aids Put Into Effect Without Prior Notification

Article 1(f) of Regulation 659/1999 laying down detailed rules for the application of Article 88<sup>127</sup> provides that a new aid is unlawful if it is put into effect in contravention of Article 88(3), i.e., without prior notification. The prohibition on implementation contained in the last sentence of Article 88(3) has a direct effect and gives rise to rights of individuals, which national

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<sup>119</sup>SOUKUP, p. 254.

<sup>120</sup>Community notice on the de minimis rule for State aid (O.J. 1996 No. C68/9).

<sup>121</sup>Commissions letter to Member States of April 27, 1989, Commission's Volume II.A, p. 64.

<sup>122</sup>Commissions letter to Member States of April 27, 1989, Commission's Volume II.A, p. 59.

<sup>123</sup>Commissions letter to Member States of April 27, 1989, Commission's Volume II.A, pp. 25 and 65.

<sup>124</sup>Case 169/82 *Commission v Italy* [1984] ECR 1603.

<sup>125</sup>Commissions letter to Member States of April 27, 1989, Commission's Volume II.A, pp. 40-43.

<sup>126</sup>However, the national court may consult the Commission, which must supply the necessary information on the compatibility or incompatibility of the aid; the mere absence of notification does not suffice: Case C-301/87 *France v Commission* [1990] ECR I-307, paragraphs 19-21; Case C-39/94 *SFEI v La Poste* [1996] ECR I-3547, paragraph 43.

<sup>127</sup>O.J. 1999 No. L83/1.



courts are bound to safeguard.<sup>128</sup> In addition, the Commission may, after giving the Member State concerned the opportunity to submit its comments, adopt a decision requiring the Member State to suspend any unlawful aid until the Commission has taken a decision on the compatibility of the aid with the Common Market.<sup>129</sup> Where the Commission declares the unlawful aid incompatible with the Common Market, it may request the Member State concerned to take all necessary measures to recover the aid from the beneficiary, in accordance with the procedures under the national law of the Member State concerned.<sup>130</sup>

#### 7.4. First Phase of Assessment

The Commission must complete its initial assessment<sup>131</sup> within a period of two months as required by the Court of Justice.<sup>132</sup> This first assessment may result in the compatibility<sup>133</sup> of the aids or, in case of serious doubts about its compatibility,<sup>134</sup> in the initiation of the procedure<sup>135</sup> to enjoin the

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<sup>128</sup>KEPPENE, p. 239. A national court may state the nullity of an unlawful state aid even if it is subsequently notified to the Commission and declared compatible, however without retroactive effect: Case C-354/90 *Fédération nationale du commerce extérieur des produits alimentaires v France* [1991] ECR I-5505; Case C-39/94 *SFEI v La Poste* [1996] ECR I-3547.

<sup>129</sup>Article 11 of Regulation 659/1999, formalising the Commission's practice as confirmed by the Court of Justice: Case C-301/87 *France v Commission* [1990] ECR I-307, paragraph 19. Commissions letter to Member States of April 27, 1989, Commission's Volume II.A, p. 25, points 55-72.

<sup>130</sup>Article 14 of Regulation 659/1999.

<sup>131</sup>This does not necessarily include the hearing of complaints: Case C-367/95 *Commission v Sytraval* [1998] ECR I-1719; MARTIN-EHLERS, pp. 245-248.

<sup>132</sup>Case 84/82 *Germany v Commission* [1984] ECR 1451, paragraph 11; Case C-225/91 *Matra v Commission* [1993] ECR I-3203, paragraphs 33-39. If the Commission fails to take a decision within two months following the notification (provided the notification is complete) the Member State may, after having informed the Commission, put the aid into effect: Case 120/73 *Lorenz v Germany* [1973] ECR 1471, paragraphs 4-5; Case C-312/90 *Spain v Commission* [1992] ECR I-4117, paragraph 18. However, the two months may be extended by mutual agreement between the Commission and the Member State concerned. An accelerated procedure applies for the clearance of State aids for small and medium-sized enterprises: Commissions letter to Member States of April 27, 1989, Commission's Volume II.A, p. 104 and – with regard to employment aid – O.J. 1995 No. C334/4, point 26 (twenty days).

<sup>133</sup>Clearances of State aid in the first phase are published in the Annual Reports on Competition Policy.

<sup>134</sup>The Commission is, in case of serious doubts, obliged to initiate proceedings: Case C-367/95 *Commission v Sytraval* [1998] ECR I-1719.

<sup>135</sup>Article 88(3). In the Commission's practice the second phase is initiated in about 10% of the cases. This percentage corresponds roughly to the proportion of merger cases in which the Commission initiates, because of serious doubts, the second phase of procedure.

aids from entering into effect.<sup>136</sup> In the event that the Commission fails to take one of these decisions within the two-month period, the state aid is automatically approved<sup>137</sup> and the Commission is prevented from acting against such aid.<sup>138</sup> The non-initiation of proceedings is therefore an act having direct effect and may be appealed.<sup>139</sup>

#### 7.5. *Second Phase of Assessment*

After the initiation of proceedings, the Commission informs the Member States and other interested parties by issuing a notice in the *Official Journal*. The Commission may proceed (on the basis of its powers under Articles 211 and 284) with the necessary investigation by addressing requests for information to Member States, enterprises or associations, including competitors.<sup>140</sup> It may also hear from interested Member States, third parties and complainants, without, however, any legal obligation to do so. However, this does not release the Commission from the duty to examine complaints carefully and to proceed to a thorough market analysis.<sup>141</sup>

#### 7.6. *Decision of the Commission and Appeals*

A decision stating that the notified aid is compatible with the Common Market in the sense of Article 88(3)<sup>142</sup> or justified under Article 86(2)<sup>143</sup> may be appealed by other Member States or third persons, provided they are di-

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<sup>136</sup>Case 171/83 *Commission v France* [1983] ECR 2621.

<sup>137</sup>Case 120/73 *Lorenz v Germany* [1973] ECR 1471; Case 171/83 *Commission v France* [1983] ECR 2621; Case 84/82 *Germany v Commission* [1984] ECR 1451.

<sup>138</sup>Case C-312/90 *Spain v Commission* [1992] ECR I-4117.

<sup>139</sup>Case C-312/90 *Spain v Commission* [1992] ECR I-4117; Case C-198/91 *Cook v Commission* [1993] ECR I-2487; Case C-313/90 *CIRFS v Commission* [1993] ECR I-1125; Case T-447/93 *AITEC* [1995] ECR II-1971.

<sup>140</sup>BAST/BLANK, pp. 181-192.

<sup>141</sup>Hearing of complaints: Case C-225/91 *Matra v Commission* [1993] ECR I-3203. Hearing of Member States: Case T-371/94 and T-394/94 *British Airways plc and others v Commission* [1998] ECR II-2405, paragraphs 75-77. The fact that a complainant participated actively during the Commission proceedings may be a decisive factor for the admissibility of the complainant's appeal: Case T-380/94 *AIUFFASS v Commission* [1996] ECR II-2169. Hearing of unions: Case T-189/97 *Comité d'entreprise de la société française de production v Commission* [1998] ECR II-335.

<sup>142</sup>Case T-371/94 and T-394/94 *British Airways plc and others v Commission* [1998] ECR II-2405. The State aid may be authorised by the Commission even if that aid has already been paid before the decision was adopted.

<sup>143</sup>Case C-348/92 *Commission v Italy* [1995] ECR I-673, paragraph 21; Case T-106/95 *FFSA* [1997] ECR II-229.

rectly and individually concerned.<sup>144</sup> If the Commission finds that the aid is incompatible, it orders the state concerned to abolish or alter such aid within a period of time to be determined by the Commission. The Member States concerned may appeal the decision (Article 230(1)) which is enforceable unless the Court of Justice issues interim measures according to Article 243.<sup>145</sup> If the State concerned does not comply with the Commission decision, the Commission or any other interested state may, in derogation of Article 226 and 227, refer the matter to the Court of Justice directly.<sup>146</sup> The recipient of the aid can invoke the principle of good faith<sup>147</sup> only where he could have had a legitimate expectation that the aid was granted in accordance with the procedure laid down in Article 88.<sup>148</sup> The non-recovery of the illegally granted aid by the Member States constitutes a further violation of the Treaty<sup>149</sup> and the Commission may oppose the exemption of a new aid.<sup>150</sup> An illegally granted State aid has to be refunded, even if this would lead to the bankruptcy of the company in question<sup>151</sup> except in cases of absolute impossibility.<sup>152</sup> A negative decision of the Commission can be

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<sup>144</sup>Article 230(2). However, a third party having a legitimate interest is not directly and individually concerned yet: Case 323/82 *Intermills SA v Commission* [1984] ECR 3809; Case C-295/92 *Landbouwschap v Commission* [1992] ECR I-5003; Case T-189/97 *Comité d'entreprise de la société française de production v Commission* [1998] ECR II-335. Competitors may (successfully) appeal the authorisation of State aid: Case T-371/94 and T-394/94 *British Airways plc and others v Commission* [1998] ECR II-2405, paragraph 58 (lack of sufficient reasoning). Under Article 33 of the ECSC Treaty third persons do not have the same rights of appeal: Case T-70/97 *Region Wallone v Commission* Case T-371/94 and T-394/94 [1997] ECR II-1513, paragraph 24.

<sup>145</sup>Appeals of individuals are brought before the Tribunal of First Instance whereas appeals of Member States have to be addressed to the Court of Justice. Case 169/84 *COFAZ v Commission* [1986] ECR 391; Case C-174/94 *France v Commission* [1984] ECR I-5229; Case C-367/95 *Commission v Sytraval* [1998] ECR I-1719, paragraph 52.

<sup>146</sup>If the Court of Justice finds that the Member State concerned has not complied with its judgement, it may impose a lump sum or penalty payment according to the new provision of Article 228(2)(2) as amended by the Maastricht Treaty. The Commission issued guidelines on the calculation of such lump sum: Commission notice on the method of setting penalty payments, O.J. 1997 No. C63/2.

<sup>147</sup>AZIZI, pp. 88-139.

<sup>148</sup>Case C-24/95 *Land Rheinland-Pfalz v Alcan Deutschland GmbH* [1997] ECR I-1591, paragraphs 25 and 43; Twenty-seventh Report on Competition Policy, points 311-314.

<sup>149</sup>Case 52/84 *Commission v Belgium* [1986] ECR 89, paragraph 14; Case C-348/93 *Commission v Italy* [1995] ECR I-673, paragraphs 24-30.

<sup>150</sup>Case C-355/95 *TWD Textilwerke Deggendorf GmbH v Commission* [1997] ECR I-2549, paragraphs 24-28.

<sup>151</sup>Case 234/84 *Belgium v Commission* [1986] ECR 2263; 27<sup>th</sup> Report on Competition Policy, point 314.

<sup>152</sup>Case 52/84 *Commission v Belgium* [1986] ECR 89, paragraph 14. The absolute impossibility must be invoked (and proved) by the beneficiary before the national

overruled by the Council at the request of a Member State in exceptional circumstances (Article 88(2)(3) and (4)).<sup>153</sup>

### 7.7. Cooperation Between Commission and National Courts<sup>154</sup>

National Courts which have to decide on the legal consequences, including interim measures, against a non-notified aid or an aid declared incompatible by the Commission may request assistance and information from the Commission in accordance with the Notice on the cooperation between Commission and national courts.<sup>155</sup>

## 8. The Consequences of Illegality

The primary consequence of the unlawfulness of a State aid is that it must cease to be paid and, where it is new aid granted without prior notification to the Commission, any past payments of aid will be clawed back from the recipient either by virtue of a recovery injunction ordered by the Commission or by virtue of an order made by a national Court, subject to any defence that the recipient of the aid may have.<sup>156</sup> A Commission decision (whether a recovery injunction or a recovery order) is challengeable before the CFI by the recipient of the aid. A failure to do so within time will preclude the recipient from disputing the lawfulness of the Commission decision in national proceedings brought against the recipient in implementation of the decision.<sup>157</sup>

A further consequence of illegality of an aid is that the validity of the legislative or administrative provisions giving effect to the aid may be im-

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authorities or Courts: Case T-67/94 *Ladbroke Racing Ltd. v Commission* [1998] ECR II-1, but not by the Member State having granted the illegal aid: Case C-280/95 *Commission v Italy* [1998] ECR I-259. See II.8. for further comments about illegality.

<sup>153</sup>This possibility has been used only in the agricultural sector; 22<sup>nd</sup> on Competition Policy, point 502.

<sup>154</sup>HAZARD, pp. 145-149.

<sup>155</sup>O.J. 1995 No. C312/8; Case C-39/94 *SFEI v La Poste* [1996] ECR I-3547.

<sup>156</sup>LONG, pp. 389-393.

<sup>157</sup>Case C-188/92 *TWD Textilwerke Deggendorf GmbH v Bundesrepublik Deutschland* [1994] ECR I-833.

pugned.<sup>158</sup> However, it is not clear how far that goes because the general principle is that, where domestic measures are incompatible with Community law, the result is not that the former are non-existent but that they must be disapplied in the individual case in order to give effect to rights derived by individual from Community law.<sup>159</sup> Accordingly, it does not appear that, where a State aid is illegal, the domestic legislative or administrative provisions giving effect to it are void or voidable in the technical sense.

In addition to the recovery of illegally granted aid, a further consequence of unlawfulness is that the State granting the aid may be liable in damages for the loss caused to competitors of the beneficiaries of the aid as a result of the illegal grant of the aid.<sup>160</sup> So far, no successful actions for damages appear to have been brought. Where the competitors injured by the grant of the aid are located, one of the main stumbling blocks to the recovery of damages has been thought to be the problem of causation. That problem was particularly acute in cases where the currencies of the States concerned did not operate at fixed parities during the relevant period. That difficulty, at least, no longer applies as between States within the Euro zone.

Community law provides no basis for rendering the recipient of unlawful State aid liable in damages to a person injured by the grant of the aid;<sup>161</sup> but that is without prejudice to the possibility that national law may provide such a remedy.<sup>162</sup> In principle, damages may also be claimed against the Community should one of its institutions act unlawfully in the application of the State aid rules and thereby cause damage to a person; however, liability is not easy to establish.<sup>163</sup>

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<sup>158</sup>E.g. Case C-39/94 *SFEI v La Poste* [1996] ECR I-3547, paragraph 40, where the ECJ said that "national Courts must offer to individuals the certain prospect that all the appropriate conclusions will be drawn from an infringement of the last sentence of Article 88(3) of the Treaty, in accordance with their national law, as regards the validity of measures giving effect to the aid".

<sup>159</sup>Cases C-10/97 to C-22/97 *Ministero delle Finanze v IN.CO.GE.'90 Srl and others* [1998] ECR I-6307.

<sup>160</sup>Liability arises under the general principle of State liability for breach of Community law: Cases C-46 and C-48/93 *Brasserie du Pecheur v Germany and R Secretary of State for Transport, ex parte Factortame Ltd and others* [1996] ECR I-1029.

<sup>161</sup>ABBAMONTE, pp. 87-93.

<sup>162</sup>Case C-39/94 *SFEI v La Poste* [1996] ECR I-3547, paragraphs 73-76.

<sup>163</sup>E.g. Case T-230/95 *Bretagne Angleterre Irlande v Commission* [1999] ECR II-123. See also, BARTH, p. 290, CROZIER, p. 162.

## III. Nature of Sectoral Aid

### 1. General

In this chapter the policy statements by the Commission on sectoral aid in general and their application shall be discussed.<sup>164</sup> In Chapter II.6. the broad context of Article 87(3) as well as certain categories and types of aid have been dealt with.

The Commission's policy statements on sectoral aid were basically formulated in the 1970s. Because the Commission's sectoral interventions are still based on these principles, a discussion of these statements, in particular the 1978 communication, is useful. Nowadays the Commission sectoral actions are increasingly governed by specific guidelines. Two further sector specific guidelines have been published, for air and maritime transport, and also other guidelines have been updated.<sup>165</sup> Furthermore, additional guidelines for certain categories and types of aid have been adopted. Particularly important in this respect is the multisectoral framework on regional aid for large investment projects.<sup>166</sup> The first assessment criterion of this framework relating to structural overcapacity basically replaces the relevant passage of the 1978 communication.<sup>167</sup>

The numerous new sectoral frameworks and other guidelines, such as the guidelines on state aid for rescuing and restructuring firms in difficulty, raise the question whether it would be better to adopt a general regime applicable to all sectors with a specification per different sector. Such an approach would also be in line with the transparency objectives advanced by Regulation 994/98 on block exemptions.

### 2. The Period Prior to Publication of the Com-

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<sup>164</sup>See on this topic in general ROSENSTOCK, chapter 4.1.2; EVANS, chapter 5.

<sup>165</sup>GREAVES, pp. 144-149.

<sup>166</sup>O.J. 1998 No. C107/7.

<sup>167</sup>In as far as the aid proposals are within the scope of the framework.

## **mission's Communication**

Prior to the publication of its communication in 1978, the Commission had published several general statements on its policy on sectoral aid. Thus the First Report on Competition Policy contains a lengthy paragraph in which the Commission enumerates criteria that should ensure that aid does minimal harm to competition and has a maximum of effectiveness with regard to the balanced development of the Community. Aid must:

- be of a selective nature and only granted to enterprises or to productions, the development and reorganisation of which justifies the presumption that they will be competitive in the long run, having regard to the expected development of the sector concerned;
- be of sufficiently temporary or even digressive nature in order to stimulate the dynamism of beneficiaries. It must foster the necessary adaptations and make it clear to the parties concerned that the artificial situation arising from the granting of aid cannot continue indefinitely. Unless aid is intended to compensate for distortions of competition at Community level, which are created by measures adopted in non-Member countries, purely conservatory aid outside reorganisation programmes and aid for the operation of plants must be excluded. Economic and social progress cannot allow, in the long run, unreasonable protection of sectors facing difficulties. Aid systems must therefore avoid preventing the optimum allocation of production factors indefinitely. They must either speed up structural changes or only slow down such changes temporarily, and this only until the necessary reconversion solutions have been found;
- be as possible, in order that the Community institutions may easily evaluate their incidence and effectiveness with regard to the aims to be attained, in order that the public authorities may be in a position to measure accurately the cost involved, and in order that the enterprises concerned may assess the true situation;

- be of a form well adapted to the objectives in view and, in so far as a choice between various methods is possible, adopt those that have the least effect on intra-Community trade and the common interest.<sup>168</sup>

### **3. The Commission's Communication on Sectoral Aid<sup>169</sup>**

The Commission, in describing the general principles, starts with a reference to Article 3(g) of the Treaty, the need to ensure that competition in the common market is not distorted. It then sets out three reasons to justify adherence to this principle:

- (i) the customs union would founder if Member States could unilaterally circumvent its requirements by granting aid;
- (ii) the common market makes little sense unless businesses tackle the market on the strength of their own resources without any aid to distort competition between them;
- (iii) lastly, and as a corollary, a system which leaves the field open to competition provides for optimum distribution of production factors and ensures the most rapid economic and social progress.

Nevertheless, aid may be justified where it contributes to the achievement of the Community's economic and social aims. This occurs when market forces would:

- (i) obstruct progress towards the realisation of these aims;
- (ii) permit them to be attained only within unacceptable time-limits or at unacceptable social cost;
- (iii) intensify competition to such an extent that it could destroy itself.

The Commission considers that sectoral aid should be authorised where it is needed to correct serious regional imbalance, to encourage or accelerate certain essential changes or developments in certain industries, to permit

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<sup>168</sup> 1<sup>st</sup> Report on Competition Policy, pt 165.

<sup>169</sup> COM(78) 221 final – May 1978, Competition law in the European Communities, Vol. II: Rules applicable to State aids (Commission of the European Communities, Brussels, 1990), p. 39; 8<sup>th</sup> Report on Competition Policy.



smooth cutbacks in certain activities where this is desirable for social reasons or to neutralise, at least temporarily, certain distortions of competition due to action outside the Community.

The aims, forms and conditions relating to such aids, justifiable in that they facilitate the orderly development of Community structures, must not conflict with the Community's general objectives and must be designed in such a way as to entail a minimum distortion of competition.

On the basis of these general principles the Commission has developed a number of criteria against which it examines the sectoral aid proposals notified to it. The main criteria are the following:

- (i) sectoral aid should be limited to cases where it is justified by circumstances in the industry concerned;
- (ii) aid should lead to a restoration of long-term viability by resolving problems rather than preserving the status quo and putting off decisions and changes which are inevitable;
- (iii) nevertheless, since adjustment takes time, a limited use of resources to reduce the social and economic costs of change is admissible in certain circumstances and subject to strict conditions;
- (iv) unless granted over relatively short periods, aids should be reduced progressively and clearly linked to the restructuring of the sector concerned;
- (v) the intensity of aid should be proportionate to the problem it is designed to resolve so that distortions of competition are kept to a minimum<sup>170</sup>; and
- (vi) industrial problems and unemployment should not be transferred from one Member State to another.

The Commission does not consider it advisable to define systematically the types of aid to which it is favourably and unfavourably disposed in the case of each industrial sector. To elaborate such guidelines for aid would risk

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<sup>170</sup>Closely related to the proportionality requirement is the anti-cumulation rule. In 1987 the Commission opened the Art. 88(2) procedure against France and Greece because it could not assess what the effects of cumulation might be, O.J. 1987 No. C300/4.

encouraging a more general recourse to aid by Member States even where it is not strictly necessary. It would, moreover, result in some degree of inflexibility, since such frameworks could not take into account the specific situation of the industry concerned in each Member State. However, in cases where it has become evident that an industry faces a situation of particular difficulty throughout the Community, or is likely to face such difficulty, it is appropriate to develop guidelines which indicate the Commission's policy on aids to this industry. The Commission's approach in the case of such industries has been based on certain common principles. It has recognised that the crises the specific industry has met have threatened either a disorderly rundown of their activities with serious adverse consequences for employment in general or a series of interventions by Member States designed to protect their industries. In the latter eventuality, aid levels would be uselessly inflated and difficulties transferred from one Member State to another at substantial cost to the Community as a whole. The purpose of the Commission's initiatives in defining guidelines has been to avoid both eventualities and at the same time to encourage the restoration of the industries' competitiveness. To these ends it has accepted aids to enable orderly adjustment to market conditions. Such adjustment requires both a restoration of competitiveness and either an avoidance of undesirable increases or, in some cases, an actual reduction in production capacity.

In more concrete terms, this has led to the specification of the following principles:

- (i) aid should not be granted where the sole effect would be to maintain the status quo. Production aids as such are therefore in principle impermissible unless they are granted for a limited period and are conditional on action by the recipient, which will facilitate adjustment;
- (ii) similarly, while rescue measures may be needed in order to provide a breathing space during which longer-term solutions to a company's difficulties can be worked out, they should not frustrate any necessary reductions in capacity and should therefore be limited to cases where they are required to cope with acute social problems; and

- (iii) since it is a common feature of the industries concerned that capacity is excessive, aid should not be given to investment projects which would result in capacity being increased.

In the case of certain industries, particularly those which are in difficulties, the Commission has sought either to ensure that these and other types of aid respect the same criteria or that they are only granted on certain conditions. Thus, where employment aids are given to maintain existing jobs, the Commission has considered that if they are concentrated on industrial sectors which face acute difficulties in all Member States and if they are not associated with appropriate adjustment measures designed to restore a company's viability, the grant of these aids will not resolve the social and industrial difficulties but will rather transfer them to other Member States. Similarly, in sectors suffering from extreme overcapacity the Commission has required Member States to agree in principle not to grant regional aids for investment projects that would result in increased capacity. A principle not specifically mentioned is the prohibition of operating aid. The Commission has always opposed such aid.

#### **4. The Multisectoral Framework on Regional Aid for Large Investment Projects**

This framework entered into force on September 1<sup>st</sup>, 1998. Although its title suggest that these rules are intended for regional aid, it has nevertheless important sectoral implications. In its 27<sup>th</sup> Report on Competition Policy the Commission explains that the objectives of the framework, to stem the amount of aid for large regional projects, also serves the more general objective of aligning the divergent rules per sector.<sup>171</sup> In paragraph 1.3 of the framework the Commission notes that the special rules for the sensitive industrial sectors, agriculture, fisheries, steel, shipbuilding, synthetic fibres, the motor industry, transport and coal, will remain applicable. The textile and clothing sector will, however, be subject solely to the provisions of this framework. The framework introduces a specific notification format for proposals to award regional investment aid within the scope of an approved

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<sup>171</sup>27<sup>th</sup> Report on Competition Policy, pt 210.

scheme. The annex to the framework provides for an standard notification form. The framework applies to:

- (i) all proposals with a total project cost of at least 50 million EUR with a cumulative aid intensity of at least 50 percent and aid per job of at least 40'000 EUR;
- (ii) proposals for which the total aid is at least 50 million EUR.

As a result of these rules, the framework will be applicable to all sectoral aid not covered by sector specific frameworks except textile and clothing.

## **5. The Application of the General Sectoral Principles**

The Commission's view on sectoral aid is clearly expressed in its 26<sup>th</sup> Report on Competition Policy:

"The Commission's negative attitude to sectoral aid schemes has been demonstrated in numerous decisions in the past. This may be the reason why few such schemes were drawn up by Member States in 1994. However, the increased number of ad hoc aid cases in favour of individual undertakings, many of them concentrated in certain sectors such as mechanical engineering, paper, foundry products and agricultural, is worrying. In its decisions on the compatibility of such aid cases, the Commission must take into account the sectoral consequences of the aid, particularly in sectors suffering from overcapacity."<sup>172</sup>

The application of the 1978 Communication has been limited because the most depressed sectors have all been the subject of specific Commission frameworks, communications or notices. The application of general principles on sectoral aid has been limited because important aid proposals increasingly involve large industrial conglomerates. Such aid proposals cannot easily be assessed in the context of one particular sector. The aid granted by Italy to Enirisorse constitutes a good example of such an aid

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<sup>172</sup>26<sup>th</sup> Report on Competition Policy, pt 363.

proposal.<sup>173</sup> The non-operating holding company Enirisorse was optimising the economic and financial resources of the ENI group, which in turn consisted of the following industrial activities: mining of non-ferrous metals, coal mining, coke production, metallurgy of non-ferrous metals and, finally, inorganic chemistry. In its decision the Commission followed its guidelines on aid for restructuring when it approved a 809 billion lire recapitalisation plan for the entire conglomerate. A year later the Commission reopened the Article 88(2) procedure because the Italian government had not fulfilled an important condition. In addition it had made fresh capital injections and was planning further injections.<sup>174</sup> On November 26, 1998, the Commission adopted a decision ordering the Italian government recovery due to the fact that the latest recapitalisation by ENI did not offer sufficient financial return since Enirisorse was soon to be wound up.<sup>175</sup>

As this example shows, conglomeration in the industry has the effect that more and more application is given to the guidelines on state aid for rescuing and restructuring rather than to the sectoral guidelines. In a number of the Commission's decisions involving sectoral aid, it specifically applied the criteria laid down in its 1978 communication.

Several Commission decisions analyse whether adequate restructuring plans had been drafted and whether the overcapacity was being tackled.<sup>176</sup> In one instance the Commission also noted that the aid was used to reduce the social and economic costs of change as well as for job creation in areas eligible for regional aid. In one decision the Commission specifically referred to its summary of its communication in the 8<sup>th</sup> Report on Competition Policy.

With one exception, the Annual Reports on Competition Policy do not discuss the Commission's communication. The 13<sup>th</sup> Report mentions three

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<sup>173</sup>O.J. 1998 No. L80/32.

<sup>174</sup>O.J. 1998 No. C70/5. The Commission's action was taken pursuant to the reception which was to be submitted as one of the conditions of the previous approval decision.

<sup>175</sup>Agence Europe, November 27, 1998.

<sup>176</sup>O.J. 1990 No. L47/28; O.J. 1989 No. L356/22; O.J. 1992 No. 159/46. A more recent example is the Commission's decision approving the aid to Esmaltaciones San Ignacio, where it concluded that the length of the proposed guarantee of seven years appears to be necessary and proportionate, O.J. 1993 No. C277/5.

particular problems in the examination of individual aid cases: aids to rescue firms in difficulties, the problems of defining the degree of restructuring which can be regarded as constituting "a compensatory Community interest" for the granting of aid, and the concept of innovation. The Commission notes that government actions to rescue firms in difficulties may easily lead to the transfer of industrial difficulties and unemployment to other Member States. On the question of defining the necessary degree of restructuring, the Commission expresses the opinion that evidence must be provided that the changes being proposed are sufficient to ensure medium- to long-term viability of the enterprises without aids. The third problem is the growing tendency to present as restructuring what is in fact simple ongoing modernisation and renewal of production facilities. For the control of State aid it is important to recognise the difference between innovation (i.e. the introduction of new products or new production technologies) and the steady development of existing products and production technologies.<sup>177</sup>

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<sup>177</sup>13<sup>th</sup> Report on Competition Policy, pt 229 and pt 230.

## IV. State Aid to the Motor Vehicle Industry

### 1. Background

The motor vehicle industry is of strategic importance to the Community. Many areas of Community policy have a direct bearing on the motor vehicle sector. It is estimated that 10 percent of the Community's employment is dependent on it.<sup>178</sup> The industry has become a world-wide one and the future viability of the European motor vehicle sector will, in part, be determined by its ability to compete and sell on the world markets.

However, as the Commission noted in its communication of July 19, 1996,<sup>179</sup> production capacity utilisation rates among most of the major European manufacturers has been below 80 percent since 1993 and is unlikely to improve significantly over the medium term. Overreliance on State aid to solve problems of industrial competitiveness vis-à-vis third country producers hinders the economically healthy influence of market forces and undermines the competitiveness of Community car manufacturing. At the international level, the agreements signed or in the process of being signed with the countries of central and eastern Europe allow the Commission to investigate the conditions under which State aid is granted outside the Union. Thus, in its 1996 Competition Policy Report, the Commission indicated that the *Daewoo* and *General Motors* cases are being studied in co-operation with the Polish authorities.<sup>180</sup>

In the period 1970-1989, the governments of several Member States injected massive amounts of aid into the modernisation and development, and indeed the survival, of their domestic car industry.<sup>181</sup> For instance, in the period 1977-1987, State aid to the motor vehicle industry, essentially in

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<sup>178</sup>Community framework on State aid to the Motor Vehicle Industry, O.J. 1989 No. C123/3, paragraph 1.

<sup>179</sup>COM (96) 327 final.

<sup>180</sup>26<sup>th</sup> Report on Competition Policy, paragraph 190.

the form of capital injections or extensive debt write-offs, is estimated at 26 billion EUR.

In view of the growing sensitivity of competition in the motor vehicle sector and bearing in mind that all manufacturers are entitled to a consistent approach compatible with the Treaty, the Commission decided to introduce, as "appropriate measures" on the basis of Article 88(1),<sup>182</sup> a Community framework on State aid to the Motor Vehicle Industry (the "1989 Framework"),<sup>183</sup> discussed in detail below. Such proposed "appropriate measures" are "simple recommendations" within the meaning of Article 249 of the EC Treaty,<sup>184</sup> though they must be reasoned.<sup>185</sup>

In summary, the 1989 framework envisaged prior notification (under Article 88(3)) of all significant cases of aid to the motor vehicle sector, irrespective of their objective, as well as an annual report of all aid payments including aid not subject to the obligation of prior notification.<sup>186</sup> Between 1989 and July 1996 the Commission approved 5.4 billion EUR of aid to the industry.<sup>187</sup>

The 1989 framework was intended to enter into force on January 1, 1989 and be valid for a period of two years.<sup>188</sup> However, following its approval by ten of the (then) twelve Member States the application of the framework was delayed until January 1990 for Spain and May 1990 for Germany;

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<sup>181</sup>Community framework for State aid to the motor vehicle industry, O.J. 1997 No. C279/1, point 1(a).

<sup>182</sup>Art. 88(1) provides that: "The Commission shall, in co-operation with Member States, keep under constant review all aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the common market."

<sup>183</sup>O.J. 1989 No. C123/3.

<sup>184</sup>EVANS, p. 439; Cases 166 and 220/86 *Irish Cement Ltd. v Commission* [1988] ECR 6473, 6492.

<sup>185</sup>Case 78/76 *Steinike & Weinlig v Germany* [1977] ECR 595.

<sup>186</sup>Community framework on State aid to the Motor Vehicle Industry, O.J. 1989 No. C123/3, paragraph 2.2.

<sup>187</sup>"Summary of the most important recent developments" (Autumn/Winter 1995) Vol. 1, No. 6, Competition Policy Newsletter, pp. 41-47; "Summary of the most important recent developments" (Summer 1997) Vol. 3, No. 2, Competition Policy Newsletter, pp. 48-52.

<sup>188</sup>Community framework on State aid to the Motor Vehicle Industry, O.J. 1989 No. C123/3, paragraph 2.5.



Spain and Germany had originally been opposed to its application.<sup>189</sup> It has since been reviewed and renewed a number of times, i.e. in December 1990,<sup>190</sup> December 23, 1992<sup>191</sup> and July 5, 1995<sup>192</sup>.

## **2. 1997 Community Framework for State Aid to the Motor Vehicle Industry**

### *2.1. Introduction*

In 1996 the Commission, with the help of independent consultants, carried out an in-depth study of the 1989 Framework which concluded that the Framework was generally effective but recommended certain adjustments concerning, in particular, the notification thresholds, the definition of the sector and the methods of carrying out the cost-benefit analysis. On the basis of this report, the Commission presented its new draft Community Framework for State Aid to the Motor Vehicle Industry for examination by the representatives of the Member States at a multilateral meeting, and then decided to propose it to the Member States as an appropriate measure under Article 88(1) of the EC Treaty.

This (new) Community Framework for State Aid to the Motor Vehicle Industry was published as a Notice No. 97/C279/01 on July 15, 1997 (the "1997 Framework").<sup>193</sup> The 1997 Framework entered into force on January 1, 1998<sup>194</sup>.

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<sup>189</sup>Community framework for State aid to the motor vehicle industry, O.J. 1997 No. C279/1.

<sup>190</sup>See Community framework on State aid to the motor vehicle industry, O.J. 1991 No. C81/4. The 1990 decision renewed the 1989 framework (with a modification which extended the prior notification obligation for Germany to Berlin (West) and the territory of the former GDR). Article 1(3) of the Commission's Decision of February 21, 1990, as published in O.J. 1990 No. L188 of July 20, 1990, is no longer valid as from January 1, 1991.

<sup>191</sup>See Community framework for State aid to the motor vehicle industry, O.J. 1993 No. C36/17.

<sup>192</sup>Framework for State aid in the motor vehicle sector, O.J. 1995 No. C284/3.

<sup>193</sup>Community framework for State aid to the motor vehicle industry for the period 1998-2000, O.J. 1997 No. C279/1 (the "1997 Framework").

<sup>194</sup>Paragraph 2.6, 1997 Framework. However, following the outcome of Case C-292/95 *Kingdom of Spain v Commission of the European Communities* [1997] ECR I-1931, this entry into force is subject to the formal consent of all Member States in order to be valid.

The 1997 Framework states that the preceding (1995) Framework, which entered into force on January 1, 1996, will serve as a basis for the assessment of aid proposals which were notified before November 1, 1997, but which have not yet been declared compatible by the Commission or are the subject of proceedings under Article 88(3) of the EC Treaty, initiated before that date.<sup>195</sup>

## 2.2. Definition of "motor vehicle industry"

The 1997 Framework defines the motor vehicle industry as meaning the "development, manufacture and assembly" of motor vehicles, engines for motor vehicles and "modules or sub-systems" for such vehicles or engines, either direct by a manufacturer or by a "first tier component supplier" and, in the latter case, only in the context of an "overall project".<sup>196</sup> The inclusion of the "development" of motor vehicles is new, compared with the 1989 Framework. The previous exclusion for "parts and accessories" for both motor vehicles and motor vehicle engines has been removed. In an earlier decision in *Suzuki Manzanares*<sup>197</sup> the Commission agreed to regard the plant in question as a components factory, which meant that it was not covered by the previous Framework and was assessable solely in the light of normal criteria applicable to regional aid. Hence the 1997 Framework may be regarded as tightening up its application to include the manufacture of components which may previously have been excluded.

The phrase "motor vehicles"<sup>198</sup> encompasses passenger cars, vans, trucks, road tractors, buses, coaches and other commercial vehicles. It appears that a lorry cabin was, under the previous Framework, treated as part of the manufacture of a motor vehicle, rather than a component.<sup>199</sup> The following are excluded: racing cars, vehicles intended for off-road use (e.g. vehicles for use on snow or carrying persons on golf courses), motorcycles, trailers, agricultural and forestry tractors, caravans, special purpose vehicles (e.g. firefighting vehicles, mobile workshops), dump trucks, works' trucks (e.g.

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<sup>195</sup> Paragraph 2.6, 1997 Framework.

<sup>196</sup> Paragraph 2.1, 1997 Framework.

<sup>197</sup> 26<sup>th</sup> Report on Competition Policy, paragraph 187.

<sup>198</sup> Paragraph 2.1(a), 1997 Framework.

<sup>199</sup> "Commission investigates transport aid to Volvo plant", *European Report*, No. 2244 July 24, 1997 at p. 1.

fork-lift trucks, straddle carrier trucks and platform trucks) and military vehicles.

The term "motor vehicle engines"<sup>200</sup> means compression and spark ignition engines. Unlike the previous Framework, it also means electric motors and turbine, gas, hybrid or other engines for motor vehicles.

A "module" or a "sub-system"<sup>201</sup> means a set of primary components intended for a vehicle or engine which is produced, assembled or fitted by a first-tier component supplier and supplied through a computerised ordering system or on a just-in-time basis. Logistical supply and storage systems and subcontracted complete operations which form part of the production chain, such as the painting of sub-assemblies, should likewise be classified among these modules and sub-systems.

A "first tier component supplier"<sup>202</sup> means a supplier, whether independent or not, supplying a manufacturer, sharing responsibility for designing and development, and manufacturing, assembling or supplying a vehicle manufacturer during the manufacturing or assembly stage with sub-assemblies or modules. Such suppliers are often linked to a manufacturer by a contract of approximately the same duration as the life of the model (for example, until the model is restyled). A first-tier component supplier may also supply services, especially logistical services, such as the management of a supply centre.

The new 1997 Framework therefore broadens the definition of the industry to include first-tier component suppliers producing modules or subsystems where these are produced in the car manufacturer's plant or on one or more industrial sites in the vicinity. In an earlier Commission Decision of April 1993 (under the previous Framework) the Commission approved aid to Cadiz Electronica, a wholly owned subsidiary of the Ford Motor Company. The aid (in the form of a regional grant of 12 million EUR from the Spanish Government) was for the installation of more flexible machinery to rationalise production of electronic modules. However, the Commission

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<sup>200</sup>Paragraph 2.1(b), 1997 Framework.

<sup>201</sup>Paragraph 2.1(c), 1997 Framework.

chose not to apply the same strict discipline that it would have done for final vehicle assembly or engine production engines because this would have led to unfair treatment by comparison with aid to projects being undertaken by independent component producers which were (at that time) not notifiable under the Framework.<sup>203</sup> Since the increase in capacity was restricted to ABS modules for use in Ford cars and since the aid was far below the threshold for that particular region, no significant distortions of competition were to be expected.<sup>204</sup>

The widening of the 1997 Framework to include certain independent component producers may result in the Commission having a more limited flexibility in similar situations in future.

An "overall project"<sup>205</sup> lasts for the life of the vehicle manufacturer's investment project. A manufacturer may, on the actual site of the investment or in one of several industrial parks in fairly close geographical proximity, integrate one or more projects of first-tier component suppliers for the supply of modules or sub-systems for the vehicles or engines being produced. The proximity could inter alia take the form of a fixed link (e.g. an automated conveyor belt) allowing the delivery of modules directly into the car factory. An "overall project" means one which groups together such projects.

An investment of one first-tier component supplier is, under paragraph 2.1(e), third sub-paragraph of the Framework, "integrated within the definition of a global project" if at least half the output resulting from that investment is delivered to the manufacturer concerned at the plant in question.

### 2.3. *General criteria for assessment of all forms of aid*

The criteria which the Commission uses to assess aid which falls above the relevant threshold varies according to the objectives of the aid in question.<sup>206</sup> In every instance, however, the Commission is to check that the aid granted is both *proportional* to the gravity of the problems to be resolved

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<sup>202</sup> Paragraph 2.1(d), 1997 Framework.

<sup>203</sup> BAYLIS, pp. 1-13.

<sup>204</sup> *Ibid.*

<sup>205</sup> Paragraph 2.1(e), 1997 Framework.

and is *necessary* for the realisation of the project. Both tests, proportionality and necessity must be satisfied if the Commission is to authorise State aid in the motor vehicle industry.<sup>207</sup> All forms of aid are assessed on this same basis. (The test of necessity was not specified as one of the general criteria for approval of aid under the 1989 Framework). In addition to the two tests, specific rules of assessment are also set out in the 1997 Framework for eight different types of aid, namely regional aid, R&D aid, rescue and restructuring aid, investment aid for innovation, aid for environmental protection and energy saving, aid to vocational training, aid for modernisation and rationalisation, and operation aid, all discussed in detail below.

### **3. Assessment of Regional Aid under the 1997 Framework**

Under the terms of the 1997 Framework, the motor vehicle industry may benefit from regional aid to assist new plants and the extension of existing ones in the assisted areas (i.e. areas qualifying for domestic regional aid) of the Community.<sup>208</sup> The Commission first checks that the region in question is eligible for aid under Community law. It is recognised that such aid makes a valuable contribution to regional development by creating or safeguarding often highly-skilled jobs and through significant indirect effects.

Prior notification of the proposed aid allows the Commission to compare the advantages from the standpoint of regional development with any unfavourable consequences for the sector as a whole<sup>209</sup> in order to ensure that all relevant factors are taken into consideration.

#### *3.1. Illustration of Commission Practice Balancing Regional and Sectoral Aid*

For example, in relation to aid for Ford and Volkswagen to establish a car factory in the Setubal peninsula in Portugal, the Commission considered

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<sup>206</sup> Paragraph 3, 1997 Framework.

<sup>207</sup> Paragraph 3, 1997 Framework.

<sup>208</sup> Paragraph 3.2, 1997 Framework.

<sup>209</sup> See, e.g., the Case of aid to Fiat for a plant in the Mezzogiorno, O.J. 1991 No. C299/4.

factors such as the economic development of the region concerned, the particular situation of the car industry, and the specific situation of "mono-space" (multi-purpose) vehicles for which there was a growing demand, and came to a conclusion that the aid was permissible.<sup>210</sup> Similarly, in assessing a French proposal to grant aid to Saab-Scania for building a new heavy trucks/goods vehicle manufacturing plant at Angers, the Commission analysed the possible effects of the aid on the industry as a whole and took particular account of the problems of declining demand and overcapacity in the Community for heavy trucks. However, in view of the expected rise in demand in 1993, the Commission considered that a concentration of the aid on the later stages of the project would reduce its distorting effect on competition and avoid exacerbating the relevant industry's current difficulties.<sup>211</sup>

The Commission may also reduce the aid intensity in order to take account of these various considerations. In the Angers case, the Commission subsequently opened proceedings under Article 88(2) when it learned that the aid was to be used for purposes different from those originally agreed.<sup>212</sup> Regional aid was also approved in favour of General Motors in Luxembourg for the setting-up of a new research and development centre on the basis that the aid would not have adverse effects on the industry sufficient to outweigh the regional benefits to a disadvantaged area as the project involved a transfer of technology to which all European manufacturers would have access.<sup>213</sup>

In October 1994, the Commission approved a proposal by the Spanish Government to grant regional aid to FASA Renault (a subsidiary of the Renault Group in Spain) in support of its plan to locate an entirely new petrol engine plant at Valladolid (Spain). The Commission stated that the project complied with the criteria for regional aid set out in the 1989 Framework and took account of the possible adverse effects on the sector as a

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<sup>210</sup>EVANS, p. 316, citing Decision at O.J. 1991 No. C257/5. This Decision was unsuccessfully challenged before the ECJ in Case C-225/91 *Matra v Commission* [1993] ECR I-3203.

<sup>211</sup>EVANS, p. 317, citing O.J. 1991 No. C160/4. See also 20<sup>th</sup> Report on Competition Policy, pp. 160-161.

<sup>212</sup>EVANS, p. 317, citing Notice C5/96 (NN138/95), O.J. 1996 No. C84/5.

<sup>213</sup>EVANS, p. 317, citing 20<sup>th</sup> Report on Competition Policy, p. 161.

whole. However, it concluded that the project would not contribute to over-capacity in the sector because there were planned reductions in capacity in other plants of the company in Europe.<sup>214</sup> In March 1995, the Commission decided not to oppose aid which the U.K. Government granted to Jaguar Cars Ltd in support of an investment project. The aid was in two parts: a £9.4 million regional assistance grant and a £1.8 million training grant (the latter was found not to be a State aid). The purpose of the aid was to fund the launch of the new X100 sports car, the replacement to the XJS. The Commission decided that the aid was not disproportionate, in view of the structural handicaps of the relevant regions, i.e. Birmingham, Coventry and Liverpool, and since it did not lead to any increases in capacity at group level, it was acceptable even though it was slightly in excess of the usual permitted regional aid.<sup>215</sup>

### *3.2. Test of Necessity/Mobility of Regional Aid*

Regional aid for the motorvehicle industry will not be approved by the Commission unless, first, the test of necessity and/or mobility is satisfied.<sup>216</sup> In order to demonstrate the necessity for regional aid, the aid recipient must clearly prove that it has an economically viable alternative location for its project or subpart(s) of a project.<sup>217</sup> Otherwise, if there were no other industrial site, whether new or in existence, capable of receiving the investment in question within the group, the undertaking would be compelled to carry out its project in the sole plant available, even in the absence of aid. Thus the existence of a viable alternative location confirms the "mobility" of the project.

However, mobility alone is not always sufficient to establish the necessity for aid. For example, the site chosen may have net competitive advantages in comparison with the alternative proposed by the investor.<sup>218</sup>

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<sup>214</sup>BAYLIS, pp. 1-13 at p. 8.

<sup>215</sup>BAYLIS, pp. 1-13.

<sup>216</sup>ERLBACHER, pp. 517-522.

<sup>217</sup>Paragraph 3.2(a), 1997 Framework.

<sup>218</sup>Paragraph 3.2(a), n. 20, 1997 Framework.

The Commission determines whether or not costs relating to the mobile aspects of a project are eligible. Eligibility is defined by the regional scheme applicable in the assisted region concerned.<sup>219</sup>

Mobility of the project may be demonstrated by investors on the basis of studies they have carried out in order to identify the final location, which may not be necessarily within the Community. The Commission verifies the likelihood of the alternatives. No regional aid may be authorised for a project or parts of a project that are not geographically mobile.

Where the alternative location is not in the EEA or in one of the countries of central and eastern Europe (CEEC), an investor must prove, notably by means of a location study, that at least one commercially viable alternative to the location chosen has been considered in the EEA or CEEC.<sup>220</sup> Otherwise, the location chosen will be considered to be the best one (rather than the essential one).

If a complete location study was not made, the beneficiary will have to provide sufficient circumstantial evidence to demonstrate that it has actively pursued an alternative location which would, in the short term, have been more cost efficient but was not pursued for specific reasons. This provision is aimed, for example, at producers of component systems to be located in the vicinity of a vehicle plant who would normally not have made such a study and for whom the alternative site is thus the same as for the vehicle producer. A car assembler who has been in competition with other sites will also not have access to the location study performed by the car company.<sup>221</sup> The Commission's experts will then have to verify the alternative circumstantial evidence, referred to above.<sup>222</sup>

A project put forward by first-tier module or sub-system suppliers that is directly linked to a mobile investment by a motor vehicle manufacturer will, by definition, be considered mobile itself.<sup>223</sup> A supplier's project may be mo-

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<sup>219</sup> Paragraph 3.2(b), 1997 Framework.

<sup>220</sup> Paragraph 3.2(a), 1997 Framework.

<sup>221</sup> Paragraph 3.2, n. 35, Annex I, 1997 Framework.

<sup>222</sup> Paragraph 3.2, Annex I, 1997 Framework.

<sup>223</sup> Paragraph 3.2(a), n. 19, 1997 Framework.



bile even if the manufacturer's project is not; the supplier would have to be able to satisfy the Commission on this point.<sup>224</sup>

Regional aid intended for "modernisation and rationalisation" is not authorised under the 1997 Framework for the motor vehicle industry and is generally considered not to be mobile.

Sometimes, entire production lines for the manufacture of motor vehicle become obsolete and are dismantled. Such occurrences, though rare, may involve an element of mobility inasmuch as a firm is often faced with the choice of adapting the existing plant or closing it and setting up a new plant<sup>225</sup> elsewhere, either in the form of an extension or on a greenfield site.<sup>226</sup> A radical change in production structure of this nature on the existing site is called a "transformation" and may be eligible for regional aid under the 1997 Framework. It is distinguishable from "restructuring" in that it is applicable to firms in financial difficulties.

"Transformation" is formally defined as "the complete dismantling of bodywork lines (motorvehicles) or power plant lines (engines) and, simultaneously, of the final assembly lines of the plant in question and the setting-up of new bodywork lines, power plant lines and final assembly lines in an overall production structure that is clearly different from the previous one".

### *3.3. Test of Proportionality/Cost-benefit Analysis of Regional Aid*

In addition to the test of necessity/mobility described above, when considering the mobile aspects of a project, the Commission satisfies itself that the planned aid is proportionate to the regional problems it is intended to help resolve.<sup>227</sup> In order to do this it applies the "cost-benefit" analysis method. This method compares, with regard to the "mobile" elements of the project, the costs which an investor would bear in order to carry out this project in the region in question with those it would bear for an identical project in a different location (which must be in the EEA or CEEC if the purpose of the investment is the manufacture of vehicles and parts of vehicles

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<sup>224</sup>Paragraph 3.2(a), n. 19, 1997 Framework.

<sup>225</sup>New plants means plant on a new site which has not yet been developed.

<sup>226</sup>Paragraph 3.2(a), 1997 Framework.

intended largely for the European markets),<sup>228</sup> which makes it possible to determine the specific handicaps of the assisted region concerned. The Commission then authorises regional aid within the limit of the regional handicaps resulting from the investment in the comparator plant.

The basis of the "cost-benefit" analysis (which has been in use since 1990 and has wide acceptance amongst private companies and government bodies) is based on the study, "The effect of different State aid measures on intra-Community competition" by the Motor Industry Research Unit.<sup>229</sup> It is a determination of the extent to which regional aid relates to the structural handicaps faced by an investor in the assisted area. It is also a procedure for evaluating the desirability of a project by weighing its benefits against its cost. The Commission places itself in the position of a private investor when calculating costs or benefits associated with a particular location. By comparing the investment and operating costs of the chosen location in the assisted area with the best alternative location, the Commission can identify those costs and benefits.

In the Commission's cost-benefit analysis, the comparator site or benchmark is, in principle, situated within the EEA or CEEC if the purpose of the investment is the production of vehicles or car components destined, to a large extent, for the European markets. In those rare cases where a company is only comparing one European site with a site outside Europe from which it would import vehicle, the cost-benefit analysis may have to be performed with a hypothetical alternative site. In cases where the company can demonstrate that more than half of the production is to be sold outside Europe, the comparator plant for the cost-benefit analysis can be situated outside Europe.<sup>230</sup>

If the cost-benefit analysis takes as comparator a location in another assisted area (i.e. an area compatible with the Common Market as regional

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<sup>227</sup> Paragraph 3.2(c), 1997 Framework.

<sup>228</sup> The study of the mobility of the investment and the cost-benefit analysis may be carried out using different alternative locations: paragraph 3.2(c), n. 23, 1997 Framework.

<sup>229</sup> Published by the Office for Official Publications of the European Communities under the number ISBN 92-826-0381-4.

<sup>230</sup> Paragraph 3.2, Annex I, 1997 Framework.

aid, under Article 88(3) of the EC Treaty or its equivalent Article 61(3) of the EEA Agreement), any difference in the regional aid rate is deemed to be neither an advantage nor a handicap for the cost-benefit analysis but is regarded as neutral by definition.<sup>231</sup>

In the interests of transparency, the standard notification form attached at Annex II of the 1997 Framework includes in Part IIA (particularly Form 1-3) very specific details to be completed relating to a cost-benefit analysis. It is unlikely that such details, e.g. of total operating costs (including labour, rent, transport, machinery/equipment, etc.), could be supplied without the active co-operation of the beneficiary involved. However, the notification requirement remains formally the obligation of the Member State and the extent to which the beneficiary will have the opportunity to verify the correctness or otherwise of the information eventually supplied to the Commission will depend to a large extent on internal procedures in the Member State. This may have implications for the position of the beneficiary in relation to an action to recover illegal aid.

The cost-benefit analysis takes particular account of "investment cost differences" and "operating cost differences",<sup>232</sup> discussed further below.

### 3.3.1. Investment Cost Differences

Differences in additional investment cost arising for the beneficiary between the desired location and the comparator one must be identified in detail. The analysis by the Commission considers at least five categories of cost: land, building and infrastructure, machinery and equipment, tools and dies and vendor tooling. Other categories may be identified when they correspond to assets that will depreciate over their lifetime. These cost differences must be explained by the beneficiary to the Commission and all available supporting documentation (including technical lay-outs of the plant before and after investment) must be submitted.<sup>233</sup>

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<sup>231</sup> Paragraph 3.2(c), sub-paragraph 5, 1997 Framework.

<sup>232</sup> See further paragraph 3.3, Annex I, 1997 Framework.

<sup>233</sup> The requirements of confidentiality are discussed further below, see IV.3.7.

Usually, the differences in investment cost between the two comparator plants requires an on-site visit by the Commission and/or its appointed experts. They are particularly concerned to establish bottlenecks in the aided plant in instances when a production capacity increase may be at stake.<sup>234</sup>

### 3.3.2. Operating Cost Differences

Differences in "operating costs" corresponding to the first full three or five years of production will also have to be examined in detail. The documents submitted with the notification form should therefore distinguish between normal or permanent cost differences and start-up cost differences for each category. Data is to be given in the currency of the Member State (with exchange rate assumptions provided) and in current prices for historic years or constant prices for future years.

The specific factors normally examined are labour costs (differences in the wage bill for production at optimal productivity which can be broken down as differences in wage rates, working hours and manpower); components/materials (differences in the cost of components and supplies, taking into account local suppliers policies, central purchasers policies, etc); inventories (differences in the financing cost of stocks for incoming material and finished products that appear as a consequence of the location choice, e.g. differences in number of days in stock on the plant and on the road); transport (differences in cost arising for the beneficiary because of the peripheral location of the regional plant, both as regards incoming materials and finished products, resulting from differences in distances and unit transport costs); and other operating handicaps (differences in cost arising for the beneficiary because of the peripheral location of the regional plant, both as regards incoming materials and finished products, resulting from differences in distances and unit transport costs); and other operating handicaps (differences in cost of, for example, various utilities and guarantees).

Studies on the choice of plant location must be submitted to the Commission whenever available in order to facilitate processing of the case and

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<sup>234</sup> Paragraph 3.3, Annex I, 1997 Framework.

speed up the final decision. This implies a degree of co-operation between the beneficiary and the Member State authorities.

### 3.3.3. Operational Handicaps/Effect on Cost-benefit Analysis

Operational handicaps are assessed over three years in the case of expansion projects and five years in the case of new plants on greenfields sites. The Commission believes that these periods are generally consistent with the time needed to overcome start-up difficulties and reach target operational levels in each case.<sup>235</sup>

"New plant" means new plant on a new site which has not yet been developed. In such cases, compared with "plant expansion", the Framework identifies a lack of certain requirements with which undertakings are faced, namely lack of adequate infrastructure, organised logistics, a workforce specifically trained for the needs of the undertaking and a sub-contracting structure. If, however, such services can be provided by a unit of the same group located in close proximity, the project is regarded, in accordance with Commission Decision 96/666/EC as an "expansion", even if it is actually built on a greenfield site.<sup>236</sup>

### 3.3.4. Position of First-tier Component Suppliers

In the case of an overall project, the "first-tier component suppliers" concerned may each benefit from the same regional handicap percentage as the vehicle manufacturer, as calculated by the cost-benefit analysis, no cost-benefit analysis being applied to them.<sup>237</sup> However, if a first-tier component supplier taking part in an overall project considers it has the specific regional handicaps that would give it a higher aid intensity, it may request a separate cost-benefit analysis, the results of which will be applied irrespective of the outcome.

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<sup>235</sup> Paragraph 3.2(c), 1997 Framework.

<sup>236</sup> O.J. 1996 No. L308/46.

<sup>237</sup> Paragraph 3.2(c), 1997 Framework.

### 3.3.5. Relationship between Cost-benefit Analysis and "Horizontal" Aid

It is important to note that if the project is to be aided under (horizontal) objectives, e.g. environmental, R&D training, etc., all of which are discussed separately below, the Commission ensures that "eligible" expenditure and the "cost-benefit" analysis does not involve any of these items, since they will be separately assessed and aided.<sup>238</sup> However, the position is somewhat different for "innovation" discussed further below, when linked to investment. Such expenditure can be aided from a regional and an innovation point of view.<sup>239</sup>

### 3.3.6. Exemption from Need for Cost-benefit Analysis

The Commission intends to approve regional maps in accordance with new regional guidelines.<sup>240</sup> Until then, if the intensity of the planned regional aid is 10 percent or less of the regional ceiling, a cost-benefit analysis will not be required by the Commission. This is stated to be because a mobile project located in an assisted region (i.e. benefiting from domestic regional aid) is deemed always to suffer from minimum disadvantages. In other words, since part of the test when considering the mobile aspects of a project is that the planned aid is proportionate to the regional problems it is intended to help resolve, in comparing with regard to the "mobile" elements of the project the costs which an investor would bear in carrying out the project in the region in question with those it would bear for an identical project in a different location, the Commission accepts a minimum level of disadvantage and hence of cost for locating the project in the assisted region.

Thus the Commission has decided not to oppose proposed U.K. Government aid to the Ford Motor Company at Bridgend, South Wales<sup>241</sup> in which

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<sup>238</sup>See Paragraph 3.1, Annex I, 1997 Framework.

<sup>239</sup>Paragraph 3.1, Annex I, 1997 Framework.

<sup>240</sup>Paragraph 3.2(c), 1997 Framework.

<sup>241</sup>Approval of a State aid pursuant to Art. 87 and 88 of the EC Treaty, Cases where the Commission does not raise objections, State aid N781/96 – The United Kingdom, Summary of the Commission's decision not to oppose the proposal of the UK Government to provide regional aid to Ford Motor Company in support of an investment project for the expansion of engine capacity in Bridgend, O.J. 1997 No. C139/4.

the proposed gross aid intensity is 2.94 percent (gge)<sup>242</sup> whereas the regional aid ceiling in Bridgend is 20 percent (nge).<sup>243</sup> Since the net intensity of the proposed aid amounted to only 1.97 percent of the eligible costs of the investment, which is less than one-tenth of the allowable regional ceiling, the Commission decided that not detailed analysis was to be made to identify separately additional cost and benefits arising for Ford from their decision to locate the new Zetec-SE engine production in Bridgend rather than elsewhere.

The Commission noted that the proposed investment (in a regionally assisted area within Article 87(3)(c) of the EC Treaty) helped to create 580 jobs at the Bridgend production site. The Zetec-SE engine project was also crucial to the long-term maintenance of engine production at the Bridgend plant and therefore contributed to safeguarding employment in a region of high unemployment, thus helping to overcome structural handicaps. However, as required by the (previous) Framework, the Commission stressed that in evaluating proposals to grant regional aid in the automotive sector, it has to assess the benefits for regional development against possible effects on the sector as a whole, such as the creation of important overcapacity. Moreover, in view of the sensitive nature of the motor vehicle sector and the high risk of unwarranted distortions of competition, it was necessary to ensure that the regional aid is in proportion to the regional problem it seeks to remedy (the above considerations are still relevant under the 1997 Framework). However, in view of the low proposed aid intensity compared with the allowable regional ceiling, an undue advantage to the company was unlikely to be created and the Commission regarded the aid as compatible with Art. 87(3)(c) of the EC Treaty and Art. 61(3)(c) of the EEA Agreement as it complied with the relevant Community Framework for State aid to the motor vehicle industry.

Despite its minor importance in terms of aid intensity, this decision served as a point of departure for the Commission to establish a new general prin-

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<sup>242</sup>That is to say nominal (before tax) value of grants and the discounted (before tax) value of interest subsidies, as a proportion of the investment cost.

<sup>243</sup>The measure which is used in calculating the intensity of aid is the "net grant equivalent" (nge) in which the tax element, which varies from one Member State to another, is deducted from the gross amount so as to obtain the net benefit to the recipient.

ciple by which DG IV can determine the need to assess separately the net incremental costs and benefits arising from the decision to locate an investment project of a company in an area eligible for regional aid as opposed to more developed region.<sup>244</sup> Although exhaustive, the cost-benefit calculation is a relatively time-consuming and complex assessment method which is deemed necessary in larger cases with relatively high aid intensities. The new Commission practice will facilitate case evaluation and speed up its handling as well as allowing DG IV to concentrate on the most important cases.<sup>245</sup>

After the regional guidelines are effective, and insofar as they introduce lower ceilings, the minimum intensity triggering the necessity for a cost-benefit analysis to be undertaken will be 20 percent of the new regional ceiling.<sup>246</sup>

#### *3.4. Test of Effect of Regional Aid on Industry and Competition*

In addition to satisfying the tests of necessity/mobility and proportionality/cost-benefit analysis, discussed above, the Commission proposes to study the effect on competition of every investment project, looking in particular at variations in production capacity (because of the structural overcapacity in the industry)<sup>247</sup> on the relevant market in the group concerned.

The Commission has established an aid ceiling for each of the regional areas covered under Article 87(3)(a) or (c) of the EC Treaty. However, even when the ceiling for regional aid in the area where the project is to be developed is higher than the aid intensity proposed in favour of an automotive company, if the level of regional aid proposed exceeds the actual cost disadvantages for that company in that assisted area, it will provide it with a competitive advantage over its unaided competitors. The risk of such distortion of competition is particularly high in the automotive sector because the level of globalisation and the structural overcapacity affecting most manu-

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<sup>244</sup>MEDERER, pp. 46-51 at p. 50.

<sup>245</sup>*ibid.*

<sup>246</sup>Paragraph 3.2(c), 1997 Framework.

<sup>247</sup>Paragraph 3.2(d), n. 25, 1997 Framework.



facturers leads to fierce price competition<sup>248</sup> (on the other hand, there are also considerable price differentials in car prices in different EC States as is well known, which is also the subject of Commission investigation).

There is also a tendency for disproportionate aid allocation to such projects because Member States and regions compete with each other to win large-scale investment projects by multi-national automotive companies. Such competitive bidding may involve not only regional aid but also other horizontal aid, ad hoc aid and general measures. Consequently, the Commission aims to limit regional aid to the automotive industry to what is strictly necessary to influence the locational choice of economically viable projects in the industry and thereby to avoid unjustifiable distortion of competition.

#### 3.4.1. Relevant Product Market/Substitutability

The relevant product market covers the products (and possibly the services) referred to in the investment project and their possible substitutes from the consumer's standpoint (on the basis of product characteristics, prices and intended use) and that of the producer (plant flexibility).<sup>249</sup> If substitutability is strong between different market segments or niches, the Commission will add those segments or niches to arrive at the relevant market. As such, the Commission does not, for example, make a distinction between most segments of the passenger-car market unless the vehicle is sufficiently distinct in its use and production mode (e.g. off-road vehicles).<sup>250</sup>

As most vehicle producers manufacture their own engines, the Commission has considered that the relevant market for engine production by a vehicle manufacturer is the vehicle market for which the engines are built. However, as regards component systems or modules (which are now covered by the 1997 Framework), the Commission is of the view that there is a separate market for each.<sup>251</sup> In the event of notification of a project involving vehicle or engine manufacture as well as the manufacture of the manu-

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<sup>248</sup> Paragraph 1.1, Annex 1, 1997 Framework.

<sup>249</sup> Paragraph 3.2(d), n. 26, 1997 Framework.

<sup>250</sup> Paragraph 2.3, Annex I, 1997 Framework.

ufacture of the corresponding component modules, the Commission will define the relevant market as the combination of the vehicle market and the markets for the different modules.<sup>252</sup> The relevant geographic market in principle covers the EEA and the CEEC.

#### 3.4.2. Market-impact Analysis: Regional "Top-up"

Aid proposals in support of projects that potentially aggravate the overcapacity problem of the industry can be moderated by reducing the regional handicap ratio.<sup>253</sup> Conversely, a project contributing to an overall improvement to the overcapacity situation can benefit from increases of up to two points (in assisted areas) to the regional handicap, estimated under the cost-benefit analysis. This kind of adjustment (referred to as "top-up") may be authorised as an additional incentive for the investor to move into an area covered by Article 87(3)(a) or (c),<sup>254</sup> provided that the aided investment will not lead to sector problems, as in the case of the Commission Decision not to oppose the aid which the U.K. Government intended to grant to Jaguar Cars Ltd. in support of an investment project.<sup>255</sup> Part of the aid was a £9.4 million regional assistance grant. The purpose of the aid package was to help fund the launch of a new X100 sports car, the replacement for the XJS. It was estimated that by launching the new car, 883 jobs would be safeguarded by 1998. The investment aid took the form of a grant of 12.6 EUR million to be paid in four instalments from 1994 to 1997. The aid intensity amounted to 11.9 percent gross, which was below the then applicable approved maximum regional aid intensity of 20-30 percent net.<sup>256</sup>

In approving the grant, the Commission considered that the investment project would make an important contribution to the development of the re-

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<sup>251</sup> Paragraph 2.3, Annex I, 1997 Framework.

<sup>252</sup> Paragraph 2.3, Annex I, 1997 Framework.

<sup>253</sup> The cost-benefit analysis provides for a calculation of the net incremental cost associated with the selection of the plant in an assisted area versus the best alternative location. The proportion between the present value of this net incremental cost and the present value of the eligible investment is called the "regional handicap ratio".

<sup>254</sup> EVANS, p. 318, citing Commission Decision O.J. 1994 No. C298/9.

<sup>255</sup> O.J. 1994 No. C298/9.

<sup>256</sup> See IV.3.1.

gions concerned; the company had actively examined various alternative locations for the project thereby underlining the necessity for regional aid to safeguard the short- and long-term prospects of the existing Jaguar locations. However, the net regional disadvantages Jaguar/Ford faced were found to be slightly below the level of proposed regional aid. Nevertheless, the Commission found that since it would not lead to any increases in capacity at group level and that the regional aid was not disproportionate in view of the structural handicaps of the relevant regions (Birmingham, Coventry and Liverpool),<sup>257</sup> an overcompensation (1.6 percent) of these disadvantages could be approved even though it was slightly in excess of the usual permitted regional aid level, in line the Commission's standard practice, and as an incentive for the investor to invest in these assisted areas.

Similarly, the Commission had approved, in October 1994, State aid to FASA-Renault for its investment at Valladolid (Spain) in support of a plan to locate an entirely new petrol engine plant there. The Commission undertook a comparative cost-benefit analysis (under the previous Framework) to establish the net regional disadvantages that FASA-Renault faced by investing in the assisted region of Valladolid. These disadvantages were found to be slightly below the proposed level of regional aid. However, taking into account all other changes in car and engine capacity by the same manufacturer at group level, the Commission concluded that the project would not contribute to the creation of overcapacity in the relevant sector at European level and would not, therefore, have any negative effects on the sector as a whole within the EEA. Therefore, in line with its standard practice, it accepted a slight overcompensation of these disadvantages as an incentive for the investor to move into the assisted area.

The "top-up" is regarded as of general application throughout the sector and a case-by-case analysis of the effect of the aid to regional development under Art. 87(3)(a) or (c) is therefore not required.<sup>258</sup> It is expressed in terms of percentage points which are to be added to or subtracted from the

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<sup>257</sup> BAYLIS, p. 8.

<sup>258</sup> EVANS, p. 318, citing Notice C44/95 (E16/95), O.J. 1995 No. C304/14, regarding the refusal of the Spanish authorities of the Commission's proposal for reintroduction of the EC framework on State aid to the motor vehicle sector.

intensity allowable, according to the cost-benefit analysis as set out in the 1997 Framework and reproduced in the table below.

	<b>Top-up</b>	
Impact on competitors	Art. 87(3)(a) regions	Art. 87(3)(c) regions
Negligible	+4	+2
Moderate	+2	+1
High	-1	-2

Under the 1997 Framework,<sup>259</sup> the impact on industry is "high" where the ratio between the capacity of the group after the investment (C(f)) and the capacity of the group before the investment (C(i)) is 1.01 or over; the impact is "moderate" where  $0.99 < C(f)/C(i) < 1.01$  or where a new segment is created on the relevant market; the impact is "negligible" where  $C(f)/C(i)$  is 0.99 or under.

The distinction between Art. 87(3)(a) and Art. 92(3)(c) regions is used to take better account of the difficulties encountered in each region and to increase the incentive effect of regional aid on investors.

### 3.5. Intensity of Regional Aid

The authorised aid, expressed as a gross grant equivalent (gge),<sup>260</sup> may not exceed the total of the amounts calculated under the tests discussed earlier of necessity/mobility, eligible costs, proportionality which may involve identification of regional handicaps, and effect of competition; the possibility of top-up has also to be considered.

The aid may also not exceed the regional ceiling applicable to the type of undertaking concerned.<sup>261</sup> The effect of allowing a "top-up" may be that comparatively high levels of aid are authorised, such as in the case of Portuguese aid to an electronic automotive components manufacturer where aid amounting to 16.8 million EUR or 39 percent, of investment costs was

<sup>259</sup> Paragraph 3.2(d), 1997 Framework.

<sup>260</sup> That is to say nominal (before tax) value of grants and the discounted (before tax) value of interest subsidies, as a proportion of the investment cost.

<sup>261</sup> Paragraph 3.2(e), 1997 Framework.

allowed because it was likely to impact considerably on the economic development of the region concerned without adversely affecting the sector at Community level.<sup>262</sup> Similarly, aid intensity of 28.9 percent was allowed for Opel in eastern Germany which would lead to the creation of 2'000 direct and 2'500 indirect jobs created.<sup>263</sup>

### 3.6. *End Result: "Regional Handicap" versus "Aid Intensity"*

The cost-benefit analysis provides for a calculation of the net incremental cost<sup>264</sup> associated with the selection of the plant in an assisted area versus the best alternative location. The proportion between the present value of this net incremental cost and the present value of the eligible investment is called the "regional handicap ratio". The regional handicap ratio is compared with the "aid intensity" expressed in gross grant equivalent<sup>265</sup> resulting from the Member State's proposal. Comparing both ratios, the following initial propositions can be put forward:

- if the aid intensity is well below the regional handicap ratio, it is assumed that the beneficiary will not receive an unjustified amount of aid; the aid will serve to compensate to a certain extent the financial disadvantages of the geographical choice;
- if the aid intensity is substantially higher than the regional handicap ratio, it may be assumed, at this point in the analysis, that the beneficiary may receive an unjustified amount of aid; the aid may serve to over-compensate the financial disadvantages of the geographical area;
- if the aid intensity is close to the regional handicap ratio, the market-impact analysis, i.e. the effect of regional aid on industry and competition, discussed further above, will define whether the proposal is acceptable.

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<sup>262</sup>EVANS, p. 318, citing Notice C44/95 (E16/95), O.J. 1995 No. C304/14, regarding the refusal of the Spanish authorities of the Commission's proposal for reintroduction of the EC framework on State aid to the motor vehicle sector.

<sup>263</sup>See 22<sup>nd</sup> Report on Competition Policy, p. 234.

<sup>264</sup>Based on an assessment of the investment and operating costs of the chosen site.

Thus, for example, (under the previous 1989 Framework) the European Commission approved regional and environmental aid from the Flemish region of Belgium to Ford Werke AG in Genk as part of an investment project consisting of a large extension of this plant's production capacity, especially through the launching of a Ford Mondeo series. After examining the dossier, the Commission came to the conclusion that the investment project conformed to Community criteria on regional State aid in the car manufacturing sector. In particular, the aid was found not to have any negative effect on the automobile sector in general as aid intensity was lower than the regional handicap that Ford had accepted owing to the fact it was investing in the Genk factory which is located in a region recognised by the Commission as eligible for regional aid ("assisted area").<sup>266</sup> The aid took the form of a loan for 24.1 million EUR, tax concessions on the property amounting to 4.5 million EUR and environmental aid in the form of a loan of 1.1 million EUR to allow reduction of polluting emissions and exhaust gases from the factory until they were below the quantities authorised by the relevant regional legislation.

### *3.7. Confidentiality*

Most of the information and technical data submitted by the beneficiary (via the Member State) in the context of the cost-benefit analysis of regional aid is communicated to the Commission under a strict requirement of confidentiality.<sup>267</sup> The cost-benefit analysis makes use, for example, of detailed information on the operating and investment cost of the project and other confidential information on the company's plans for sales, production and capacity.

The requirement of confidentiality is also made binding, via contractual provisions to that effect, on any consultancy company employed by the Commission to provide an independent technical expert report to verify data submitted by a potential beneficiary. Such a consultancy company faces

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<sup>265</sup>That is to say nominal (before tax) value of grants and the discounted (before tax) value of interest subsidies, as a proportion of the investment cost.

<sup>266</sup>"Commission approved Belgian Regional and Environmental aid to Ford", Agence Europe, July 28, 1995.

<sup>267</sup>Paragraph 2.4, Annex I, 1997 Framework. For a discussion of confidentiality in the general context of a fair hearing, see WEATHERILL/BEAUMONT, p. 265.

the prospect of heavy fines for breach of such confidentiality.<sup>268</sup> There would arguably also be the prospect of further sanctions such as the possibility of an action for damages in contract and/or tort and the real risk of no re-employment by the Commission.

## **4. Assessment of Other Types of Aid under the 1997 Framework**

In addition to the two tests of necessity and proportionality<sup>269</sup>, specific rules of assessment are set out in the 1997 Framework. These rules have already been examined above in relation to regional aid.<sup>270</sup> The specific rules for a further seven types of aid, namely R&D aid, rescue and restructuring aid, investment aid for innovation, aid for environmental protection and energy saving, aid to vocational training, aid for modernisation and rationalisation, and operating aid, are discussed in detail below.

### *4.1. Research and Development (R&D) Aid*

Under the 1997 Framework, aid for R&D will be assessed under the Community framework for State aid for research and development.<sup>271</sup> However, the motor vehicle framework reiterates the requirement for the Commission to carry out a thorough analysis of the breakdown of costs between the different categories of R&D; investors must clearly distinguish industry research and genuine precompetitive development from the introduction of new technology in the form of productive investment or competitive development.<sup>272</sup>

R&D aid may therefore be distinguished from, for example, investment aid for innovation (discussed further below)<sup>273</sup>. R&D aid may not be granted, for example, for the development of new engines which comply with existing legal standards, because this is a normal industrial competitive require-

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<sup>268</sup> Paragraph 2.4, Annex I, 1997 Framework.

<sup>269</sup> See IV.2.3.

<sup>270</sup> See IV.3.

<sup>271</sup> O.J. 1996 No. C45/5.

<sup>272</sup> Paragraph 3.3, 1997 Framework.

<sup>273</sup> See IV.4.3.

ment.<sup>274</sup> Thus, for example, in an earlier Commission Decision of September 1995, the development and pre-industrialisation stages of the R&D cycle, by which a new, but non-innovative truck series was prepared by the truck producer DAF and aided by the Dutch State, was considered by the Commission to be a standard development, albeit of a new model which was less polluting and more fuel efficient than its predecessors, for a truck company in order to remain competitive in the European market.<sup>275</sup> By contrast, the Commission considered that aid paid to DAF at the end of 1992 was in conformity with relevant guidelines for the assessment of R&D aid because it was linked to the VOLEM project (accelerated development of low emission engines) which contained a sufficient element of pre-competitive research to justify the level of aid actually paid.<sup>276</sup>

Account is taken of the commercial risk associated with the technical uncertainty of the research.<sup>277</sup> Earlier case law includes instances of aid granted for R&D purposes in the motor vehicle sector. For instance, the Commission approved aid granted by the Austrian Government and the Vienna local administration to Opel in July 1995 for, inter alia, R&D to develop a new small-size engine family with three- and four-cylinder versions, claiming reduced fuel consumption and emissions. Part of the aid was for process-related R&D and innovative investment.<sup>278</sup> In particular, the innovative character of the relevant engine lay in the need to combine a great number of different and often non-related technologies to compensate for the inherent handicaps of a three cylinder layout. Its introduction was also found to carry a considerable risk with regard to its smoothness and balance and thus market acceptance. Various elements of the production process also had to be considered innovative on a European level and involved considerable risks for the company as to their efficiency and practicability.<sup>279</sup>

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<sup>274</sup>EVANS, p. 315 citing Decision N657/94, O.J. 1996 No. C74/8, not to oppose the R&D aid which the Dutch Government intended to provide to DAF Trucks NV for the Volem project.

<sup>275</sup>25<sup>th</sup> Report on Competition Policy, p. 211.

<sup>276</sup>25<sup>th</sup> Report on Competition Policy, p. 212.

<sup>277</sup>MORCH, pp. 61-66 at p. 64.

<sup>278</sup>BAYLIS, pp. 1-13 at p. 8.

<sup>279</sup>Commission approved aid to Opel Austria support of R&D, Environmental and Training Expenditure (95/07/26), Reuter EU Briefing, August 2, 1995. Ref: IP/95/833.



## 4.2. Rescue and Restructuring Aid

### 4.2.1. Commission Practice Prior to the 1997 Framework

Early Commission practice in the motor vehicle sector allowed aid to recipients where such restructuring aid enabled them to become competitive or to alleviate the social costs of restructuring. For example, restructuring aid for British Leyland was authorised because of the essential role it played as an employer in the British economy and its contribution to trade balance.<sup>280</sup> Similarly, aid was also authorised to create new activities for the re-employment of workers made redundant by the restructuring of Volkswagen in Germany<sup>281</sup> and French aid to assist the merger of Citroën with Peugeot to facilitate the creation of a more profitable group.<sup>282</sup> In 1975, rescue aid was authorised to Chrysler because of employment problems which would have been caused by plant closures in Scotland.<sup>283</sup> The Commission also authorised (subject to various conditions) £469 million of the £800 million aid package to the Rover Group by the U.K. Government,<sup>284</sup> which had been notified to it, in the form of a capital contribution aimed at a debt-write off to be awarded in the context of its acquisition by British Aerospace. The Commission noted that the proposed measure of debt write-off was presented as the last discretionary aid which the U.K. Government was to award the Rover Group and was clearly linked to the restructuring plan of the Group. It also noted that part of the Rover Group's state of debt was due to unaided restructuring efforts in earlier years, which included capacity reductions.<sup>285</sup> However, the Commission was concerned to ensure that the

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<sup>280</sup>EVANS, p. 313, citing 5<sup>th</sup> Report on Competition Policy, pp. 84-85.

<sup>281</sup>Ibid.

<sup>282</sup>Ibid., pp. 83-84.

<sup>283</sup>Ibid., p. 85. See also, regarding Dutch aid to Volvo, Bull. EC 5-1978, 2135.

<sup>284</sup>Commission Decision 89/58/EEC, concerning aid provided by the U.K. Government to the Rover Group, an undertaking producing motor vehicles, O.J. 1989 No. L25/92. The U.K. Government lodged an appeal against its decision. The ECJ found for the Government on purely procedural grounds: *Case C-294/90 British Aerospace and Rover v Commission* [1992] ECR I-5823. The Commission opened fresh Article 88(2) procedures which concluded that the U.K. Government be ordered to repay all of the £44.4 million additional aid granted in breach of the Commission's earlier decision.

<sup>285</sup>Commission Decision 89/58/EEC, concerning aid provided by the U.K. Government to the Rover Group, an undertaking producing motor vehicles, O.J. 1989 No. L25/92, p. 98.

intensity of aid should be proportionate to the problem it was designed to resolve and allowed only a debt-write off £469 million which corresponded to 30 percent of the total restructuring cost which it felt was more in line with the reduction of capacity pursued by Rover Group.<sup>286</sup> It concluded that the aid in the form of a debt write-off should lead to the restoration of the company's viability and, through the proposed restructuring, contribute to the avoidance of structural problems which the Community motor vehicle industry may face in the near future. For these reasons the Commission considered that the aid permitted by it would facilitate the development of the sector concerned at Community level without adversely affecting trading conditions to an extent contrary to the common interest.<sup>287</sup>

By contrast, one decision in which the Commission concluded that the aid involved was not to be authorised because it was not linked to a restructuring plan and could not be demonstrated as being in the Community interest, related to Italian government aid of 206.2 billion and 408.9 billion lire to Alfa Romeo<sup>288</sup> (the Italian Government did not attempt to justify the aid on other grounds, e.g. regional aid). The decision was confirmed by the ECJ which concluded, inter alia, that the Commission had taken into account the existence and effect of restructuring programmes but no such plan existed for Alfa Romeo and the Commission was justified in concluding that the aid was not related to a restructuring programme for the take-over of a private company.<sup>289</sup>

The Commission also scaled down certain aid proposed by the Spanish Government for a restructuring plan of Enasa<sup>290</sup> because it was considered to be excessive. In July 1994, following a lengthy investigation, the Commission also decided against certain aspects of restructuring aid for Volkswagen in eastern Germany. The Commission prohibited part of the aid relating to Volkswagen's takeover of a former East German car company being sold by the Treuhandanstalt. The German Government had proposed

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<sup>286</sup> *Ibid.*, p. 99.

<sup>287</sup> *Ibid.*

<sup>288</sup> Commission Decision 89/661/EEC, concerning aid provided by the Italian Government to Alfa Romeo, an undertaking in the motor vehicle sector, O.J. 1989 No. L394/9.

<sup>289</sup> Case C-305/89 *Italy v Commission* [1991] ECR I-1603.

compensation of 34 million EUR for the losses of the company but the Commission found that this was disproportionate to the restructuring expenses and had no regional justification. The aid was found to have the character of operating aid which, under the (then applicable) Framework, could never be allowed and the Commission requested repayment of the incompatible aid which had been granted unlawfully, i.e. without prior notification.<sup>291</sup>

In January 1995, the Commission opened proceedings under Art. 88(2) of the EC Treaty in connection with a restructuring plan for Suzuki Motor SA (Santana) aided by national and regional governments of Spain. The Commission considered that the restructuring plan was vague and unconvincing and did not aim to restore the long-term viability of the company.<sup>292</sup>

The Commission also took a negative decision in respect of the amount of aid equal to the difference between the real value of the truck firm FBG on the market and the price fixed for the sale of the latter to Mercedes-Benz by the Treuhandanstalt. The Commission required part of the aid to be recovered and interest paid from the date of the sale, i.e. January 1, 1994.<sup>293</sup>

In September 1995, the Commission took a partly negative decision in respect of two Art. 88(2) procedures opened in 1993 to examine the compatibility of State aid elements contained in the public intervention of the Dutch State and the Region of Flanders in favour of the truck producer DAF before and after its bankruptcy. The Commission required the Dutch State to recover from DAF a total of 17.9 million EUR of aid which did not comply with the 1989 Framework, in particular because the aid (17.7 million EUR), which qualified as a rescue and restructuring aid, was granted without being linked to a restructuring plan ensuring the long-term viability of the company.

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<sup>290</sup> HANCHER/SLOT/OTTERVANGER, p. 94, citing 19<sup>th</sup> Report on Competition Policy, point 184.

<sup>291</sup> BAYLIS, p. 8. See further, Commission Decision of July 27, 1994 concerning aid granted to the Volkswagen Group for investments in the new German Bundesländer (94/1068/EC), O.J. 1994 No. L385/1.

<sup>292</sup> 25<sup>th</sup> Report on Competition Policy, p. 212.

<sup>293</sup> 26<sup>th</sup> Report on Competition Policy, paragraph 189.

#### 4.2.2. Rescue and Restructuring Aid under the 1997 Framework

The situation under the 1997 Framework is that rescue and restructuring aid which is above the relevant thresholds is now to be assessed under the (horizontal) Community guidelines on State aid for rescuing and restructuring firms in difficulty,<sup>294</sup> without prejudice to the second sub-paragraph of paragraph 3.1 of the 1997 Framework. This states that as structural over-capacity in the motor vehicle industry is set to continue until the end of the decade, the Commission will prohibit State aid which is aimed at a net increase in production capacity.

In addition, the Commission will usually require a reduction in installed capacity. The Commission also considers it necessary for the reduction in production capacity to be proportional to the intensity of the aid, i.e. the amount of the aid divided by the cost of restructuring. Restructuring aid, like rescue aid, is in principle intended to be a one-off operation.

#### 4.3. *Investment Aid for Innovation*

It is recognised that, in general, the European motor vehicle industry needs to improve its competitiveness as compared with its competitors in the United States, Korea and Japan. The technical and industrial gap with these countries is illustrated by the average time required to build a vehicle: 25 hours in Europe, 22 hours in the United States and 16 hours in Japan.<sup>295</sup> "Innovation" in this context means "the development and industrialisation in Europe, the EEA and the countries of CEEC of genuinely or substantially new products or process, that is products or process which have not yet been used or marketed by other parties operating in the industry".<sup>296</sup> It may therefore be distinguished from R&D aid which relates more to precompetitive development and is discussed above.<sup>297</sup>

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<sup>294</sup>Currently the Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty, O.J. 1994 No. C368/12, hereinafter referred to as "Rescue Guidelines", as revised by Community Guidelines on State aid for rescuing and restructuring firms in difficulty, O.J. 1997 No. C283/2, ("the 1997 Rescue Guidelines").

<sup>295</sup>Paragraph 3.4, n. 28, 1997 Framework.

<sup>296</sup>Paragraph 3.4, 1997 Framework.

<sup>297</sup>See IV.4.1.

Previous Commission practice suggests that aid for innovation must relate to product where, for example, "exceptionally high levels of automation and productivity, world first standards of flexibility, speed in model changeover, system reliability and product design" are involved.<sup>298</sup> In December 1988, loans to Citroën and SMAE were found not to involve modernisation investment, but genuine innovations at Community level which could therefore be exempted by the Commission under Article 87(3)(c), whereas a loan to Peugeot contributing to the modernisation of plant and the rejuvenation of products was not considered as innovatory and was hence incompatible with Article 87 EC.<sup>299</sup>

The Commission did, however, approve the innovation programme of Ferrari in Italy (decision of September 13, 1989).<sup>300</sup> In that case the Commission took account of the fact that the programme would not increase the company's production capacity. It also noted that Ferrari is a low-volume producer of high-quality cars and therefore operates in a different competitive environment from most car manufacturers.

A genuine innovation carries a risk of failure and the Commission will take account of the scale of this risk when it assesses the intensity of the aid envisaged. For instance, (under the previous Framework) the Commission approved aid granted by the Austrian Government and the Vienna local administration to Opel in July 1995 for R&D to develop a new small-size engine family with three-and four-cylinder versions, claiming reduced fuel consumption and emissions. Part of the aid was for process related to innovative investment.<sup>301</sup> In particular, the innovative character of the relevant engine lay in the need to combine a great number of different and often non-related technologies to compensate for the inherent handicaps of a three-cylinder layout. Its introduction was also found to carry a considerable risk with regard to its smoothness and balance and thus market acceptance. Various elements of the production process also had to be considered in-

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<sup>298</sup>EVANS, p. 315, citing Notice C45/91 (ex NN255/91), O.J. 1993 No. C37/15, regarding the proposal of the Italian authorities to provide State aid to the Fiat Group in support of its second Mezzogiorno investment plan.

<sup>299</sup>Commission Decision 89/305/EEC concerning aid from the French Government to an undertaking in the motor vehicle sector, Peugeot SA, O.J. 1989 No. L123/52.

<sup>300</sup>Cited by BUIGES/MEIKLEJOHN, pp. 67-97 at p. 91.

<sup>301</sup>BAYLIS, p. 8.

novative on a European level and involved considerable risks for the company as to their efficiency and practicability.<sup>302</sup>

An innovative project must concern only one plant location (or a small number of sites if different complementary sub-projects take place on a small number of sites<sup>303</sup>) within the same group in the motor vehicle industry; no aid will be granted for parts of the project carried out in other branches of a group.

Investment aid for innovation will therefore only be authorised in duly justified cases as an incentive to industrial or technological risk-taking. The maximum intensity of such aid is set at 10 percent of all eligible costs, corresponding to engineering activities and investments of direct and exclusive relevance to the innovative part of the project.<sup>304</sup>

#### *4.4. Aid for Environmental Protection and Energy Saving*

Another category of eligible aid specified in the 1997 Framework is that of environmental protection and energy saving. Prior to this, environmental aid was also permitted under the earlier 1989 Framework. In July 1995, the Commission approved regional and environmental aid from the Flemish region of Belgium (which was an "assisted area" and hence eligible for domestic regional aid) to Ford Werke in Genk. The aid was part of project to increase production capacity in relation to the new Ford Mondeo series and included environmental aid of 1.1 EUR million.<sup>305</sup>

Aid granted under the horizontal framework, i.e. Community guidelines on State aid for environmental protection,<sup>306</sup> may be regarded as compatible with the 1997 Framework for the motor vehicle industry.<sup>307</sup> Under Commis-

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<sup>302</sup>Commission approved aid to Opel Austria support of R&D, Environmental and Training Expenditure (95/07/26), Reuter EU Briefing, August 2, 1995. Ref: IP/95/833.

<sup>303</sup>Paragraph 3.5, n. 28, 1997 Framework.

<sup>304</sup>Paragraph 3.4, 1997 Framework.

<sup>305</sup>BAYLIS, p. 7. The Commission also approved, in July 1995, aid granted by the Austrian government and the Vienna local administration to Opel, inter alia, environmental improvements in relation to emission controls which reached standards in line with Community guidelines.

<sup>306</sup>O.J. 1994 No. L72/3.

<sup>307</sup>Paragraph 3.5, 1997 Framework.

sion practice (in relation to earlier motor vehicle frameworks), for instance, aid for general pollution was accepted, in line with the relevant Guidelines on State aid for environmental protection. Thus, in relation to Commission's approval of aid in 1995 for Opel Austria, a wholly-owned subsidiary of General Motors Corporation based in Aspern/Vienna, the Commission accepted that the investment in new cleaning and washing process for the relevant engine components would lead to a significant reduction in effluent emission and to the recycling of these effluents, which either went beyond the relevant national standards or were voluntary measures in these sense that no standards then existed. The proposed aid intensity of 30 percent was also found to be within the limits then foreseen by the Guidelines.<sup>308</sup>

On 23<sup>rd</sup> May 1997, the Commission decided not to raise any objection to aid granted by Spain for a project designed to apply new technology in the painting system so as to reduce pollution.<sup>309</sup> Switching from the present system based on organic solvents to the new water-based paint method would make it possible to reduce emissions well beyond current mandatory standards. The total environmental protection investment involved in the project amounted to 13 million EUR but the eligible cost calculated on the basis of the criteria set out in the (previous) 1989 motor vehicle Framework and in the Community guidelines on State aid for environmental protection was 3.4 million EUR. The reduction took account of the savings generated under the new method. Consequently the aid was provided in the form of a direct grant applying the intensity ceiling of 30 percent of the eligible costs. The Commission took the view that the aid qualified for the derogations provided for in Article 87(3)(c) of the EC Treaty and Article 61(3)(c) of the EEA Agreement, since the aid does not affect trade to an extent contrary to the common interest.

The above (horizontal) environmental protection Guidelines involve complex technical evaluations of matters such as "ecological" costs incurred by the investor. The Commission also makes a thorough study, under those

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<sup>308</sup>Commission approved aid to Opel Austria support of R&D, Environmental and Training Expenditure (95/07/26), Reuter EU Briefing, August 2, 1995. Ref: IP/95/833.

<sup>309</sup>State aid, Main developments between April 1, and July 15, 1997, *Summary of the most important recent development*, Competition Policy Newsletter, Vol. 3, No. 2, Summer 1997, pp. 42-48 at p. 48, citing Case N669/96.

Guidelines, of the cost savings on energy, raw material and so on, which the investor has secured as a result of the environmental protection component in the project, so that there is no unnecessary subsidy.

#### *4.5. Aid for Vocational Training*

The 1997 Framework repeats the philosophy of its predecessor, in that it confirms that the Commission has a generally positive attitude towards training, retraining and reconversion programmes. State aid for such purposes will, however, be scrutinised to ensure that it is not used solely to reduce the costs a firm would normally have to bear.<sup>310</sup>

In July 1995, the Commission approved aid to Opel granted by the Austrian government and the Vienna local administration<sup>311</sup> which included, inter alia, aid for basic training (0.6 million EUR) and on-the-job training (0.5 million EUR). The Commission considered that such levels fell within the criteria set out in the (earlier) Framework and that the training measures proposed would correspond to genuinely qualitative changes in the required skills of the workforce.<sup>312</sup> The basic training elements were not considered to be company specific. On this basis and since the level of aid was found to be within reasonable limits, the proposed aid for training was considered acceptable according to the (then) rules on aid for vocational training under the (earlier) Framework for aid to the motor vehicle industry.

In March 1995, the Commission also decided not to oppose aid which the U.K. government granted to Jaguar Cars Ltd in support of an investment project which consisted, in part, of a £1.8 million training grant. In view of the fact that the subsidised training consisted entirely of courses providing general vocational skills which were not specifically related to the motor vehicle industry and could thus be applied to companies in other sectors of the industry, the Commission considered that this measure did not constitute aid within the meaning of Article 87(1) of the EC Treaty in the sense that it did not favour a particular industry or the production of certain goods. The Commission has stated its intention to adopt a (horizontal) Community

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<sup>310</sup>Paragraph 3.6, 1997 Framework.

<sup>311</sup>BAYLIS, p. 8.

<sup>312</sup>Ibid.



framework on training aid which it intends to apply also to the motor vehicle industry.<sup>313</sup>

#### *4.6. Aid for Modernisation and Rationalisation*

No aid for the purpose of modernisation and rationalisation may be granted to undertakings in the motor vehicle industry.<sup>314</sup> Aid for modernisation and rationalisation, which may for example, involve keeping relevant equipment up-to-date, is to be distinguished from aid for innovation, such as the development of new equipment. Aid for innovation is permissible under the conditions laid down by the Framework 1997, referred to above. However, aid for modernisation and rationalisation should be financed from a company's own funds as an essential function of remaining competitive on a world market, i.e. if an undertaking is unable to finance its own modernisation, its ability to compete and its viability will eventually disappear.

#### *4.7. Operating Aid*

Operating aid is to be distinguished from aid for innovation and from modernisation and rationalisation aid, discussed above.<sup>315</sup> The 1997 Framework takes a strict view (as did its 1989 predecessor) that operating aid creates lasting distortions of competition in sectors such as the motor vehicle industry and that therefore no new operating aid will be authorised by the Commission, even in assisted areas (i.e. those eligible for domestic regional aid).<sup>316</sup> Furthermore, on the basis of Article 88(1) of the EC Treaty the Commission will suggest that Member States currently granting this type of aid under existing schemes should gradually abolish operating aid benefiting one or several undertakings in the motor vehicle industry.

The Commission Decision to authorise certain aid to Rover<sup>317</sup> displays elements relating to both operating aid and restructuring aid. In relation to the former, the Commission found that £231 million of the notified aid to the

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<sup>313</sup>Paragraph 3.6, 1997 Framework.

<sup>314</sup>Paragraph 3.7, 1997 Framework.

<sup>315</sup>See IV.4.2. ff.

<sup>316</sup>Paragraph 3.8, 1997 Framework.

Rover Group was not true financial debt but working capital which amounted to operating aid and could not be exempted. The items involved which were regarded as operating aid included the financing of stocks of finished vehicles, certain long-term accruals (i.e. certain guarantees offered on cars sold in the U.S.), direct and indirect costs arising from strikes which took place in 1988 which were regarded as ordinary operating costs, and certain interest payments on debt.<sup>318</sup>

In July 1994, the Commission decided, after a lengthy investigation, that certain aspects of restructuring aid for Volkswagen in eastern Germany (relating to Volkswagen's takeover of a former East German car company, Sächsische Automobilbau GmbH which was being sold by the Treuhandanstalt had the character of operating aid<sup>319</sup> under an earlier motor vehicle framework and were therefore incompatible with it (there was found to be no regional justification for the aid).

The Commission has indicated its intention to scrutinise an aid scheme for a Volvo Trucks cabin plan in Umea, Sweden which provides subsidies under a regional "transport aid" scheme, officially approved by the Commission in February 1997, designed to offset the high cost of inbound and outbound deliveries to and from installations in remote Nordic areas. The aid is paid in reimbursements against the presentation of transport invoices and compensation is limited to cost incurred on Swedish territory. Although Sweden and Finland negotiated this "transport aid" concept during accession negotiations in 1994 the Commission believes that the aid may nevertheless not be compatible with the provisions of the (previous) Framework for motor vehicle and has decided to open a formal inquiry into the Swedish authorities' grant of some 11 million EUR during the 1995-1997 period. It has been suggested by the Commission that such subsidies should not be authorised even in disadvantaged regions such as remote Nordic areas, since they relieve the company of part of its normal running costs and thus constitute an on-going advantage to the company concerned. The Umea

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<sup>317</sup>Commission Decision 89/58/EEC concerning aid provided by the U.K. Government to the Rover Group, an undertaking producing motor vehicles, O.J. 1989 No. L25/92.

<sup>318</sup>*ibid.* at p. 96.

<sup>319</sup>BAYLIS, p. 9.

plant turned out some 40,000 lorry cabs in 1995 with its 1860 workers and has finished a series of significant investments so as to be regarded as the most up-to-date cabin manufacturer in Europe<sup>320</sup>. In view of this, the argument put forward by the Commission is that the company cannot therefore claim that without national transport aid it would be more cost-effective to relocate production of cabins to another area.

#### *4.8. Cost of Land for Industrial Sites in the Motor Vehicle Sector*

The 1997 Framework does not expressly create a specific category or type of aid relating to the acquisition of land by motor vehicle manufacturers. Nevertheless, details relating to the acquisition of land feature in many questions on the notification form (discussed below). The Commission has specifically investigated the sale of land in a number of cases. In 1987, it approved the sale of land to Daimler-Benz after the terms of the proposed sale had been amended and Daimler agreed to bear site preparation costs<sup>321</sup>. However, in 1991, the Commission opened Art. 88(2) proceedings in respect of the sale by the Berlin Senate to Daimler-Benz AG of a very large site near the Berlin Wall to Daimler at a price more than 400 percent below market value.<sup>322</sup> The Commission also issued a Decision disapproving the sale of a 580 acre site at Burnaston by the Derbyshire County Council which involved a subsidy of £4.2 million to Toyota.<sup>323</sup> The Commission has since issued a Notice concerning the sale of land by public authorities.

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<sup>320</sup>"State Aid: Commission investigates transport aid to Volvo plant", European Report, No. 2244, July 26, 1997 at p. 1.

<sup>321</sup>HANCHER/SLOT/OTTERVANGER, p. 49.

<sup>322</sup>HANCHER/SLOT/OTTERVANGER, p. 50 citing Commission Communication pursuant to Art. 88(2) of the EC Treaty to other Member States and interested parties regarding the land purchase agreement of 16 July 1990 between the Land of Berlin (Germany) and Daimler-Benz AG, C3/91, Germany (91/C/128/05), O.J. 1991 No. C128/3.

<sup>323</sup>HANCHER/SLOT/OTTERVANGER, p. 50 citing O.J. 1992 No. L6/36.

## 5. Notification Rules under the 1997 Framework

### 5.1. Categories of Aid to be Notified/Relevant Thresholds

The 1997 Framework specifically identifies three categories of aid which are subject to prior notification on the basis of Article 88(3) of the EC Treaty. They are aid under an approved scheme, ad hoc aid and rescue and restructuring aid for firms in difficulty.<sup>324</sup> Each category is discussed below.

A "scheme" is a measure taken by a Member State, usually in the form of legislation, which lays down conditions of eligibility for aid, the ceilings and intensity of the aid available, and the machinery for payment. A scheme differs from a "one-off", "ad-hoc" or "specific" measure in that it is not aimed at a particular firm, but rather at a class of firms whose identities and number are still undefined. The scheme is said to be "applied" every time a firm is to receive aid under it on the conditions which the Commission sets out in the authorising decision.<sup>325</sup>

All aid which public authorities plan to grant to an individual project or an overall project under authorised aid schemes, for a firm or firms operating in the motor vehicle industry, is subject to prior notification if either the nominal amount of the investment project<sup>326</sup> or the total cost of the project<sup>327</sup> exceeds the threshold of 50 million EUR (previously 17 million EUR) or the total gross aid for the project, whether State aid or aid from Community instruments (e.g. Structural Funds and framework programmes) and irrespective of the form and objectives of the measure, exceeds 5 million EUR (unchanged from the 1989 Framework).

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<sup>324</sup> Paragraph 2.2, 1997 Framework.

<sup>325</sup> *Competition law in the European Communities*, Vol. IIB, Explanation of the rules applicable to State aid, Situation in December 1996 (1997), European Commission at pp. 29-30.

<sup>326</sup> An investment project is usually defined as an investment by an undertaking in new assets that are necessary to set up, expand, modernise or rationalise production facilities on a specific industrial site: paragraph 2.2(a), n. 14, 1997 Framework.

<sup>327</sup> The total cost of a project is defined as the total expenditure by an undertaking on the acquisition of new tangible and intangible fixed assets which are part of an investment project and will be depreciated (or leased) during their lifetime. Conse-

The Commission will analyse the projects of the manufacturer and each first-tier component supplier in order to determine the compatibility of each of the aid measures envisaged. An investment project should not be artificially broken down into several sub-projects and/or over several financial years in order to avoid the obligation to notify.

Ad hoc aid,<sup>328</sup> i.e. any aid which the public authorities intend to grant outside an approved scheme to one or more undertakings operating in the motor vehicle, or aid classifiable as rescue and restructuring aid<sup>329</sup> must also be notified in advance under Art. 88(3) of the EC Treaty unless it complies with the thresholds and rules of the Commission notice and the new regulation on the de minimis rule for State aid.<sup>330</sup>

## 5.2. Notification Form

State aid must be notified directly to the Secretariat General of the Commission on the form attached at Annex II to the 1997 Framework and supplemented by an appropriate form to be obtained from the Directorate General for Competition.<sup>331</sup> Annex II is very detailed and includes the standard notification form and forms relating to the "cost-benefit analysis". It is assumed that the forms will be completed with the assistance of the beneficiary in view of the considerable amount of technical and market information required as well as details of the beneficiaries own operational costs, etc. The administrative costs involved for the beneficiary company in terms of time and expertise in compiling the forms should not be underestimated.

Among the general information required in every case are the group and (beneficiary) company's most recent financial accounts (including details of turnover and net profit) for the current year and previous two years. The project classification, i.e. the aid objective (mobile regional investment, rescue, restructuring, R&D, innovation, environment protection and energy savings or training) are to be clearly identified.

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quently, the cost is equal to the amount of capital invested in a project: paragraph 2.2(a), n. 15, 1997 Framework.

<sup>328</sup>Paragraph 2.2(b), 1997 Framework.

<sup>329</sup>Paragraph 2.2(c), 1997 Framework.

<sup>330</sup>Council Regulation No. 69/2001 (O.J. 2001 No. L10/30), Commission Notice on the de minimis rule for State aid (O.J. 1996 No. C68/9), see also II.3.3.

The form also requires a project overview, with a brief description, where relevant, of the products, market segments and, if the project results in a transfer of activity from another area, relevant details. Project details also include the exact location, whether it is in an assisted area or not, and the project timing, i.e. start and end dates of investment cash-flow.

The details of the total project cost are broken down into specific heads of budget which include capital costs, land, buildings, plant and machinery, equipment, intangible and other items. Details of project financing require a breakdown of the various sources of investment from own resources, private capital contributions, external borrowing (whether public or private), national public body and Community assistance.

The information relating to public assistance also requires further elaboration to indicate the type of public aid scheme involved (i.e. grant, interest subsidy, tax credit, loan, loan guarantee, equity participation, reduction in social security contributions), the nature of the scheme (i.e. approved aid schemes: regional development, R&D, training, environmental protection, energy saving, ad hoc, its national legal basis (i.e. law, regulation or other legal form describing the conditions under which public support may be granted) and the public entity (i.e. national, regional, local authority) providing the support.

The gross grant equivalent (gge)<sup>332</sup> of each of the types of public support listed and the State aid net present value (i.e. State aid cash flow discounted to the base year by using the official discount rate over the appropriate investment period) must also be calculated in accordance with the relevant document published/communicated by the Commission.

The form also requires an indication of envisaged public support which does not represent aid an explanation of why this is so. Presumably this will assist in the Commission's decision about whether the envisaged support is genuinely outside the scope of Art. 87 of the EC Treaty. It also requires de-

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<sup>331</sup> Paragraph 2.2(d), 1997 Framework.

tail of pending applications for public support, at company and/or group level, for public support in Europe and the authorities involved (i.e. European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD), R&D funds, etc.).

A separate form for Market Information requires description of the models, i.e. product type including different versions (e.g. Ford Mondeo, Renault Laguna, etc.) supplied by the Group within the EEA, in order of importance on the relevant market. Market forecasts expressed in million/thousands of units are also required for each model, on the national market, other EEA markets<sup>333</sup>, CEEC markets<sup>334</sup>, the rest of the world. A grand total of these is also needed.

In addition, overall company sales for all models in million/thousands of units are required for the national market, other EEA markets, CEEC markets, the rest of the world, and in total. Sales in national market and other EEA markets must include imports. An indication of forecast group sales volumes (including imports) expressed in million/thousands of units is also required for the above categories. The effect on the project in terms of capacity, employment, production, and market share (domestic, other EEA and non-EEA) must be specified. Member States should attach any relevant supporting documents to the notification forms. As regards regional aid in particular, studies on the final plant location site should be provided wherever available.

A separate set of forms in Annex II deal with mobile investment projects in an assisted area (i.e. one that is eligible for domestic regional aid) and include detailed information relevant to the cost-benefit analysis. It requires, in particular, a detailed description of total operating costs (i.e. labour, components/material, rent, inventory, carrying costs, energy/water, telecommunications, outward transport, training, other) and total investment

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<sup>332</sup>That is to say nominal (before tax) value of grants and the discounted (before-tax) value of interest subsidies, as a proportion of the investment cost.

<sup>333</sup>EEA markets are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden, United Kingdom, Iceland, Liechtenstein, Norway.

<sup>334</sup>CEEC markets are: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

costs (i.e. land purchase, building/construction, machinery/equipment, tools and dies, supplier tooling, other) and details of other costs.

The net incremental costs (i.e. by reference to the total operating costs and total investment costs) for implementing the project in the disadvantaged area (Location A) as opposed to the commercially viable alternative (Location B) must be specified. In addition, the eligible investment (i.e. net share of the investment which is considered to be eligible for State aid by the national administration according to the aid scheme) and the handicap intensity (i.e. net incremental costs referred to above) divided by the net present value (i.e. value of cash-flows discounted to the base year by using the official discount rate over the appropriate investment period) of investment costs in Location A (operating costs and investment costs) should be expressed as a percentage.

A separate form covers details of cost-benefit analysis assumptions in Location A. This includes, in particular, the Group's plants and their production capacities in thousands of units before and after the investment project as well as an indication of whether the production capacity would be shifted from one plant to another following the project's implementation or within the time scope of the project.

A third form deals with cost-benefit assumptions in Location B. Sales and Costs breakdowns for both Location A and B are also required. Finally, the details for the mobile investment project in an assisted area require the completion of Form 6, relating to Public Support. This requires a breakdown of support type (i.e. grants, equity participation, loans, loan guarantees, tax relief/credit, reduction in social security contributions, other) and an estimate of public support in gross grant equivalent (gge) and State aid net present value terms.

Member States may contact the Commission in advance of a formal notification to obtain informal advice to ensure that the subsequent notification is as complete as possible. This is particularly relevant when, for instance, the existence of aid within certain measures is uncertain; the aid measure serves more than one objective (e.g. horizontal and sectoral aid); when it is doubtful whether a cost-benefit analysis is required (e.g. a project at or near



the relevant thresholds or when a company has not carried out a location study).

### *5.3. Investigation and Approval by the Commission*

Upon registration of the notification, the Commission will inform the Member State as soon as possible and usually within 15 working days about any information which may be lacking in order to make the notification complete for an assessment of all aspects of the case. At the same time, it will propose to the Member State a meeting in its offices or on the site of the investment to discuss the information already received and to be received.<sup>335</sup> In cases where there may be considerable cost differences between the two comparator location sites, it is likely that the Commission's experts will want to visit the relevant sites.

On this occasion, the Member State and the Commission can be assisted by appropriate experts so that all technical and financial information can be discussed in detail. During the meeting, missing information for a full assessment of the case will be identified by the Commission and agreement reached by all parties on supportive material to be provided and on the prospective timetable for decision-making. Following that meeting, the Commission will confirm its final request for further information in writing.<sup>336</sup>

Once the additional information requested by the Commission is received, the decision will normally be adopted within 30 working days for notified aid under an approved aid scheme(s) or two months for notified ad hoc aid. However, within this deadline the Commission will invite the Member State (which can, if appropriate, be assisted by experts) to review the cost-benefit analysis in a meeting in Brussels. It may well be in the interest of the Member State to include representatives of the beneficiary undertaking in its delegation. Any errors and misinterpretations can then still be corrected before a final decision is arrived at.

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<sup>335</sup>Paragraph 4.3, Annex I, 1997 Framework.

<sup>336</sup>Paragraph 4.2, Annex I, 1997 Framework.

#### *5.4. Ex-post Control*

A copy of the final (signed) aid contract between the Member State and the undertaking concerned must be sent to the Commission immediately.<sup>337</sup> In its decision, the Commission may require ex post monitoring and assessment of aid already granted, the amount of detail varying according to the case and the potential distortion of competition.

In order to enable the Commission to check compliance with its decision, the Member State, with the assistance of the aid recipients, must submit either an interim report on the aid payments or an interim report on performance of the aid contract. This is to be followed by a final report on the objectives, in terms of timetable, investment and compliance with the specific conditions imposed by the Member State. It should also include actual achievements.

The ex post monitoring mechanism appears to be far more rigorous than under the previous (1989) regime.

#### *5.5. Annual Report*

In addition to the ex post reporting obligations outlined above, Member States are also requested to provide the Commission with an annual report giving data on all aid, whatever its form, granted in the past year to undertakings in the motor vehicle industry.<sup>338</sup> Aid which does not have to be notified must also be mentioned in the annual report. This includes all aid which falls below the relevant thresholds but may arguably not include grants of de minimis aid.

The annual report (for which there is a model form) must be sent by the Member State by April 1 of the year following the reference year to the Directorate General for Competition. They may, at the request of a Member State, be communicated in their original language.

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<sup>337</sup> Paragraph 2.3, 1997 Framework.

<sup>338</sup> Paragraph 2.4, 1997 Framework.

#### *5.6. Aid under Community Instruments*

One of the thresholds for notification of aid, namely 5 million EUR for total gross aid irrespective of source, i.e. whether State aid or aid from Community instruments, implies a duty on the Commission to monitor all aid applications and authorisations under Community instruments<sup>339</sup> and ensure that they are consistent with the 1997 Framework. These include measures financed by the Structural Funds or benefiting from aid from the European Investment Bank (EIB) or other financial instruments.

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<sup>339</sup>Paragraph 2.5, 1997 Framework.

## V. Conclusion

Aid to the automobile sector has in, the period prior to the entry into force of the 1997 Framework, given rise to some major disputes between the Commission and the Member States. The impression one gets from reading the Commission's decisions and notices is that the Commission is gradually getting a grip on these extensive aid operations.

In all the major disputed, prior to the entry into force of the 1997 Framework, other Member States have not hesitated to submit their comments. It seems likely that such representations did provide the Commission with active support for its developing policy. It is striking that in the period after the entry into force of the framework, Member States have not made much use of the possibility to come forward with comments.

Another point to note is that the Commission did achieve extensive restructuring of the industry. As Advocate General Van Gerven noted in his opinion in the Alfa Romeo case, both the Renault and the Rover aid operation did involve a restructuring plan. In the absence of such a restructuring plan the Commission had, according to the Court, correctly applied Art. 87 of the EC Treaty and therefore not violated the equal treatment principle.<sup>340</sup>

The operation of the 1997 Framework appears to have enabled the Commission to strengthen its control of aid in the automobile sector.

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<sup>340</sup>Case C-305/89 *Italy v Commission* [1991] ECR I-1603.

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