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Competition Law's Market Failure Paradox

Economic Efficiency, Consumer Welfare and Public Policy in EU Antitrust and State Aid Law

Hjærtström, Max

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Competition Law's Market Failure Paradox

Economic Efficiency, Consumer Welfare and
Public Policy in EU Antitrust and State Aid Law

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Competition Law's Market Failure Paradox

In modern markets, a puzzle is afoot: Can competition law, traditionally aimed at ensuring economic efficiency and consumer gains, also protect broader societal needs? Conventionally, economic theory tells us that intervention in the market is only warranted in the case of a market failure. This research dives into the theory of 'market failure' within EU competition law, examining its rise from a policy term to a potential legal concept. This thesis reveals that despite being constructed as an objective economic concept, its application in law varies across the different legal fields. The findings highlight a contemporary market failure paradox in EU competition law, leading to inconsistencies in the enforcement of the legal provisions.



Max Hjærtström.

Competition Law's Market Failure Paradox

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Economic Efficiency, Consumer Welfare and Public
Policy in EU Antitrust and State Aid Law

Max Hjärtström



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DOCTORAL DISSERTATION

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Abstract:

This thesis addresses the pressing challenge for contemporary markets to secure socially and economically outcomes. It highlights the increasing prominence of market failures, notably those accentuated by sustainability and income inequality issues, within competition law discourse from both doctrinal perspectives and in the realm of policymaking.

The thesis aims to investigate the role and value of market failure theory within the context of competition law, particularly when assessing the compatibility of public policy measures with the legal framework. Whilst competition law has undergone a modernisation process over the past two decades, emphasising economic efficiency and consumer welfare, the integration of broader public policy goals within this framework remains nebulous. In this context, market failure theory has gained some traction in EU antitrust scholarship as a concept capable of explaining the outcome of public policy measures. This research unveils the juridification of the concept in EU competition law, yet notes the challenges posed by the ambiguous definition of market failure.

To achieve its purpose, the thesis is constructed upon three pillars. Initially, it establishes a framework for assessing the relevance of market in EU competition law. The theory of market failure is conceptualised as a tool to systematise the applicable law. The principle of proportionality is identified as a fundamental tool for conceptualising market failure as a legal requirement. Subsequently, the thesis applies the market failure framework across the different areas of EU competition law, thereby determining its functionality. Finally, it dissects the nexus of market failure within the different fields of EU competition law.

The core argument posits a contemporary 'market failure paradox' within EU competition law, which manifests both theoretically and in practice. The theoretical paradox arises from the ubiquitous nature of market failures, as delineated by economic theory, and their exceptional treatment in EU competition law. Such a paradox leads to inconsistent and ambiguous enforcement policies, thereby undermining the coherence of competition law modernisation. On a practical level, this thesis demonstrates that the role and value of market failure are not constant, varying in alignment with varied objectives across EU competition law sectors. Consequently, this ostensibly objective economic concept can be deployed within the legal framework to both expand and restrict public policy intervention in markets.

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Policy in EU Antitrust and State Aid Law

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Abbreviations

AG	Advocate General
CAP	Common principles of assessment
CBA	Cost and benefit analysis
CJEU	Court of Justice of the European Union
C-and-C	Command and Control
DGcomp	Directorate-General for Competition
ECJ	European Court of Justice
GBER	General Block Exemption Regulation
GC	General Court
LRM	Least restrictive measure
NCA	National competition authority
REA	Refined economic approach
R&D	Research and development
SAAP	State aid action plan
SAM	State Aid Modernisation Communication
SGEI	Services of general economic interest
TFEU	Treaty on the Functioning of the European Union
TEU	Treaty of the European Union

PART I

Prolegomenon

1. INTRODUCTION

1.1 Backdrop: Market Failure, Competition Law, and Economic Paradigms in an Age of Crisis

We live in an area of the ‘biggest market failure in the history of mankind’: climate change.¹ Moreover, markets are failing to ensure socially and economically sustainable outcomes.² At the same time, there have been numerous calls to broaden competition law analysis to include sustainability as a goal to be pursued by the legal framework.³ Policymakers, on their side, are today asking whether antitrust law can address burgeoning challenges such as sustainability, economic inequality, stagnant wages⁴ and issues created by the recent inflation surge.⁵ These ongoing developments suggest that competition law can no longer afford to overlook suboptimal market performance that reduces social utility.

¹ ‘Quote from Martijn Snoep, Authority for Consumers and Markets of the Netherlands, ‘UNCTAD’s Ad Hoc Expert Meeting on Competition, Consumer Protection and Sustainability’”²⁸ September 2022, Available at: < <https://unctad.org/news/how-make-markets-work-sustainable-development>>.

² *ibid.*

³ See Chapter 4, section 4.3.2.2.

⁴ Salil K Mehra, ‘What Is an Antitrust Problem, Anyway? Towards Antitrust Unlimited’ (2023) 68(2) The Antitrust Bulletin 191, 191. On these recent developments, see e.g., recent policy guidelines from the Dutch and British NCAs, Autoriteit Consument & Markt, ‘ACM’s oversight of sustainability agreements: Competition and sustainability’ ACM/UIT/596786 (4 October 2023); Competition & Markets Authority, ‘Green Agreements Guidance: Guidance on the application of the Chapter I prohibition in the Competition Act 1998 to environmental sustainability agreements’ (12 October 2023) CMA 185; Mark Jephcott, Devina Shah and Lisa Kingsbury, ‘Sustainability, consumer protection and competition law: six months on and looking forward’ European Competition Law Review (2023) 44(1) 11, 11.

⁵ For instance, in the food retail sector, Swedish Competition Authority has conducted investigations into price increases suspecting ‘greedflation’ practices, Konkursverket, ‘Livsmedelskedjan: Konkurs i kristider’ analys i korthet 2023:6 (2023), available at: <<https://www.konkursverket.se/informationsmaterial/rapportlista/livsmedelskedjan---konkurs-i-kristider/>>.

Conversely, over the past two decades, the EU competition law framework has been narrowly reconstructed around the concepts of economic efficiency and consumer welfare. These paradigms were articulated by the Commission during the modernisation of the legal framework.⁶ Under the influence of economic concepts and theory, this process introduced a more effect-based approach,⁷ assessing the impact of measures on efficiency and consumer welfare, with a particular focus on short-term price effects.⁸ In this light, the modernisation process catapulted economic efficiency to be the primary objective of EU competition law.⁹

However, the relationship between efficiency, consumer welfare, and the broader goals of competition law remains ambiguous.¹⁰ This ambiguity extends to public policies pursuing objectives beyond the promotion of efficiency and, by extension, consumer welfare as understood in EU competition law. The focus on

⁶ e.g., Commission Press release IP/04/411, 'Commission finalises modernisation of EU antitrust enforcement rules' (Brussels, 30 March 2004); Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L 1/1; Commission, 'Guidelines on vertical restraints' (2010/C 130/01); Communication from the Commission, 'Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements' (2011/C 11/01); Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices; Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02); Mario Monti, 'EU competition policy After May', SPEECH/04/489 of 24 October 2003 given at the Annual Conference on International Antitrust Law and Policy of the Fordham Corporate Law Institute; Dermot Cahill, John D Cooke and Wils Wouter, *The Modernisation of EU Competition Law Enforcement in the European Union: FIDE 2004 National Reports* (CUP 2004); Wolf Sauter, *Coherence in EU Competition Law* (OUP 2016).

⁷ e.g., Sauter, *Coherence in EU Competition Law* (n 6) 44-59; Lars-Hendrik Roeller and Oliver Stehmann, 'The Year 2005 at DG Competition: The Trend towards a More Effects-Based Approach' (2006) 29 *Review of Industrial Organization* 281; Paul Heidhues and Rainer Nitsche, 'Comments on State Aid Reform – Some Implications of an Effects-Based Approach' (2006) (1) *State Aid Law Quarterly* 23; Alison Jones, 'The Journey toward an Effects-Based Approach under 101 TFEU – The Case of Hardcore Restraints' (2010) 55(4) *Antitrust Bulletin* 783; Anne C Witt, 'The European Court of Justice and the More Economic Approach to EU Competition Law – Is the Tide Turning?' (2019) 64(2) *Antitrust Bulletin* 172.

⁸ Different economic and econometric tools are in this regard used to determine the distortive effects of anticompetitive conduct.

⁹ e.g., Laura Parret, 'Shouldn't We Know What We Are Protecting? Yes We Should! A Plea for a Solid and Comprehensive Debate About the Objectives of EU Competition Law and Policy' (2010) 6(2) *European Competition Journal* 339, 349, '[e]fficiency is often seen as the overall, general objective of competition policy'.

¹⁰ Most scholars recognise that EU competition is based on a myriad of objectives, see Chapter 4, section 4.3.1.

reducing prices and maximising output may inadvertently create other market failures, yielding outcomes that are not economically, socially or environmentally sustainable. Thus, it is posited that a narrow confinement of the objectives of competition law to mere economic efficiency may not be desirable. Notably, social and environmental sustainability concerns manifest themselves in markets and can influence firm behaviour and State action in those markets.¹¹ On a broader scale, a multitude of public policy objectives may be implemented through various instances of market intervention.

It is imperative to recognise that competition law, at its foundational core, is intertwined with the well-being of society, positioning itself within a broader economic equilibrium framework. Generally, and in line with the Commission's modernisation approach, in competition theory a distinction between 'legitimate' and 'illegitimate' competition is not made, but an instrumental definition of competition based on the (perceived) social utility of a practice is preferred.¹² Concurrently, in economic theory, public policy interventions in the market mechanism are viewed as warranted only if the market fails to produce optimal social utility.¹³ To determine the right junctures for when the State should step in to correct markets, welfare economics has provided us with a normative theory: market failure.¹⁴ Within this theory, imperfect competition represents only one facet of potential market failures. As a facet of welfare economics, market failure is intrinsically linked to the achievement of an economic equilibrium, i.e., the maximisation of social welfare. The theory is commonly conceived of as the antipode to perfect competition,¹⁵ in the sense that it refers to circumstances in which markets no longer deliver 'optimal' economic outcomes. Within this

¹¹ For a similar view see Bruce Wardhaugh, '7 – The Environment, Sustainability Goals and the Climate Crisis' in Bruce Wardhaugh (ed), *Competition Law in Crisis: The Antitrust Response to Economic Shocks* (CUP 2022) 195, 196.

¹² Alan J Meese, 'Price Theory, Competition and the Rule of Reason' 2003 University of Illinois Law Review 77. 77. The author pointed out that '[s]uch an approach would treat as "competitive" any practice that, under the circumstances, would seem to further society's welfare when compared to the *status quo*'.

¹³ See Chapter 2, section 2.1.

¹⁴ The definition of market failure is laid down in Chapter 2, section 2.2.

¹⁵ John O Ledyard, 'Market Failure' in Lawrence E Blume and Steven N Durlauf (eds), *The New Palgrave Dictionary of Economics* (2nd edn, Palgrave Macmillan 2008) 300.

context, the notion of market failure is fundamentally predicated on the concept of economic efficiency.¹⁶

This thesis critically explores the role of market failure within the EU competition law framework with a particular focus on public policy intervention extending beyond mere competition law enforcement. In other words, it investigates its ‘legal anatomy’.¹⁷ The primary assertion of this research posits that the ambit of competition law demands expansion to encompass broader objectives beyond economic efficiency and consumer welfare. Within this context, economic theory suggests that market failure theory offers an avenue to integrate objectives beyond narrowly-defined economic efficiency, whilst also conforming to the more economic approach ushered in the modernisation framework.

Although the influence of market failure theory on the legal framework remains nebulous, its relevance has been underscored in various academic and policy platforms – spanning regulation theory,¹⁸ EU competition law scholarship,¹⁹ and EU soft law documents.²⁰ It seems plausible that the growing recognition of the concept market failure in EU competition law has been catalysed by the limitations modernisation process putting into place a more economic approach. This thesis demonstrates that the concept of market failure has increasingly found resonance not only with the Commission but also with the EU judiciary, possibly indicating a juridification of this economic construct, underpinned by an imperative to broaden competition law analysis.

However, within the legal assessment of EU competition law, the role and meaning of market failure remains ambiguous. This thesis aims to dispel that

¹⁶ See Chapter 2, section 2.1.

¹⁷ This paronomasia is based on the seminal article by Bator entitled ‘the anatomy of market failure’ (n 21).

¹⁸ e.g., Giandomenico Majone, *Regulating Europe* (Routledge 1996) 28-30; Anthony I Ogus, *Regulation: Legal Form and Economic Theory* (Hart 2004) 29-42; Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice*. (OUP 2012)15-22; Cento Veljanovski, ‘Economic Approaches to Regulation’ in Robert Baldwin, Martin Cave and Martin Lodge (eds), *The Oxford Handbook of Regulation* (OUP 2010) 20-22; Tony Prosser, ‘Regulation and Social Solidarity’ (2006) 33(3) *Journal of Law and Society* 364, 364.

¹⁹ See section 1.4 of the current chapter.

²⁰ In particular in State aid. See, Commission, ‘State aid action plan’ (Communication) COM (2005) 107 final; Commission, ‘Communication on State aid modernisation (Communication) COM (2012) 209 final. See also, Max Hjærtström, ‘The Role of Market Failure in State Aid Analysis Under Article 107(3)(c) TFEU: Some Initial Reflections’ (2019) 2 *Europarättslig Tidskrift* 211.

ambiguity, constructing a framework for assessing the role of market failure in EU competition law. It is demonstrated that market failure is an inherently obscure and value-laden notion. Over six decades have passed since Bator famously asked ‘[w]hat is it we mean by “market failure”’,²¹ but the notion remains unresolved, with no clear consensus in light. In essence, the meaning of market failure lacks a uniform definition and varies depending on the welfare function adopted. As a result, an exploration into the precise meaning of market failure within EU competition law becomes indispensable. Ultimately this thesis concludes that the application of a market failure analysis in EU competition law reveals a dual paradox tied to both its meaning and functionality.

These issues emphasise the necessity for this research. Current understanding of the ambiguous relationship between ‘the more economic approach’, market failure and the core values of EU competition law remains incomplete, giving rise to significant legal uncertainty. Whilst existing scholarship has made valuable contributions to the field, it predominantly approaches public policy and normative economics as distinct concepts that resist unification. From this perspective, economic assessments and legal balancing are portrayed as diametrically opposed. Nonetheless, the concept of market failure might provide a conduit between these divergent viewpoints. This thesis delves into this potential, examining if and how market failure theory can explain public policy interventions within the more economic framework of EU competition, and simultaneously serve as a vehicle to incorporate broader objectives into competition law analysis. Central to this exploration is the inquiry of whether conventional economic axioms, such as efficiency and consumer welfare, can be transposed *mutatis mutandis* to public policy interventions, or if a reorientation is imperative within the legal framework. Therefore, re-evaluating the *legal* meaning of market failure within the core values of EU competition is paramount.

1.2 Framing the Research

First, this section delineates the purpose, aims, and research questions of the thesis. Subsequently, the applicable legal framework is outlined, followed by an explanation of the scope of the thesis. The fourth subsection defines important

²¹ Francis M Bator, ‘The Anatomy of Market Failure’ (1958) 72 Quarterly Journal of Economics 351.

terms used in the research. Thereafter the assumptions and hypotheses of the research are explained. Finally, to fulfil the overall aim and answer the research questions, certain delimitations must be made, which are described in the last subsection.

1.2.1 Aims, Research Questions and Objectives

This thesis adopts a problem and/or interest-focused approach to legal science.²² The central problem it addresses is the feasibility of leveraging the concept of market failure as an alternative way to incorporate public policy objectives within EU competition law. The overall aim of this thesis is, by interpretation and systematisation, to explore and clarify the role of market failure theory in EU competition law, specifically within the assessment of measures derogating from that framework on the basis of public policy ('public policy intervention').

The research question that this thesis addresses is:

What role and value, if any, does market failure hold within legal analysis of public policy intervention on markets in EU competition law?

To reach its aim and answer the research question, the thesis has five interrelated objectives.

First, a framework for assessing the relevance of market failure in EU competition law is established. With this objective, the theory of market failure is conceptualised as a tool to systematise the applicable law. For this reason, the theory of market failure in economic, legal, and political science is deconstructed in order to distinguish its different meanings and assess its relevance within the legal framework. Two sets of standards of market failure emerge: a narrower and a broader one. It is suggested that it is only through an application of the principle of proportionality that market failure can be used as a legal tool/requirement in EU competition law. Chapter 3 of this thesis provides a framework for assessing the role of market within this legal discipline.²³

²² Within the terminology of Peter Westberg, 'Avhandlingsskrivande Och Val Av Forskningsansats: En Idé Om Rättsvetenskaplig Öppenhet' in Lars Heuman (eds), *Festschrift till Per Olof Bolding* (Juristförlaget 1992) 421.

²³ See Chapter 3, section 3.3. The assertion is that, in EU competition law, the only feasible way to conduct a market test in EU competition law is to conceptualise the proportionality assessment as a 'market diagnostic test'.

Second, having constructed a theoretical framework, the next step is to assess the legal regime of exceptions to EU antitrust and State aid rules. This task also includes an analysis of the objectives of the legal fields.

Third, the market failure framework established in the first step is applied to the different areas of EU competition law. Such an assessment determines the *function* of market failure within the legal field. In essence, this exercise answers the ‘*how*’ -question of market failure.²⁴ The feasibility of interpreting the positive law as a market failure test is assessed.

Fourth, the *meaning* of market failure in the different fields is analysed. If the previous objective replied to the ‘*how*’ question this exercise answers the ‘*why*’ question.²⁵ The role of, and the relationship between, the different grounds of exceptions are analysed (both efficiency grounds and external values). The extent to which Member States and private firms can promote public policy objectives through intervention/derogation in the market is an issue linked to different policies of the Union (e.g., environmental policy²⁶ or social policy²⁷). It is determined how these grounds of derogation reflect different goals and values and consequently what the meaning of market failure is *in EU competition law*. The manner in which failing markets are remedied by public policy intervention within this legal field might not correspond to economic theory. If traditional market failure standards are insufficient, an alternative explanation must be provided.

Fifth and last, a comparison is made between the State aid regime and the antitrust provisions. This provides the thesis with the basis for producing fruitful and justified conclusions.

Furthermore, the main research question, together with the aim of the research, brings about a set of sub-research questions:

- (a) *How is market failure defined in theory?*
- (b) *Can a broad definition of market failure sufficiently encompass a wide spectrum of public policy considerations?*

²⁴ This question relates to the *function* of market failure, i.e., *how* does it function?

²⁵ The question relates to the *nature* of market failure, i.e., *why* is it used?

²⁶ Articles 12 and 191-193 TFEU.

²⁷ Articles, 3(3) TEU and 151-161 TFEU.

- (c) *What type of framework can be developed to assess the relevance of market failure analysis within EU competition law?*
- (d) *Can the legal framework of EU competition law be understood through the lens of a mainstream economic conception of market failure?*
- (e) *If not, can an alternative approach to market failure be identified?*
- (f) *Can an EU competition law concept of market failure be discerned?*
- (g) *What is the role of economic efficiency as a justificatory ground within EU competition law?*
- (h) *Does the test based on economic efficiency differ fundamentally from the assessment of so-called external objectives?*
- (i) *Considering the above, do the outcomes derived from public policy evaluations under EU antitrust law vary when compared against the State aid provisions?*

Breaking down the research question into this set of sub-research questions ensures that the purpose of the thesis is fulfilled, i.e., to explore and clarify the role of market failure analysis in EU competition law.

1.2.2 The Applicable Legal Provisions

The majority of this thesis studies the legal justifications in EU primary law for anticompetitive agreements and State aid. However, Chapter 6 also investigates market failure from the perspective of what is termed ‘legal qualification’ to compare the different ‘legal techniques’ and their implications on market failure analysis.

Before providing an overview of the applicable legal provisions, something should be said about the nature of these legal provisions. It is argued that there are two possible ways through which a judge can grant an exception to the competition law provisions: legal qualification and legal justification. This distinction is

explained by Sullivan.²⁸ Legal qualification or ‘categorization’ is a ‘job of classification and labelling’.²⁹ In contrast, legal justification or ‘balancing’ is rather ‘liker grocer’s work (or Justice’s) – the judge’s job is to place competing rights and interests on a scale and weigh them against each other’.³⁰ Legal justification thus describes rules that provide exceptions via a balancing exercise. Legal qualification, on the contrary, is the method by which a measure falls outside of the scope of the applicable provisions by virtue of its characteristics. In other words, a qualification approach requires that the outcome follows from the taxonomy/classification of a rule. To illustrate, consider the following example related to prudential supervision, where statutory capital requirements are imposed on ‘credit institutions’. In a legal dispute, the definition and scope of a ‘credit institution’ could come under question in the context of firms that, through an online platform, offer short-term loans without the prerequisite of collateral. By interpreting the notion of ‘credit institution’ narrowly to exclude firms offering short-term unsecured loans, provided that they fulfil a set of criteria, a judge could be considered to ‘create’ an exception to the rule (the capital requirements) through the process of qualification. According to Sullivan, ‘the outcome follows, without any explicit judicial balancing [...]’.³¹ In competition law both these ‘legal techniques’ are present.³²

Having established the nature of the exceptions to competition law, this subsection briefly outlines the applicable legal provisions. This thesis takes a ‘holistic approach’,³³ analysing the theory of market failure within the different provisions of competition law. For the purpose of distinguishing between these provisions, this thesis refers to either ‘antitrust law’ or ‘State aid law’.

First, the antitrust provisions of the Treaty are Articles 101 and 102 TFEU. These are applicable to all firms, without making any distinction between public

²⁸ Kathleen M Sullivan, ‘Post-Liberal Judging: The Role of Categorization and Balancing’ (1992) 63 University of Colorado Law Review 293. For an analysis of this approach under Article 34 TFEU, see Ioannis Lianos, ‘In Memoriam Keck: The Reformation of the EU Law on the Free Movement of Goods’ (2014) 5 CLES Research Paper Series.

²⁹ *ibid.*, 293.

³⁰ *ibid.*, 294.

³¹ Sullivan (n 28) 293.

³² See Chapters 5 and 6.

³³ See section 1.2.3.3 of the current chapter.

and private undertakings.³⁴ This is also the case for the State aid provisions, although these are also addressed to the Member States. Rather than placing any weight on the legal (or *de facto*) form of the entity, both sets of provisions are applicable to any entity engaged in economic activity.³⁵ This is a critical feature as it might have great implications on the Member States' possibilities to pursue different public policies through the use of public or publicly controlled undertakings.³⁶ The submission of public firms to the antitrust provisions is not unproblematic, inasmuch as, contrary to the free movement provisions,³⁷ there is no explicit justification of public policy under these provisions.³⁸ Article 101(3) only provides an exception for certain agreements that generate efficiency benefits.³⁹ In addition, although these provisions are directed toward undertakings, Member States can in certain specific circumstances be subjected to the antitrust provisions,⁴⁰ via the so-called loyalty clause in Article 4(3) TEU.⁴¹

Although the Treaty provisions do not provide for any explicit public policy exception under competition, the case law of the Court has, via the recognition of unwritten rules, legitimised public policy considerations in certain cases.⁴² In

³⁴ See for a more in-depth analysis see Chapter 4, sections 4.2.1.1 and 4.2.1.2.

³⁵ Case C-41/90 *Höfner and Elser v Macrotron* EU:C:1991:161, para. 21. However, this definition is relative and a State body can be considered an undertakings *only* for the part of its activity which is qualified as economic, see, e.g., Case C-49/07 *Motosykletistiki Omospondia Ellados NPID (MOTOE) v Elliniko Dimosio* EU:C:2008:376, para 25; Case T-155/04 *SELEX Sistemi Integrati v Commission* EU:T:2006:387.

³⁶ The only exception to this rule is Article 106(1) TFEU.

³⁷ These prohibitions are subject to both textual and non-textual exceptions. See, to this effect Articles 36 and Article 62 TFEU; Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* EU:C:1979:42; Case C-288/89 *Gouda* EU:C:1991:323.

³⁸ Erika Szyszczak, 'Services of General Economic Interest and State Measures Affecting Competition.' (2014) 5 *Journal of European Competition Law & Practice* 508, 508.

³⁹ See Chapter 4, section 4.2.

⁴⁰ Case 13/77 *INNO v ATAB* EU:C:1977:185, paras 31 and 32; Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* EU:C:2014:2147, para 28.

⁴¹ Articles 4(3) TFEU stipulates: 'Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties. The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives.'

⁴² Case C-309/99 *Wouters* EU:C:2002:98, para 97; Joined Cases C-427/16 and C-428/16 *CHEZ Elektro Bulgaria* EU:C:2017:890, para 55, that exception applies to measures which 'are limited to

addition, through the exercise of legal qualification, certain entities can be excluded from the application of these provisions on the basis that they are not engaged in economic activity.⁴³

All these possible justifications are analysed from the viewpoint of market failure and public policy in Chapters 5 and 6.

Second, beyond the antitrust provisions, in certain instances EU competition law is not only addressed to undertakings but also catches public measures directly in the form of State aid.⁴⁴ Within the competition law framework, Article 107 TFEU declares State aid ‘which distort competition or threatens to distort competition [...] in so far as it affects trade between Member States [...] incompatible with the internal market’. For State aid to be declared compatible it must fall within the categories of Article 107(2) or Article 107(3). For this purpose, the Commission possesses significant discretion in declaring State aid compatible with the internal market.⁴⁵ For that reason, State aid is a perplexing legal field characterised by a significant amount of soft law. Exercising that discretion, the Commission has adopted an economic test based on market failure. However, the relationship between discretionary ‘rule-making’ by the Commission via soft law and the legal requirements of the Treaty is ambiguous. The State aid regime is analysed in Chapters 7, 8 and 9, which analyse both the general State aid regime and a number of sectorial frameworks.

1.2.3 The Scope of the Research

This section determines and describes the scope of the study. Three issues are subsequently explained. First, the research provides an analysis of public policy

what is necessary to ensure the implementation of legitimate objectives’. These exceptions are analysed in Chapter 6, section 6.1.2.

⁴³ This exceptions is twofold. First, acts of so-called public authority cannot be qualified as economic activity (e.g., Case C-113/07 P *SELEX Sistemi Integrati v Commission* EU:C:2009:191). Second, activities based on solidarity are also excluded (e.g., Case C-67/96 *Albany* EU:C:1999:430).

⁴⁴ A measure only constitutes state aid if involves a transfer of state resources (Case C-379/98 *PreussenElektra* EU:C:2001:160, para 57; Case C-706/17 *Achema and Others* EU:C:2019:407, para 69), which makes it an inherently public measure, see for further discussion Chapter 4, section 4.2.1.2.

⁴⁵ See Chapter 7, section 7.3.2.2. For an analysis see Michelle Cini, ‘State Aid Control from a Political Science Perspective’ in Leigh Hancher and Juan Jorge Piernas López, *Research Handbook on European State Aid Law* (Edward Elgar 2021) 1.

intervention beyond a traditional approach focusing on direct State measures. Second, the meaning of public policy for the purposes of this research is explained. Third, the holistic approach taken by the thesis is described and justified.

1.2.3.1 Unpacking Public Policy Beyond Direct State Measures

Market failure is conventionally thought of as a welfarist and utilitarian explanation of State intervention in markets.⁴⁶ It is, nevertheless, suggested that it is necessary to broaden the scope of the analysis to include anticompetitive measures taken by firms as well. Three arguments are forwarded to this effect.

First, as explained above, EU competition law makes no distinction between public and private firms when applying the antitrust and State aid provisions.⁴⁷ In addition, even if public policy were to be limited to State action, there are different layers of such policy intervention, which is not limited to direct intervention via regulation or the grant of public subsidies. Public policy interventions may vary in their application, but the objective remains the same: to further an objective deemed socially desirable. In this sense, public policy measures are multifarious and to reduce the concept to direct intervention via regulation would be unsatisfying. This research shows that public policy intervention does not inevitably fall within a clear-cut public or private sphere. Beyond a binary opposition between the market and the State there is a significant grey zone.

Second, it is argued that in the past decade there have been signs of a shift in public policy implementation from traditional command-and-control ('C-and-C') regulation to market-governed implementation with a focus on inclusive and sustainable development.⁴⁸ This approach has also been adopted in EU

⁴⁶ Bradley W Bateman, 'Analyzing Market Failure: Adam Smith and John Maynard Keynes' (2015) 45(5) *History of Political Economy* 127. For a similar view see e.g., Alain Marciano and Steven G Medema, 'Market Failure in Context: Introduction' (2015) 47 *History of Political Economy* 1, 1.

⁴⁷ For a deeper analysis of the notion of economic activity see Chapter 4, sections 4.2.1.1 and 4.2.1.2 and Chapter 6, section 6.1.3.

⁴⁸ José Carlos Marques and Peter Utting, 'Introduction: Understand Business Power and Public Policy in a Development Context' in José Carlos Marques and Peter Utting, *Business, Politics and Public Policy* (Palgrave Macmillan 2010) 1, 4: 'Global corporations are now considered key partners in efforts to promote inclusive and sustainable development'. See e.g., OECD Guidelines for Multinational Enterprises, available at: <<https://mneguidelines.oecd.org/guidelines/>>; United Nations, 'Guide to Corporate Sustainability' (2015 Report), available at <<https://unglobalcompact.org/library/1151>>.

competition law, where the Commission recently adopted the new draft Guidelines on Horizontal Cooperation, including a chapter on sustainability cooperation.⁴⁹ These are closely examined in Chapter 5.

Finally, public policy exceptions to Article 101(3) have been subject to extensive writing in EU competition law scholarship.⁵⁰ The existence of some room for public policy objectives under that Article provides evidence for its legal relevance.⁵¹ This thesis builds on this research and provides a new perspective by the analysis of market failure under Article 101(3).

1.2.3.2 The Concept of Public Policy: Objectives and Values

Public policy is an enigmatic and broad notion. This subsection, therefore, delineates the notion of public policy for the purpose of this research.

However, before continuing, a few remarks on the use of public policy as a legal ground for derogation are in order. Lawyers might traditionally have a sceptical stance toward the inclusion of public policy in legal analysis. Dworkin famously distinguished between ‘arguments of principle’, which are based on rights, from ‘argument of policy’.⁵² In hard cases, i.e., cases where there is no settled rule that dictates the outcome, ‘a proper decision could be generated by either policy or principle’.⁵³ In the framework of justifications of anticompetitive measures under EU competition law, many cases can be qualified as hard cases

See also in the EU, the rules in corporate sustainability reporting, Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

⁴⁹ Communication from the Commission, Approval of the content of a draft for a Communication from the Commission, ‘Guidelines on the applicability of Article 101 of the Treaty of the Functioning of the European Union to horizontal co-operation agreements’ (2022/C 164/01). This trend is also visible in various States signifying a further competition law modernisation, see to this effect policy guidelines from the Dutch and British NCAs, Autoriteit Consument & Markt, ‘ACM’s oversight of sustainability agreements: Competition and sustainability’ (n 5); Competition & Markets Authority, ‘Green Agreements Guidance: Guidance on the application of the Chapter I prohibition in the Competition Act 1998 to environmental sustainability agreements’ (n 5).

⁵⁰ See Chapter 4, section 4.3.2.

⁵¹ See Chapter 5, section 5.2.2.1.2.

⁵² Ronald M Dworkin, *Taking Rights Seriously* (Duckworth, 1977).

⁵³ *ibid.*, 83. Although Dworkin is not in favour of generally recognising that judgments should be guided by policy. At page 84 he writes: ‘I propose, nevertheless, the thesis that judicial decisions in civil cases, even in hard cases [...], characteristically are guided and should be generated by principle not policy’.

since they require balancing. They are characterised by a balancing exercise based on proportionality and can be justified both on written and unwritten grounds.⁵⁴ Moreover, even acknowledging that not all cases where policy grounds are forwarded in EU competition are hard cases, since there exists a legal rule for determining the outcome, the unique characteristics of EU competition law interweave EU policies with those of the Member States in varying balancing acts. In this context, the applicable legal provisions, by their very nature, are open-ended and require some value judgment in the sense of judicious balancing.

We now turn our attention towards the content of the notion of public policy. Sometimes, scholarly contributions analysing public policy under Article 101(3) TFEU omit defining the concept.⁵⁵ Based on this, it appears that there is an implicit understanding, or even quasi-consensus, that public policy refers to non-competition interests. However, for the purpose of this thesis, it is imperative to further define these interests.

First, one critical aspect of public policy appears to be the State involvement in defining the content of such public policy. Indeed, the term *politia* in late Latin refers to ‘the state’ or ‘civil administration’.⁵⁶ From that view public policy ‘is about what governments choose to do and or not to do’.⁵⁷ Contrary to broad political values such as democracy or freedom, ‘[p]olicy values manifest themselves in particular areas of government action’.⁵⁸

Yet, a modern concept of public policy is not necessarily limited to specific government action in a given field. Other scholars, on the contrary, see public policy as ‘values’.⁵⁹ These public policy values ‘are the ends embodied in, and

⁵⁴ See Chapter 3, section 3.1.3 on the principle of proportionality. These grounds are then studied thoroughly throughout Chapters 5 and 6.

⁵⁵ e.g., Anne C Witt, ‘Public Policy Goals Under EU Competition Law - Now Is the Time to Set the House in Order’ (2012) 8 European Competition Journal 443. Her contribution examines, under the title ‘public policy’, a variety of interests, such as industrial policy considerations; social policy values; environmental benefits or cultural benefits.

⁵⁶ <<https://www.etymonline.com/word/policy>>.

⁵⁷ Jonathan Boston, Andrew Bradstock and David Eng, ‘Ethics and Public Policy’ in Jonathan Boston, Andrew Bradstock and David Eng, *Public Policy: Why Ethics Matter* (Australian National University Press 2010) 1.

⁵⁸ *ibid.*

⁵⁹ Jenny Stewart, *Public Policy Values* (Palgrave Macmillan, 2009).

implemented through, the collective choices we make through policy processes'.⁶⁰ Such a definition would appear to not limit public policy implementation strictly to the public sphere.

Regardless of the level of implementation, however, the content of public policy appears to always refer to a collective aim. Dworkin wrote that:

Arguments of policy justify a political decision by showing that the decision advances or protects some collective goal of the community as a whole.⁶¹

Monti, in a piece examining public policy in EU competition law, adopts a notion inspired by Dworkin: public policy includes 'considerations of the collective goals of a community as a whole, goals in the case of the EC, are identified in the Treaties'.⁶²

It is suggested that adopting a similar notion of public policy for this research is appropriate. Nonetheless, certain aspects of public policy formulation make it difficult to limit the notion to goals 'identified in the Treaties'. Sometimes the Treaties only include very broad goals and offer the Member States a large margin of discretion in defining public policy therein.⁶³ On the contrary, however, the development of competition policy is an exclusive EU competence.⁶⁴ Notwithstanding the exclusive competence of the EU, this research shows that public policy forwarded as justification for anticompetitive measures need not be shared by *all* the Member States.⁶⁵ This ambiguous division of competences is further explored in Chapters 5, 6, and 8.

In summary, it can be deduced from the above that public policy can be understood as both actions and values reflecting a collective goal of a community. In the case of the EU, the competence of defining of public policy can fall on either the Union or the Member States.

⁶⁰ *ibid.*, 14.

⁶¹ Dworkin (n 52) 82.

⁶² Giorgio Monti, 'Article 81 EC and Public Policy' (2002) 39 Common Market Law Review 1057. 1059.

⁶³ For instance, public health, see Articles 6 and 168 TFEU.

⁶⁴ Article 3(b) TFEU.

⁶⁵ See Chapter 8, section 8.1.3.1.

For the purpose of this thesis, public policy is understood as ‘common objectives/values that follow from the EU Treaties and the case law of the EU Courts or national values recognised by the EU Courts’.⁶⁶ In addition, since the subject of the study is derogations from the competition law framework, public policy refers to any of these values/objectives other than competition policy.⁶⁷

1.2.3.3 The Case for a Holistic Approach

As stated previously, this thesis adopts a holistic approach by assessing the different provisions of EU competition law. It has been demonstrated that such an analysis is both logical and coherent, given that both Articles 101(3) and 107(3) TFEU are explicitly addressed to undertakings. Such an approach provides a basis for comparing between the EU antitrust law framework and State aid law. Furthermore, comparisons are drawn with the wider framework of EU economic law.⁶⁸ It is suggested that drawing comparisons with the free movement provisions, when relevant, might reveal new insights. Therefore, Chapter 3 includes a section on proportionality in free movement law as a starting point to fully comprehend the function of that principle. The use of proportionality in free movement law is well established and can serve as a basis for a deeper understanding of the different expressions of proportionality in EU antitrust and State aid law. Similarly, in Chapter 6, parallels are drawn between antitrust and free movement law when convergence is visible. There are several reasons that make such a comparison relevant.

First, although the two sets of provisions are not usually applied together, it appears that the application of free movement law and competition is not exclusive,⁶⁹ creating a possible overlap within the enforcement of these articles.

⁶⁶ This notion is sufficiently broad to encompass a wide array of goals that the Treaties cover, such as environmental protection, public health, education, employment, social cohesion equality etc.

⁶⁷ Throughout this thesis these goals are referred to as ‘public policy goals’ or ‘broader goals/objectives’. These two terms are used as synonyms to denote values other than the protection of competition.

⁶⁸ The term EU economic law, employed in this context to refer to both the free movement provisions and the competition law provisions.

⁶⁹ Christoph Krenn, ‘A Missing Piece in the Horizontal Effect “Jigsaw”: Horizontal Direct Effect and the Free Movement of Goods’ (2012) 49(1) Common Market Law Review 177, 205, pointed out that ‘the Courts applies competition law and fundamental freedoms cumulatively’, in particular in relation to State conduct.

Second, applying a holistic approach to the study of the Treaty provisions is also supported by the application of Article 106(2) TFEU to public services under both competition law and free movement law.⁷⁰

Third, whilst there may be instances where the scope of these Articles overlaps, in situations where they do not intersect their distinct scope of application is mostly of a *formal* nature, contingent on the origin of the measure at stake rather than its objective. In other words, their respective scope of application is not centred around the nature – or the effect – of the measure in question but depends on whether a measure is attributable to the State⁷¹ or undertakings engaged in economic activity.⁷² One set of rules will, in principle, apply.

Finally, there is at least a potential convergence between free movement and competition law regarding the substantive assessment of measures.⁷³ In terms of their objectives, competition is integral to the achievement of the internal market.⁷⁴ Conversely, economic integration is a constitutional goal of competition law, which, as put by Sauter, ‘is clearly consistent with a view of the overall external coherence of EU law within the body of EU law as a whole’.⁷⁵ The aim of economic integration appears accordingly pivotal to both the internal market and EU competition law.⁷⁶

⁷⁰ Although Article 106(2) applies to undertakings, Member State may rely on this provision as a defence under both competition law and free movement law. For a case examining the conditions of Article 106(2) TFEU under the freedom to provide services, see, Case C-171/17 *Commission v Hungary* EU:C:2018:881.

⁷¹ A notion which has been interpreted broadly, see Chapter 4, section 4.2.1.

⁷² Case C-41/90 *Höfner* (n 35), para 21.

⁷³ The rationale behind these rules is examined closer further on in this research. The issue of legal convergence between free movement law and competition law has been subject to extensive research, see, Claus-Dieter Ehlermann, ‘The Contribution of EC Competition Policy to the Single Market’ (1992) 29 *Common Market Law Review* 257; Lawrence W Gormley, ‘Competition and Free Movement: Is the Internal Market the Same as a Common Market’ (2002) 13(6) *European Business Law Review* 517; Mortelmans (n 29); Julian Nowag, *Environmental Integration in Competition and Free-Movement Laws* (OUP 2017); Protocol n 27 to the Lisbon Treaty.

⁷⁴ See, Article 3 of the Rome Treaty.

⁷⁵ Sauter, *Coherence in EU Competition Law* (n 6) 73.

⁷⁶ For a similar view, see Julian Nowag, ‘Changing the Competition Regime without Altering the Treaty’s Chapter on Competition?’ in Martin Trybus and Luca Rubini (eds), *The Treaty of Lisbon and the Future of European Law and Policy* (Edward Elgar 2012) 398.

A certain degree of substantive convergence between free movement and competition law is also noticeable in the case law of the Court. Points in common can be found between entry barriers, which is an essential concept of competition theory, and barriers to trade under the free movement provisions. In antitrust law, barriers to entry and protection against market foreclosure, or market partitioning, appear to have always occupied an essential place within the EU's competition law framework.⁷⁷ In several cases, such as *GSK*, the ECJ has 'equated' a barrier to parallel trade as an object restriction of competition.⁷⁸ In cases such as *Eco Swiss*⁷⁹ or *Courage Ltd v Crehan*,⁸⁰ the Court further emphasised the internal market aim of the competition rules:

[Article 101 TFEU] constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular for the functioning of the internal market'.⁸¹

Another substantive commonality can be observed in that both sets of legal rules are based on an assessment of the effect on trade between Member States.⁸² Finally, although the similarities between these two branches of law should not be

⁷⁷ Vasiliki S. Brisimi, *The Interface Between Competition and the Internal Market: Market Separation Under Article 102 TFEU (Hart Studies in Competition Law)* (Bloomsbury Publishing 2014) 29.

⁷⁸ Case C-501/06 *P GlaxoSmithKline Services (GSK) and Others v Commission and Others* EU:C:2009:610, para 59. See also, Case 19/77 *Miller International Schallplatten GmbH v Commission* EU:C:1978:19, paras 7 and 18; Joined cases 32/78, 36/78 to 82/78 *BMW Belgium SA and others v Commission* EU:C:1979:191, paras 20 to 28 and 31; Joined Cases C-468/06 to C-478/06 *Sot.Lélos kai Sia and Others* EU:C:2008:504, para 65.

⁷⁹ Case C-126/97 *Eco Swiss China Time Ltd v Benetton International NV* EU:C:1999:269, para 36.

⁸⁰ Case C-453/99 *Courage Ltd v Bernard Crehan and Bernard Crehan v Courage Ltd and Others* EU:C:2001:465.

⁸¹ Case C-453/99 *Courage* (n 80), para 20. See also, e.g., Joined Cases C-468/06 to C-478/06 *Sot.Lélos kai Sia and Others* (n 78), para 65: 'In relation to the application of Article [101 TFEU], the Court has held that an agreement between producer and distributor which might tend to restore the national divisions in trade between Member States might be such as to frustrate the objective of the Treaty to achieve the integration of national markets through the establishment of a single market'; Case C-501/06 *P GlaxoSmithKline Services (GSK) and Others v Commission and Others* (n 78), para 61.

⁸² David O'Keefe and Antonio Bavasso, 'Four Freedoms, One Market and National Competence: In Search of a Dividing Line' in David O'Keefe and Antonio Bavasso (eds), *Judicial Review in European Union Law* (Kluwer Law International 2000) 544 in Kamiel Mortelmans, 'Towards Convergence in the Application of the Rules on Free Movement and on Competition?' (2001) 38 *Common market law review* 613.

overestimated, a certain degree of convergence takes place both between the prohibitions (scope and applicability) and between the exceptions.⁸³

In essence, it is argued that a holistic approach, including both antitrust and State aid provisions, provides a *de novo* analysis of the role of public policy intervention through the lens of market failure. From a systemic perspective, the broader field of ‘EU economic law’ includes both the competition and the free movement provisions. Moreover, drawing comparisons, when relevant, not only between the field of State aid and competition law but also to the free movement provisions contributes to deepening the analysis.

1.2.4 On Terms and Concepts

This thesis refers to terms and concepts lacking a uniform understanding. To aid the reader this subsection clarifies some key concepts used throughout this research.

First, EU competition law is based on a myriad of objectives, and there seems to be a quasi-consensus in scholarship that the legal field includes objectives beyond efficiency goals.⁸⁴ In scholarship, a distinction is frequently made between ‘economic’ and ‘non-economic’ objectives.⁸⁵ It is suggested that the term non-economic is misleading as it is difficult, if not impossible, to draw such precise boundaries of what is and what is not ‘economic’. Economics encompasses a vast array of factors that influence market outcomes and human behaviour. In practice, it is challenging to delineate between what is purely economic and what could be considered non-economic. Many aspects of human activity that might initially seem unrelated to economic factors can, in fact, have significant economic implications. The use of the term ‘non-economic’ risks, therefore, reducing the scope of the research to an extent that incorrect conclusions may be drawn.⁸⁶

⁸³ Mortelmans (n 82).

⁸⁴ See Chapter 4, section 4.3.1.

⁸⁵ see e.g., Rutger Claassen and Anna Gerbrandy, ‘Rethinking European Competition Law: From a Consumer Welfare to a Capability Approach.’ (2016) 12 Utrecht Law Review 1; Mortelmans (n 82); Małgorzata Kozak, ‘Competition Law and the COVID-19 Pandemic -- Towards More Room for Public Interest Objectives?’ 17 Utrecht Law Review.

⁸⁶ For instance, it may suggest that there are broad possibilities to include ‘non-economic’ objectives, or conversely that only ‘economic’ objectives are taken into account, when in reality the picture is more nuanced. An example would be to refer to environmental protection as ‘non-economic’.

Instead, the term ‘efficiency objectives’ is suggested. Within efficiency objectives an additional distinction must be made between ‘narrow efficiency goals’ and broader ‘efficiency goals’. On the one hand, ‘narrow efficiency goals’ describe objectives that further efficiency, consumer welfare and ultimately competition without considering broader efficiencies created for society.⁸⁷ On the other hand, the term ‘broader efficiencies’ describes efficiencies that are produced in terms other than competition. These include, for instance, innovation, the creation of positive externalities such as education or the protection of public health.⁸⁸ These broader efficiencies might have to be balanced against narrow efficiency objectives when determining the outcome of a case. Finally, instead of the designation ‘non-economic’ objectives the term ‘external objectives’ is preferred. It is used to describe objectives that do not aim to achieve narrow/broad efficiency but rather other socially desirable outcomes such as reducing economic disparities,⁸⁹ encouraging employment,⁹⁰ promoting ethical standards in sport,⁹¹ etc. They are coined ‘external’ as they cannot be integrated into a narrow efficiency-based test without admitting trade-offs.⁹²

Second, to describe measures that infringe competition law but may be justified on the basis of broader efficiencies or external objectives, this research uses the term ‘public policy intervention’. As explained and justified above, although public policy naturally has an undercurrent of State intervention, it is suggested that this term should also include anticompetitive agreements under Article 101(3) TFEU. As for the term ‘intervention’, it can be defined as ‘the action of becoming intentionally involved in a difficult situation, in order to improve it or prevent it from getting worse’.⁹³ As a result, public policy intervention refers to situations where the State or private firms intervene in the market with the objective of producing an effect deemed socially desirable on the basis that it furthers one or more public policy objectives.

⁸⁷ i.e., efficiencies beyond competition.

⁸⁸ On externalities, Chapter 2, section 2.2.1.

⁸⁹ See e.g., regional State aid in Chapter 9, section 9.2.

⁹⁰ For an example under antitrust law see cases cited in Chapter 5, section 5.3.1.2.1.2.

⁹¹ See Chapter 6, section 6.1.2.1.1.

⁹² On the nature of a broad market failure standard see Chapter 2, section 2.2.2.

⁹³ <<https://dictionary.cambridge.org/dictionary/english/intervention>>.

1.2.5 Assumptions and Hypotheses

The analysis is based on an assumption and formulates several hypotheses. The working assumption can be described as follows:

Public policy exceptions form an integral part of the legal framework of EU competition law. These exceptions must be reassessed within the more economic approach.

This assumption will be substantiated throughout this thesis, where it is shown through a market failure analysis that there is a stark discrepancy between the role of public policy in EU competition law and the more economic approach. Moreover, the research also formulates a series of hypotheses:

Public policy intervention in the market, infringing upon the competition law provisions, is acceptable only to the extent that the same result cannot be achieved by the market alone.

A market failure approach based on economic efficiency is insufficient to explain the outcome of public policy measures under both EU antitrust and State aid law.

A narrow efficiency/consumer welfare approach is insufficient to explain public policy exceptions to EU competition law.

The traditional doctrinal distinction between non-economic and economic objectives is inapt to explain the competition law framework.

The roles and values of market failure differ across the different fields of EU competition law, considering their scope and functionality.

The first hypothesis is a direct translation of the triangular relationship *prohibition-exception-justification*, which results from the default mode of EU competition law.⁹⁴ This default mode model presumes that any public policy intervention – be it by Member States or private firms – that lessens competition and negatively affects trade is unlawful, absent legitimate justification. From this, the hypothesis postulates that a common feature of the different legal possibilities

⁹⁴ See Chapter 3, section 3.1.2.

of intervention is the incapacity of the market to autocorrect according to societal preferences.

The second hypothesis is based on a *prima facie* discrepancy between economic theory and ‘legal reality’. If this discrepancy is substantiated, it prompts the question of whether it is possible to define a broader EU law doctrine of market failure? Furthermore, it is within the context of this hypothesis that the dichotomy between efficiency and external objectives is explored. In addition to market failure, issues such as equity⁹⁵ and solidarity⁹⁶ have often been considered alternative rationales for public policy intervention. Within this conflict, a market failure analysis of EU competition law might contribute with important insights into the scrutiny of public policy measures and the balance between different objectives.

The third and fourth hypotheses relate to a broader reading of the competition law’s welfare objective explored in Chapter 4. It is revealed that various broader efficiencies are assessed within the welfare analysis under Article 101(3). Consequently, and as noted above, it is suggested that the traditional distinction between ‘economic’ and ‘non-economic’ objectives lacks precision and adequacy in explaining these exceptions. Numerous objectives traditionally considered as non-economic can be incorporated into a market failure analysis, which is inherently economic.

Should the fifth hypothesis be proven, it shows that the use of market failure as an ‘economic’ and ‘objective’ notion is not clear-cut. Rather, the meaning of market failure varies depending on the functionality and objectives of the specific legal provisions. A more economic approach is then not a fit-all strategy to modernise EU competition law but must be designed with caution and due attention to the legal objectives of the different fields of EU competition law.

⁹⁵ e.g., Stiglitz E Joseph and Rosengard K Jay, *Economics of the Public Sector*, international student edition (4th ed, Norton 2015) 95-96; Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice*. (OUP 2012) 22, considered alternative explanations of regulation such as ‘rights-based’ and ‘social rationales’; Stephen Breyer, ‘Typical Justifications for Regulation’ in Robert Baldwin, Colin Scott and Christopher Hood (eds), *A Reader on Regulation* (OUP 1998) 59, 64-65.

⁹⁶ e.g., Prosser (n 18) 365.

1.2.6 Delimitations

In essence, market failure provides a justification for public intervention in the market.⁹⁷ However, market failure is only one of a myriad of theoretical explanations for state intervention via public policy objectives in the market generally. As pointed out by Nelson:

[t]he range and linkage of issues and policies makes analysis of appropriate government roles complicated – more complicated, I fear, than many professional economists and political scientists seem to recognize.⁹⁸

The first sacrifice of the research is the focus on market failure. Alternative explanations for public policy intervention from economics or political science are excluded. Rather than comparing these different theories from a legal perspective, this research focuses on the possible application of market failure and the discrepancy between market failure as an economic theory and a legal concept.

The research also makes delimitations regarding the scope of the legal analysis. First, it does not deal with any exceptions to the applicable law on the basis of secondary law. Second, despite drawing conclusions in relation to antitrust law generally, Article 102 TFEU is not directly part of the analysis. There are two reasons for the exclusion of that provision.

Firstly, Article 102 is less interesting quantitatively in the matter of public policy intervention in markets. The scholarly debate on EU competition law and public policy has also revolved around the role of Article 101(3) TFEU. A possible explanation for this focus is the lack of cases under Article 102. The doctrine of the efficiency defence under Article 102 has only been recognised in case law and is not part of the Treaty provisions themselves.

Secondly, the conclusions drawn from Article 101 apply *mutatis mutandis* to Article 102. This is the case both for legal justification and legal qualification. Notwithstanding the fact that Article 102 does not contain a textual exception such as an identical efficiency test under Article 102 mirrored on the one in Article

⁹⁷ Richard O Zerbo Jr and Howard E McCurdy, 'The Failure of Market Failure' (1999) 18(4) *Journal of Policy and Management* 558, 558.

⁹⁸ Richard R Nelson, 'Roles of Government in a Mixed Economy' (1987) 4(4) *Journal of Policy Analysis and Management* 541, 542.

101(3).⁹⁹ The criteria are therefore largely the same.¹⁰⁰ Along the same line, the *Wouters* rule of reason applies to both Articles 101 and 102.¹⁰¹

Another limitation is the exclusion of the regime governing services of general economic interest (SGEI). Article 106(2) TFEU prescribes that these public services can benefit from a general derogation from the above-mentioned provisions if the application of the latter would ‘obstruct the performance’ of the task assigned to them. There are two reasons for excluding SGEI from the scope of this research.

First, Article 106(2) is a *lex specialis* that, it is suggested, deviates from the overall welfare function of Article 101(1). EU law scholarship has put forward the idea of Article 106(2) as an ‘autonomous provision’, applicable horizontally to not only the competition law provisions.¹⁰² This thesis, on the contrary, undertakes an analysis of the role of market failure in the post-modernisation competition law framework with its focus on efficiency and consumer welfare. On this basis, it is suggested that Article 106(2) does not necessarily form part of the same nucleus of values as the rest of the competition law provisions.

Second, it is worth noting that the concept of market failure under Article 106(2) has already been the subject of extensive scholarly inquiry and analysis.¹⁰³ Moreover, that research, whilst centred on Article 106(2), does not account for the interplay between that Article and the antitrust or State aid provisions. The focus on Article 106(2) in scholarship underscores the independent function of that provision, distinct from the competition provisions.

⁹⁹ Case C-209/10 *Post Danmark* EU:C:2012:172, para 41.

¹⁰⁰ Communication from the Commission, ‘Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings’ 2009/C 24/02, paras 28-31.

¹⁰¹ See Chapter 6, section 6.1.2.

¹⁰² Erika M Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (Hart 2007) 216; Tarjei Bekkedal, ‘Article 106 TFEU Is Dead. Long Live Article 106 TFEU!’ in Johan W van de Gronden and others, *Legal Issues of Services of General Interest* (Springer 2011) 61, 62.

¹⁰³ See section 1.4.1 of the current chapter.

1.3 Methodology

A dual methodological task lies before this thesis. It must not only establish a methodology for the research but also, by applying that methodology, construct a conceptual and methodological framework for the analysis of market failure within EU competition law. In order to provide such a framework, a thorough analysis and deconstruction of the theories of market failure are imperative, aiming to dismantle the prevailing ambiguities to the fullest extent possible. This task is undertaken in Chapters 2 and 3 of this thesis. Nevertheless, before delving into the conceptualisation of market failure, the first methodological task must be resolved: defining the methodology employed in this thesis.

This section addresses the use of legal doctrine and its relationship to economics. First, the use of a legal doctrinal research method is established. Second, the interplay between law and economics is described through analysing the so-called economic approach to law. Finally, it is concluded that, in order to conduct this research, the thesis applies a legal doctrinal research method coupled with elements from a mainstream economic approach to law via the use of interdisciplinary engagements.

1.3.1 Legal Doctrine

Within the context of Westberg's terminology, this research can be characterised as adhering to a 'problem and/or interest-oriented approach'.¹⁰⁴ A key driver in problem-oriented research is the constant exploration of alternative approaches to the more conventional paradigms.¹⁰⁵ This thesis encompasses and embraces a problem perspective, endeavouring to navigate the complexities of integrating public policy objectives in competition by adopting an alternative approach: market failure.

However, the relationship between efficiency, consumer welfare, and the broader goals of competition law remains ambiguous.¹⁰⁶ This ambiguity extends to public policies pursuing objectives beyond the promotion of efficiency and, by extension, consumer welfare as understood in EU competition law. The focus on

¹⁰⁴ Westberg (n 22) 421.

¹⁰⁵ *ibid.*, 437.

¹⁰⁶ Most scholars recognise that EU competition is based on a myriad of objectives, see Chapter 4, section 4.3.1.

reducing prices and maximising output may inadvertently create other market failures, yielding outcomes that are not economically, socially or environmentally sustainable. Thus, it is posited that a narrow confinement of the objectives of competition law to mere economic efficiency may not be desirable. Notably, social and environmental sustainability concerns manifest themselves in markets and can influence firm behaviour and State action in those markets.¹⁰⁷ On a broader scale, a multitude of public policy objectives may be implemented through various instances of market intervention. It is, therefore, necessary to clarify how legal doctrine, as a conventional approach, can contribute to resolving the problem posed – i.e., the relevance of market failure theory in EU competition law when assessing public policy intervention.

For that purpose, the research applies legal doctrine (legal dogmatics) in order to systematise and interpret the law.¹⁰⁸ The main objective of legal dogmatics is to achieve coherence, ‘by means of production of general and defeasible theories [...] presenting the law as a net of principles, rules, meta-rules and exceptions, at different levels of abstraction’.¹⁰⁹ Coherence is also a desirable feature of every legal system. Coherence can be deconstructed into two levels: so-called *external* coherence – the coherence between the provisions and the legal system as a whole – and *internal* coherence – the system and components of the legal field/provision itself.¹¹⁰ In this respect, coherence must be evaluated from the EU legal system as a whole, aligning with the holistic approach of this research.¹¹¹ Finding itself in a tri-border area along the junction of constitutional law, competition law, and economics, the external aspect of coherence is decisive. Regarding the traditional doctrinal part of the research, the methodology can be divided into three limbs.

Firstly (i), the research establishes the normative framework within the field by mapping the actual and possible exceptions regarding measures taken on the basis of public policy to the application of EU competition law. Employing a *de lege lata* analysis, this study analyses, systematises and interprets the current state

¹⁰⁷ For a similar view see Wardhaugh (n 11) in Wardhaugh (ed) (n 11) 195, 196.

¹⁰⁸ Aleksander Peczenik, ‘Scientia Iuris - An Unsolved Philosophical Problem’ (2000) 3(3) Ethical Theory and Moral Practice 273, 273.

¹⁰⁹ *ibid.*, 291.

¹¹⁰ Sauter, *Coherence in EU Competition Law* (n 6) 9-10.

¹¹¹ See section 1.2.3.3 of the current chapter.

of the law¹¹² in light of the economic normative concept of market failure. Systematisation in legal research can be seen as a prerequisite for interpretation¹¹³ – even more so when analysing heterogenic and possibly incongruent legal norms consisting of both rules and principles.¹¹⁴ This process lays the foundation for developing relevant distinctions between different types of provisions and cases, and for further mapping of these under the studied concepts and principles.

Secondly (ii), the research categorises and systematises the case law of the EU Courts, as well as decisions of the Commission that assess exceptions to the legal framework, focusing particularly on the proportionality assessment in the different fields. This task is performed in accordance with the theoretical market failure framework developed in Chapter 3. Whilst the larger part of this examination consists of a *de lege lata* analysis of the proportionality assessment, the exercise ultimately requires analysing the methodology of the Court when balancing conflicting principles and interests,¹¹⁵ i.e., economic efficiency and external objectives. Such an analysis goes beyond a simple descriptive analysis of the law,¹¹⁶ since it demands not only inquiry into the justification (validity) of the national norm, but also into its application (appropriateness),¹¹⁷ which requires in its turn analysis and evaluation of all possible alternative norms applicable to a given situation.¹¹⁸

Such an analysis lays the groundwork for the third and final step (iii), at the point of which the results obtained through the first and second steps are assessed. A conclusive assessment is conducted of how the EU Courts and the Commission apply and interpret the different legal principles in order to unravel the relationship between EU competition law and the theory of market failure. This includes

¹¹² Peczenik, 'Scientia Iuris - An Unsolved Philosophical Problem' (n 108) 273.

¹¹³ Aulis Aarnio, 'Introduction' in Aleksander Peczenik, *On Law and Reason* (Springer 2008) 1, 3.

¹¹⁴ A distinction between rules and principles is necessary when analysing the balancing of conflicting norms. Robert Alexy, 'On the Structure of Legal Principles' (2000) 13 *Ratio Juris* 294.

¹¹⁵ On this context, the research will necessitate legal research on the balancing of legal principles, which as such inherently arises in cases involving Member States *derogating* from EU law.

¹¹⁶ However, as Peczenik, 'Scientia Iuris - An Unsolved Philosophical Problem' (n 108), 276 pointed out, 'the distinction between *de lege lata* and *de lege ferenda* is not clear-cut' and legal doctrine is at the same time descriptive and normative.

¹¹⁷ Klaus Günther, *The Sense of Appropriateness: Application Discourses in Morality and Law*. (State University of New York Press 1993), 25. See also, Robert Alexy, 'Justification and Application of Norms' (1993) 6(2) *Ratio Juris* 157.'

¹¹⁸ Günther (n 117) 34, 257, 271, 298.

analysing the interplay of the different policies and objectives that are sought to be achieved – efficiency and external objectives.

1.3.2 The Relationship Between Law and Economics

The use of economic theories in conjunction with legal doctrine might initially seem a puzzling matter. Bodig described legal scholarship as being ‘characterised as a normative and non-instrumentalist perspective on law’.¹¹⁹ Whether or not an entirely non-instrumentalist view of legal doctrine is fully accurate, the relationship between law and other sciences is indeed both nebulous and conflictual.

Therefore, this subsection aims to shed some light on the ambiguity that characterises the possible relationship between law and economics. Whilst the legal dogmatic approach remains crucial for this thesis, it has been claimed that many academic lawyers have today decoupled themselves from the traditional role of the legal scholar.¹²⁰ The reliance on economic concepts and assumptions in legal scholarship is as such nothing controversial or novel; competition lawyers are well familiar with concepts such as demand and supply curves, economic equilibrium, and game theory. Economic insights are even visible in the case law of the Court.¹²¹

Accordingly, when analysing the law in light of economic theory, including concepts such as market failure, there is a need to do so methodologically consistently and epistemologically convincingly, from both a legal and an economic point of view. For that purpose, it must be investigated whether any alternative theory offers complementary tools to analyse the relevance of market failure in law. This subsection explains and analyses the relationship between economics and law as a subject, and legal science as a method.

¹¹⁹ Matyas Bodig, ‘Legal Doctrinal Scholarship and Interdisciplinary Engagement’ (2015) 8(2) *Erasmus Law Review* 43, 43.

¹²⁰ Philip Langbroek and others, ‘Methodology of Legal Research: Challenges and Opportunities’ (2017) 13(3) *Utrecht Law Review* 1, 1.

¹²¹ In this respect, see Marcus Glader, *Innovation Markets and Competition Analysis – EU Competition Law and US Antitrust Law* (Lund University, DPhil Thesis 2004)15, pointed out that (arguably) the contribution of economics is not limited to explaining the functioning of markets, but the enforcement of the law by courts also demands economic analysis at some level.

First, the two mainstream types of an economic approach to law are described. The focus hereunder is on what has been labelled the ‘law and economics movement’.¹²² Second, the role of an economic approach to law is explained in order to identify its functions. Third, the methodological traits of an economic approach to law, and therefore those of economics itself, are explored. Finally, critiques of the concept must be studied to understand its possible shortcomings.

1.3.2.1 The Nature of an Economic Approach to Law

In order to initiate the exploration of the relationship between law and economics it is essential to comprehend the notion of an economic approach to law. In reality, there is not one monolithic interpretation of an economic approach to law, but a multitude of different schools.¹²³ However, on a general level two different approaches can be identified: ‘law and economics’ and ‘economic analysis of the law’. A significant challenge in disentangling these terms is that they are often used interchangeably as synonyms.¹²⁴ It even appears that these two sets of economic approaches to law often blend together; as put by Paces, ‘[l]aw and economics is a school of thought broadly concerned with the Economic Analysis of Law’.¹²⁵ However, as explicated below, these are two theoretically distinct approaches.

First, the origins of Law and Economics, and subsequently Economic Analysis of the Law, can be traced back to the eighteenth century and scholars

¹²² See e.g., Richard A Posner, ‘The Law and Economics Movement’ (1987) 77(2) *The American Economic Review* 1; Herbert Hovenkamp, ‘The First Great Law & Economics Movement’ (1990) 42(4) *Stanford Law Review* 993; James J Heckman, ‘The Intellectual Roots of the Law and Economics Movement’ (1997) 15(2) *Law and History Review* 327.

¹²³ Heico Kerkmeester, ‘Methodology: General’ in Gerrit De Geest (ed), *Encyclopedia of Law and Economics* (Edward Elgar 2000) 383, 383: ‘Such schools include Chicago Law and Economics, Public Choice Theory, Institutional Law and Economics and Neo institutional law and Economics’. See also, Mercurio and Steven G Medema, *Economics and the Law: From Posner to Post-Modernism* (Princeton University Press 1997), who considered Chicago law and economics; public choice theory; institutional law and economics; neo institutional law and economics and critical legal studies.

¹²⁴ e.g., Richard A Posner, *Economic Analysis of Law* (7th edn, Wolters Kluwer 2007); Alain Marciano, ‘Economics Analysis of Law’ in Alain Marciano and Giovanni Battista Ramello (eds), *Encyclopedia of Law and Economics* (Springer 2019) 629, 630; Cooter Robert and Thomas Ulen, *Law & Economics* (6th edn, Pearson 2012).

¹²⁵ Alessio M Paces, ‘A Law and Economics Perspective of Normative Analysis’ in Sanne Taekema, Bart van Klink and Wouter de Been, *Facts and Norms in Law: Interdisciplinary Reflections of Legal Method* (Edward Elgar 2016) 171, 171.

such as Beccaria and Bentham, and to a refusal to accept the legal world as it is from an economic standpoint.¹²⁶ The genesis of the discipline, as we know it today, occurred in the U.S. around the 1950s.¹²⁷ Nevertheless, the branch truly surfaced¹²⁸ with two important publications in 1961 by Coase¹²⁹ and Calabresi.¹³⁰ Further pivotal contributions by scholars, in particular Posner, contributed to the development of the field.¹³¹ It has been claimed that these latter publications, along with subsequent work, served as a catalyst for Law and Economics to metamorphose into a separate branch of analysis: Economic Analysis of the Law.¹³²

Second, regarding the functionality of the distinction between Law and Economics and Economic Analysis of the Law, the demarcation appears frangible and alludes to the objective of research, rather than to a fixed set of methodological factors. Miceli defined Economic Analysis of the Law as either positively describing the law using economic theories or, alternatively, making use of the latter normatively with the aim of ‘prescribing better rules’.¹³³ Similarly, Calabresi defined Economic Analysis of the Law as a theory that ‘uses economic theory to

¹²⁶ e.g., Thomas J Miceli, ‘Economic Models of Law’ in Francesco Parisi (ed), *The Oxford Handbook of Law and Economics: Volume 1: Methodology and Concepts* (OUP 2017) 9, 11; Richard A Posner, *Frontiers of Legal Theory* (Harvard University Press 2001) 31-32; Cento Veljanovski, *The Economics of Law* (2nd ed, IEA 2006) 27. For a long and slightly alternative story see, Heath Pearson, *Origins of Law and Economics* (CUP 1997) 5-43.

¹²⁷ As pointed out by Ejan Mackaay, *Law and Economics for Civil Law Systems* (Edward Elgar 2013) 29, the Journal of Law and Economics was founded in 1958.

¹²⁸ However, a big driver was also the works of Gary Becker, see e.g., Gary Becker, ‘The Economics of Discrimination’ (1958) 53 Journal of American Statistical Association 1047.

¹²⁹ Ronald H Coase, ‘The Problem of Social Cost’ (1960) 3 Journal of Law and Economics 1.

¹³⁰ Guido Calabresi, ‘Guido Calabresi Some Thoughts on Risk-Distribution and Law of Torts’ (1961) 70 Yale Law Journal 499; Guido Calabresi, ‘The Decision for Accidents: An Approach to Nonfault Allocation of Costs’ (1965) 78 Harvard Law Review 713.

¹³¹ See, e.g., Posner, *Economic Analysis of Law* (n 124) first published in 1972. See also the works of Manne, Henry G Manne, ‘Mergers and the Market for Corporate Control’ (1965) 73 Journal of Political Economy 110; Henry G Manne, ‘Our Two Corporate Systems: Law and Economics’ (1967) 53 Virginia Law Review 259.

¹³² See, Sophie Harnay and Alain Marciano, ‘Posner, Economics and the Law: From “Law and Economics” to an Economic Analysis of Law’ (2009) 31(2) Journal of the History of Economic Thought 215. Guido Calabresi, *The Future of Law and Economics* (Yale University Press 2016) 14-15.

¹³³ Miceli (n 126) 9. For the distinction between positive and normative economic analysis of the law, see the subsequent section below.

analyse the legal world'.¹³⁴ In such an analysis, 'economics dominates and law is its subject of analysis and criticisms'.¹³⁵ Within an economic analysis of the law, economic theory is thus applied to legal material in order to explain the law or prescribe better rules. In this analysis, if the legal world does not fit economic theory, it could be claimed to be 'irrational'.¹³⁶ An example of an economic analysis of the law would be Posner's efficiency theory of common law.¹³⁷

In contrast, Law and Economics is described as concerned with 'the relationship between law and markets as alternative institutions for organizing economic activity'.¹³⁸ From this point of view, Miceli considered that Law and Economics uses economic theory in order 'to understand how law and markets interact as alternative social institutions for coordinating human behaviour', instead of simply making law the subject matter of economic analysis.¹³⁹ If, in the words of Calabresi, Economic Analysis of the Law applies economic theory to 'analyse the legal world', Law and Economics has its starting point in the 'acceptance of the world as it is, as the lawyer describes it to be', and it then examines whether economic theory can explain that world.¹⁴⁰ Herein, the relationship between legal and economic science is 'bilateral'.¹⁴¹ Although economic theory is still applied to law, Law and Economics would not only provoke legislative changes but also frequently instigate changes in economic theory itself.¹⁴²

Following such an interpretation, Law and Economics appears to refer to a more encompassing form of analysis since it is not limited to law. As put by Marciano, Law and Economics focuses on the 'economy, the economic system, or

¹³⁴ Calabresi, *The Future of Law and Economics* (n 132) 2.

¹³⁵ *ibid.*, 2, 4. As noted by Calabresi, '[i]n its most aggressive and reformist mode, having looked at the world from the standpoint of economic theory, if it finds that the legal world does not fit, it proclaims that world to be "irrational"'.

¹³⁶ *ibid.*, 2.

¹³⁷ See section 1.3.2.3 of the current chapter.

¹³⁸ Miceli (n 126) 9.

¹³⁹ *ibid.*, 18-19.

¹⁴⁰ Calabresi, *The Future of Law and Economics* (n 132) 5.

¹⁴¹ *ibid.* Calabresi pointed out that 'Economic theory examines the law, but not infrequently this examination leads to changes in economic theory rather than to changes in law or in the way legal reality is described'.

¹⁴² *ibid.*, 6.

economic activities’, by studying the effect of legal rules on the economy.¹⁴³ The primary differentiating factor from Economic Analysis of the Law is that, ‘a law and economics approach rests on a definition of economics by scope, object, domain, or subject matter’.¹⁴⁴ In contrast, the object of study changes in Economic Analysis of the Law, where economic activities are replaced by law (not only taking it into account in the form of an environment in which economic activities are performed) which becomes the very subject of study.¹⁴⁵ From that perspective, the earlier works of Coase and other economists are often considered as Law and Economics research ‘and not simply’ Economic Analysis of the Law.¹⁴⁶

In conclusion, the notion of an economic approach to law exhibits a bifurcated nature. The distinction between the two sets of approaches appears to rest under the underlying premises of the subject matter. Economic Analysis of the Law is confined to the study of the legal system in isolation. For example, studying the economic effects of a piece of legislation, or analysing a legal field upon certain economic premises. Conversely, Law and Economics includes a broader economic analysis that includes law but is not limited to it. As a result, Economic Analysis of the Law has been conducted mainly by *legal* economists, contrary to Law and Economics.¹⁴⁷ By applying this distinction to prominent work within the field, one can position Coase and his contemporaries, who were economists themselves, within the sphere of Law and Economics, whilst Posner epitomises the more recent approach of Economic Analysis of the Law.¹⁴⁸ However, it is essential to note that this distinction is not always clear-cut and that the terms are frequently used interchangeably. For the sake of clarity, when referring to the methodologies available to the legal economists¹⁴⁹ – variously described in the literature as either Law and Economics or Economic Analysis of the Law – the term ‘economic approach to law’ is used in this thesis. This is

¹⁴³ Marciano (n 94) 629, 630.

¹⁴⁴ *ibid.*, 631.

¹⁴⁵ *ibid.*

¹⁴⁶ Calabresi, *The Future of Law and Economics* (n 132) 14.

¹⁴⁷ Mackaay (n 127) 20 noted that the earlier work was done mostly by economists. However, with the exception of Calabresi and Manne.

¹⁴⁸ Steven G Medema, *The Hesitant Hand: Taming Self-Interest in the History of Economic Ideas* (Princeton University Press, 2009) 169-171; Calabresi, *The Future of Law and Economics* (n 132) 14-15.

¹⁴⁹ i.e., those focusing on the application of economic theory to legal material.

possible because, as is further explored in the two subsequent subsections, notwithstanding their differences, both these doctrinal branches are founded upon a fixed set of economic premises, shaping their respective methodologies.

1.3.2.2 The Role and Function of an Economic Approach to Law

Having established the notions of an economic approach to law, this subsection now turns towards its role and functions. The role of *an*¹⁵⁰ economic approach to law is multifaceted, primarily because this approach can be divided into two distinct analyses: normative and positive analysis.¹⁵¹

Normative analysis seeks to demonstrate that certain courses of action may be economically inefficient; or, for instance, transcending the paradigm of economic efficiency, that society is not efficiently achieving a goal set out in legislation.¹⁵² This strand grapples with the normative question of how the law *ought* to be, as adjudged by a predetermined economic standard. Therefore, the theory prescribes ‘better rules’.¹⁵³ On the contrary, a positive analysis attempts ‘to explain legal rules and outcomes as they are rather than to change them to make them better’.¹⁵⁴ Herein, the explanation of outcomes serves as a prediction of human behaviour.¹⁵⁵ Within this setting, the theory does not prescribe better rules (how the law *ought* to be) but rather the effects of legal rules (how they *are*) from an economic perspective. Posner’s efficiency theorem, which endeavours to explain judge-made common law as maximising efficiency, is an example of a positive economic analysis.¹⁵⁶

¹⁵⁰ The author of this thesis explicitly refrains from employing the term ‘economic approach’ in definitive form. Given the multiple functions and approaches associated with the use of economics within legal science, referring to *the* economic approach to law may appear misleading.

¹⁵¹ This distinction is widely recognised, see e.g., Miceli (n 126) 9; Posner, *Economic Analysis of Law* (n 124) 24; Calabresi, *The Future of Law and Economics* (n 132); Kerkmeester (n 123) 383; Mackaay (n 127) 6-17, Alessio M Paccess and Louis Visscher, ‘Methodology of Law and Economics’ in Bart van Klink and Sanne Taekema (eds), *Law and Method: Interdisciplinary Research into Law* (Mohr Siebeck 2011) 85; Veljanovski, *The Economics of Law* (n 126) 56. Others implicitly use the distinction, e.g., Robert and Ulen (n 124) 4-7.

¹⁵² Posner, *Economic Analysis of Law* (n 124) 25, taking the example of crime prevention.

¹⁵³ Miceli (n 126) 9.

¹⁵⁴ Posner, *Economic Analysis of Law* (n 124) 25.

¹⁵⁵ e.g., Alessio M Paccess and Louis Visscher (n 151) 4.

¹⁵⁶ See section 1.3.2.3 of the current chapter.

In theory, these two analytical frameworks could logically blend.¹⁵⁷ The findings derived from positive analysis frequently trigger discussions of a normative character, i.e., recommendations on how the law ought to be.¹⁵⁸ However, there is no uniform view on the matter. Whilst most scholars appear to recognise the possibility of the two sets of analysis, others claim that only a positive analysis is possible.¹⁵⁹ The critique of normative analysis stems from the (acclaimed) axiom that the efficiency of a legal rule can be objectively determined; hence, any consideration of desirability ‘is to add a value judgment that is not a part of an economic analysis’.¹⁶⁰ Others argue that economic analysis is inherently normative.¹⁶¹ At any rate, the distinction between positive and normative analysis introduces a spectrum of functionalities for an economic approach to law. These functions, however, are not adamant but rather fluid, drawing upon the duality of normative and positive analysis.

Second, in order to explore these functions in light of the distinction between positive and normative analysis, three taxonomies are now described.¹⁶² Hirsch identified three different ‘approaches’ to successfully conducting law and economics research.¹⁶³ The first one is the application of economics in rule formulation. It is premised upon an assumption that legal rules should ‘maximize or minimize some specified goal’, ‘ideally’ based on normative or welfare economics.¹⁶⁴ From that perspective, rules ought to be formulated only when they maximise economic efficiency (welfare economics). For instance, the theory of market failure proclaims that how the state *should* intervene in the economy is based on normative economics. The second approach is to utilise economic paradigms to evaluate the effect of legal rules; i.e., positive economic analysis of

¹⁵⁷ Just as the line between *de lege lata* and *de lege ferenda* is not always clear-cut, see Peczenik, ‘Scientia Iuris - An Unsolved Philosophical Problem’ (n 108) 276.

¹⁵⁸ e.g., Alessio M Paccess and Louis Visscher (n 151) 4.

¹⁵⁹ Kerkmeester (n 123) 398 discussed the views of David Friedman, ‘Law and Economics’ in John Eatwell, Murray Milgate and Peter Newman (eds), *The Invisible Hand* (Palgrave Macmillan 1989) and Gerrit De Geest, *Economische Analyse van Het Contracten- En Quasi-Contractenrecht: Een Onderzoek Naar de Wetenschappelijke Waarde van de Rechtseconomie* (MAKLU 1994).

¹⁶⁰ *ibid.*

¹⁶¹ *ibid.*, the inherent normativity follows from the emphasis on economic efficiency.

¹⁶² However, there are evidently alternative taxonomies of the role of an economic approach to law.

¹⁶³ Werner Z Hirsch, *Law and Economics* (2nd edn, Academic Press 1988) 4-10.

¹⁶⁴ *ibid.*, 4.

the law.¹⁶⁵ Rather than providing a general theory to the analysis, such as general equilibrium analysis,¹⁶⁶ the analysis is partial.¹⁶⁷ Thus, economic and/or econometric models must be built.¹⁶⁸ An example of such an analysis is the evaluation of the effects and the costs of crime prevention.¹⁶⁹ The third and final approach concerns so-called ‘neo-institutional rule formation’, an approach that focuses on transaction costs in relation to their legal environment.¹⁷⁰

Similarly, Mackaay also dissected economic analysis into three different levels.¹⁷¹ At the first and most basic level, economics is used to determine the effects of legal rules, which is a typical positive analysis. The second level shifts the analysis to the rationale of legal rules.¹⁷² At this level, economics is employed to ‘consider the reasons why we have the rule we do – their objective or purpose to correct failures, mismatches, miscoordination that would occur without them’.¹⁷³ At first glance, this type of analysis seems predominantly normative. Determining the rationale of a legal provision implies a normative judgment on how that rule should be interpreted. However, this function elucidates a possible blend between positive and normative analysis, as described above. If the effects of the rules are to be evaluated, the objective of the rules must be established – unless a neo-classical paradigm of economic efficiency is the sole benchmark. Mackaay considered a shorter example that bridges between positive and normative analysis:

[I]f the overall rationale of civil liability law is taken to minimise the costs of mishaps and their prevention, we can examine the component doctrines of fault (negligence), causality, damages as proven, faculty of

¹⁶⁵ *ibid.*, 8.

¹⁶⁶ For an explanation of equilibrium theory see Chapter 2, section 2.1.

¹⁶⁷ Hirsch (n 153) 8.

¹⁶⁸ *ibid.*

¹⁶⁹ *ibid.*

¹⁷⁰ *ibid.* It can be defined as focusing ‘on transactions and the manner and extent to which their costs are affected by the legal and economic environment in which they take place’.

¹⁷¹ Mackaay (n 127) 6-17.

¹⁷² *ibid.*, 9.

¹⁷³ *ibid.*

discernment, contributory negligence or strict liability to see how they make sense in this light.¹⁷⁴

From a legal theoretical perspective, determining the rationale of particular legal rules brings about a teleological approach, albeit intertwined with positive economic theory. By the use of a ‘counterfactual scenario’,¹⁷⁵ the rationale of the rule is discerned via the predictability of economic theory. In order to consider the rationale of legal rules, the lawyer economist evaluates alternative (or absence of) rules to explain the rules and/or to determine the incentives that the law produces. The third and final level in Mackaay’s taxonomy is the measurement of ‘the desirability of legal rules’.¹⁷⁶ This is a quintessential normative analysis, in which the effects of the rule are evaluated against a normative standard (most often efficiency) to determine the ‘best rule’. Such an assessment often intersects with welfare economics, such as market failure;¹⁷⁷ the State should only intervene in the market to the extent that rules promote economic efficiency by correcting market failures.¹⁷⁸

In a slightly different vein, Paccess and Visscher identified ‘two levels’ of the economic approach to law by distinguishing the object of study.¹⁷⁹ The first one analyses human behaviour, i.e., rational choice theory and maximisation of utility. The second concerns the objectives of the legal system. The authors added to this second level that:

[T]he concept of market failure, which in law and economics is regarded as the primary *raison d’être* of law. Legal rules are analysed as instruments to correct market failure, or at least to reduce its adverse consequences.¹⁸⁰

In conclusion, having explored what an economic approach to law is, this section has described its multiple approaches and functions, which are multiple. An

¹⁷⁴ *ibid.*

¹⁷⁵ i.e., comparing the effects of the law with a counterfactual, often the absence of the relevant provisions at stake.

¹⁷⁶ Mackaay (n 127) 13.

¹⁷⁷ Werner Z Hirsch (n 163) 4; Alessio M Paccess and Louis Visscher (n 151) 1.

¹⁷⁸ As argued by traditional welfare economics explained in Chapter 2, section 2.1.

¹⁷⁹ Alessio M Paccess and Louis Visscher (n 151) 1.

¹⁸⁰ *ibid.*

economic approach to law can be employed to study either human behaviour (by a positive analysis) or the legal system as such (by a positive and/or normative analysis). The former approach applies economic models to predict the effects of law. Conversely, the analysis of the legal system primarily focuses on the rationale of legal rules or on their desirability.

1.3.2.3 The Method of an Economic Approach to Law

Having established the notion and explored some of the various functions of an economic approach to law, this subsection now transitions to address its methodology. The objective of this subsection is to explore whether it is possible to define a common methodological structure in the economic approaches to law. The argument advanced in the following analysis is that an economic approach to law is theory-laden. Most research within the field relies on microeconomic assumptions (or paradigms) which subsequently frame the methodology of the research. The concept of market failure is precisely a microeconomic theory which fits within that framework.¹⁸¹ However, the reliance on specific economic theories is not immutable, which paves the way for model-building and research transcending these microeconomic paradigms.

First, to apprehend the method of an economic approach to law, the nature of economic science must be clarified. Becker famously wrote that '[w]hat most distinguishes economics as a discipline from other disciplines in the social sciences is not its subject matter but its approach'.¹⁸² Economics as a science is typically defined as the study of the distribution of scarce resources,¹⁸³ (i.e., microeconomics). To address diverse questions, economic models make important assumptions about, inter alia, human behaviour and markets.¹⁸⁴ Economic theory is predicated on a constellation of assumptions that are not perfect. In fact, each model, and the corresponding assumptions, necessarily result in a sacrifice in terms of reality:

¹⁸¹ *ibid.*

¹⁸² Gary Becker, *The Economics Approach to Human Behavior* (University of Chicago Press 1976) 5.

¹⁸³ e.g., 'Economics' in Nigar Hashimade, Gareth Myles and John Black, *A Dictionary of Economics* (5th edn OUP 2017): 'A social science that studies individual and group decisions on how to use scarce resources to satisfy their wants and needs'.

¹⁸⁴ e.g., N Gregory Mankiw, *Principles of Economics* (Dryden Press 1998) 20.

To be sure, there is a necessary sacrifice in reality when using a model to isolate a particular phenomenon, but the hope is that the factors that are excluded from the model are extraneous to the particular question of interest and so can be safely ignored, at least as a first approximation.¹⁸⁵

Second, if economics can be explained by its approach of relying on economic assumptions and models, then an economic approach to law is mirrored in that image. Thus, at its most abstract level of methodology, an economic approach to law is based on the application of economic theory and its assumptions to law.¹⁸⁶ The analytical point of departure of the legal economists then lies in ‘assumptions about human behaviour’,¹⁸⁷ which in turn are theory-dependent.¹⁸⁸ In most economic analysis, a key concept is that of ‘methodological individualism’, suggesting that economics only considers the decisions of individuals.¹⁸⁹ Collective or social changes must be ‘analysed in terms of individual choices and their composite effects’ and ‘[t]he welfare of society must be understood as being a function of that of its members’.¹⁹⁰

Third, the mainstream position of an economic approach to law consists of applying neo-classical microeconomic theory and is ‘most often associated with the “Chicago school”’,^{191,192} which emphasises economic liberalism and welfare maximisation. The Chicago school’s approach to law constitutes a ‘straightforward application of microeconomics (or price-theoretic) analysis to the

¹⁸⁵ Miceli (n 126) 9, 10.

¹⁸⁶ Pablo Salvadr Coderch and Antoni Terra Ibàñez, ‘Law and Economics’ in Marciano and Battista Ramello (eds) (n 124) 1243, 1244: ‘To talk about Law and Economics or, equally, of the Economic Analysis of Law is to refer to the application of economic science tools to national and international systems of statutory law, as well as to legal policy proposals’.

¹⁸⁷ Kerkmeester (n 123) 390.

¹⁸⁸ i.e., variable in function of theory relied on.

¹⁸⁹ e.g., Emmanbuel V Towfigh, ‘The Economic Paradigm’ in Emmunel V Towfigh and Niels Petersen, *Economic Methods for Lawyers* (Edward Elgar 2015) 18, 18.

¹⁹⁰ Mackaay (n 127) 48.

¹⁹¹ A prominent economic school of thought that has substantially shaped competition law policy. It includes well-known economists and thirteen Nobel Prize winners such as, Becker, Coase, Friedman, Lucas, Hayek, Stigler etc. However, it also includes lawyers such as Posner.

¹⁹² Miceli (n 126) 13; Calabresi, *The Future of Law and Economics* (n 132) 7.

law'.¹⁹³ The premises of the Chicago school were described by Posner in *Economic Analysis of Law*, viewed as a 'coursebook in law-and-economics'.¹⁹⁴

Posner carries out, through his method, a systematic and methodological application of economics to the realms of statutory and common law. The first and crucial premise of Posner's theory is the notion of the human being as a rational maximiser of his satisfactions, 'in *all* areas of life' – his 'self-interest'.¹⁹⁵ For instance, this applies both to a person deciding whether or not to commit a crime or to the legislator when adopting a piece of legislation.¹⁹⁶ This approach leads to a denial of the existence of public interest, instead suggesting that 'legislators are rational maximizers of their satisfaction just like everyone else'.¹⁹⁷

The second premise is that legal rules function as price incentives. Rules result in changes in price, which creates incentives – either costs or benefits – that influence behaviour to maximise one's self-interest.¹⁹⁸ The change in price is analysed solely from an efficiency perspective. Albeit distributional effects might arise with a change in price, Posner considered the impact of price changes on income to be exceeded by 'the substitution effects of a price change',¹⁹⁹ i.e., the increase in demand for a substitutable cheaper product.

The final premise is that legal rules should be assessed on the basis of, and promote, economic efficiency.²⁰⁰ Posner developed what he termed 'the efficiency theory of the common law', which asserts that the common law, i.e., judge-made law, 'is best (not perfectly) explained as a system for maximizing the wealth of

¹⁹³ Mercuro and Medema (n 123) 57.

¹⁹⁴ James E Krier, 'Review of *Economic Analysis of Law* by Richard A Posner' (1974) 122(6) *University of Pennsylvania Law Review* 1664 as cited in Alain Marciano (n 124) 630.

¹⁹⁵ Posner, *Economic Analysis of Law* (n 124) 3; Posner, 'The Law and Economics Movement' (n 122) 5.

¹⁹⁶ Richard A Posner, *The Problems of Jurisprudence* (Harvard University Press 1993) 352.

¹⁹⁷ *ibid.*, 354. This is what is commonly referred to as 'Public Choice Theory'. The positive study of regulation was founded by Stigler, see George J Stigler, 'The Theory of Economic Regulation' (1971) 2(1) *The Bell Journal of Economics and Management* 3.

¹⁹⁸ Posner, *Economic Analysis of Law* (n 124) 4-5; Posner, 'The Law and Economics Movement' (n 122) 5.

¹⁹⁹ Posner, *Economic Analysis of Law* (n 124) 5.

²⁰⁰ Mercuro and Medema (n 123) 57-60; Posner, 'The Law and Economics Movement' (n 122) 5. Posner, *Economic Analysis of Law* (n 124) 11, Posner himself equated the concept of economic efficiency to an 'allocation of resources in which value is maximized'.

society',²⁰¹ understood as total surplus.²⁰² In other words, the common law strives to achieve Pareto's or Kaldor-Hicks' efficient outcomes.²⁰³ In contrast, legislation is 'less likely to promote economic efficiency [... although laws also] are permeated by economic concerns and illuminated by economic analysis'.²⁰⁴ By reasons of these premises, a commonality of the different works adopting a mainstream approach is to either implicitly overlook distributional effects, or explicitly reject them.²⁰⁵ This stance raises a tension between an individualistic view of law – which seeks to maximise welfare through efficiency – and a collectivist approach promoting distributive justice.²⁰⁶

Finally, however, the theoretical choice is not necessarily inflexible nor limited to neo-classical microeconomics. According to Calabresi, there is no predefined particular economic theory that must be used within an economic approach to law.²⁰⁷ Other theoretical perspectives, such as a Marxist or a Keynesian approach, can also be employed.²⁰⁸ What fundamentally defines an economic approach to law is not the choice of theory, but rather 'the relationship between the theory and the world it examines'.²⁰⁹ In essence, applying an economic approach to law boils down to analysing the legal rules in light of certain economic theories and assumptions. However, these assumptions may be modified if alternative assumptions could better fit the particular object of study.²¹⁰ Thus, there is no all-purpose approach to an economic approach to law. Rather, what characterises this method is the relationship between reality and theory: the application of economic theory to the legal reality.

²⁰¹ Posner, *Economic Analysis of Law* (n 124) 25.

²⁰² Posner, *The Problems of Jurisprudence* (n 196) 356. Although the term is not used by Posner himself. For an explanation of total surplus, see Chapter 2 section 2.1.

²⁰³ Posner, 'The Law and Economics Movement' (n 122). For an explanation of the concepts see Chapter 2, section 2.1.

²⁰⁴ Posner, *Economic Analysis of Law* (n 124) 25.

²⁰⁵ For instance, Robert and Ulen (n 124) 7.

²⁰⁶ The dichotomy between efficiency and distributional functions is elaborated upon in Chapter 2, section 2.1 and 2.2.

²⁰⁷ Calabresi, *The Future of Law and Economics* (n 132) 7.

²⁰⁸ *ibid*

²⁰⁹ *ibid*.

²¹⁰ Kerkmeester (n 123) 383.

In summary, the methodology of an economic approach to law mirrors that of economics itself. An economic approach to law accepts the economic assumptions inherent in the theory being used, and these assumptions guide the analysis. Accordingly, the methodology is characterised by being theory-laden. The mainstream approach consists of the application of microeconomic theory and assumptions. The closest to what can be defined as a methodological grid of economic analysis can be found in the Chicago movement, specifically in the works of Posner.²¹¹ As stated above, market failure is a microeconomic concept, closely intertwined with economic efficiency, which would fit well under a mainstream model of an economic approach to law. However, before determining the methodology of this research, attention must be given to certain fundamental critiques of the mainstream approach.

1.3.2.4 The Critiques of an Economic Approach to Law

In order to establish the precise methodology for this thesis, certain critiques of the economic approaches to law must be considered. Before all, the traditional economic presumptions of welfare have, evidently, been challenged from an internal point of view (within economics itself), a matter that is not further explored here.²¹² The emphasis of this subsection is placed on external critiques, particularly those originating from legal science. As the ‘second part’ of an economic approach *to law*, legal science has critiqued the theory on several fronts, particularly the mainstream approach. Four types of critiques are subsequently explained hereunder.

First, the mainstream position of an economic approach to law has been significantly criticised for its (or lack of) moral foundations.²¹³ What is the moral

²¹¹ However, Posner’s efficiency theory remains limited (mostly) to common law.

²¹² Niamh Dunne, *Competition Law and Economic Regulation* (CUP 2015) 6. These involve e.g., the works of Nobel Price laureate in Economics Richard H Thaler, *Misbehaving: The Making of Behavioural Economics* (Penguin Books 2016); Amartya K. Sen, *Commodities and Capabilities* (OUP 1999); Martha Nussbaum, ‘Nature, Function, and Capability: Aristotle on Political Distribution’ (1988) *Oxford Studies in Ancient Philosophy* 145; Cass R Sunstein, *Behavioral Law & Economics* (CUP 2000). See, Ioannis Lianos, ‘The Poverty of Competition Law: The Long Story’ (2018) 2 CLES Research Paper Series for a detailed analysis. See also, more general critiques of the neo-classical assumptions e.g., Amartya Sen, *Inequality Reexamined* (OUP 1995).

²¹³ These critiques are discussed in David Driesen and Robin Paul Malloy, ‘Critiques of Law and Economics’ in Parisi (ed) (n 126) 300. See, e.g., Jules L Coleman, ‘Efficiency, Utility and Wealth Maximization’ (1980) 8(3) *Hofstra Law Review* 509; Jules L Coleman, ‘Economics and the Law: A Critical Review of the Foundations of the Economic Approach to Law’ (1984) 94(3) *Ethics* 649; Jules L Coleman, ‘The Normative Basis of the Economic Analysis: A Critical Review of Richard

justification for the third premise of Posner's theory, according to which law should be understood in terms of, and promote, efficiency? Through this line of critiques, Posner's view on the matter has successively evolved.²¹⁴ Lately, the moral underpinning of his theory appears to be 'pragmatic':

The strongest argument for wealth maximization is not moral, but pragmatic. [...] We look around the world and see that in general people who live in societies in which markets are allowed to function more or less freely not only are wealthier than people in other societies but have more political rights, more liberty and dignity, are more content (as evinced, for example, by their being less prone to emigrate) – to that wealth maximization may be the most direct route to a variety of moral ends.²¹⁵

However, without any solid moral foundations, such a justification appears insufficient and is unlikely to satisfy the critics. The normative critique holds that wealth maximisation through economic efficiency cannot be viewed as a goal within itself, but rather as a means toward another end.²¹⁶ These critiques reject efficiency as a synonym for justice,²¹⁷ and sometimes even as a 'proxy for any objective worth seeking for its own sake'.²¹⁸ Moral philosophy often proclaims justice to be the main goal of society;²¹⁹ '[t]he morally good is connected with the

Posner's "The Economics of Justice" (1982) 34(5) Stanford Law Review 1105; Anthony T Kronman, 'Wealth Maximization as a Normative Principle' (1980) 9(2) Journal of Legal Studies 227; Ronald M Dworkin, 'Is Wealth a Value?' 1980 (9)2 The Journal of Legal Studies 191.

²¹⁴ Peczenik, 'Scientia Iuris - An Unsolved Philosophical Problem' (n 108) 286. Earlier, the moral foundations of economic efficiency appear to have been rooted in both utilitarian moralism and, later, a consent-based theory. See, also Coleman, 'Economics and the Law: A Critical Review of the Foundations of the Economic Approach to Law' (n 213).

²¹⁵ Posner, *The Problems of Jurisprudence* (n 196) 382, 384. 'A sensible pragmatism does not ignore theory. The mounting evidence that economic capitalism is more efficient than socialism gives us an additional reason for believing economic theory (not every application of it, to be sure). The theory in turn gives us greater confidence in the evidence. Theory and evidence are mutually supporting. From the perspective of economic theory'.

²¹⁶ Driesen and Malloy (n 213) 301.

²¹⁷ e.g., Ronald M Dworkin, 'Why Efficiency: A Response to Professors Calabresi and Posner' (1980) 8 Hofstra Law Review 563; Arthur Allen Leff, 'Economic Analysis of Law: Some Realism about Nominalism' (1974) 60 Virginia Law Review 451.

²¹⁸ Brian H Bix, 'Moral Philosophy and Law and Economics' in Parisi (ed) (n 126) 288, 293; Jules L Coleman, *Market, Morals and the Law* (CUP 1998).

²¹⁹ Driesen and Malloy (n 213) 300, 301.

just'.²²⁰ As is further explored in the next chapter, the two main concepts of justice put forward within economics and moral thinking are a utilitarian view (economic efficiency) and a Rawlsian approach based on distributive justice.²²¹

At the core of these critiques is not only justice as a principle, but also a scepticism toward individual preferences as a paradigm; what an individual considers society should do may differ from his or her self-interest.²²² Moreover, scholars have adverted to the immorality of a system based on preferences. As put by Sunstein, a system where 'efficiency is a function of aggregated private willingness to pay' gains wealthier individuals who are willing to pay more.²²³ Yet, most analyses within an economic approach to law focus precisely on wealth maximisation.²²⁴ Posner originally defended the moral foundations of wealth maximisation, arguing that it was the best foundation for a theory of justice.²²⁵ Nevertheless, as Bix pointed out, both Posner and Calabresi partially accepted that critique and recognised that wealth maximisation is *one* objective amongst several, thus acknowledging that there might be a need to conduct trade-offs between wealth maximisation and justice/fairness.²²⁶ This acknowledgement is crucial for this research, where external objectives with a redistributive agenda must be recognised when such objectives exist. What legal value does efficiency (wealth maximisation) hold next to other objectives? As is further explored in the subsequent chapter, a narrow and a broader concept of market failure might very well depend on the standard of justice adopted – translated within economics as the welfare function.²²⁷

²²⁰ Peczenik, *On Law and Reason* (n 113) 83.

²²¹ In economics these approaches are presented as welfare standards, see Chapter 2 sections, 2.1 and 2.2.2.2.

²²² Driesen and Malloy (n 213).

²²³ Cass R Sunstein, *Free Markets and Social Justice* (OUP 1997) 343-344. See also, Cass R Sunstein, 'Willingness to Pay vs. Welfare' (2007) 1 *Harvard Law and Policy Review* 303; Zachary Liscow, 'Is Efficiency Biased?' (2018) 85(7) *The University of Chicago Law Review* 1649.

²²⁴ Miceli (n 126) 12.

²²⁵ Richard A Posner, 'Utilitarianism, Economics, and Legal Theory' (1979) 8(1) *The Journal of Legal Studies* 103, 125. 125. See also, Richard A Posner, 'The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication' (1980) 8(3) *Hofstra Law Review* 387.

²²⁶ Bix (n 218) 288, 293. See, Guido Calabresi and A Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 *Harvard Law Review* 1089; Posner, *Economic Analysis of Law* (n 124) 34-35.

²²⁷ See Chapter 2, sections 2.2.2.2 and 2.2.2.3.

Second, in addition to the normative critique, there is an interpretative critique.²²⁸ This critique is anchored within a ‘semiotic’ legal approach and constitutes a critique of an economic approach to law ‘as a rhetorical form’.²²⁹ Rather than viewing law as a subject of economic theory and analysis, this approach proposes treating economics as a subject of law:²³⁰

In making an “interpretative turn” to evaluate economic criteria, assumptions, and doctrines from the perspective of law, one no longer ask if a legal rule is efficient but rather if an efficiency criterion promotes justice and fairness in a given situation.²³¹

Thus, the interpretative critique shifts the focus from a traditional economic analysis of law to an analysis where legal values are at the centre. Economic efficiency should be understood as a proxy for implementing normative values.²³² Key to this critique is that economists implicitly transform the underlying values of law, such as fairness and justice, into a narrower sense by replacing the terms with efficiency or wealth maximisation.²³³ As a result, economics operates a shift in the normative values of the law and is thus neither neutral nor objective.²³⁴ Economic concepts such as ‘free markets’, ‘competition’ or ‘efficiency’ function ‘as an “interpretative screen” to filter and direct legal reasoning in favour of meanings and values embedded within the language and assumptions of the economist’s trade’.²³⁵ Inversely, the lawyer should evaluate how market mechanisms can achieve legal goals and values such as justice or fairness.²³⁶ Although this thesis does not adopt a semiotic approach, this line of critique still remains highly relevant when comparing the legal framework to economic theory.

²²⁸ Driesen and Malloy (n 213) 300, 306.

²²⁹ *ibid.*, 300, 306-307. Developed by Kevelson. See, Roberta Kevelson, *The Law as A System of Signs* (Springer 1988). Other scholars include, Jack M Balkin, ‘The Promise of Legal Semiotics’ (1991) Yale Law School Faculty Scholarship Series, Paper 278.

²³⁰ Driesen and Malloy (n 213) 307.

²³¹ *ibid.*

²³² *ibid.* In this context, parallels can be drawn to the relationship between economic efficiency and welfare in competition theory, see Chapter 4, section 4.3.2.

²³³ *ibid.*, 309.

²³⁴ *ibid.*, 308.

²³⁵ *ibid.*

²³⁶ *ibid.*, 307.

As explained below, the objective is not to understand the law as maximising economic efficiency, but to critically assess the relevance of the economic theory of market failure within the legal reality.²³⁷

The third critique is from a methodological standpoint. There are significant critiques regarding the coherence of efficiency²³⁸ and the assumption of rationality²³⁹ from a legal perspective. A key claim connected to the economic nature of an economic approach to law is that of its empirical nature, in contrast to legal doctrine. However, economic models have been criticised for lacking realism. According to Leff,²⁴⁰ there is nothing empirical about an economic approach to law:

Since people are rationally self-interested, what they *do* shows what they value, and their willingness to pay for what they value is proof of their rational self-interest. Nothing merely empirical could get in the way of such a structure because it is definitional.²⁴¹

According to this critique, the proposition of an economic approach is circular: ‘what people do is good, and its goodness can be determined by looking at what they do’.²⁴² As such, this structure is not influenced by any empirical evidence.

Finally, there is the fourth critique, which stands on a more conceptual footing. The additional value and autonomy of an economic approach to law has been criticised in legal scholarship. Peczenik and Spector doubted the universal claim of Posner’s theory (in that it is applicable to all areas of law).²⁴³ Peczenik, interestingly, claimed that Posner’s theory, in reality, may be nothing more than

²³⁷ The critical perspective is further elaborated upon in the ensuing subsection.

²³⁸ Driesen and Malloy (n 213) 303. See, in particular Dworkin (n 213), who argued that the “wealth maximization” in economic analysis of the law is different from economic efficiency in economics. Since a decision based on a dispute between people rarely can be strictly Pareto efficient, the benchmark of wealth maximisation is preferred.

²³⁹ Michael Freeman, *Lloyd’s Introduction to Jurisprudence* (9th ed, Sweet & Maxwell 2014) 524.

²⁴⁰ Leff (n 217) 451.

²⁴¹ *ibid.*, 457.

²⁴² *ibid.*, 458. Leff pointed out that ‘in *these* terms there is no other way they [people] can behave’.

²⁴³ Peczenik, ‘Scientia Iuris - An Unsolved Philosophical Problem’ (n 108) 288, and Horacio M Spector, ‘Self-Ownership and Efficiency’ in Aulis Aarnio, Robert Alexy and Gunnar Bergholtz (eds), *Justice, Morality and Society. A Tribute to Aleksander Peczenik* (Juristförlaget 1997). discussed therein.

‘one of many theories of legal dogmatics, helping us to understand and normatively improve some parts of the law’.²⁴⁴ This critique suggests that an economic approach to law does not hold any autonomous value but constitutes a sub-branch of legal doctrine. This interpretation is crucial for adopting the method of this thesis. If these types of analytical elements can be incorporated into a legal doctrinal research method, what is the value of an economic approach to law? Moreover, if such an interpretation is correct, the doctrinal research method should continue to form the cornerstone of that methodology.

In conclusion, an economic approach to law seems to be a functional approach devoid of a common methodological framework. This approach has been the subject of numerous critiques, not the least from legal doctrine. Most prominently, the holy grail of efficiency maximisation, a core tenant embedded within a mainstream economic analysis, has been denounced. However, as a disclaimer, an economic approach to ‘economic law’²⁴⁵ specifically is far less controversial and manages to avert some of the critiques. As previously stated, the use of economic theory in a legal setup is standardised practice for most competition lawyers. The influence of the Chicago School’s Economic Analysis of Law on the design and implementation of competition law is irrefutable.²⁴⁶ The strongest controversies of an economic approach to law tend to arise when its principles are applied to non-market law, a question which, however, is not relevant for this thesis. Nonetheless, these critiques maintain a considerable degree of importance when analysing the concept of market failure. As is developed further on in this thesis, a tension exists between efficiency and external objectives, a tension arguably exacerbated by the dichotomy between efficiency and equity as delineated within economic theory. Market failure as a welfare economics approach must thus be applied with caution.²⁴⁷

²⁴⁴ *ibid.*

²⁴⁵ Economic law is here understood as the provisions of law dealing with the organisation of markets.

²⁴⁶ Mercurio and Medema (n 123) 53.

²⁴⁷ Anthony B Atkinson and Joseph E Stiglitz, *Lectures on Public Economics* (Princeton University Press 2015) 8.

1.3.3 The Methodology of this Thesis

Having established the significance and relevance of legal doctrine as well as the meanings, functions, and methodologies of an economic approach to law, it is now time to define a coherent methodology for this research. The precedent subsection established that an economic approach to law is mainly defined by the application of economic theory and its underlying assumption to the legal reality. However, the mainstream perspective to an economic approach to law, often associated with the Chicago School, has been subject to substantial critique both on normative and methodological levels. Specifically, the normative value and the methodological persuasiveness of efficiency or wealth maximisation have been heavily contested.

This research does not propose to abandon the legal research method or completely decouple the methodology from the dogmatic approach; instead, it advocates for a more nuanced approach. This subsection defines a methodology that employs certain elements of an economic approach to law in order to bridge the chasm between legal and economic perspectives. The proposed research method consists of the legal doctrinal research method as a basis fused with certain ‘interdisciplinary engagements’ via the use of an economic approach to law in a ‘pragmatic manner’. The remainder of this subsection explains this two-fold methodology.

1.3.3.1 Interdisciplinary Engagements

The terminology ‘interdisciplinary engagements’, borrowed from Bodig,²⁴⁸ serves in this context the purpose of distinguishing between truly interdisciplinary research and the application of what Peczenik referred to as ‘auxiliary sciences’.²⁴⁹

First, to comprehend what constitutes ‘interdisciplinary engagements’ within the framework of this research, it is incumbent to reflect on the meaning of ‘truly interdisciplinary research’. However, the lack of a clear-cut definition of interdisciplinarity introduces definitional complexities that erode the autonomous value of an economic approach to law. As previously discussed, Peczenik’s critique suggests that an economic approach to law is nothing but a theory of legal dogmatics.²⁵⁰ In contrast, Posner argued that ‘[t]he foremost interdisciplinary field

²⁴⁸ Bodig (n 119) 43. However, it must be said that the use and purpose of this term developed in this thesis in distinct and might not correspond to the view of Bodig.

²⁴⁹ Peczenik, ‘Scientia Iuris - An Unsolved Philosophical Problem’ (n 108) 276.

²⁵⁰ (n 215).

of legal studies is economic analysis of law, or as it is more commonly referred to, “law and economics”.”²⁵¹ This perspective aligns with numerous works within legal scholarship that consolidate that interdisciplinary ambition.²⁵² However, no explanation has been provided regarding the meaning of ‘interdisciplinarity’ itself.

It is important to recognise that each discipline, including the legal discipline,²⁵³ offers its own methodology and assumptions.²⁵⁴ Within this line of reasoning, Balkin offered a strongly critical account of the interdisciplinary nature of the ‘law and’ movement,²⁵⁵ including law and economics. According to Balkin, simply relying on information from another discipline, or using methods from that discipline, is not in any way a testimonial of the interdisciplinary nature of such research.²⁵⁶ In reality, using economics in order to study legal material, ‘still leads back to the sort of questions that law professors traditionally ask themselves and the kind of answers that they traditionally seek’.²⁵⁷ True interdisciplinarity can only be achieved by ‘combining two disciplines or changing the questions asked by either’.²⁵⁸ Du Laing argued a similar view and considered that:

[Q]uite a few scholars commentating on interdisciplinarity legal research seem to suggest that the interdisciplinarity component in this type of legal research and the scientific integration it entails mainly if not merely involves incorporating methodological tools from other disciplines, rather than developing a shared theoretical framework.²⁵⁹

²⁵¹ Posner, *Frontiers of Legal Theory* (n 126) 31.

²⁵² e.g., van Klink and de Been (n 95).

²⁵³ Albeit there exists a range of different legal methods, one example of a legal assumption is the theory of sources of law see Peczenik (n 75); Aleksander Peczenik, ‘A Theory of Legal Doctrine’ (2001) 14 *Ratio Juris* 75.

²⁵⁴ Jack M Balkin, ‘Interdisciplinarity as Colonization’ (1996) 53 *Wash. & Lee L. Rev* 949 pointed out that ‘[disciplines offer the academic forms of cultural know-how, or what I like to call “cultural software”. [...] They offer assumptions about what is a good argument, what is an interesting problem, and what constitutes good enough evidence or a good enough proof’.

²⁵⁵ Balkin (n 254) 950.

²⁵⁶ *ibid.*, 958.

²⁵⁷ *ibid.*

²⁵⁸ *ibid.*

²⁵⁹ Bart Du Laing, ‘Promises and Pitfalls of Interdisciplinary Legal Research: The Case of Evolutionary Analysis in Law’ in Mark Van Hoecke (ed), *Methodologies of Legal Research: What Kind of Method for What Kind of Discipline* (Hart 2011) 253.

From this perspective, the straightforward application of economic theory to legal material is not an interdisciplinary endeavour. Nevertheless, it is worth noting that there is no universally accepted understanding of interdisciplinarity, and the approach above may be questionable. Other scholars convincingly define the ‘law and’ categories as a sort of ‘hybridization’ of legal doctrine into ‘interdisciplinary subfields’ including ‘economics and law’.²⁶⁰ The disagreement between these scholarly positions appears to stem from the different concepts of the degree of interdisciplinarity required by the researcher.

Second, however, this thesis argues that ‘interdisciplinarity engagements’ can be made within legal theory itself. There are sound arguments to say that legal research cannot be ‘purely monodisciplinary’ since the legal scholar is required to comprehend the society in which law is rooted.²⁶¹ Peczenik argued that one of the pursuits of legal dogmatics is precisely ‘the use of auxiliary sciences’.²⁶² Thus, the line between doctrinal studies and interdisciplinarity can be blurry in certain cases. Bodig’s use of interdisciplinary engagements fulfils the purpose of identifying certain situations in which theory from other sciences may be necessary for legal scholars, rather than exploring how legal doctrine might be of assistance to other disciplines.²⁶³ Accordingly, there is no ambition to combine disciplines into a new interdisciplinary field in the sense of Balkin’s critique. The use of interdisciplinary engagements should be read in parallel with Bodig’s understanding of jurisprudence as revolving ‘around cultivating doctrinal knowledge about law’.²⁶⁴

²⁶⁰ Stuart Henry, ‘Interdisciplinarity in the Field of Law, Justice, and Criminology’ in Robert Frodeman, Julie Thompson and Roberto Carlos Dos Santos Pacheco, *The Oxford Handbook of Interdisciplinarity* (2nd edn, OUP 2017) 397, 397. Who noted at 398, that ‘[i]nterdisciplinarity approaches to law have much to do with the idea that law exists in a socio-political context, rather than being an independent system of rules, as legal formalists and legal positivists had argued. The lines between legal doctrine of formal law and other social orders become blurred once it is acknowledged that law is just one form of social control, each shaped by culture, social structure, custom, tradition, and a variety of reciprocal obligations and duties that exercise control over human behaviour’.

²⁶¹ Sanne Taekema and Wibren van der Burg, ‘Introduction: The Incorporation Problem in Interdisciplinarity Legal Research’ (2015) 8 *Erasmus Law Review* 39, 40.

²⁶² Peczenik, ‘Scientia Iuris - An Unsolved Philosophical Problem’ (n 108) 276, noted the examples of ‘psychology behind the treatment ideology in criminal law and sociology behind the deterrence ideology’.

²⁶³ Bodig (n 119) 44.

²⁶⁴ *ibid.*, 43.

The use of interdisciplinary engagements might be necessary in certain situations,²⁶⁵ two of which are of interest for this thesis.

The first category pertains to understanding the extra-legal origins of legal norms, which goes hand in hand with the application of an economic approach to law.²⁶⁶ When analysing measures that deviate from EU competition law, understanding the rationale of legislation is crucial. Economic efficiency, as one of the normative goals of EU competition law, must be interpreted and upheld by the EU Courts and the Commission.²⁶⁷ Equally, an analysis of the rationale of the rules is critical because other goals might conflict with, or even take precedence over, efficiency.²⁶⁸ Moreover, the issue of the primary goals of EU competition law, and their extra-legal origins, has sparked significant *legal* debates.²⁶⁹ Epistemologically, efficiency cannot be explained from a purely internal legal perspective, and must arguably be substantiated by economic theory.

In the second category, interdisciplinary engagements are necessary to address ‘frictions between disciplinary perspectives’.²⁷⁰ This is particularly relevant to the purposes of this research. When sciences outside the legal discipline have significant support within a field, there is a risk of incompatibility between sciences. Sometimes, the (legal) concepts embedded in other sciences are so intertwined that the ‘internal coherence of the doctrinal structures may depend on it’.²⁷¹ Examples include ‘anticompetitive conduct’ or, again, ‘economic

²⁶⁵ *ibid.*, 49-50.

²⁶⁶ As explained in the previous subsections, the use of economic theory plays a significant role in determining the rationale of legal rules.

²⁶⁷ Glader (n 121) 15.

²⁶⁸ For an analysis of the potential conflict between goals of competition law, see .e.g., Parret, ‘Shouldn’t We Know What We Are Protecting? Yes We Should! A Plea for a Solid and Comprehensive Debate About the Objectives of EU Competition Law and Policy’ (n 9).

²⁶⁹ e.g., Parret, ‘Shouldn’t We Know What We Are Protecting?’ (n 9); Lianos, ‘The Poverty of Competition Law: The Long Story’ (n 212); Gerard Damien and Ioannis Lianos (eds), *Reconciling Efficiency and Equity: A Global Challenge for Competition Policy* (CUP 2019); Pinar Akman, ‘The Role of “Freedom” in EU Competition Law’ (2014) 34 *Legal Studies* 183; Francis Kieran, ‘A Separation of Powers Approach to Non-Efficiency Goals in EU Competition Law’ (2013) 19(1) *European Public Law* 189; Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (OUP 2011); Conor Talbot, ‘Ordoliberalism and Balancing Competition Goals in the Development of the European Union’ *The Antitrust Bulletin* 2016, Vol. 61(2) 264-289; Claus-Dieter Ehlermann and Laraine L Laudati, *European Competition Law Annual 1997: The Objectives of Competition Policy* (Hart 1998).

²⁷⁰ Bodig (n 119) 50.

²⁷¹ *ibid.*

efficiency', which may not be coherently constructed internally without incorporating insights from other disciplines. Similarly, the trade-off between consumer welfare and efficiency may occasionally pose challenges from an economic perspective.²⁷² This issue is also implicated in relation to market failure. Can the concept of market failure be internalised within legal doctrine in a way that distinguishes it from its economic conceptualisation? Or, does the coherence of the doctrinal structures within the field depend upon economic theory? Exploring these potential interdisciplinary engagements aligns with the purpose of this study, which aims to explore and clarify the role of market failure theory in EU competition law.

In fine, the term 'interdisciplinary engagement' is used in this research to design a grey zone between interdisciplinary research and legal scholarship. From this standpoint, the research paints a picture of a legal system that is 'open, responsive or purposive', and claims to embody 'legal research that makes room for other perspectives',²⁷³ in this case economic ones (and possibly political/philosophical²⁷⁴). However, it is crucial to emphasise that it is not asserted that this research has any empirical nature by the force of economic theory. Its primary purpose is to describe the law, and the analysis is founded on a dogmatic and hermeneutic basis, leaving room for normative considerations.²⁷⁵ The use of economics, nonetheless, serves the purpose of guiding the inquiry as to the meaning of market failure within EU competition law.²⁷⁶ From this perspective the methodology should be understood as legal dogmatics engaging with normative economic theory.

²⁷² Massimo Motta, *Competition Policy* (CUP 2004) 19 ff.

²⁷³ As is one of the views of the legal system referred to by Pauline C Westerman, 'Open or Autonomous? The Debate of Legal Methodology as a Reflection of the Debate on Law' in Van Hoecke (ed) (n 259) 87.

²⁷⁴ On the political dimension of market failure see Maher M Dabbah, 'Measuring the Success of a System of Competition Law: A Preliminary View' (2000) 21(8) *European Competition Law Review* 369.

²⁷⁵ Aulis Aarnio 'Introduction' Peczenik, *On Law and Reason* (n 113) 1, 2. '[I]legal dogmatics is a typical interpretative discipline'.

²⁷⁶ *ibid.*, legal dogmatic 'uses facts provided by sociology of law, but the interpretation itself has a non-empirical nature. According to normal usage, legal dogmatics has two functions: to interpret and to systematise legal norms'.

1.3.3.2 A Pragmatic Approach

In addition to the application of interdisciplinary engagements, this thesis adopts a ‘pragmatic approach’ to the use of economics. Instead of creating a false dilemma between legal doctrine and an economic approach to law, this subsection describes a pragmatic strategy for adopting an economic approach. Although a mainstream approach has been identified, much of the work that incorporates an economic approach to law appears to be heuristic in nature. Kerkmeester contended that, in reality, ‘most legal economists follow a pragmatic, eclectic, approach and that with a few exceptions, it is hard to fit them in a particular school of which they faithfully follow the rule’.²⁷⁷ Accordingly, as reiterated above, the work of legal economists is characterised less by the adherence to a particular school and more by the mere use of economic theory. This is achieved by examining the law through the lens of certain economic assumptions, which are then alterable if necessary.²⁷⁸ If market failure is a predetermined microeconomic concept, its underlying assumptions and methodology must be thoroughly explored. However, these assumptions are not uncritically accepted as framing the legal reality,²⁷⁹ thereby leaving the analysis receptive to external perspectives.

In particular, it must be investigated whether a market failure test can be discerned at a legal level and, if so, how that test is structured.²⁸⁰ Within the analysis, external elements, beyond classical microeconomics, are accommodated where they are insightful and relevant for this thesis. The assumptions of market failure theory are neither endorsed nor disregarded, but analysed from a critical perspective in order to investigate the value of market failure theory within EU competition law. Consequently, the pragmatic approach is also inherently critical, facilitating a hybrid legal-economic analysis. For instance, in Chapter 2, various interpretations for conceptualising a broader market failure, beyond traditional paradigms, are identified.²⁸¹ Equally, the issue of balancing between economic and

²⁷⁷ Kerkmeester (n 123) 383.

²⁷⁸ *ibid.*

²⁷⁹ For instance, as put by Alessio M Paccess and Louis Visscher (n 151) cited above, market failure is seen as ‘the primary *raison d’être* of law’.

²⁸⁰ The research question aims to determine the role of market failure *in law*, rather than focusing on how law could apply a specific efficiency-based market failure theory.

²⁸¹ See Chapter 2, section 2.2.

external objectives accommodates perspectives transcending these traditional paradigms.

Another layer of hybridity resides in the actual application of economic theories in relation to the subject matter. Economic theory and assumptions are placed not within the context of human behaviour, but within the legal framework of the applicable legal provisions.²⁸² As the author of this thesis is not an economist, the analysis remains doctrinal. Although the boundaries of a specific market failure cannot truly be measured, the existence and function of a market failure test on a legal level is nonetheless assessable.²⁸³ Two levels of interaction can be identified in this context, in which insights from normative economic theory are helpful. The first level of interaction occurs when delineating a workable concept of market failure. As explained, market failure is ostensibly a welfare economics concept, however, it remains undefined in law.²⁸⁴ Therefore, it is necessary to closely scrutinise economic theory in order to develop an understanding of the concept, which is the overarching objective of the subsequent chapter. Second, the understanding of market failure within economics and adjacent theories is then juxtaposed against the legal reality obtained via the application of legal dogmatics.²⁸⁵ Here, non-legal theory can assist in understanding not only the legal test of public policy intervention but also the interplay between external and efficiency objectives. In accordance with Bodig's typology of interdisciplinary engagements, this part is critical for both explaining the extra-legal origins of law (when it aligns) and identifying frictions (when it diverges). The functions of an economic approach to law fit within that description by enabling analysis of the rationale of the law via a normative analysis.

In conclusion, this section has shown that an economic approach to law can manifest in various forms. Whether the proposed pragmatic and hybrid research methodology aligns with a conventional economic approach to law is a dubious matter. Albeit, adopting a perspective of the legal system as 'open, responsive or purposive',²⁸⁶ the thesis utilises insights from normative economic theory, which

²⁸² Meaning that the research does not take a traditional positive approach where the effects of law as an incentive to behaviour would be analysed.

²⁸³ On the nature of that legal test see Chapter 3, section 3.3.

²⁸⁴ However, the concept features frequently in State aid soft law, see Chapter 7, section 7.4.2.

²⁸⁵ Whilst acknowledging that the theory may or may not align with the 'legal reality'.

²⁸⁶ Westerman (n 273) in Van Hoecke (ed) (n 259) 87, 87.

can be designated as ‘interdisciplinary engagements’. Within such a system, economic insights can form part of a legal analysis as the foundation of values that the legal system may or may not reflect. As demonstrated throughout this thesis, EU competition law is based on divergent objectives that reflect contrasting values, including economic ones.

1.4 The State of the Art

This section serves to distinguish the present research from previous investigations related to market failure theory in EU law. Although market failure has been subjected to previous research, this thesis presents a novel analysis of the subject. To the best of the author’s knowledge, the previous contributions have primarily focused on Article 106(2) TFEU and some specific facets of Article 101(1).

1.4.1 Current Scholarship Assessing Article 106(2)

Where market failure has garnered the most attention in legal doctrine is within the context of Article 106(2) TFEU. According to that Article:

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

Market failure has been largely analysed within the definition of SGEI, predominantly because it has been perceived as a necessary condition for the qualification of a SGEI. Generally, the identification of SGEI is determined on a national level involving a high degree of discretion.²⁸⁷

²⁸⁷ Article 1 of Protocol 26 of the Treaties; Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02) (n 6), para 37; Joined Cases C-66/16 P to C-69/16 P *Comunidad Autónoma del País Vasco and Itelazpi v Commission* EU:C:2017:999, para 70; Case C-121/15 *ANODE* EU:C:2016:637, para 41.

Sauter first brought attention to the concept of market failure within the framework of Article 106(2).²⁸⁸ Discovering the notion of universal service obligations (USO) under the SGEI framework, Sauter suggested that ‘the concept of market failure (and/or government failure) is a logical starting point when defining the scope of SGEI and [USO]’.²⁸⁹ The essence of his argument is that in order to identify a SGEI, it is decisive to establish that the market is failing, meaning that the service ‘would not be adequately provided in a market setting’.²⁹⁰ From this important contribution follows a series of consequences, in particular, market-based remedies must within an ex ante analysis prove insufficient in order to consider imposing a USO on a SGEI.²⁹¹ An important observation made by Sauter is his recognition that market failure can be understood from different standards, albeit the precise nature of market failure under 106(2) remains unclear. This observation serves as the starting point for constructing a market failure framework in Chapter 3 of this thesis.

Building upon Sauter’s work, Ølykke and Møllgaard argued for an economic definition of SGEI based on economic theory and, specifically, market failure.²⁹² The authors took a quantitative approach relying on an analysis of a substantial number of cases of the EU Courts. Ølykke and Møllgaard proposed using economic theory to identify undersupply, in particular network externalities or informational asymmetries, and the following market failure. Through their contribution, the authors proposed a definition of SGEI as ‘the strengthening of a component of a network that underprovides services to a significant share of the population of a Member State’.²⁹³

Further developing the works of the above-mentioned authors, Burke conducted a systematic study of government failure, coupled with an analysis of market failure, under Article 106(2).²⁹⁴ The purpose of Burke’s comprehensive

²⁸⁸ Wolf Sauter, ‘Services of General Economic Interest and Universal Service in EU Law’ (2008) 2008 33(2) *European Law Review* 167.

²⁸⁹ *ibid.*, 175.

²⁹⁰ *ibid.*, 182.

²⁹¹ *ibid.*

²⁹² Grith Skovgaard Olykke and Peter Mollgaard, ‘What is a Service of General Economic Interest?’ (2016) 41(1) *European Journal of Law and Economics* 205.

²⁹³ *ibid.*, 226.

²⁹⁴ Jarleth M. Burke, *A Critical Account of Article 106(2) TFEU: Government Failure in Public Service Provision* (Hart 2018).

research was ‘to expose the extent of underlying government failure [...] in the operation of Article 106(2)’.²⁹⁵ Whilst his contribution focuses on a government failure analysis, it unveils issues of market failure under the SGEI exceptions to competition law. However, given the focus on government failure and the purpose of Burke’s contribution, the question of the role of market failure as an analytical tool remains uncharted territory. Its role is simply limited to being one possible cause of a government failure. In Burke’s research, market failure is restricted to analyse government intervention under Article 106(2), employing a narrow efficiency-based conception of market failure.²⁹⁶ This perspective results from Burke’s reliance on government failure theory to examine the efficiency of interventions in terms of their objectives. Nonetheless, Burke’s significant contribution retains its relevance to this research, as it establishes crucial groundwork for comprehending the paramount importance of economic efficiency in the provisions of the Treaty.

Whilst the contributions of Sauter, Ølykke and Møllgaard, and Burke are undoubtedly significant, their applicability to understanding the role and interpretation of market failure within the context of EU antitrust and State aid laws remains constrained. Their analyses are predominantly confined to a core aspect of the test under Article 106(2) – the definition of SGEI and the proportionality assessment embedded within it.

1.4.2 Current Scholarship Beyond Article 106(2)

Current research extending beyond Article 106(2) TFEU typically employs a pragmatic, efficiency-based approach to determine the strict applicability of such theory to legal material (economic analysis of the law). Whilst these contributions have advanced the field, this research differentiates itself through its distinct scope and purpose.

Colomo suggested that market failure and transaction costs are useful explanatory tools within the assessment of a restriction of competition under

²⁹⁵ *ibid.*, 188.

²⁹⁶ *ibid.*, 24, where Burke considered that ‘market failure theory does have a number of specified remedies but they are particular to the market failure in question and being efficiency constrained, are of limited practical use when considering disapplication review’.

Article 101(1) TFEU.²⁹⁷ He argued that Article 101(1) leaves a certain margin for efficiency considerations of private transactions, including positive externalities such as environmental benefits. Although Colomo's contribution holds significance in the scholarly debate on Article 101(1) and restrictions of competition, it only marginally intersects with the focus of this thesis. Given the different purpose and scope of this research, there is still ample room for further exploration regarding the exact role of Article 101(1) in relation to public policy intervention. Moreover, this research expands upon the presence of efficiencies under Article 101(1), as identified by Colomo, to examine whether they can serve as a basis for market failure analysis, accommodating diverse public policy goals beyond the promotion of competition.

Kloosterhuis' analysis delves into non-economic activities under EU competition law from the perspective of market failure.²⁹⁸ Placing the focus on the category of public goods (a type of market failure), he concluded that certain activities can be analysed using public goods theory, given their non-excludable nature.²⁹⁹ Kloosterhuis' contribution is instrumental in further developing an understanding of market failure within the definition of economic activity itself.³⁰⁰ In this regard, it is important to acknowledge a certain overlap between Kloosterhuis' contribution and the section addressing non-economic activities in Chapter 6 of this thesis. Nevertheless, it is contended that despite the valuable insights presented by the contribution, there remains an avenue for further scholarly development and refinement, particularly by adopting a broader analytical framework. Kloosterhuis' work, as he himself acknowledged,³⁰¹

²⁹⁷ Pablo Ibanez Colomo, 'Market Failures, Transaction Costs Are Article 101(1) TFEU Case Law' (2012) 37(5) *European Law Review* 541.

²⁹⁸ Erik Kloosterhuis, 'Defining Non-Economic Activities in Competition Law' (2017) 13(1) *European Competition Journal* 117. A similar argument regarding non-economic activities is also adopted by Odudu, see Okeoghene Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (OUP 2006).

²⁹⁹ *ibid.*, 134. Kloosterhuis also defined as category of 'social goods' capable of explaining a broader range of activities.

³⁰⁰ His contribution is analysed in greater detail in Chapter 6, section 6.2.1.1.1.1.

³⁰¹ Kloosterhuis, (n 298) 145: 'Only a broad interpretation of the concept of market failure thus appears to offer sufficient guidance to explain the definition of non-economic activities with respect to social security'.

highlights the inadequacy of a narrow market failure standard to explain these various ‘exceptions’, particularly in relation to social security.³⁰²

Another contribution that aligns with the aforementioned trajectory has been proffered by Kloosterhuis and Janssen. They asserted that the *Wouters* case law³⁰³ can be explained by invoking economic theory, with specific emphasis on the theory of market failure.³⁰⁴ When analysing the case law ‘from an economic point of view’, the authors argued that the majority of the judgments involve measures aimed at remedying a particular market failure to the benefit of the consumers.³⁰⁵ One specific form of market failure that attracts attention is information asymmetries,³⁰⁶ which are predisposed to arise within markets for liberal services. Analysed from this perspective, the authors posited that the *Wouters* doctrine exhibits convergence, to a discernible degree, with Article 101(3) TFEU.³⁰⁷ Although this contribution remains relevant and furnishes valuable insights into the role of information asymmetries in the regulation of certain professions, the precise role of market failure within this assessment remains ambiguous. The contribution of Kloosterhuis and Janssen principally avers that the judgments ‘can be explained by a legitimate interest to protect consumers against possible detrimental effects of information advantages of member of the liberal profession’.³⁰⁸ Nonetheless, the existence of a market failure test is not critically examined in a systematic manner within their contribution. Uncertainty persists regarding the degree to which economic efficiency, framed in the context of market failure, is actually assessed. Furthermore, similar to the preceding scholarly contribution, there endures an opportunity for further development by adopting a broader analytical framework. Such an approach would facilitate a more nuanced examination to determine the extent to which objectives that

³⁰² For a closer examination of this case law see, Chapter 6, section 6.1.3.2.

³⁰³ On the *Wouters* case law, see Chapter 6, section 6.1.2.

³⁰⁴ Charlotte Janssen and Erik Kloosterhuis, ‘The *Wouters* Case Law, Special for a Different Reason?’ (2016) 37 *European Competition Law Review* 335.

³⁰⁵ *ibid.*, 339.

³⁰⁶ On the nature of externalities, see Chapter 2, section 2.2.1.1.

³⁰⁷ Janssen and Kloosterhuis (n 304) 338.

³⁰⁸ *ibid.*, 339.

transcend the bounds of narrow efficiencies are indeed factored into the legal analysis.³⁰⁹

Having explored the contributions in the current scholarship, the ensuing section aims to identify the scholarly intervention of the thesis.

1.5 Significance and Scholarly Novelty

This research adopts a *de novo* approach to investigate the role and meaning of both narrow and broader market failure standards in EU competition law.³¹⁰ It adopts an open-ended problem-based approach to assess the feasibility of market failure theory to be employed as a normative and analytical tool to include broader public policy considerations, such as environmental and economic sustainability within competition law analysis.

By focusing on public policy intervention, this thesis assesses market failure theory within the realm of both the antitrust and the State aid provisions, offering a unique and extensive analysis. To date, there has been an absence of equally extensive legal research focused on the concept of market failure within EU competition law. Through an exploration of divergent notions of market failure in economic and political theory, this thesis lays the groundwork for a fresh analysis that directly assesses the relevance and meaning of market failure within the legal assessment of public policy intervention. In doing so, it builds upon current research by providing a theoretical framework that encompasses multiple nuanced meanings of market failure, transcending the limitations of traditional neo-classical paradigms. Through an in-depth examination of the meaning, role, and limitations of market failure in EU competition law, this research can contribute to the body of legal scholarship in the following manner.

Provide a reinterpretation of the legal field by adopting a comprehensive approach that encompasses both narrow and broad standards of market failure.³¹¹ Rather than applying a narrowly construed notion of market failure to the law (economic analysis of the law), the legal framework is analysed from multiple

³⁰⁹ On the distinction between narrow and broader definitions of market failure, see Chapter 2 section 2.2.

³¹⁰ On the interpretation of broader standards of market failure, see Chapter 2 section 2.2.2.

³¹¹ *ibid.*

standards that extend beyond neo-classical paradigms. By doing so, it seeks to determine the role of market failure in legal assessment. Within this framework, both efficiency and external objectives are assessed to provide a holistic picture of the law.³¹² Although the existence of various standards of market failure has been acknowledged in current scholarship,³¹³ their specific nature and their relevance within the domain of EU competition law remain unexplored. Therefore, this research holds the potential to yield fresh insights and contribute to the expansion of existing scholarship.

Provide an *intervention in the theoretical and political debate on market failure and economic analysis in EU law*. By analysing legal material using market failure theory, the thesis offers the reader insights into the divergent meanings of the concept in economics and law. Rather than strictly adhering to the application of microeconomic theory to the legal framework, a critical approach is adopted, emphasising limitations and theoretical divergences. Moreover, this research adds to the vibrant discourse on economic analysis in EU competition law, which now encompasses the analysis of public policy measures. In this respect, the project adopts an approach based on ‘interdisciplinary engagements’³¹⁴ to uncover discrepancies between economic reasoning and ‘legal reality’. The analysis extends beyond the mere assessment of the relevance of economic theory and aspires to ‘detach’ market failure from its economic roots. This study explores the meaning of failing markets in law, and the possibility of the State and private firms to remedy such failures.

By adopting a *broad approach comparing the different provisions of antitrust and State aid law*, this research brings a fresh perspective on the internal coherence and the interplay between these legal fields with respect to public policy intervention. As stated previously, the applicability of these legal rules is determined by the intensity of the intervention rather the effects or objectives of the intervention. Accordingly, it is argued that such an analysis contributes to the

³¹² Objectives that conventionally are separated from strict efficiency gains typically manifested through short-term price effects. See section 1.2.4 of the current chapter.

³¹³ Kloosterhuis (n 298); Burke (n 294); Sauter, ‘Services of General Economic Interest and Universal Service in EU Law’ (n 288).

³¹⁴ This thesis does not adopt an interdisciplinarity approach but rather critically builds on the theoretical insights of economic analysis of the law. However, it is submitted that economic analysis of the law constitutes an exclusively dogmatic exercise. For an in-depth exploration on the nature of interdisciplinarity and the role of interdisciplinary engagements in legal science, see section 1.3.3.1 of the current chapter.

understanding of the precise boundaries and parameters governing such intervention.

1.6 Outline of the Thesis

The remainder of this thesis is structured into nine chapters.

Chapter 2 embarks on an examination of the meaning and role of market failure in economics. This chapter demonstrates that market failure can be interpreted through either a narrow or a broad lens, highlighting the diverse conceptual understandings of the concept.

Chapter 3 pivots to an assessment of market failure within law generally and EU competition law specifically. This chapter proffers a theoretical framework for assessing the role and value of market failure in EU competition law, setting the stage for the subsequent chapters. This framework is constructed on the basis of a comprehensive analysis of the theory of market failure, encompassing both economic and legal perspectives. Furthermore, this chapter emphasises that a market failure analysis can only be effectively applied within the principle of proportionality. Thus, after conducting an examination of the role of proportionality in the various fields, the proposed framework is firmly grounded in the proportionality analysis of public policy intervention.

Chapters 4 to 6 delve into a market failure analysis of the antitrust provisions. Chapter 4 provides an introduction to the antitrust provisions, emphasising the role of economic efficiency and consumer welfare, thereby underpinning the in-depth analysis of market failure under the antitrust provisions presented in Chapters 5 and 6. Specifically, Chapter 5 analyses the role of market failure within the ambit of Article 101(3), whilst Chapter 6 examines its role under Article 101(1), shedding light on its applicability within the definition of an ‘undertaking’ and its significance within the *Wouters* doctrine. These chapters provide both a theoretical and practical analysis, exploring the feasibility of incorporating either a narrow or a broad market failure test within the antitrust provisions. On a theoretical level, Chapter 4 deconstructs the narrow and broad interpretations of consumer welfare in EU competition law scholarship. Moreover, through an analysis of the relevant case law and the Commission’s soft law, Chapter 5 demonstrates, inter alia, the limited nature of the test under Article 101(3), which curtails the role and value of market failure theory in antitrust law.

Notably, these chapters highlight the multitude of challenges posed by the inclusion of broader efficiencies, such as sustainability, as advocated by the Commission, and critically assess the present boundaries and future trajectory of the antitrust provisions through the prism of market failure theory.

Chapters 7 through 9 investigate the role of market failure within EU State aid law. Chapter 7 introduces the legal area of State aid and the nexus between market failure and State aid modernisation. It analyses the Commission's 'common principles of assessment' (CAP) and their encapsulation of a market failure criterion. Chapter 8 is devoted to a case study of the CAP in the direct assessment under Article 107(3)(c). Chapter 9 discerns the role and value of market failure within specific sectorial frameworks. It focuses on two main regimes: the environmental protection and energy framework and the regional aid regime. These chapters aim to define the core criteria of compatibility of State aid from a market failure perspective. It is revealed that market failure plays a pivotal role in the context of State aid modernisation and the Commission's soft law regimes. However, these chapters also underscore ambiguities surrounding the precise meaning and role of market failure within EU State aid law, posing challenges the objectives of the modernisation agenda aimed at establishing objective and predictable State aid rules. Furthermore, the chapters critically evaluate the limitations of the EU Courts' judicial review, constrained by the broad margin of discretion afforded to the Commission in the area.

The tenth and final chapter provides a synthesis of the research. It highlights the multifarious applications of market failure theory, offering comprehensive insights into its nature and function across both antitrust and State aid law. This chapter presents the thesis of a market failure paradox, unravelling its intricacies and implications. It concludes by providing some key insights and recommendations for future research in the field.

PART II

Framing Market Failure

2. MARKET FAILURE IN ECONOMICS

This chapter is devoted to the exploration of market failure theory in economics and in law, with the objective of establishing a workable framework to guide the analysis of this research. The chapter aims to provide answers to the following sub-research questions:

How is market failure defined in theory?

Can a broad definition of market failure sufficiently encompass a wide spectrum of public policy considerations?

To that end, the chapter is divided into two sections. The first section, intended to present a complete understanding of the picture, provides the reader with the founding theory and assumptions of economic theory. It traverses the spectrum from the foundational principles of neo-classical economics to the efficiency paradigm of welfare economics. These theories constitute the underpinning of both market and competition law. Furthermore, the section discusses how the State is conceptualised as a rule-maker for the purpose of public policy intervention.

Building upon this economic foundation, the chapter moves on to the second section. Here, with the aim of building a persuasive framework for the analysis of this thesis, the role and the definition of market failure theory are explored. These fundamental theories will prove instrumental in defining a framework for the thesis. This section, examining both the scope and limitations of market failure theory, demonstrates the lack of a uniform understanding of the concept and exposes the existence of divergent interpretations. It is suggested that broadly, market failure comes in two different shapes: a narrow standard and potentially broader ones.

2.1 Laying the Foundation: Neo-classical Economics and Beyond

Despite being based on a myriad of various economic theories and models,³¹⁵ neo-classical economics has shaped the foundations of modern competition theory. The study of markets remains today construed around a series of assumptions developed in neo-classical economics. As mentioned in the previous chapter, these assumptions are not perfect, and might not correspond to an accurate description of the real world. In the methodological inquiry of the previous chapter, it was noted that the soundness of the following utilitarian-based and efficiency-preoccupied theories have been challenged internally within economics, for instance with more recent theories in behavioural economics.³¹⁶ Moreover, it explored how the theories are also challenged from an external view,³¹⁷ in particular by legal doctrine.³¹⁸ Nevertheless, these imperfect foundations have shaped the framework of the Western market society, including the EU.³¹⁹ The prevailing narrative suggests that the State has been re-conceptualised – this assertion, however, has recently been met with critique in the wake of both the financial crisis³²⁰ and the COVID-19 pandemic – from a main player in the market to an observant rule maker, stepping in to correct the failures of the market, whilst allowing the market players to pursue their own self-interest. However, the quality of the State as a rule maker is nothing new in economics. Even Smith recognised

³¹⁵ Damien Geradin, Anne Layne-Farrar and Nicolas Petit, *EU Competition Law and Economics* (OUP 2012) 61, remarked that ‘[t]oday, competition economics is generally described as a composite discipline borrowing from different economics schools of thought’.

³¹⁶ See (n 212).

³¹⁷ Jean Tirole, *Economics for the Common Good* (Princeton University Press 2017) 34 noted that, ‘[s]pecialists in other disciplines [...] have a different view of the market. While they recognize its virtues, they often accuse economists of not sufficiently considering the ethical issues it raises, and of not acknowledging the need to establish a clear boundary between the commercial and the noncommercial’.

³¹⁸ See Chapter 1, section 1.3.2.4.

³¹⁹ Neo-classical assumptions have shaped market failure theory and the role of the State in the market, for a closer examination see section 2.2 of the current chapter. To a certain extent this is also the case for both US antitrust law and EU competition law, see to this effect, K Kip Viscusi, Joseph E Harrington and David EM Sappington, *Economics of Regulation and Antitrust* (MIT Press 2018) 3.

³²⁰ Bateman (n 46) 140; Richard A Posner, *A Failure of Capitalism* (Harvard University Press 2009); Joseph E Stiglitz, *Freefall* (Penguin Books 2010). These views attest to a constant evolution of the perception of the State as a market regulator.

the need for a legal framework to guarantee freedom of competition.³²¹ From this perspective, the State thus has a function to ‘to establish and enforce the “rules of the economic game”’.³²²

The preceding chapter briefly touched upon the notions of methodological individualism and rationality.³²³ The supremacy of individual preferences owes its status to Smith’s vision of the ‘invisible hand’.³²⁴ It laid the foundations for the presumption that society is economically better served if economic operators can freely pursue their own self-interest, and by doing so the self-interest of individuals will coincide with the larger interest of society. The claim is that the pursuit of self-interest – within a competitive market – achieves economic efficiency.³²⁵ Methodological individualism assumes that social welfare can only be understood as the total sum of all individual welfare.³²⁶ The genius of Smith laid the foundation of neo-classical economics and competition policy.³²⁷ The invisible hand, or the ‘market mechanism’, ensures that without government intervention supply and demand will reach an equilibrium resulting in market clearance.³²⁸ Markets and States are complementary in the sense that the invisible hand will only be effective to the extent that the State corrects market failures by providing a legal framework within which individual firms are held accountable for decisions impacting the well-being of society.³²⁹ Rationality, on the other hand, implies that individuals act rationally in the goal of maximising their utility, i.e.,

³²¹ Roger J Van den Bergh and Peter D Camesasca, *European Competition Law and Economics: A Comparative Perspective*, vol (2nd ed Sweet & Maxwell 2006) 61, in particular ‘by preventing conclusion between firms and abuses by dominant firms, consisting in the erection of barriers to entry to combat the erosion of their market power’.

³²² Atkinson and Stiglitz (n 247) 4.

³²³ See Chapter 1, sections 1.3.2.3 and 1.3.2.4.

³²⁴ Adam Smith, *The Theory of Moral Sentiments* (Metalib 2005, cop 1759) 169; See also, Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Metalib 2007, cop 1776) 349.

³²⁵ Jean Tirole (n 317) 161.

³²⁶ Ogus (n 18) 23.

³²⁷ Although the author of this theses recognises that the economic origins of competition policy draw from a series of different economic strands.

³²⁸ Robert S Pindyck and Daniel L Rubinfeld, *Microeconomics* (Dryden Press 2005) 24.

³²⁹ Tirole (n 317) 161.

their satisfaction in relation to their preferences.³³⁰ These two assumptions shaped the commonly known system of a market economy.³³¹

Later, the branch of *welfare economics* developed tools to measure the well-being of the economy and the need for State intervention respectively. Welfare economics can be defined as a '[n]ormative evaluation of markets and economic policy'.³³² Buchanan summarised welfare economics of the mid-twentieth century as 'theories of market failure'.³³³ In order to understand market failure it is crucial to establish the meaning of equilibrium theory. Very simply described, welfare is maximised through the attainment of an economic equilibrium where it is not possible to improve the efficiency of the economy.³³⁴ An equilibrium is attained when economic efficiency is complete in a way that consumer and producer surplus – i.e., total surplus – is maximised.³³⁵ A general equilibrium, contrary to a partial equilibrium, is determined in all the markets of an economy simultaneously.³³⁶ Building on the early works of Walras, the theory resulted in the mid-1900s in the development of the Arrow-Debreu-McKenzie model, which proved mathematically the existence of a general equilibrium, in the sense of Pareto efficiency.³³⁷

In neo-classical economics the type of efficiency typically referred to in an equilibrium is *Pareto efficiency*.³³⁸ A Pareto equilibrium occurs when there is no

³³⁰ See, e.g., Mankiw (n 184) 431, who defined utility as 'a measure of happiness or satisfaction'. The author also pointed out that '[u]tility is a measure of well-being and, according to utilitarians, is the ultimate objective of all public and private actions. The proper goal of the government, they claim, is to maximize the sum of utility of everyone in society'.

³³¹ Ogus (n 18) 23; Mankiw (n 184) defined a market economy as, 'an economy that allocates resources through the decentralized decisions on many firms and households as they interact in markets for goods and services'.

³³² Pindyck and Rubinfeld (n 328) 590.

³³³ James M Buchanan, 'Market Failure and Political Failure' (1988) 8(1) *Cato Journal* 1.1.

³³⁴ Equilibrium theory, however, is a vast, complex, and contrasting topic of economic theory, and recent developments have called into questions its foundational assumptions. See Blume and Durlauf (n 4) 605-606.

³³⁵ Mankiw (n 184) 145.

³³⁶ Jeffrey M Perloff, *Microeconomics* (8th edn, Pearson 2018) 332.

³³⁷ Burke (n 294) 23; Hugo F Sonnenschein, 'Chicago and the Origins of Modern General Equilibrium' 2017 (125)6 *Journal of Political Economy* 1728.

³³⁸ Named after the Italian economist Vilfredo Pareto who developed this theory in Vilfredo Pareto, *Manuale d'Economia Politica* (Società Editrice Libreria 1906). It is also the type of efficiency typically relevant for market failure analysis (Ledyard (n 15) 300).

feasible allocation of resources which could make at least one individual better off whilst all the individuals remain at least as well off as they were initially.³³⁹ In this sense, a Pareto improvement can be made when it makes one individual better off whilst not degrading the status quo for any other individual. By analysing the allocation of resources, Pareto efficiency refers to so-called allocative (or static) efficiency.

In the quest to measure and consequently achieve Pareto efficiency, welfare economics rests on the bedrock of two fundamental theorems. The first reflects Smith's invisible hand, and holds that under certain conditions a competitive economy results in a Pareto optimal equilibrium; whilst the second theorem postulates that, under those conditions, every Pareto optima may be achieved by a lump-sum transfer of resources.³⁴⁰ The theorems suggest that markets are efficient organisations.³⁴¹ Although the conditions under which a competitive economy achieves Pareto efficiency vary, generally and simplified, three conditions are presented: (i) there are enough markets; (ii) consumer and producers behave competitively; and (iii) an equilibrium exists.³⁴² The third criterion refers to the attainment of a competitive equilibrium of supply and demand, where consumer surplus and producer surplus – referred to as total surplus – is maximised. If one of these conditions is missing, markets are said to fail.³⁴³ Accordingly, in order to reach a competitive equilibrium, along with the achievement of Pareto efficiency, one can note that there is, in addition to economic assumptions of human behaviour, a general requirement of an absence of market failures. With that knowledge in mind five further points can be made.

First, the notion of a competitive equilibrium echoes the principles of equilibrium theory. It follows from the above that the attainment of a general equilibrium necessitates a competitive equilibrium. This state of equilibrium has been referred to in competition theory as *perfect competition*. Whilst classical

³³⁹ Ben Lockwood, 'Pareto Efficiency' in Blume and Durlauf (eds) (n 15) 292.

³⁴⁰ Hans W Friederiszick, Lars-Hendrik Röller and Vincent Verouden, 'European State Aid Control: An Economics Framework' in Paolo Buccirossi (ed), *Handbook of Antitrust Economics* (MIT Press 2008) (MIT Press 2008) 632; Joseph E Stiglitz, 'The Invisible Hand and Modern Welfare Economics' (1991) NBER Working Paper Series, Working Paper No. 3641, 4.

³⁴¹ Bernard Salanié, *Microeconomics of Market Failure* (MIT Press 2000) 6.

³⁴² Ledyard (n 15).

³⁴³ As will be described in the following section, there exists a myriad of market failures that might cause an inefficient allocation of resources.

economics embraced a dynamic view of competition as a behavioural concept,³⁴⁴ neo-classical economics took a more static perspective.³⁴⁵ Emphasis was placed on the structure of competition rather than the behaviour of the market participants. In order to measure competition and determine the conditions under which the invisible hand will maximise competition between firms, a concept of ‘perfect competition’ was thus defined. According to Hayek, perfect competition presupposes:³⁴⁶

1. A homogeneous commodity offered and demanded by a large number of relatively small sellers or buyers, none of whom expects to exercise by his action a perceptible influence on price.
2. Free entry into the market and absence of other restraints on the movement of prices and resources.
3. Complete knowledge of the relevant factors on the part of all participants in the market.

The theory of Hayek has proven essential to competition theory worldwide. In such a competitive edifice, competition is entirely unimpaired and there is complete elasticity,³⁴⁷ leading to maximum efficiency since the unit price of a product equals marginal costs.³⁴⁸ However, economic theory has criticised the theory of perfect competition since, practically, it ‘does not and cannot exist’.³⁴⁹ Therefore, a theory of ‘workable competition’ emerged,³⁵⁰ associated with the

³⁴⁴ Van den Bergh and Camesasca (n 321) 59.

³⁴⁵ *ibid.*, 61.

³⁴⁶ Friedrich A von Hayek, *Individualism and Economic Order* (Routledge and Kegan Paul 1949) 95.

³⁴⁷ i.e., perfect elasticity: the price of the product corresponds strictly to the consumer demand, and any increase of the price would result in a drop of consumer demand.

³⁴⁸ Robert H Frank, *Microeconomics and Behavior* (McGraw-Hill 2006) 370-372.

³⁴⁹ John M Clark, ‘Toward a Concept of Workable Competition’ (1940) 30 *American Economic Review* 241, 241; Hayek (n 346) 92, who noted that ‘if the state of affairs assumed by the theory of perfect competition existed, it would not only deprive of their scope all the activities which the verb to “compete” describes but would make them virtually impossible’.

³⁵⁰ The term “workable competition” was coined by John M Clark in Clark (n 349). However today it is an established notion between both economists and lawyers, see, e.g., Ernst-Joachim Mestmäcker, ‘Towards a Concept of a Workable European Competition Law’ in Kiran Klaus Patel and Heike Schweitzer (eds), *The Historical Foundations of EU Competition Law* (OUP 2013). The ECJ has also referred to the concept, see, Case 26/76 *Metro v Commission* (*Metro I*) EU:C:1986:399.

Harvard School and the structure-conduct-performance paradigm.³⁵¹ Yet, a definitional conundrum is that there is no clear yardstick to which one can measure the concept of ‘workable competition’, which leaves the door open to conjectural critique.³⁵² The underlying idea appears to be that ‘competition policy should aim to produce ‘the best competitive arrangement practically attainable’.³⁵³ For the purpose of achieving an optimal arrangement, from a welfare economics perspective the theory of perfect, or workable, competition relies on the presumption that unfettered competition reallocates resources in an optimal way and is accordingly achieving efficiency.

Second, the other theorem entails a fundamental consequence as it allows for a separation between efficiency and equity.³⁵⁴ As put by Stiglitz:

[The second theorem] says that we can separate out issues of economic efficiency from issues of equity. Economists need not concern themselves with value judgments; whatever the government’s distributive objectives, it implements these through initial lump sum taxes and subsidies, and then leaves the market to work for itself.³⁵⁵

Accordingly, the distinction between efficiency and equity provides for two possible modes of welfare increasing intervention: either by ‘making the cake bigger’ or by ‘dividing the cake better’.³⁵⁶ As a result, economic policy is guided

³⁵¹ Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases, and Materials* (OUP 2016) 24.

³⁵² e.g., Jesse W Markham, ‘An Alternative Approach To The Concept Of Workable Competition’ (1950) 40 *American Economic Review* 349, 349-350 who pointed out that ‘[t]hat the term workable competition defies a precise definition, even in the presence of agreed upon standards of workability in some political or moral sense, becomes evident when one attempts to define the “industry” to which the concept is to be applied’.; Dale L Cramer and William L Heuser, ‘Variations in the Definition of the Degrees of Competition’ (1960) 19 *American Journal of Economics & Sociology* 383, 383; See also, on potential definitions of “effective competition”, Simon Bishop and Mike Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*. (Sweet & Maxwell, 2010) 16.

³⁵³ *ibid.* See, for a reference to the concept by the ECJ, Case 26/76 *Metro I* (n 350), para 20: ‘the degree of competition necessary to ensure the observance of the basic requirements and the attainment of the objectives of the EEC Treaty’.

³⁵⁴ Friederiszick, Röller and Verouden (n 340) 632.

³⁵⁵ Stiglitz, ‘The Invisible Hand and Modern Welfare Economics’ (n 340) 5.

³⁵⁶ Friederiszick, Röller and Verouden (n 340) 632.

by efficiency rationales whilst distributive justice is an entirely political issue.³⁵⁷ However, even though the second welfare theorem, in theory, alleviates the necessity for equity-enhancing market regulation,³⁵⁸ the precise role of such intervention is naturally dependent upon the type of welfare standard adopted. A common dualist distinction is to separate a utilitarian and a Rawlsian approach.³⁵⁹ Yet, most economists adopt a utilitarian welfare approach in order to focus on efficiency,³⁶⁰ a criterion which is seen as neutral and independent from any distributional policy concerns.³⁶¹ In the spirit of Smith's invisible hand, a utilitarian approach focuses on the sum of welfare created without making interpersonal comparisons. In sum, the second welfare theorem is the basis for excluding equity concerns from the scope of market regulation.

Third, the debate surrounding the appropriate welfare standard to be adopted has been a central tenet in competition law as well.³⁶² The objectives of EU competition law and their interaction with market failure theory is further examined in Chapters 4, 5 and 6 of this thesis.³⁶³ As explored in the previous chapter, economic efficiency is *one* of the goals of EU competition law,³⁶⁴ although sometimes presented as the 'overall, general objective'.³⁶⁵ The existence of conflicting objectives is problematic from the point of view of defining a welfare function in economic terms. With regard to welfare standards, there are

³⁵⁷ Ioannis Lianos, Valentine Korah and Paolo Sicilliani, *Competition Law: Analysis, Cases & Materials* (Oxford University Press 2019) 92.

³⁵⁸ Which is then limited to lump-sum transfers.

³⁵⁹ Friederiszick, Röller and Verouden (n 340) 634 ft 38: 'Two classical concepts put forward in this regard by economists are the utilitarian approach of putting equal weight on individual utilities and the Rawlsian approach of putting all weight on the individual with lowest utility. However, an infinite amount of possible preference functions are possible'.

³⁶⁰ Bateman (n 46) 132.

³⁶¹ Friederiszick, Röller and Verouden (n 340) 634.

³⁶² See Chapter 4, section 4.3.2.

³⁶³ On the development of a market failure framework for that analysis, see Chapter 3, section 3.3.

³⁶⁴ See Chapter 1, section 1.3.2.2. Although competition law has multiple and evolving objectives, a proclaimed primary objective is consumer welfare, frequently coupled with economic efficiency. See Communication from the Commission, 'Guidelines on the application of Article 81(3) of the Treaty' (Notice) 2004/C 101/08, para 13, which state that '[t]he objective of Article [... 101] is to protect competition in the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources'.

³⁶⁵ Parret, 'Shouldn't We Know What We Are Protecting?' (n 9) 349. See for a detailed examination, Chapter 4, sections 4.3.1 and 4.3.2.

two types of welfare generally recognised in competition doctrine: *consumer* welfare and *total* welfare (also-called *social* welfare).³⁶⁶ As stated, total welfare is the sum of producer and consumer surplus, in other words the profit that the producers³⁶⁷ and the consumers make in light of a transaction.³⁶⁸ Total welfare thus combines allocative and productive efficiency.³⁶⁹ Although there is a lack of consensus on the meaning of consumer welfare,³⁷⁰ it can for the sake of simplicity (often) be equated to consumer surplus.³⁷¹ Whilst, traditionally, economists focused on total/social welfare,³⁷² the choice between these two theories of welfare is one of the most enduring and contingent controversies in contemporary competition law.³⁷³ Yet, the meaning of consumer welfare in relation to total welfare via efficiency maximisation remains nebulous. Even if these two sets of standards would yield the same result in most cases,³⁷⁴ economists and scholars point out potential divergences between consumer welfare and efficiency.³⁷⁵

Fourth, however, asserting that a utilitarian welfare approach is anchored in static efficiency is in itself not sufficient. From an economic perspective, welfare must be assessed not only in a static environment but also dynamically, i.e., future welfare (innovation).³⁷⁶ This topic has been central to competition law and policy

³⁶⁶ Jones and Sufrin (n 351) 11.

³⁶⁷ i.e., the profit gained by the producer when comparing the cost of production to the price of product.

³⁶⁸ i.e., the difference between the price that the consumer is willing to pay for a product and the price actually paid for the same product.

³⁶⁹ e.g., Nazzini (n 269) 33. For a different view, see, Christian Buelens and others, ‘The Economic Analysis of State Aid: Some Open Questions’ (2007) 286 *European Economy - Economic Papers* 9, who include distributional objectives in the notion of social welfare.

³⁷⁰ e.g., Pinar Akman, “‘Consumer Welfare’ and Article 82EC: Practice and Rhetoric” (2009) 32 *World Competition: Law and Economics Review* 71, 72. For a detailed analysis see Chapter 4, section 4.3.2.

³⁷¹ Jones and Sufrin (n 351).

³⁷² Bishop and Walker (n 352) 29.

³⁷³ Michael Harker, ‘Antitrust Law and Administrability: Consumer versus Total Welfare’ (2011)

34 *World Competition: Law and Economics Review* 433.

³⁷⁴ Bishop and Walker (n 352) 32; Motta (n 272) 19.

³⁷⁵ Motta (n 272) 19; Bishop and Walker (n 352) 31-32; Parret, ‘Shouldn’t We Know What We Are Protecting?’ (n 9) 350.

³⁷⁶ Motta (n 272) 19; Van den Bergh and Camesasca (n 321) 29.

debates.³⁷⁷ As stated above, a traditional definition of efficiency means that producer and consumer welfare is maximised.³⁷⁸ This is referred to as static efficiency, meaning that it is assumed that ‘technologies (costs) are given, and that the most efficient technology available is used’.³⁷⁹ Static efficiency comprises both productive (goods and services are produced at the lowest possible cost) and allocative (or Pareto) efficiency.³⁸⁰ Perfect competition is said to maximise static efficiency. However, next to static efficiency there is dynamic efficiency, also called ‘Schumpeterian competition’, or simply ‘innovation’, which measures technical evolution.³⁸¹ Innovation is essential for society as welfare, and a Pareto efficient solution might be dynamically inefficient.³⁸² The complication lies in that these different efficiencies do not always coincide;³⁸³ which leads to it being impossible to effectuate a Pareto improvement. On those grounds, economists sometimes express a preference for the so-called Kaldor-Hicks efficiency.³⁸⁴ This variant of efficiency is central to economic analysis of the law and occurs when an allocation of resources results in net benefits to society compared with the overall costs.³⁸⁵ Put differently, the benefit generated to the winners outweighs the

³⁷⁷ For examples from both sides of the Atlantic see e.g., Gregory J Sidak and David J Teece, ‘Dynamic Competition in Antitrust Law’ (2009) 5(4) *Journal of Competition Law & Economics* 581; Marina Lao, ‘Ideology Matters in the Antitrust Debate’ (2014) 79(2) *Antitrust Law Journal* 649; Valentine Korah, ‘Dynamic Competition and Public Policy, Technology, Innovation and Antitrust’ (2008) 31(1) *World Competition: Law & Economics Review* 145; Jonathan B Baker, ‘Exclusion as a Core Competition Concern’ (2013) 78(3) *Antitrust Law Journal* 527; Robert H Bork and Gregory J Sidak, ‘What Does the Chicago School Teach about Internet Search and the Antitrust Treatment of Google?’ (2012) 8(4) *Journal of Competition Law & Economics* 663; Inge Govaere, ‘In Pursuit of an Innovation Policy Rationale: Stakes and Limits under Article 82 TEC’ (2008) 31(4) *World Competition: Law & Economics Review* 541; Federico Etro, ‘Competition Policy: Toward a New Approach’ *European Competition Journal* (2006) 2(1) 29.

³⁷⁸ Pindyck and Rubinfeld (n 328) 395.

³⁷⁹ Motta (n 272) 41.

³⁸⁰ Dunne (n 212) 8.

³⁸¹ Dynamic competition was mainly developed by the Austrian School, Joseph A Schumpeter, *Capitalism, Socialism, Democracy* (Reprinted Routledge 1994) 81, famously described the process of innovation as ‘creative destruction’.

³⁸² A particularly strong argument is that innovation contributes more to economic growth than allocative efficiency, see Driesen and Malloy (n 213) 302.

³⁸³ Motta (n 272) 19.

³⁸⁴ Named after economists John Hicks and Nicholas Kaldor, see, John Hicks, ‘The Foundations of Welfare Economics’ (1939) 49 *Economic Journal* 696; Nicholas Kaldor, ‘Welfare Propositions of Economics and Interpersonal Comparisons of Utility’ (1939) 49 *Economic Journal* 549.

³⁸⁵ ‘Kaldor-Hicks efficiency’ in Jonathan Law, *A Dictionary of Law* (OUP 2018). See also, Posner, ‘The Law and Economics Movement’ (n 122) 5.

loss of the losers. In EU competition law, Kaldor-Hicks efficiency serves to effectuate trade-offs where Pareto improvements are unattainable;³⁸⁶ most often, however, it maximises total welfare and is therefore said to lead to Pareto efficiency.³⁸⁷ Nevertheless, the Kaldor-Hicks standard provides more flexibility – it can be seen as a more ‘practical’ and ‘pragmatic criterion’³⁸⁸ – compared to the strict, and extremely difficult Pareto standard.³⁸⁹ Important to note is that although a Kaldor-Hicks approach requires ‘interpersonal comparisons of utility’³⁹⁰ – contrary to a Pareto approach – it still takes a utilitarian view (hence the link to Pareto efficiency above). This is the case since the worth of wealth being transferred via a measure is assumed to be of equal value to everyone.³⁹¹ This again ignores any redistributive concerns that might arise from the transaction.³⁹²

Lastly, it is necessary to revisit the imperfection of these assumptions. As explained earlier, neither perfect competition nor Pareto efficiency is, in reality, attainable. Therefore, the idealised world of a static general equilibrium is consequently unachievable. As put by Dunne:³⁹³

[T]he static model of market equilibrium and efficiency represents an idealised state of affairs that cannot be realised in the real world. Thus, there is a problem of ‘second best’: namely, how to identify and secure the next best outcome, given that the optimal is unachievable. Policy-makers must decide whether to pursue the most efficient market-based allocation achievable in the circumstances, which may have significant imperfections, or whether instead to opt for some non-market-based regulatory solution that secures the distribution that society considers

³⁸⁶ Van den Bergh and Camesasca (n 321) 29.

³⁸⁷ *ibid.*

³⁸⁸ Robert N Stavins, ‘Environmental Economics’ in Blume and Durlauf (eds) (n 15) 882-883.

³⁸⁹ Nelson (n 98) 546 pointed out that ‘it is devilishly difficult to devise simple collective choice mechanisms that will generate Pareto-optimal outcomes’.

³⁹⁰ Paul Burrows and Cento Veljanovski, *The New Law-and-Economics: A Research Review* (Centre for Socio-Legal Studies 1982) 37 as cited in Freeman (n 239) 519.

³⁹¹ Freeman (n 239) 519.

³⁹² Emmunel V Towfigh and Niels Petersen (n 189) 12.

³⁹³ Dunne (n 212) 13.

optimal in the circumstances, but with the risk that accompanies interference with the market process.

In light of this, if market failure is predicated on an unachievable standard of efficiency, the question of the optimal solution arises. The second-best option cannot be achieved by a Pareto improvement, leading to a common preference for the Kaldor-Hicks standard. However, as observed, most economists opt for making such evaluations on a purely efficiency-based standard, leaving any distributional concerns aside. From this perspective, only efficiency-related market failures are acknowledged. This ushers the chapter into the second section, where different notions of market failure are explored.

2.2 The Theory of Market Failure

Having explored the foundations of welfare economics, this section examines the theory of market failure. In the preceding section, it was established that the objective of Pareto efficiency – or Kaldor-Hicks efficiency – is to maximise social welfare. In reality, an array of circumstances exists wherein markets, absent government intervention (or public policy intervention broadly), do not lead to the highest possible social welfare. This could arise either because markets are not economically efficient, or (depending on the welfare function) due to the failure of the market to take into account some external policy objective. Therefore, this section sets out to delineate and analyse the fundamental traits of market failure theory in order to provide a foundation for the following section, where a framework for the analysis is constructed. Two key claims are advanced in this section. First, it is argued that there are two possible ways to understand market failure. The first one can be labelled a ‘narrow definition’. As explored above, the welfare standard adopted is traditionally an efficiency-based one excluding any broader objectives not based on economic efficiency. The second variant is a broader open-ended definition,³⁹⁴ where the content of the market failure can be enlarged by taking into account broader objectives. Second, it is suggested that market failure cannot be extended to accommodate external objectives without revisiting its founding principles. Consequently, the theory remains a partial

³⁹⁴ These are open-ended since they do not provide a clear and precise definition of market failure but advocate for a broader conceptualisation of the failure of markets going beyond economic efficiency.

explanation of public policy intervention, which can only be functionally expanded by admitting trade-offs between economic efficiency and external considerations.

Simply defined, market failure is ‘conceived of as the failure of the market to bring about results that are in the best interests of society as a whole’.³⁹⁵ The issue of market failure brings about two questions: (i) *what* is its function; and (ii) *how* does it operate that function?

First, the function of market failure is best described by asking *why* market failure? From a normative perspective, the purpose of market failure analysis is to determine the need and desirability of government intervention in the market.³⁹⁶ In this connection, market failure is often presented as a *normative tool* – it defines when the state *should* intervene.³⁹⁷ However, market failure has also been construed as claiming to be an *analytical tool* – measuring the appropriateness and to some extent the effectiveness of government intervention.³⁹⁸ In that sense, market failure is perceived as a dual ‘diagnostic tool’, providing not only a reason for intervention (rationale), but also a ‘treatment’ to mal-functioning markets (remedy).³⁹⁹ Originally, the normative tool was the sole function of market failure, but it gradually transformed into a ‘full-scale diagnostic tool frequently employed by policy analysts to determine the exact scope and nature of government intervention’.⁴⁰⁰ This duality has been described by certain scholars as a ‘double market failure test’.⁴⁰¹ In this sense, policy analysts argue that the dual diagnostic tool demands that there is not only a market failure, but also that government intervention is only legitimate if it is efficient in remedying the failure.⁴⁰²

³⁹⁵ Marciano and Medema (n 46) 1; Mankiw (n 154) 150, placed emphasis on efficiency stating that due to special circumstances the market does not operate efficiently from the standpoint of society as a whole.

³⁹⁶ From that perspective, market failure is a concept of normative economics.

³⁹⁷ Zerbe Jr and McCurdy (n 97) 558.

³⁹⁸ *ibid.*

³⁹⁹ Zerbe Jr and McCurdy (n 97) referred to this as the ‘double market failure test’.

⁴⁰⁰ *ibid.*, 558.

⁴⁰¹ David L Weimer and Aidan R Vinning, *Policy Analysis: Concepts and Practice* (Prentice Hall 1992) 179, as cited in Zerbe Jr and McCurdy (n 97) 559.

⁴⁰² Zerbe Jr and McCurdy (n 97): sufficient justification ‘is established when the gains from government intervention outweigh the dangers of government intervention’. See, to this effect the similarity with the government failure explained in Chapter 3, section 3.2.2.

Second, the *modus operandi* of market failure relates to the question of *what* is measured. This issue links directly back to the issue of a narrow welfare standard based on economic efficiency compared to potential alternatives. The following subsections deal with that question by analysing the possible definitions of market failure. These two questions are fundamental to the market failure analysis in subsequent chapters.⁴⁰³

The remainder of this section is divided into three subsections. In the first and the second subsections, the narrow and the broad standards of market failure are explored respectively. The third section then reflects upon the meaning of, and the relationship between, these two definitions.

2.2.1 The Narrow Definition

A ‘narrow’ definition of market failure is founded on a purely efficiency-based concept of an optimal market equilibrium.⁴⁰⁴ As seen above, in welfare economics the focus is placed on Pareto efficiency.⁴⁰⁵ Consequently, the failure occurs when the conditions of the competitive equilibrium are violated and markets are unable to work efficiently.⁴⁰⁶ Different economic tools would be used to measure whether or not a consumption or production activity is inefficient, often based on a price that exceeds marginal costs.⁴⁰⁷ In this context, market failure is often thought of as based on a static and moral-free notion of economic efficiency.⁴⁰⁸ The concept of market failure owes its existence to the early works of Samuelson⁴⁰⁹ and Bator.⁴¹⁰ Bator argued the following:

⁴⁰³ A common framework is developed Chapter 3, section 3.3.

⁴⁰⁴ For the notion of economic efficiency, see section 2.1 of this chapter.

⁴⁰⁵ Ledyard (n 15) 300. ‘The best way to understand market failure is first to understand market success, the ability of a collection of idealized competitive markets to achieve an equilibrium allocation of resources that is Pareto optimal’. This might well be prolonged into the often-preferred Kaldor-Hicks efficiency. See also, e.g., ‘Market Failure’ in Black John, Nigar Hashimzade and Gareth Myles, *A Dictionary of Economics* (5th edn, OUP 2017).

⁴⁰⁶ e.g., Salanié (n 341) 1. See also, e.g., ‘Market Failure’ in George Norman and Darlene C Chisholm, *Dictionary of Industrial Organization* (Edward Elgar 2014).

⁴⁰⁷ Perloff (n 336) 302.

⁴⁰⁸ On the moral foundations of efficiency see, Chapter 1, section 1.3.2.4.

⁴⁰⁹ Paul A Samuelson, ‘The Pure Theory of Public Expenditure’ (1954) 36 *Review of Economics and Statistics* 387.

⁴¹⁰ Bator (n 1).

What is it we mean by “market failure”? Typically, at least in allocation theory, we mean the failure of a more or less idealised system of price-market institutions to sustain “desirable” activities or to stop “undesirable” activities. The desirability of an activity, in turn, is evaluated relative to the solution values of some explicit or implied maximum-welfare problem.⁴¹¹

However, the task of defining, and thereby identifying, market failure is made complex due to the ubiquity of sources that may contribute to different types of market failure.⁴¹² The predicament encountered here mirrors that of perfect competition; can there truly be any perfect market? Bator himself recognised that many things could lead to a false Pareto equilibrium.⁴¹³ Bator’s taxonomy of market failure ordered them according to their causes in terms of externalities.⁴¹⁴ Indeed, the recognition of market failure prompted a deeper exploration and sophistication of the concept. Building upon earlier discussions centred on externalities, public goods and natural monopolies, subsequent developments in the field of economics expanded the scope of market failure to include issues such as incomplete markets, imperfect information and imperfect competition.⁴¹⁵ Since then, endless typologies of market failures have been made.⁴¹⁶ Yet, there are, at least, some well-accepted categories⁴¹⁷ of market failure that lead to an inefficient allocation of resources.⁴¹⁸

⁴¹¹ *ibid.*

⁴¹² Majone (n 18) 29 ‘only the imagination of economists sets a limit to an ever-lengthening list of market failures’.

⁴¹³ Bator (n 1) 352.

⁴¹⁴ See section 2.2.1.1 of the current chapter.

⁴¹⁵ Stiglitz, ‘The Invisible Hand and Modern Welfare Economics’ (n 340) 3. For an early reflection on market failure see, Alfred E Kahn, ‘The Tyranny of Small Decisions: Market Failures, Imperfections, and the Limits of Economics’ (1966) 19(1) *Kyklos* 23, who distinguished market failure from ‘market imperfections’, the latter category being defined as imperfections of competition.

⁴¹⁶ See, e.g., Salanié (n 341); Ogus (n 18) 30; Robert Baldwin and Martin Cave, ‘Why Regulate?’ in Baldwin, Cave and Lodge, *The Oxford Handbook of Regulation* (n 18).

⁴¹⁷ See Figure 2.1.

⁴¹⁸ These categories (loosely defined) are recognised by most scholars, see e.g., Pindyck and Rubinfeld (n 328) 606; Majone (n 18) 28-29; Veljanovski Cento, ‘Economic Approaches to Regulation’ in Baldwin, Cave and Lodge, *The Oxford Handbook of Regulation* (n 18) 20-22; Peter Dorman, *Microeconomics: A Fresh Start* (Springer 2014) 109; Zerbe Jr and McCurdy (n 97) 561;

2.2.1.1 Externalities

Externalities can be defined as the indirect effects of production and/or consumption activities on third parties, which are not directly reflected in the market.⁴¹⁹ In other words, the impact of an activity on a ‘bystander’.⁴²⁰ The economic objection to externalities is that they are not reflected in the market price and thus lead to economic inefficiency.⁴²¹ The externality can be positive if it creates a benefit for a third party, or negative if the effect is adverse.⁴²² Negative externalities are a source of economic inefficiency since the social marginal cost⁴²³ is higher than the marginal cost of the product.⁴²⁴ In other words, the cost for society caused by the production or the consumption of the good exceeds the cost of production. In order to get rid of the inefficiency created by a negative externality the State needs to ‘internalise’ it⁴²⁵ – i.e., alter the incentives of producers and consumers so that the external effects of the transaction are taken into account.⁴²⁶ Pollution is a typical example of a negative externality most often caused by a production activity. Here, the State can internalise the externality by, for instance, imposing a tax on the production reflecting the social cost of the pollution caused to society. However, more direct ways of intervening in the markets are also conceivable.⁴²⁷

‘Market Failure’ in John, Hashimzade and Myles (n 405); Friederiszick, Röller and Verouden (n 340) 632-634; Jacques Pelkmans, ‘The Economics of Single Market Regulation’ (2012) 25/2012 Bruges European Economic Policy Briefings 3; Daniel F Spulber, *Regulation and Markets* (MIT 1989) 40 ff.

⁴¹⁹ Pindyck and Rubinfeld (n 328) 641.

⁴²⁰ Mankiw (n 184) 200.

⁴²¹ Pindyck and Rubinfeld (n 328) 642.

⁴²² Mankiw (n 154) 200.

⁴²³ i.e., the cost of production for society, which is calculated by adding the marginal external cost to the marginal costs.

⁴²⁴ Pindyck and Rubinfeld (n 328) 642.

⁴²⁵ Whilst the author of this thesis is aware of the importance of private solutions to market failures in economic theory, it is important to note that such considerations are irrelevant for this definition. See e.g., private solutions through the elimination of transaction costs and the transfer of property rights according to the Coase theorem, Coase (n 129).

⁴²⁶ Mankiw (n 184) 202.

⁴²⁷ This is further explored in Chapters 5, 6, 7 and 8. However, an example of market regulation (through so-called market mechanisms) to combat externalities can be found in environmental protection, see e.g., Directive 2003/87/EC of the European Parliament and of the Council of 13

Positive externalities, on the other hand, generate marginal external benefits⁴²⁸ in addition to its marginal benefits.⁴²⁹ In this scenario, the social cost is less than the private cost of production,⁴³⁰ so the social marginal benefits exceed the private benefits. The inefficiency of a positive externality is present in that the social costs are less than the private costs resulting in skewed incentives and potential undersupply of the good. For instance, R&D generates positive benefits for society in terms of technological spillovers.⁴³¹ This is a positive production externality that can be internalised by subsidising the production activities⁴³² in order to make sure that it is produced at a socially optimal level.⁴³³ Another example of a positive externality is the benefit produced to society by education. Again, the State maintains an interest in ensuring that the costs of the goods reflect the social benefit by subsidising education services.

2.2.1.2 Imperfect competition

Competition in markets is not necessarily a given; even Smith recognised the need for a legal framework to guarantee the freedom of competition.⁴³⁴ If a Pareto optimum requires a competitive equilibrium, another category of market failure is, therefore, imperfect competition.⁴³⁵ There are different types of anticompetitive

October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC 87.

⁴²⁸ i.e., the benefit to third parties caused by the production of an extra unit.

⁴²⁹ Pindyck and Rubinfeld (n 328) 644.

⁴³⁰ Mankiw (n 184) 204.

⁴³¹ Pindyck and Rubinfeld (n 328) 645.

⁴³² Mankiw (n 184) 204. See also, Communication from the Commission, ‘Guidelines on State aid for broadband networks’ (2023/C 36/01), para 46: ‘In the broadband sector, one form of market failure may relate to positive externalities that are not internalised by market operators. For example, while fixed and mobile networks are key enablers for the provision of additional services and for innovation, the overall benefits are likely to be higher than the economic benefits they generate for the networks’ investors, especially in remote regions or low-population-density or unpopulated areas. The market may therefore generate insufficient private investment in fixed and mobile networks, in particular in certain areas’.

⁴³³ This is precisely the rationale for subsidising R&D projects within the State aid framework, see, Communication from the Commission, ‘Framework for state aid research and development and innovation’ (2014/C 198/01).

⁴³⁴ Van den Bergh and Camesasca (n 321) 61, in particular ‘by preventing conclusion between firms and abuses by dominant firms, consisting in the erection of barriers to entry to combat the erosion of their market power’.

⁴³⁵ Ogus (n 18) 30.

distortions. Monopolies are one of the main concerns in economic theories on imperfect competition.⁴³⁶ Market power may lead to monopolies, resulting in lower output and higher prices; a monopoly price exceeds marginal costs, whilst in a competitive economy the price of a commodity equals marginal cost.⁴³⁷ Ultimately, a monopoly brings about a transfer of wealth from consumers to producers.⁴³⁸ However, the concern of (narrow) market failure as mentioned is efficiency. Thus, the loss of society is not measured in the redistribution of income from consumers to producers, but by a loss to society in terms of efficiency. The two main economic objections to monopoly are the following. First, a monopoly leads to so-called deadweight loss, i.e., a loss of economic efficiency.⁴³⁹ Theory holds that the monopoly price leads to a situation in which buyers that would have purchased the commodity at a competitive price will now instead buy another product that they desire less. The loss of efficiency is due to the loss of output – in its turn, due to the substitution by certain consumers – compared to a competitive market.⁴⁴⁰ Second, a monopoly may lead to so-called ‘rent-seeking’. This phenomenon refers to a situation where a monopoly spends resources on socially inefficient activities, for instance, activities to maintain or exercise its monopoly power, lobbying activities, legal costs to deal with competition law issues, etc.⁴⁴¹ The view is that these resources are wasted from a societal angle.⁴⁴²

Between the two extremes of monopoly and perfect competition, there are several circumstances which might lead to a loss of efficiency due to market power or other anticompetitive practices. These are, generally, dealt with by competition law, which thus seeks to limit market power and its influence on welfare. An important source of imperfect competition is barriers to entry, which is a key concept of the study of industrial organisation. This concept has been given two

⁴³⁶ See, e.g., Joan Robinson, *The Economics of Imperfect Competition* (MacMillan, 1933); Edward H Chamberlin, ‘Monopolistic or Imperfect Competition?’ (1937) 51 *Quarterly Journal of Economics* 557; Arthur C Pigou, *The Economics of Welfare* (4th edn, Macmillan 1932).

⁴³⁷ Jones and Sufrin (n 351) 8.

⁴³⁸ Dunne (n 212) 15.

⁴³⁹ e.g., Motta (n 272) 41 ff.

⁴⁴⁰ e.g., Richard Whish and David Bailey, *Competition Law* (9th ed, OUP 2021) 9-10.

⁴⁴¹ Pindyck and Rubinfeld (n 328) 360.

⁴⁴² Posner, *Economic Analysis of Law* (n 124) 287.

main interpretations.⁴⁴³ First, Bain suggested a broad effect-based approach to barriers to entry.⁴⁴⁴ Bain defined a barrier to entry as:

[...] the extent to which, in the long run, established firms can elevate their selling prices above the minimal average costs of production and distribution (those costs associated with operation at optimal scales) without inducing potential entrants to enter the industry.⁴⁴⁵

Second, a narrower definition based on the existence of additional costs suffered by new entrants has been proposed by Stigler.⁴⁴⁶ According to Stigler, a barrier to entry is a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter industry but is not borne by firms already in the industry.⁴⁴⁷ There is no clear consensus in the EU on which approach to embrace. Moreover, in reality, entry barriers are diverse and can be structural, regulatory, strategical barriers etc.⁴⁴⁸

Nevertheless, this research will only indirectly and marginally address the issue of imperfect competition and, therefore, competition law as a remedy to market failure. The focus of this study lies in examining the exceptions for public policy measures within the applicable legal framework. The instances where Member States or firms intervene to directly remedy imperfect competition are scarce. This category as a ground for public policy intervention is to be only relevant where a (temporary) infringement of the competition provisions is necessary in order to foster long-term competitive markets.⁴⁴⁹ That being said, the

⁴⁴³ Jones and Sufrin (n 351) 79.

⁴⁴⁴ Joe S Bain, *Industrial Organization* (2nd edn, John Wiley 1967).

⁴⁴⁵ *ibid.*, 252.

⁴⁴⁶ George J Stigler, *The Organization of Industry* (Irwin 1968).

⁴⁴⁷ *ibid.*, 67.

⁴⁴⁸ Nicolas Petit, *Droit Européen de la Concurrence* (Montchrestien 2013) 162-168.

⁴⁴⁹ This is the case in liberalised sectors. As a rule, liberalisation in the EU has been achieved through a tripartite transformation process: (i) abandon of natural monopolies; (ii) regulation of the market aiming at ensuring its proper functioning (e.g., access of new entrants) in order to foster the advancement of a competitive environment; (iii) a progressive deregulation in parallel to the establishment of a (workable) competitive environment. Within this framework, the interplay between regulation and competition law is sometimes problematic, see to this effect Margherita Colangelo, 'The Interface Between Competition Rules and Sector-Specific Regulation in the Telecommunications Sector: Evidence from Recent EU Margin Squeeze Cases' (2013) 14 *Competition and Regulation in Network Industries* 214.

remedy of imperfect competition is part of *competition law's status quo* and the *default mode*, meaning that competitive markets are assumed to maximise efficiency.⁴⁵⁰

2.2.1.3 Information problems

Information asymmetry, also known as imperfect information, is another widely recognised form of market failure. In order for the economy to reach an equilibrium, economic agents must *act* competitively. To act accordingly market agents must have complete information of markets. Against that background, an information asymmetry occurs in a '[s]ituation in which a buyer and a seller possess different information about a transaction'.⁴⁵¹ A frequent example would be a market where a seller possesses information about the quality of the product he or she sells, which is not available to the buyer.⁴⁵² Information asymmetries may also occur on the other side of the transaction. For instance, insurance markets are often victims of information asymmetries in that the buyer possesses more information about his or her general state of health than the insurer.⁴⁵³ Another example is the market for loans. Small or medium enterprises may have difficulties in obtaining financing for economically efficient projects since credit institutions do not possess sufficient information to distinguish 'good' loans from 'bad' ones.⁴⁵⁴

Markets affected by imperfect information may lead to so-called 'adverse selection'. Adverse selection refers to a situation where products of different quality are sold at the same price due to information asymmetries on one side of the market.⁴⁵⁵ In this scenario, adverse selection leads to a market failure in that high-quality goods are driven out of the market by low-quality goods,⁴⁵⁶ and thus

⁴⁵⁰ See Chapter 3, section 3.1.2.

⁴⁵¹ Pindyck and Rubinfeld (n 328) 614.

⁴⁵² As was the case in Akerlofs example of the automobile market. See, George A Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84(3) The Quarterly Journal of Economics 488.

⁴⁵³ Pindyck and Rubinfeld (n 328) 615.

⁴⁵⁴ Commission, Staff Working Document, 'Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3' Available at: http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf (15 May 2009), para 21.

⁴⁵⁵ Charles Wilson, 'Adverse Selection' in Blume and Durlauf (eds) (n 15) 25.

⁴⁵⁶ Pindyck and Rubinfeld (n 328) 616.

leads to incomplete or missing markets.⁴⁵⁷ States have various means to address information asymmetries through regulating markets, for instance by consumer regulation or subsidies for financing certain projects.

2.2.1.4 Public Goods

The theory of public goods⁴⁵⁸ is vast and has given rise to multiple and sometimes incongruous interpretations. Over the course of the evolution of economic theory, various theories have been presented to distinguish certain categories of goods from ‘ordinary’ private goods. Public goods are commonly characterised in economics by two key attributes: they are non-rivalry and non-excludability.⁴⁵⁹ Their non-rival nature implies that there is no extra cost incurred by the provision of the good to an additional consumer; the additional individual represents zero marginal cost.⁴⁶⁰ They are also non-excludable meaning that it is impossible, or in any case difficult, to exclude individuals from enjoying the good.⁴⁶¹ Therefore, public goods entail a ‘free-rider’ problem,⁴⁶² leading to inefficiency via undersupply.⁴⁶³ Hence, there is an argument that these goods should be provided by the State which can finance them, generally through taxation. Public goods are sometimes presented as specific types of externalities.⁴⁶⁴ In this regard, an externality is present in the sense that it is impossible to prevent individuals not paying for the service from enjoying it.⁴⁶⁵

⁴⁵⁷ Rainer Nitsche and Paul Heidhues, ‘Study on Methods to Analyse the Impact of State Aid Competition’ (2006) 244 European Economy – Economic Papers 56.

⁴⁵⁸ The concept of public goods is largely seen as coined by Paul A Samuelson in Samuelson (n 409). Although Samuelson referred to ‘collective consumption goods’ enjoyable by all consumers ‘in the sense that each individual’s consumption of such a good leads to no subtraction from any other individual’s consumption of that good’.

⁴⁵⁹ Tyler Cowen, *The Theory of Market Failure: A Critical Examination* (George Mason University Press 1988) 3–4.

⁴⁶⁰ Stiglitz and Rosengard (n 95) 86.

⁴⁶¹ *ibid.*

⁴⁶² i.e., the fact that consumers deliberately do not pay for a good which is non-excludable in knowledge that others will.

⁴⁶³ Perloff (n 336) 638.

⁴⁶⁴ e.g., Ogus (n 18) 35.

⁴⁶⁵ Cowen (n 459) 3.

In general, the list of ‘pure’ public goods is short since most goods are rivalrous in consumption.⁴⁶⁶ Examples of claims of such pure public goods are national defence, the provision of lighthouses,⁴⁶⁷ broadcasting services⁴⁶⁸ or street lightning.⁴⁶⁹ However, as stated above, the literature on public goods is immense and there is no consensus on the precise boundaries of public goods as a source of market failure. Especially, it remains ambiguous to what degree, if any, ‘impure’ public goods – goods that are not strictly non-rivalrous and/or non-excludable – can be a source of market failure. To the extent that a good possesses one of these characteristics, and produces positive externalities, there could be an argument for the State to intervene in their provision.⁴⁷⁰ Here, the sub-category of merit goods (positive externalities) has sometimes been advanced in order to provide an argument for government intervention.⁴⁷¹ Merit goods are frequently defined as goods that produce externalities and might be underestimated by the consumers in terms of utility.⁴⁷² Just as for positive externalities, examples are health care, education,⁴⁷³ or even culture.⁴⁷⁴ The concept of merit goods elicits controversy, as evidenced by the existence of divergent interpretations.⁴⁷⁵ Within the realm of economics, the concept is presented as a divergence from consumer sovereignty and is thus characterised by elements of community preferences and/or paternalism.⁴⁷⁶ Stiglitz and Rosengard perceived merit goods as separated from economic efficiency since they present a case of paternalistic intervention insofar as the public provision of merit goods is based on the presumption that individuals

⁴⁶⁶ Atkinson and Stiglitz (n 247) 405.

⁴⁶⁷ Pindyck and Rubinfeld (n 328) 616. Although heavily criticised and even claimed disproved by Coase in Coase (n 129).

⁴⁶⁸ Atkinson and Stiglitz (n 247) 405.

⁴⁶⁹ Nitsche and Heidhues (n 457) 56.

⁴⁷⁰ Ogus (n 18) 35, argued that these goods, ‘unless corrected by regulatory interventions, [...] are subject to a degree a market failure’.

⁴⁷¹ The concept was introduced by Musgrave in Richard A Musgrave, *The Theory of Public Finance: A Study in Public Economy* (McGraw-Hill 1959).

⁴⁷² Nitsche and Heidhues (n 457) 56.

⁴⁷³ *ibid.*; Natalia Fiedziuk, ‘Towards a More Refined Economics Approach to Services of General Economic Interest’ (2010) 16(2) *European Public Law* 271, 281.

⁴⁷⁴ See Commission Decision 2013/126/EU *Ciudad de la Luz* OJ L85/1.

⁴⁷⁵ Richard A Musgrave, ‘Merit Goods’ in Blume and Durlauf (eds) (n 15) 579.

⁴⁷⁶ *ibid.*, 580.

may not act in their best interest.⁴⁷⁷ In this regard, a merit good is determined on the basis of ‘community preferences’ rather than individual preferences (contrary to methodological individualism).⁴⁷⁸ Nonetheless, the role of this form of inefficiency in relation to market failure remains unclear. The relevance of merit goods is explored throughout this research to the extent that they generate positive externalities and, therefore, may remedy some degree of market failure.⁴⁷⁹

2.2.1.5 Conclusions

These conventional market failures are often described as ‘economic’ objectives of regulation,⁴⁸⁰ or ‘efficiency rationales’:⁴⁸¹ they are characterised by the disruption of static efficiency, resulting from market failure, leading to an inefficient allocation of resources. Whilst the list presented above could be made endlessly long, these classic forms of market failures revolve around efficiency considerations. The notion of efficiency, both from a static and dynamic perspective, is inherently utilitarian. Accordingly, economic efficiency in that sense is not construed under social interest parameters but refers to the maximisation of welfare in the neo-classical sense of the term. In this context, market failure is strictly mirrored by a neo-classical welfare approach to economic success. However, taking into account dynamic perspectives necessarily involves trade-offs which erode the strictly static nature of the concept.

⁴⁷⁷ Stiglitz and Rosengard (n 95) 95.

⁴⁷⁸ Musgrave, ‘Merit Goods’ (n 475) 580. ‘[c]ommunity values are thus taken to give rise to merit goods’.

⁴⁷⁹ Ogus (n 18) 34. This is also the position of the Commission in State aid control, see Chapter 7, section 7.4.2.1.1. For a similar approach to merit goods see, Wolf Sauter, *Public Services in EU Law* (CUP 2015).

⁴⁸⁰ e.g., Ogus (n 18) 29–46.

⁴⁸¹ e.g., Friederiszick, Röller and Verouden (n 340) 632.

Figure 2.1/Narrow Market Failure

Externalities	<i>Ex:</i> negative externalities on public health; ⁴⁸² positive externalities generated by work training. ⁴⁸³
Information Asymmetries	<i>Ex:</i> regulation of profession; ⁴⁸⁴ consumer protection regulation. ⁴⁸⁵
Anticompetitive conduct	<i>Ex:</i> abuse of market power; ⁴⁸⁶ anticompetitive agreements. ⁴⁸⁷
Public Goods	<i>Ex:</i> television or broadband signals, ⁴⁸⁸ or other ‘pure’ public goods. ⁴⁸⁹
Merit Goods	<i>Ex:</i> public health care; ⁴⁹⁰ free education. ⁴⁹¹

⁴⁸² e.g., Case C-198/14 *Valev Visnapuu v Kihlakunnansyyttäjä* EU:C:2015:751, para 118.

⁴⁸³ Communication from the Commission, ‘Criteria for the analysis of the compatibility of State aid for training subject to individual notification’ (2009/C 188/01), para 6.

⁴⁸⁴ There an argument for regulating markets where there exist information asymmetries occur due to highly technical services, see in this regard, Opinion of AG Jacobs in Joined Cases C-180/98 to 184/98 *Pavel Pavlov and Others* EU:C:2000:151.

⁴⁸⁵ e.g., Case C-24/00 *Commission v France* EU:C:2004:70 00, para 52.

⁴⁸⁶ As prohibited under Article 102 TFEU.

⁴⁸⁷ As prohibited under Article 101 TFEU.

⁴⁸⁸ e.g., the 2023 ‘Guidelines on State aid for broadband networks’ (n 432).

⁴⁸⁹ See tasks of public authority under the Antitrust provisions, e.g., Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* EU:C:1994:7, para 9 regarding supervision of public airspace.

⁴⁹⁰ e.g., Case C-205/03 *FENIN v Commission* EU:C:2006:453, para 1; Case C-67/96 *Albany* (n 43), para 85.

⁴⁹¹ In particular, public education fully funded by the State does not constitute economic activity, see, Sauter, *Public Services in EU Law* (n 479) 56 and Case C-318/05 *Commission v Germany* EU:C:2007:495 referred to therein.

2.2.2 The Broad Definition(s)

If the traditional view of market failure accentuates the achievement of an orthodox notion of economic efficiency, a broad market failure test, by comparison, emphasises the societal interest in regulation as opposed to efficiency based on individual preferences.⁴⁹² Rather than being singularly committed to economic efficiency, the emphasis is placed on preventing non-optimal market outcomes in terms of efficiency and/or other social objectives.

Nevertheless, the feasibility of expanding market failure to encompass external objectives is far from clear-cut. The problem of market failure is its insularity, due to its ‘strict conception’.⁴⁹³ The insular nature of market failure is manifested in its construct, which is internal to ‘the definition of the properties of idealized systems’.⁴⁹⁴ It neglects any external objective beyond the achievement of efficiency through an optimal allocation of resources. Accordingly, it is argued that in order to adopt a broader definition of market failure, it becomes necessary to transcend the strict conception of economic efficiency and admit trade-offs between different values – i.e., between efficiency and external objectives. Trade-offs are a natural outcome of balancing conflicting objectives. If external considerations are necessary, it is indeed indirectly recognised that Pareto-efficient markets might not lead to optimal social outcomes; not necessarily because the outcome is inefficient, but because some other objective outweighs the efficiency concern. Hence, efficiency is not abandoned, but potential conflict surfaces when economic efficiency and an alternative objective are not entirely complementary.

Exploring a broader conception of market failure, Marciano and Medema suggested that a broad definition of market failure could be the failure of the market to generate optimal outcomes from a societal point of view,⁴⁹⁵ which may or may not correlate with the achievement of narrowly construed economic efficiency. Drawing inspiration from Musgrave’s distinction of the essential roles

⁴⁹² However, this broad notion is explored from a legal perspective, with a particular focus on matters of justice and social regulation. Economic challenges to the assumptions of rationality and individual preferences (e.g., bounded rationality and behavioural economics) are not addressed.

⁴⁹³ Marciano and Medema (n 46) 4.

⁴⁹⁴ *ibid.*

⁴⁹⁵ *ibid.*

of the State,⁴⁹⁶ the authors set out a ‘modern tripartition’ of market failure.⁴⁹⁷ The first category is *stability failure*, understood as macroeconomic stability.⁴⁹⁸ The State, from a macroeconomic perspective, might intervene when markets do not achieve optimal outcomes in terms of, for instance, GDP, unemployment or aggregate prices. The second category is *distribution failure*, understood as a failure to maximise social welfare from a broad perspective, including a society’s preferences for distributions of income and/or wealth.⁴⁹⁹ Thirdly, the category of *allocation failure* goes back to the narrow definition of market failure present in Bator’s theory.⁵⁰⁰ The Musgravian triangle neatly depicts two tensions that have been raised and used to critique a static notion of market failure. It is argued hereunder that these tensions are observable both on a theoretical level and within developments of EU law.

On one side, a narrow efficiency-based theory of market failure does not necessarily coincide with macroeconomic considerations, as it tends to disregard long-term economic growth and its dynamic perspectives. On the flip side, the second tension pertains directly to the second welfare theorem; if markets fail to establish an efficient distribution of resources from a broader societal perspective, it raises the question of whether a redistribution failure can be regarded as a source of market failure justifying public policy intervention. Whilst these aspects are typically ignored by economists,⁵⁰¹ distribution constitutes one of the primary critiques of neo-classical theories.⁵⁰² Contemporary market failure theory builds upon the critiques directed towards neo-classical theories and the inexistence of perfect market success.⁵⁰³ The following two subsections explore these two aspects of a broader market failure test. Finally, it is argued that although public

⁴⁹⁶ Musgrave’s framework separated State activity into three branches, resource allocation, macroeconomic stabilisation and income redistribution, see, Musgrave, *The Theory of Public Finance: A Study in Public Economy* (n 471), chapter 1. See also, Richard A Musgrave, ‘The Voluntary Exchange Theory of Public Economy’ (1939) 53(2) *The Quarterly Journal of Economics* 213.

⁴⁹⁷ Marciano and Medema (n 46) 4.

⁴⁹⁸ *ibid.*, 5.

⁴⁹⁹ *ibid.*

⁵⁰⁰ *ibid* (emphases added).

⁵⁰¹ e.g., Friederiszick, Röller and Verouden 12 (n 340) 642; for a deep analysis see Bateman (n 46).

⁵⁰² Though it is worth noting that this point is perhaps more frequently raised by non-economists.

⁵⁰³ Marciano and Medema (n 46) 3.

policy intervention may extend beyond the pursuit of narrowly construed economic efficiency, there is no consensus on the role of these intervention categories in the context of market failure.

2.2.2.1 Macroeconomic Failures

Static efficiency alone falls short in capturing the macroeconomic role of the State and public policy. Macroeconomic stability may include economic growth (GDP), employment rate, and inflation control. Sometimes the creation of employment may have a distributional aspect and overlap with equity, as exemplified in the regional aid regime.⁵⁰⁴ However, GDP⁵⁰⁵ in itself does not provide any insights into a State's distribution of income.⁵⁰⁶ Analogously, the State has a vested interest in regulating the control of the inflation rate of the economy.⁵⁰⁷ The broader performance and structure of the economy at large may require intervention in the markets. The potential role of competition law in this regard remains ambiguous. It has been suggested that competition law itself delivers macroeconomic benefits through a causal link between stringent competition law enforcement and economic growth.⁵⁰⁸ However, there is no consensus on the matter, and the overlap between competition policy and macroeconomic policy remains nebulous.

With respect to macroeconomic considerations of measures deviating from the competition law framework, the role of these external considerations vis-à-vis market failure is abstruse. From a Keynesian perspective, stability failure as a justification for intervention would be crucial.⁵⁰⁹ At its extreme, a Marxist approach to economics would result in the abandonment of the market system as

⁵⁰⁴ Article 107(3)(a) provides that 'aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment [...]' may be compatible with the internal market. In particular, the need for equity intervention via regional aid is in some cases assumed, see, Commission, 'Guidelines on regional State aid for 2014-2020' (2013/C 209/01); Viktor Kreuschitz and Hanns Peter Nehl, 'Aid Subject to a Discretionary Assessment under Article 107(3) TFEU' in Herwig CH Hofmann and Claire Micheau (eds), *State Aid Law of the European Union* (OUP 2016) 240, 259. For an analysis of the regional aid regime see, Chapter 9, section 9.2.

⁵⁰⁵ i.e., the measurement of an economy in terms of output and income.

⁵⁰⁶ Michael Burda and Charles Wyplosz, *Macroeconomics: A European Text* (7th edn, OUP 2017) 5.

⁵⁰⁷ Ogus (n 18) 45.

⁵⁰⁸ Geradin, Farrar and Petit (n 315) 11 analysed these studies.

⁵⁰⁹ Bateman (n 46) 128, who wrote that Keynes is often cast as the 'great defender of the need for state intervention to sustain capitalism'.

such.⁵¹⁰ These alternative schools of thought employ different tools to measure the welfare of a State; Keynes's measurement of the level of employment as economic success is a departure from economic efficiency as understood in welfare economics.⁵¹¹ Keynesian theory has been interpreted as designating national income as the variable of welfare,⁵¹² and by employing that variable, macroeconomic market failure might be appropriate to consider.⁵¹³ Moreover, in contrast to static efficiency, dynamic efficiency has proven crucial for economic growth.⁵¹⁴ Economists and lawyers alike have considered that economic growth contributes more to wealth than allocative efficiency.⁵¹⁵

Recently, the Great Recession altered the landscape of macro-economic policy and the mindset of economics towards State intervention (and arguably broader public policy intervention) in the economy.⁵¹⁶ Macroeconomic stability and the minimisation of systemic risks took precedence over short-term economic efficiency (particularly via deregulation).⁵¹⁷ For instance, within EU State aid law, macroeconomic rationales extended the compatibility regimes for aid to financial and non-financial undertakings in order to cope with the crisis.⁵¹⁸ The prevention of 'systemic risk and ensuring the stability of the financial system' was

⁵¹⁰ David Campbell, 'The "Market" in the Theory of Regulation' (2018) 27(5) *Social & Legal Studies* 545. 555-558: At the extreme end of the spectrum Marxist economics, which propose to abandon the market order as such. Yet, these schools have in turn been criticised in that they do not present a plausible theory of the State.

⁵¹¹ Bateman (n 46) 128.

⁵¹² *ibid.*, 133.

⁵¹³ *ibid.*, 135.

⁵¹⁴ RPJ Vallin, 'Aux Origines de l'expression 'justice Sociale'' [1960] (1960) 68 (5) *Chronique Social de France* 372.

⁵¹⁵ Driesen and Malloy (n 213) 302.

⁵¹⁶ Bateman (n 46) 140-141: 'Posner's analysis represents clear evidence that there are other forms of "market failure" than the traditional definition of an individual market that is somehow prevented from coming to an efficient equilibrium'. See, Richard A Posner, *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression* (Harvard University Press 2009); Richard A Posner, *The Crisis of Capitalist Democracy* (Harvard University Press 2010).

⁵¹⁷ e.g., Driesen and Malloy (n 213) 302.

⁵¹⁸ Whilst the older case law of the Court adopted a highly restrictive stance, requiring 'exceptional circumstances to the economy as a whole' (Case C-301/96 *Germany v Commission* EU:C:2003:509) six different communications subsequently extended the scope of Article 107(3)(b) to cover the rescue and restructuring of individual credit institutions, e.g., Communication from the Commission, 'The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis' (2008/C 270/02). This is further discussed in Chapter 9.

accommodated as a rationale for State aid.⁵¹⁹ However, as is demonstrated throughout this thesis, the role that macroeconomic market failures could play outside of that framework remains uncertain.

In sum, it is posited that a narrow conception of market failure does not accommodate any macroeconomic considerations beyond those that coincide with allocative efficiency. Macroeconomic concerns challenge the ‘invisible hand’ by indirectly acknowledging that the pursuit of private interest fails to maximise welfare. The only pathway to a coherent framework wherein States, and also possibly firms, could intervene both in microeconomic terms and at a macroeconomic level would be to supplement the traditional notion of market failure with a second term of macroeconomic failure. As articulated by Bateman, the traditional failure ‘is a decidedly microeconomic concept’; whilst a contemporary vision of market failure would seize ‘the sense that the failure is a systemic failure of the entire economy’.⁵²⁰

2.2.2.2 Distributional Concerns

The issue of redistributive failure introduces matters of equity.⁵²¹ The second key critique of a narrowly defined market failure concept based solely on static efficiency is its exclusion of equity-oriented intervention in the market. Whilst such an approach fails to adequately provide an explanation for regulation based on human rights, such as non-discrimination or social solidarity,⁵²² many economists argue that inserting equity into the analysis would undermine its normative strength.⁵²³ Nonetheless, the role of the State (and public policy) is unquestionably broader than merely correcting efficiency-based market failures.⁵²⁴ The conception of government as a provider of the basic structures for

⁵¹⁹ Case C-526/14 *Kotnik* EU:C:2016:570, para 88.

⁵²⁰ Bateman (n 46) 135.

⁵²¹ However as pointed out by Driesen and Malloy (n 213) 302, ‘some scholars have also argued that a reasonably equal distribution of wealth matters more to economic growth than allocative efficient transactions’.

⁵²² For an account of these rationales see e.g., Baldwin, Cave and Lodge, *Understanding Regulation: Theory, Strategy, and Practice*. (n 18) 22; See also Prosser (n 18) 365.

⁵²³ Friederiszick, Röller and Verouden (n 340) 634.

⁵²⁴ Generally, a distinction is made between efficiency and equity when determining the objectives of regulation. See, although differently formulated, e.g., Baldwin and Cave (n 416) 23-24; Stephen Breyer, ‘Typical Justifications for Regulation’ in Baldwin, Scott and Hood (n 95) 59-92; Ogas (n 18) 28-31.

human interactions and productive human action dates back to Hobbes and Locke;⁵²⁵ equality was at the core of Kant's theory of the social contract,⁵²⁶ and in the Rawlsian theory of justice.⁵²⁷ Thus, the State has the mandate to uphold standards of equity, basic rights, freedoms and obligations,⁵²⁸ which might necessitate public policy intervention in the market. As proposed in this thesis, this intervention could be executed either directly by the State or indirectly through the intermediary of an undertaking.

A degree of equity-based interventionism has also gained recognition in economics. As noted by Campbell, 'Pigou believed social regulation might be necessary even if competitive market conditions obtained, but he also believed that economic regulation of monopoly was necessary to ensure that those conditions obtained as widely as possible'.⁵²⁹ Perloff contended that in order to reach a general economy-wide equilibrium, the government must ensure not only that the equilibrium is efficient, but also that it is equitable.⁵³⁰ Yet, when measuring the well-being of markets, efficiency and equity are generally considered separate matters, due to the implications of the second welfare theorem. Sen observed that Pareto efficiency 'is quite uninterested in equity'.⁵³¹ This highlights the imperfect nature of these economic assumptions. Whilst according to the second welfare theorem, there should be no conflict or trade-offs between efficiency and equity, many economists today acknowledge that such a trade-off is necessary. A Pareto-efficient, or Kaldor Hicks-efficient, market may or may not be equitable,⁵³² and

⁵²⁵ Nelson (n 98) 545.

⁵²⁶ John Christman, *Social and Political Philosophy: A Contemporary Introduction* (Routledge 2002) 50.

⁵²⁷ In this sense, Nelson (n 98) 545, argued that 'freedom is sometimes presented as a value that trades off against, or constrains, the pursuit of equity'. See, also for a discussion of freedoms as limitations to government action, David Miller, *Political Philosophy: A Very Short Introduction* (OUP 2003) 55.

⁵²⁸ For an account see Nelson (n 98) 544-545.

⁵²⁹ Campbell (n 510) 551-552. See also, Frank Stilwell, *Political Economy* (3rd edn, OUP 2012) 48: 'Pigou recognised that economic welfare (or well-being) is only one aspect of broader societal goals. Economic welfare is not synonymous with social welfare. Nor is it independent of the distribution of income'.

⁵³⁰ Perloff (n 296) 332.

⁵³¹ Amartya Sen, 'Markets and Freedoms: Achievements and Limitations of the Market Mechanism in Promoting Individual Freedoms' (1993) 45(4) *Oxford Economic Papers* 519, 521.

⁵³² Tirole (n 317) 160.

frequently equity and efficiency conflict.⁵³³ This raises the question: should market failure analysis include equity-based rationales? Can the concept of market failure be extended to include considerations unrelated to economic efficiency? These conceptual challenges are related to a wider reading of market failure based on a broad social welfare standard.

Indeed, the failure of markets may be interpreted widely. Tirole noted that ‘some of the moral criticisms of the market are simply reformulations of the concept of “market failure”’, and proposed the failure to deliver equity to be seen as a market failure.⁵³⁴ However, incorporating justice or inequality into economic analysis is a complex and contentious endeavour. It raises the question of the nature and scope of equity concerns that could be deemed relevant in such an analysis. As briefly mentioned in the previous chapter and to be examined in more detail in Chapters 4, 5 and 6, within EU competition law there are claims that ‘non-economic’ principles play a critical part in the analysis.⁵³⁵ Despite the centrality of justice in law, the concept of justice within economic writings has been perceived as underdeveloped,⁵³⁶ even though most textbooks on regulation recognise that distributional issues cannot be overlooked.⁵³⁷ Whether these are labelled as equity, rights-based,⁵³⁸ or solidarity-based,⁵³⁹ they all share the common feature of being based on external objectives, rather than efficiency in the sense of welfare economics.

A critical aspect of this thesis is precisely to explore and reassess the dichotomy between efficiency and equity in EU competition law to determine the

⁵³³ Perloff (n 336) 361.

⁵³⁴ Tirole (n 317) 159-160.

⁵³⁵ Parret, ‘Shouldn’t We Know What We Are Protecting?’ (n 9) 354 argued out that ‘[f]airness has been and still is one of the cornerstones of the European competition regime’. For recent research, see Lianos, ‘The Poverty of Competition Law: The Long Story’ (n 212); Damien and Lianos (eds) (n 269). From a broader perspective, under the free movement provisions only non-economic objectives are acceptable, see e.g., Case 7/61 *Commission v Italy* EU:C:1961:31.

⁵³⁶ See the critiques in Chapter 1, section 1.3.2.4.

⁵³⁷ e.g., Veljanovski, ‘Economic Approaches to Regulation’ (n 18) who pointed out that ‘there will often be views about the fairness and acceptability of market and regulatory outcomes. Thus, it would be surprising of the economics of regulation, especially in its guise of a normative theory, was able to ignore these ‘non-economic’ factors’. See also, Prosser (n 18) 375-378.

⁵³⁸ Baldwin and Cave (n 373) 22.

⁵³⁹ Prosser (n 18) 365, made a distinction between three rationales for regulation: ‘those based on economics principles, those based on individual rights, and those based on social solidarity’. Also referred to as ‘social regulation’, see e.g., Cento (n 6) 18.

extent to which equity rationales (broadly formulated) can be upheld as a justification for public policy intervention in markets. The relationship between efficiency and equity is further elaborated upon in the following subsection. It is argued that in order to understand the role of market failure in EU competition law, the distinction between efficiency and equity must be maintained by differentiating between efficiency and external objectives in the analysis.

Finally, it should be noted that there is ongoing scholarly debate regarding the possibility of competition law to incorporate distributional goals, such as fairness or equality of opportunity.⁵⁴⁰ Hence, it is crucial to include these considerations within a broader concept of market failure analysis.

2.2.2.3 Intermediary Conclusions: Identifying Trade-Offs

In drawing a close to subsection 2.2.2, it becomes clear that by acknowledging that efficient markets may not result in optimal outcomes, there is an argument for considering external objectives. In this connection, macroeconomic or equity-based objectives might be relevant.⁵⁴¹

Nevertheless, a broad definition of market failure confronts a notable challenge. Namely, there is no consensus among economists concerning the social welfare standard to adopt when measuring the desirability of these policies from a market failure perspective.⁵⁴² In other words, determining the appropriate level of equity remains a mystery. Economists assert that introducing equity inevitably invites value judgments, which potentially undermine the scientific integrity of economic analysis. As mentioned in section 2.1, a commonly drawn dichotomy separates a utilitarian view from a Rawlsian approach to welfare.⁵⁴³ However, an

⁵⁴⁰ Joseph E Stiglitz, 'Towards a Broader View of Competition Policy'. in Tembinkosi Bonakele, Eleanor M Fox and Liberty Mncube, *Competition Policy for the New Era: Insights from BRICS Countries* (OUP 2017) 4, 18; Lianos, Korah and Sicilliani (n 357) 109-114.

⁵⁴¹ Nevertheless, as Bateman (n 46) 142 pointed out in relation to certain macroeconomic failures that a recognition of further market failures 'does not mean that economists should necessarily abandon the traditional conception of microeconomic market failure, which remains useful when analysing markets, but that if they are aware of the value-laded nature of that analysis, they may become more welcoming in accepting other types of market failure, such as mass unemployment'.

⁵⁴² Bateman (n 46) 140; Jean-Marie Dufour, 'Market Failure, Inequality and Redistribution' (2008) 6(1) *Éthique et économique/Ethics and Economics*, 7.

⁵⁴³ (n 359).

endless list of different welfare functions could be considered.⁵⁴⁴ Thus, equity remains a ‘political question’.⁵⁴⁵ This thesis is, naturally, not suited to define a welfare function encapsulating both efficiency and equity considerations for the purposes of EU competition law. However, an analysis of trade-offs between efficiency and external objectives can elucidate the role of market failure in EU competition law.

Certainly, instances where equity and efficiency converge render such an analysis less fruitful. However, as stated above, these two sets of objectives often conflict.⁵⁴⁶ Therefore, from a legal perspective, the most suitable method⁵⁴⁷ to analyse the role of market failure in EU competition law involves accepting trade-offs between narrowly construed utilitarian efficiency and external objectives in a balancing exercise. The act of balancing is not unfamiliar to lawyers.⁵⁴⁸ A trade-off approach is also consistent with the traditional view, according to which most economists advocate that market failure does not involve any consideration of the distribution of welfare, provided it does not enhance efficiency.⁵⁴⁹ In this context, the criterion of efficiency, touted by economists as a ‘value-free form of positive

⁵⁴⁴ See in this connection, Colin M Macleod, ‘Market Failure, Justice and Preferences’ 2008 6(1) *Éthique et économique/Ethics and Economics* 2, who analysed a set of alternative standards next to traditional total welfare: ‘[f]or instance, we might ask whether (or the degree to which) an unregulated market can reliably satisfy any of the following familiar evaluative standards drawn from contemporary discussions of distributive justice: (a) securing basic capabilities for all persons (Sen/Nussbaum), (b) providing equal opportunity for welfare (Arnsperg), (c) maximizing aggregate human welfare (Mill), (d) distributing economic resources so as to provide the greatest benefit to the least advantaged (Rawls’s difference principle) or (e) establishing and maintaining equality of resources (Dworkin)’.

⁵⁴⁵ Friederiszick, Röller and Verouden (n 340) 634, ‘[t]he criterion of efficiency offers a neutral concept, allowing economists to identify situations off the social welfare frontiers independent of political concerns about distribution’.

⁵⁴⁶ Perloff (n 336) 361.

⁵⁴⁷ At least for a non-economist adopting a legal doctrinal analysis such as the author of this thesis.

⁵⁴⁸ Toni Marzal, ‘From Hercules to Pareto: Of Bathos, Proportionality, and EU Law’ (2017) 15(3) *International Journal of Constitutional Law* 621, 629 considered that, ‘[t]he method of balancing is today extremely widespread, and is said to dominate public and private law adjudication around the globe, in both international and domestic settings’.

⁵⁴⁹ e.g., Charles Wolf Jr, ‘A Theory of Nonmarket Failure: Framework for Implementation Analysis’ (1979) 22(1) *The Journal of Law & Economics* 107, 110-111; Dufour (n 542) 5, emphasises that ‘market failure is associated in a fundamental way with the distinction between efficiency and equity issues’. Pelkmans (n 418) 25 recognises that better regulation should then *only* lead to welfare increasing regulation (read economic efficiency); Bateman (n 46) 132.

analysis',⁵⁵⁰ can be separated from external objectives, which necessitate evaluative judgments. Thus, by analysing the balancing of conflicting legal objectives, the legal meaning of market failure can be objectively determined without being tainted by political biases. Moreover, given the nature of the EU competition law framework, the balance between efficiency and external objectives is a matter of law and not merely political conjecture.⁵⁵¹ The validity of a trade-off scenario is further supported by the fact that most public policy measures aimed at redistribution produce spillover effects on efficiency, and vice-versa.

2.3 Conclusions: Identifying Trade-Offs

This chapter has underscored the inherent difficulty, if not near impossibility, of articulating a singular, rigorous definition of market failure. The existence of multifaceted and competing definitions of the market failure concept presents an obstacle to establishing a uniform meaning. However, it is conventionally perceived as a narrow, efficiency-based concept, largely disregarding any external rationales for government intervention in the market.⁵⁵² An efficiency-oriented definition of market failure suffers from an internal deficit in that it is predicated on an idealised system, which is hardly attainable in practice. This perspective has been critiqued by scholars for its lack of empirical soundness,⁵⁵³ including within EU law scholarship,⁵⁵⁴ thereby casting a shadow of doubt over the theory's reliability as a guide for regulation. Therefore, it becomes incumbent to perceive

⁵⁵⁰ Bateman (n 46) 142. However, Bateman considered that 'as economists work with more and more complex forms of human decision making, they are likely to conclude that their traditional form of applied utilitarian analysis is itself value laden. Whereas the value-laden nature of utilitarian analysis is evident to most noneconomists, it has not been obvious to economists'.

⁵⁵¹ However, on the legal relevance of balancing see Chapter 3, sections 3.1.1 and 3.1.3.

⁵⁵² (n 501).

⁵⁵³ Zerbe Jr and McCurdy (n 97) 559 proposed to abandon market failure in favour of an analysis based on transaction costs, which provides 'a better method for understanding the nature of collective action, although it is not a diagnostic tool in the same sense that the market failure concept purports to be'. On the nature of transaction costs, see Coase (n 129) 3; Douglas W Allen, 'What Are Transaction Costs?' in Richard O Zerbe Jr and Victor P Goldberg (eds), *Research in Law and Economics* (JAI Press 1991) 1.

⁵⁵⁴ Skovgaard Olykke and Molgaard (n 292) 223: 'This is an imperfect theory in that it only explains when government intervention e.g. in the form of SGEI *should* occur – as opposed to a positive theory that explains when and how it *does* occur'.

the role of the State and public policy wider in law, both conceptually and empirically. Pursuant to this, two additional categories of failure have been explored: macroeconomic failures and equity failures. It is posited that in order to investigate the role of market failure analysis in EU competition law, the concept needs to be analysed both from a narrow and a wide perspective by admitting trade-offs.

Nevertheless, the adoption of a broad approach to market failure unveils its own challenges. On the one hand, there exists no consensus on the role of these external objectives in relation to economic efficiency. In economics, efficiency is construed as a value-free concept, which can be mathematically proven. In contrast, a broader welfare standard covering both equity and stability failure is arduous to insert into the analysis due to the requirement of evaluative judgments. This issue represents both a conceptual and methodological dilemma, given the absence of clear boundaries in both definitions of market failure. On the other hand, by framing market failure on the basis of different and sometimes conflicting objectives, clashes are unavoidable.

Accordingly, it is proposed that the meaning of market failure in EU competition law can only be investigated by admitting trade-offs between efficiency-based considerations and other potential external objectives. Two types of balancing must be distinguished. At one end of the spectrum, whilst trade-offs are also necessary in a narrow market failure theory predicated on Kaldor-Hicks efficiency, the analysis remains guided by the efficiency of the public policy intervention. This is referred to as *efficiency balancing*. On the other end, broader market failures can only be integrated into the analysis by acknowledging trade-offs between non-efficiencies (e.g., equity) and economic efficiencies. This is referred to as *welfare balancing*. Welfare balancing deviates from the mathematical formula proclaimed within neo-classical market failure and necessitates a value-laden analysis. The thesis now turns to the following chapters wherein the relevance, along with certain inherent complexities, of market failure and a potential trade-off scenario is explained in light of the legal framework of EU competition law. The objective is to construct a workable analytical framework.

3. CONSTRUCTING A WORKABLE CONCEPT OF MARKET FAILURE ANALYSIS

This chapter embarks on the task of creating a workable framework for the research. It begins with a reflection on the conceptualisation of market failure analysis within the realm of competition law. From a general perspective, the question arises as to whether it is possible to translate market failure theory into legal terms and, if so, how? To this effect, the chapter examines its relevance in adjudication vis-à-vis legislative policy making.

So far in this thesis, it has been demonstrated that market failure can be understood both in a narrow and broad sense. Furthermore, in order to accommodate external objectives beyond narrow economic efficiency into the analysis, it is necessary to recognise trade-offs between these two sets of objectives (*welfare balancing*). Five points are investigated in three distinct sections.

First, this chapter explores the fundamentals of market failure analysis within the EU legal order as a whole. It is shown that there is, within the EU market economy, an inherent tension between external and efficiency objectives. Accordingly, the EU market order, apart from efficiency, safeguards broader objectives, thereby necessitating their integration within a trade-off scenario.

Second, the chapter probes and establishes the before-mentioned default mode and the prevailing status quo of competition law. This is a critical step for fostering a holistic understanding of the legal and analytical framework. If the preceding section examined the multifarious objectives of the EU legal order as a whole, this section narrows its focus on the paramount role of efficiency and unfettered competition within the legal structure of EU competition law. The

argument posits that the existence of such a default mode renders a market failure analysis of the applicable legal provisions both logical and convincing.

Third, the ensuing section examines the potential role of the general principle of proportionality in the analysis of market failure. This investigation demonstrates that the principle of proportionality is instrumental in formulating a market failure test in law. In this context, it is determined how the principle of proportionality can be construed as a market failure test for the purpose of this research. The principle of proportionality is scrutinised from both a broad perspective as well as within the context of its specific application across the diverse domains of EU competition law.

Fourth, this chapter moves to illuminate the conceptual difficulties in market failure analysis from a legal perspective. This part is instrumental in clarifying the thesis's approach towards identifying and analysing a 'market failure test'. Moreover, recognising the potential pitfalls of the analysis is critical for crafting a robust and coherent analytical framework.

Finally, the chapter offers an analytical framework designed to provide a roadmap for analysing the various legal fields of competition law through the lens of market failure. This framework hinges on a proportionality analysis of the legal provisions, the practice of the Commission and the case law of the EU Courts.

3.1 EU (Competition) Law and Market Failure

Under this heading, the relevance of market failure theory in the broader realm of EU law and more specifically EU competition law is critically analysed. The preceding chapter detailed the usage of economic theory; the focus here shifts to examining the relevance of these theories within the larger context of the EU's economic legal framework. This section addresses the first three points delineated above.

Initially, the potential balancing act between efficiency and external (social) objectives in the single market is introduced. The second segment of this subsection delineates and describes the default mode of EU competition law. Finally, the role of the principle of proportionality within this framework is situated and examined from a market failure perspective.

3.1.1 The Single Market Balancing Equity and Efficiency

The recognition of trade-offs between efficiency and external objectives is arguably part of the EU legal order. This subsection introduces the delicate balancing between these objectives in the single market enterprise.

This section advances the argument that within the single market, there is a constant and evolving tension between economic integration – achieved through the means of economic freedom and unfettered competition – and the promotion of, in particular, national social policies.⁵⁵⁵ Whilst a default mode advocating for market-based solutions has been asserted, a closer explanation of which is provided in the ensuing subsection, in reality the balancing between the different objectives of the EU market order poses a complex conundrum. By reason of the mixed nature of the economies of numerous Member States,⁵⁵⁶ the Single Market finds itself along the junction of a ‘market system’ and a ‘collectivist system’ (as much as no legal system is exclusively construed on one side of this regulatory spectrum).⁵⁵⁷ This dual nature of the Single Market leads to a tale of two stories.

At one end of the spectrum, the EU ‘economic law’ framework has forcefully integrated economic freedom and unfettered competition into a default mode where national regulatory intervention is disfavoured.⁵⁵⁸ The overall tendency of free and open economies is ‘lesser’⁵⁵⁹ regulation and modest state interference. Public intervention on a national level poses an ideological challenge to the EU’s ‘economic constitution’. The concept of an ‘economic constitution’⁵⁶⁰

⁵⁵⁵ As a consequence, the Treaty system contain numerous possibilities of exempting measures from the competition law provisions, in particular Articles 101(3), 106(2) and 107(3) TFEU.

⁵⁵⁶ Geradin, Layne-Farrar and Petit (n 315) 4.

⁵⁵⁷ Ogus (n 18) 1.

⁵⁵⁸ Erika Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (Hart 2005) 1 who noted in relation to the ‘changing role of state intervention in markets’ that ‘[b]y the 1990s the emergent economic constitution of the EU embodied a growing orientation towards private market provision and a growing affinity with the concurrent liberal market approach of greater privatisation and reduced tolerance of public provision’. However, one might ask if, today, the situation has reversed, see e.g., Tomasz Zielenkiewicz, ‘Discussion on the notion of competition as a subject of state interventionism’ (2023) 44(5) *European Competition Law Review* 212.

⁵⁵⁹ In reality, privatisation has not necessarily led to *lesser* regulation but *different* regulation. See to this effect e.g., Majone (n 18) 1-3.

⁵⁶⁰ See, in this respect, Hermann-Josef Blanke, ‘The Economic Constitution of the European Union’ in Hermann-Josef Blanke and Stelio Mangiameli, *The Economic Constitution of the European Union* (Springer 2012) 369, 370-371: ‘The fundamental decisions of economic policy that have been laid down in the supranational constitution by the Treaties of Rome of 1957 –

was developed in the interwar period into a theory of economic law by prominent scholars of the Freiburg School of Law and Economics such as Walter Eucken and Franz Böhm.⁵⁶¹ As put by Sauter at that time, ‘classic liberalism has sought to ban the state from the economy, and saw only a minimal role for a ‘watchman’ state’.⁵⁶² Yet, between *laissez-faire* and State paternalism, the Ordoliberalists proposed a third way, the *social market economy*.⁵⁶³ The innovation of the Ordoliberalists was the insistence on the necessity of a constitutional framework to guarantee individual freedoms and economic progress. The EU has been heavily influenced by Ordoliberal thinking, which underpins its market and competition policy.⁵⁶⁴ Möschel pointed out that competition policy is central to Ordoliberal thinking and the central characteristics are: (i) protecting individual economic freedom; (ii) the strong role of the State in preserving competition, but without intervention of the government in market prices; (iii) the rule of law (i.e., a competition law); (iv) and the insertion of competition policy in ‘the economic order of a free and open society’.⁵⁶⁵

At the other end of the spectrum, the EU market system admits the importance and role within the internal market of national public policy. The EU

namely the opening up of the national economies by means of the free market and the principle of non-discrimination as well as the increase in competition within a more open market, which is protected from distortion by rules of competition – can be interpreted as a decision to establish an economic constitution that is based on Ordoliberal ideas on the general conditions of a free market economy’. See also in the context of the free movement of goods, Opinion of AG Szpunar in Case C-148/15 *Deutsche Parkinson Vereinigung eV v Zentrale zur Bekämpfung unlauteren Wettbewerbs eV* EU:C:2016:394, para 1: ‘The present case bears testimony to the fact that the Treaty provisions on the internal market, and, in particular, those relating to the free movement of goods continue to be at the core of the EU legal edifice and the EU’s economic constitution’.

⁵⁶¹ Wolf Sauter, *Competition Law and Industrial Policy in the EU* (Clarendon 1997) 27.

⁵⁶² *ibid.*

⁵⁶³ Harald Hagemann, ‘Ordoliberalism, the Social-Market Economy, and Keynesianism in Germany, 1945-1974’ in Roger E Backhouse and others, *Liberalism and the Welfare State: Economists and Arguments for the Welfare State* (OUP 2017) 57, 58: ‘The social-market economy, sometimes called “Rhine capitalism” (with Bonn as the capital of the FRG in the first four decades), was the German version of a third way—between *laissez-faire* economic liberalism, which was discredited by the Great Depression, and a centrally planned economy—that economists and politicians in many countries were looking for, as, for example, in Sweden, which became the prototype of a Western welfare state in the first decades after World War II’.

⁵⁶⁴ See, e.g., Gareth Dale and Nadine El-Enany, ‘The Limits of Social Europe: EU Law and the Ordoliberal Agenda’ (2013) 14 *German Law Journal* 613, 613.

⁵⁶⁵ Wernhard Möschel, ‘The Proper Scope of Government Viewed from an Ordoliberal Perspective: The Example of Competition Policy’ 2011 (2011) 33(3) *Journal of Economic Studies* 3, 3.

legal framework recognises the existence of ‘non-economic’ public services⁵⁶⁶ and the necessity of public intervention both in the financing⁵⁶⁷ and operation of SGEI. A strong public sector economy bears evidence of a legal social and economic European model underpinned by an idea of (neo-) ‘embedded liberalism’.⁵⁶⁸ In reality, even Ordoliberalism recognised the importance of social welfare and coined the notion of a social market economy,⁵⁶⁹ or ‘Rhine capitalism’.⁵⁷⁰ The Union institutions claim the existence of a European model, defined as a social model, which is a question of values such as social protection, health, education, and care services, reunited around a common objective: the combination of economic performance and competitiveness with social justice.⁵⁷¹ Overall, the EU approach is rooted in a view of the State as (mostly) legitimate and nonbenevolent.⁵⁷² A certain deference to over-interference from the EU in the provision of these services is also identifiable in the case law of the Court.⁵⁷³

As often is the case, a more nuanced picture of the single market tale emerges in the middle of the spectrum. Whilst Article 3 TEU makes the establishment of a market economy an objective of the EU, it does so by reference to ‘a highly competitive *social* market economy’.⁵⁷⁴ Yet, the meaning of a social

⁵⁶⁶ i.e., public services which are not engaged in economic activity as defined in the case law of the Court. See, Communication from the Commission on the application of the European Union State aid rules to compensation granted to the provision of services of general economic interest, 2012/C/8/02, point 11.

⁵⁶⁷ e.g., Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (notified under documents C(2011)9380), point 2.

⁵⁶⁸ Jotte Mulder, ‘Responsive Adjudication and the “Social Legitimacy” of Internal Market’ (2016) 22(5) *European Law Journal* 597, 697 who referred to the ‘multi-level ‘embedded liberalism’ on the internal market’.

⁵⁶⁹ Especially the theories of Eucken, see, Blume and Durlauf (eds) (n 15) 2460; Alexander Ebner, ‘The Intellectual Foundations of the Social Market Economy: Theory, Policy, and Implications for European Integration’ (2006) 33(3) *Journal of Economic Studies* 206, 213.

⁵⁷⁰ Hagemann (n 563) 58.

⁵⁷¹ Explanatory Statement to the European Parliament resolution on a European Social Model for the future (2005/2248(INI)).

⁵⁷² Geradin, Layne-Farrar and Petit (n 315) 4.

⁵⁷³ In particular, when adjudicating in certain sectors, such as healthcare, the Court has been more restrictive with the application of the EU antitrust provisions, see Chapter 5, section 5.2.2.1.2. See also on the definition of non-economic activities, Chapter 6, section 6.1.3.

⁵⁷⁴ (emphasis added).

market economy is not fixed. A social market economy has been interpreted as a constant search for a way to combine ‘economic efficiency, individual freedom and social balance’.⁵⁷⁵ Such an interpretation postulates that the concept of a social market economy does not define a ‘well-established end-state ideal’, but rather a ‘procedural model of a specific institutional mode of governing the complexity and dynamism of socio-economic change in a pluralist setting’.⁵⁷⁶ If that interpretation is correct, the inclusion of a notion of a social market economy could be seen as a recognition of the (exceptional?) role of public policy goals other than competition and economic welfare in the market, a sort of ‘balancing act between the market and the social dimension’⁵⁷⁷ on a national level. If so, however, there are claims that the balance until the present has been carried out in a distinctly Ordoliberal sense.⁵⁷⁸ Therefore, the effects of the inclusion of the notion of social market economy and the removal of the objective of free and undistorted competition from the Treaties⁵⁷⁹ should not be exaggerated.

However, other scholars claim that the notion can be seen as a counterweight to the long-standing application of market rules to the welfare systems of the Member States. As Damjanovic argued, the ‘negative welfare integration process’⁵⁸⁰ does not necessarily lead to the destabilisation of national welfare regimes, as the latter, after the Lisbon Treaty, have been placed on an equal footing with the market rules.⁵⁸¹ Accordingly, it is ultimately the task of the EU, and in particular the ECJ, to ‘interpret the EU market rules as social market

⁵⁷⁵ Ebner (n 569) 218.

⁵⁷⁶ Ebner (n 569) 220.

⁵⁷⁷ As phrased by former Commissioner for Employment, Social Affairs and inclusion, László Andor, ‘Building a social market economy in the European Union’ Manchester 20 October 2011 (SPEECH/11/695).

⁵⁷⁸ Dale and El-Enany (n 564) 620.

⁵⁷⁹ Ebner (n 257) 393 who pointed out that this led many scholars to assume that the Treaty of Lisbon would reinforce the social dimension of European integration.

⁵⁸⁰ Dragana Damjanovic, ‘The EU Market Rules as Social Market Rules: Why the EU Can Be a Social Market Economy’ (2013) 2013 Common Market Law Review 1685, 1690. Damjanovic argued that the application of EU market rules to national welfare systems, ‘[...] leads to the so-called negative integration of these field at the EU level, which can however not be accompanied by positive integration measures, because the Union has not been given the appropriate competences for this’.

⁵⁸¹ *ibid.*, 1715-1716

rules', which would not only allow the inclusion of national welfare systems into the internal market but also the creation of the EU social market economy.⁵⁸²

Whichever notion of a social market economy is adopted, in the light of the two stories of the internal market the Union has a 'dual commitment',⁵⁸³ which has been described as 'the EU law's *core nucleus* of shared values'.⁵⁸⁴ It is argued that the dual commitment of the EU must be solved by a balancing exercise. It is within this balancing exercise that the analysis of this thesis is situated.

It follows from the above that there is nothing expressly establishing a market order solely based on economic welfare and efficiency in the Treaties. On the contrary, the constitutional documents of the EU appear to indicate the existence of a balancing process between economic welfare, efficiency and other public policy objectives.

3.1.2 The Default Mode and Status Quo of Competition Law

So far, this thesis has only touched upon the notion of a 'default mode'. This subsection seeks to describe the nature of this default mode, along with the status quo of competition law, to demystify their relevance to the structure of the legal provisions.

The 'default mode' is not axiomatic but merely provides an approach to understanding market failure in the legal framework. Traditionally perceived as an instrument for public policy analysts,⁵⁸⁵ the role of the market within legal analysis may seem uncertain, particularly if it lacks an empirical basis.⁵⁸⁶ In this context, a forced interpretation and construction of the legal system around the theory of market failure would then be deemed pointless. However, as presented in the preceding chapter, the notion of the EU competition law provisions as a default mode favouring unimpeded trade and competition renders a market failure analysis of the exceptions to these provisions logical and constructive.

⁵⁸² *ibid.*, 1717.

⁵⁸³ Mulder (n 568) 597. Mulder employed the term 'dual commitment' to describe '[t]he challenge [...] to reconcile freedom of (economic) movement with the social protection and regulation structures of Member States'.

⁵⁸⁴ *ibid.*, 598

⁵⁸⁵ Zerbe Jr and McCurdy (n 97) 558.

⁵⁸⁶ See, section 3.2.1 of the current chapter.

It is argued that, in EU competition law, the relevance of market failure analysis is directly apparent in the way the legal obligations and exceptions are construed. At the most abstract level, the default mode of the EU is characterised by the adherence to a market system for organising society. The broad scope of the EU economic provisions⁵⁸⁷ enforces a *de facto* default mode in relation to public policy intervention in the market. Burke argued that within the EU, ‘reliance on markets as a default system of economic organisation’ is not just a *de facto* default mode, but ‘expressly hardwired into the Treaty scheme’.⁵⁸⁸ If such an interpretation is correct, the default mode would operate as a meta-rule for the internal market.

Consequently, public policy interventions at the national level are explained as deviations from the default mode requiring justification. Such deviations are not only required to be legitimate but also proportionate. This characteristic of the EU competition law framework makes it unique, and the default mode becomes a logical starting point for market failure analysis.

The default mode is not absolute but qualified by a multitude of different derogations. Therefore, whilst the concept of a default mode may initially appear at odds with the balancing exercise previously discussed, this is not necessarily the case. With regard to the EU’s dual commitment, it would certainly be wrong to conclude blindly that the EU market system affords a consistent preference for market-based solutions over the protection of, for instance, social rights.⁵⁸⁹ Instead, the balancing is taking place within the justificatory process of the default mode. It is precisely through this lens of the triangular relationship between *prohibition-exception-justification* that market failure affirms its relevance.

There are various possibilities in EU competition law for firms or public authorities to justify public policy intervention in the market. Yet, the principle of prohibition remains the rule. This principle is further substantiated by the fact that exceptions are typically interpreted strictly,⁵⁹⁰ and subject to a proportionality test. As a result, public policy measures that infringe any of the prohibitions in Articles

⁵⁸⁷ See Chapter 1, section 1.2.3.3.

⁵⁸⁸ Burke (n 294) 25.

⁵⁸⁹ For an opposing view see e.g., Burke (n 12) 25.

⁵⁹⁰ This is the case in state aid (Case C-67/09 *P Nuova Agricast and Cofra v Commission* EU:C:2010:607, para 74), free movement of goods (Case C-319/05 *Commission v Germany* EU:C:2007:678, para 88) and freedom to provide services (Case C-546/07 *Commission v Germany* EU:C:2010:25 07, para 48).

101(1), 102 or 107(1) TFEU must, as a general rule, be justified, implying that they are based on a legitimate objective and proportionate.

An important consequence of the default mode is the hypothesis previously outlined:⁵⁹¹

Public policy intervention in the market, infringing upon the competition law provisions, is acceptable only to the extent that the same result cannot be achieved by the market alone.

Such a hypothesis presupposes a legal test of the market conditions in order to scrutinise both:

- i) The need for public policy intervention
 - ii) The extent of public policy intervention
- Market diagnostics*

The need for public policy intervention refers to the identification of a market failure that cannot be corrected by the market alone. The extent of such an intervention involves an assessment of the capacity of the remedy to the market failure. For instance, Burke in his exposition of government failure, referred to ‘market feasibility’, which ‘entails a consideration of how markets are performing and the nature of any impediments to them delivering on general interest objectives’.⁵⁹² This thesis will use the term *market diagnostics* to refer to a potential legal assessment of market conditions, including an assessment of the need and the extent of public policy intervention (*double market failure* test). In essence, if the existence of a market failure is to be recognised, there must be a clear inability of the market to successfully deliver an optimal outcome independently (market success). In order to perform a market diagnostics a counterfactual test can be applied to assess the market, either in the absence of a restriction on competition or ‘with another realistic alternative scenario’.⁵⁹³ This

⁵⁹¹ See Chapter 1, section 1.2.5.

⁵⁹² Burke (n 294) 102.

⁵⁹³ Citation from the counterfactual proposed by the Commission under Article 102 TFEU, ‘Guidance on the Commission’s enforcement priorities in applying Article 82’ (n 100), para 21. On the importance of counterfactuals in the substantive assessment of EU competition law, see, Damien Geradin and Ianis Girgenson, ‘The Counterfactual Method in EU Competition Law: The Cornerstone of the Effects-Based Approach’ SSRN, Working Paper, December 11, 2011; Duncan Sinclair, ‘Counterfactuals in Anti-Competitive Contracts and Abuse of Dominance Cases under Articles 101 and 102 TFEU’ 2010 31(12) European Competition Law Review 509. For legal

test can be explicit or implicit. For instance, the legal framework for public services under the State provisions provides for a comparison between the market under public policy intervention on one hand and *normal* market conditions on the other.⁵⁹⁴ This thesis aims to examine whether such an approach is implicitly applied across the different provisions of EU competition law when assessing measures deviating from the default mode based on public policy.

This subsection now moves on to explaining a related concept. This thesis introduces the notion of the ‘status quo of competition law’, which further strengthens the default mode. This concept pertains to core assumptions in traditional competition theory, primarily the presumption that unfettered competition results in the optimal allocation of resources and thereby serves the best interests of consumers.⁵⁹⁵ It is posited that this status quo is not merely a neo-liberal construct but deeply rooted in the provisions and interpretation of EU competition law.⁵⁹⁶ As put by Patel and Schweitzer:

Finally, a competition law ‘theory’ or ‘philosophy’ evolved which was widely accepted for a long time [...]. According to this theory, competition law was to be seen in close connection with a fundamental decision in favour of a free market economy. [...] Such a system was also expected to be in the best interest of consumers and to serve as a source of prosperity and wealth.⁵⁹⁷

This quote implies that this may not remain the sole paradigm of competition policy. However, this thesis argues that the assumption that unfettered competition enables optimal resource allocation, and thus benefits consumers, is firmly embedded in the structure of the Treaties. To the degree that efficiency and consumer welfare are viewed as the primary drivers of competition policy, perfect competition is believed to result in an effective allocation of resources and a maximisation of efficiency by the elimination of any market failures related to

application of the concepts see, e.g., Case C-56/65 *Société Technique Minière v Maschinenbau Ulm* EU:C:1966:38; Case C-382/12 P *MasterCard and Others v Commission* EU:C:2014:2201.

⁵⁹⁴ e.g., Joined Cases C-83/01 P, C-93/01 P and C-94/01 P *Chronopost* EU:C:2003:388, paras 68-77; Joined Cases C-341/06 P and C-342/06 P *Chronopost (II)* EU:C:2008:375, paras 80-114.

⁵⁹⁵ See Chapter 2, section 2.1 on the notion of perfect competition and Chapter 1, section 1.3.2.3 and 1.3.2.4 on the Chicago school.

⁵⁹⁶ See e.g., Chapter 5, section 5.4.1.4.

⁵⁹⁷ Patel and Schweitzer (eds) (n 350) 1.

market power or imperfect competition. It is further suggested that the status quo of competition law promotes a preference for unfettered competition in relation to other efficiency gains implemented by measures deviating from the competition law framework.

In other words, within the balancing test, a *prima facie* preference is given to maintain unrestricted competition, due to the presumption outlined above. This is evident from both Article 101(3) and 107(3).⁵⁹⁸ Article 101(3)(b) specifies that an agreement can never be exempted if it results in an elimination of competition ‘in respect of a substantial part of the products in question’. As explored in Chapter 5, this Article implies that competition is protected as such, regardless of whether an agreement could generate efficiency gains that may outweigh the inefficiencies created by the distortion of competition.⁵⁹⁹ Although less explicit, a similar stance appears to be suggested by Article 107(3)(c), which requires that aid measures do not ‘affect trading conditions to an extent contrary to the common interest’.

The impact of competition law’s status quo depends on the weight attributed to it in the respective areas of EU competition law, a topic to be explored in subsequent chapters. Nevertheless, the concept is crucial as it prioritises unfettered competition within the balance between efficiency benefits (or external objectives) and restrictions of competition. Thus, the competition law’s status quo can manifest both in welfare balancing (between competition external values) and efficiency balancing (between competition and other efficiencies).⁶⁰⁰

In conclusion, within this legal framework, scrutiny of public policy is cardinal, as any deviations must not only be legitimate but also proportionate. Depending upon the rigour of the review, proportionality can be instrumentalised either to oversee or to circumscribe public policy interventions in the market. In essence, this section has argued that the legal configuration of these provisions presents an opportunity to investigate the legal value of market failure theory within the field.

⁵⁹⁸ See Chapter 5, section 5.3.1.4. and Chapter 8 section 8.2.1.4

⁵⁹⁹ *ibid.* See also, Lianos, Korah and Sicilliani (n 357) 673: ‘It shows that there are instance in which competitive rivalry is valued as such, even if efficiency gains may compensate the consumers affected by the conduct fund restrictive to competition’.

⁶⁰⁰ For instance, as explored in Chapters 5, 6, 8 and 9, competition may have to be balanced with efficiencies broader than the protection of competition alone, such as positive externalities on innovation, so-called dynamic efficiencies.

3.1.3 The Role of Proportionality in Market Failure Analysis

This subsection briefly introduces the proportionality principle within the meaning of the default mode and, ultimately, market failure analysis. It is argued that beyond examining the different rationales of public policy intervention, the meaning of market failure as legal justification in EU competition law can only be comprehensively explored by analysing and dismantling the Court's proportionality assessment of public policy intervention. The nature of proportionality both intrinsically and in relation to market failure is closely analysed throughout this thesis. This subsection carries out a preliminary assessment of proportionality in order to construct a workable framework for the research carried out in the subsequent chapters. Accordingly, the proportionality assessment is explored from a market failure perspective, aiming to pinpoint the potential role of proportionality in market failure analysis. As argued above, certain analogies can be made between the proportionality test and a potential market failure test. This makes the proportionality assessment the natural focus of the analysis.

First, this subsection begins by describing that proportionality is a multifaceted notion with various substantive expressions, although a prevalent tripartite construct is widely endorsed in EU law. Following this, it elucidates the nature of the proportionality assessment in the context of free movement law. Whilst free movement law is not directly part of the analysis of this research, such description enables the construction of a deeper understanding of proportionality in the broader field of EU economic law, of which competition law forms an integral part. Thereafter, the section explores the diverse incarnations of the proportionality principle within competition law, investigating how these might deviate from the general application of proportionality in EU law. Finally, it is argued that the existence of a market failure test in EU competition law can be investigated only through an analysis of the proportionality assessment under the different provisions.

3.1.3.1 The Basic Framework of the Principle of Proportionality

As stated above, it is critical to analyse the general principle of proportionality⁶⁰¹ in order to investigate the presence or the prospect of a market diagnostics test carried within the legal framework. Proportionality stands as one of the most

⁶⁰¹ On the nature of proportionality as a general principles of EU law see e.g., Joined Cases C-497/15 and C-498/15 *Euro-Team* EU:C:2017:229 para 42.

important general principles of EU law. As a ‘general’ principle, proportionality is ‘inherent in a series of infinite applications of the law’.⁶⁰² It is often described as an important element of liberal democracy, constituting protection for individuals from the State and regulatory intervention.⁶⁰³ It applies to all EU acts⁶⁰⁴ as well as the measures of Member States that fall within the scope of EU law.⁶⁰⁵ From the perspective of justification of intervention in the market order, proportionality is not an exception⁶⁰⁶ but rather constitutes an overarching general requirement.

The meaning of proportionality is equivocal,⁶⁰⁷ and some scholars claim that it is impossible to identify a fixed substantial meaning of the principle.⁶⁰⁸ A general and most basic understanding of proportionality is that actions must be proportionate to their objectives.⁶⁰⁹ Alexy famously described the principle of proportionality as consisting of ‘three sub-principles: the principles of suitability, necessity, and proportionality in the narrower sense’.⁶¹⁰ In his analysis, principles should be understood as ‘optimization commands’,⁶¹¹ requiring ‘that something be realized to the greatest extent possible given the legal and factual possibilities’.⁶¹² Mirrored in Alexy’s sub-principles, a common interpretation of proportionality in

⁶⁰² Tor-Inge Harbo, ‘The Function of the Proportionality Principle in EU Law’ (2010) 16(2) European Law Journal 158, 159.

⁶⁰³ Takis Tridimas, *The General Principles of EC Law* (OUP 1999) 137. See, also Case C-46/87 *Hoechst v Commission* EU:C:1989:337, para 19, for an affirmation of the proportionality principle as ‘protection against arbitrary or disproportionate intervention’.

⁶⁰⁴ Tridimas (n 603) 90.

⁶⁰⁵ Tridimas (n 603) 124.

⁶⁰⁶ Marzal (n 548).

⁶⁰⁷ See e.g., Vicki C Jackson and Mark Tushnet, *Proportionality: New Frontiers, New Challenges* (CUP 2017); Aharon Barak, *Proportionality: Constitutional Rights and Their Limitations* (CUP 2012).

⁶⁰⁸ Harbo (n 602) 160.

⁶⁰⁹ Takis Tridimas, ‘Proportionality in Community Law: Searching for the Appropriate Standard of Scrutiny’ Evelyn Ellis (ed), *The Principle of Proportionality in the Laws of Europe* (Hart 1999) 65, 65.

⁶¹⁰ Robert Alexy, ‘Constitutional Rights and Proportionality’ (2014) 22 *Revue* 51, 52.

⁶¹¹ Alexy, ‘On the Structure of Legal Principles’ (n 114) 295.

⁶¹² Robert Alexy, *A Theory of Constitutional Rights* (OUP 2002) 47.

EU law is that it constitutes a ‘three- or four-part legal test’.⁶¹³ First, to effectuate a proportionality assessment the measure in question must pursue a legitimate objective, in other words, be based on a legitimate ground of derogation. Nevertheless, it could be submitted that this requirement is not part of the actual proportionality assessment but rather a precondition for even conducting a proportionality review. Following the verification of a legitimate objective, the measure must then be: (i) suitable; (ii) necessary; and (iii) proportionate *stricto sensu*.⁶¹⁴ Whilst the proportionality *stricto sensu* appears to fit the doctrinal understanding of proportionality as a ‘balancing act’, it is also the condition that has bewildered legal scholarship.⁶¹⁵ In particular, in relation to State measures infringing EU law some scholars consider that rather than through a *stricto sensu* test, national measures are scrutinised via a so-called least restrictive measure (LRM) standard.⁶¹⁶

The nature of the proportionality assessment appears contextual. Hence, rather than abstractly defining the meaning of proportionality, the nature of the proportionality assessment must be analysed in the interplay between justifications and restrictions. In other words, regard must be given to the general rule under which the principle is applied.⁶¹⁷ In the scope of this thesis, the principle of proportionality is assessed in relation to the different primary law provisions of EU competition law.

The following two subsections briefly outline the nature of the proportionality principle in free movement law and competition law respectively. The assessment under the two sets of provisions is linked to market failure theory.

⁶¹³ Alison L Young and Gráinne De Búrca, ‘Proportionality’ in Stefan Vogenauer and Stephen Weatherill (eds), *General Principles of Law: European and Comparative Perspectives* (Hart 2017) 133, 137.

⁶¹⁴ Gráinne De Búrca and Paul Craig, *EU Law: Text, Cases and Materials* (5th edn OUP 2011) 526. For EU antitrust law see Wolf Sauter, ‘Proportionality in EU Law: A Balancing Act?’ (2013) 15 *Cambridge Yearbook of European Legal Studies* 43, 448. Harbo (n 602) 265 (yet, without the legitimate objective-requirement).

⁶¹⁵ De Búrca and Craig (n 614) 551; Paul Craig, *EU Administrative Law* (OUP 2012) 591.

⁶¹⁶ Wolf Sauter, ‘Proportionality in EU Competition Law’ (2014) 7 *European Competition Law Review* 327, 327.

⁶¹⁷ Daniel Thym, ‘The Constitutional Dimension of Public Policy Justifications’ in Panos Koutrakos, Shuibhne Niamh Nic and Philip Syrpis (eds), *Exceptions from EU Free Movement Law: Derogations, Justification and Proportionality* (Hart 2016) 170, 174.

3.1.3.2 The Link to Proportionality as Market Diagnostics in Free Movement Law

It is important to note that academic scholarship recognises a divergence in the function of the principle of proportionality in competition law and free movement law.⁶¹⁸ Nevertheless, it is argued that a comprehensive analysis of its application in free movement law is beneficial for three reasons. Firstly, free movement law is one of the substantive fields of EU law where proportionality has received its most fundamental and explicit role. Thus, it establishes a contextual foundation for analysing the treatment of public policy intervention under this principle. Secondly, the application of proportionality in free movement law has been immensely commented upon, in particular due to its omnipresence in light of the broad scope of these provisions.⁶¹⁹ A parallel can be drawn to the broad applicability of the competition law provisions. Thirdly, as is demonstrated below, the use of the principle in free movement law has drawn criticism for seemingly morphing into an efficiency test rather than a balancing act. This critique holds relevance for this research as it spurs an investigation throughout this thesis into whether this efficiency-axial approach is similarly prevalent in competition law.

In the setting of free movement law, proportionality works as a safeguard for the four freedoms against arbitrary restrictions.⁶²⁰ The proportionality principle systematically applies to the exceptions contained in Article 36 TFEU⁶²¹ and the provisions on the freedom to provide services.⁶²² Through the recognition of the

⁶¹⁸ Sauter, 'Proportionality in EU Competition Law' (n 616); Max Hjärtström and Julian Nowag, 'General Principles of EU Law in EU Antitrust Law' in Katja Ziegler, Päivi Neuvonen and Violeta Moreno-Lax, *Research Handbook on General Principles of EU Law* (Edward Elgar Press 2022) 423; Jacques Steenbergen, 'Proportionality in Competition Law and Policy' (2008) 35(3) *Legal issues of Economic Integration* 259.

⁶¹⁹ e.g., Craig (n 615) 617 ff; Marzal (n 548). In particular in the relation to the broad scope of the provisions. Gareth Davies, 'Understanding Market Access: Exploring the Economic Rationality of Different Conceptions of Free Movement Law' (2010) 11(8) *German Law Journal* 671, 686, argued that 'this turns free movement law into a general proportionality review of economic regulation.

⁶²⁰ Tridimas (n 603) 193 'It is applied to determine the compatibility with the Treaty of national measures which interfere with the fundamental freedoms. The function of the principles in this context is to promote market integration. [...] The importance of proportionality as an instrument of market integration is illustrated by contrasting the approach of the Court to restrictions on free movement imposed by national measures and such restrictions imposed by Community measures'.

⁶²¹ e.g., Case C-17/93 *Openbaar Ministerie v Van Der Veldt* EU:C:1994:299, para 15; Case C-573/12 *Ålands Vindkraft AB* EU:C:2014:2037, para 76.

⁶²² e.g., Case C-342/15 *Piringer* EU:C:2017:196, para 53; Case C-249/15 *Wind 1014 and Daell* EU:C:2018:21, para 39.

doctrines of ‘mandatory requirements’⁶²³ or ‘imperative reasons relating to public interest’,⁶²⁴ the proportionality assessment has been extended to an indefinite list of (acclaimed) ‘non-economic’ values.⁶²⁵ Due to the broad scope of these provisions, proportionality is an intrinsic component of virtually every free movement case. As put by Marzal:

In sum, the application of free movement is framed by the Court as a problem that involves choosing between conflicting considerations, which may take the form of principles, interests, individual rights, policy objectives, institutional competences, or abstract values, where free movement clashes with any one of these types of norms.⁶²⁶

In the field of free movement, the proportionality test commonly adopts a two-step approach. This entails that (provided that a legitimate objective is invoked) the national measure must be (i) appropriate (or ‘suitable’) and (ii) necessary for the purpose of achieving its legitimate aim (often understood as a LRM test).⁶²⁷ Indeed, the Court continuously emphasises in its case law that a measure can be justified ‘only if that measure is appropriate for securing the achievement of the objective pursued and does not go beyond what is necessary in order to attain it’.⁶²⁸ There are certainly exceptions to this finding.⁶²⁹ In reality, the intensity of the proportionality review appears to vary from one case to another, leaving

⁶²³ Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* (n 37), para 8.

⁶²⁴ Which is viewed as transposition of the doctrine of mandatory requirements into the field of the freedom to provide services. See, Case C-288/89 *Gouda* (n 37) paras 13-14. On the proportionality requirement, see e.g., Case C-522/15 *Commission v Ireland* EU:C:2017:698, para 74.

⁶²⁵ The Court’s case law underscores that when Member States invoke a mandatory requirement the measure in question ‘must be proportionate to the objective pursued and that objectives must not be capable of being achieved by measures which are less restrictive of [intra-EU] trade’ (Case C-368/95 *Familiapress* EU:C:1997:325, para 19; Case C-470/93 *Mars GmbH* EU:C:1995:224, para 15).

⁶²⁶ Marzal (n 548) 628.

⁶²⁷ Malcolm Jarvis, ‘The Proportionality Test: Constructive Dialogue between English and Scottish Courts’ in Koutrakos, Niamh Nic and Syrpis (eds) (n 617) 265, 266. See also, Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (3rd edn, OUP 2010) 171.

⁶²⁸ Confirmed by the Court in Case C 387/18 *Delfarma* EU:C:2019:556, para 29 and Case C-488/20 *Delfarma* EU:C:2021:956, para 37.

⁶²⁹ Marzal (n 548) 632, considered ‘two notable exceptions’ in Case C-169/91 *Council of the City of Stoke-on-Trent and Norwich City Council v B & Q plc* EU:C:1992:519; Case C-112/00 *Schmidberger* EU:C:2003:333.

sometimes a larger margin of discretion to the Member State.⁶³⁰ However, if the two-step approach seems to be the most commonly applied standard, in a market failure analysis the proportionality requirement would verify that the remedy is *suitable* to tackle the failure (by promoting welfare that the market is failing to produce) and that it is *necessary* (a LRM-type of review). If necessity is interpreted as a LRM standard, it provides a clear link to the idea of market failure as a ‘double test’,⁶³¹ viewing market failure as both a normative and a diagnostic tool.⁶³² Zerbe and McCurdy considered that the diagnostic approach to market failure means if the failure can be remedied by less intrusive means (for instance a tax expenditure rather than a public monopoly); incentives allowing the market to correct itself are to be preferred.⁶³³ In other words, public policy intervention by the State should only be an option insofar as ‘a less-intrusive generic policy cannot be utilized or that an effective contract for private production cannot be designed to deal with the market failure’.⁶³⁴ It is in this connection that the sub-principle of necessity affirms its relevance as a possible tool for assessing the existence of nonmarket failure.

This subsection now proceeds to examine two works demonstrating the possibility to conceive the proportionality assessment in free movement law as operating in economic terms.⁶³⁵ First, Marzal, in a critical account of the use of a LRM standard of proportionality, proposed interpreting the Court’s proportionality assessment as a cost-based test, the intensity of which is founded upon the distinction between technical and evaluative judgments.⁶³⁶ He considered that the reasoning of the Court ‘radically shifts from a Herculean balancing of values framework to a seemingly innocuous and purely factual review of Pareto efficiency’.⁶³⁷ However, as seen, Pareto efficiency is essentially unattainable in

⁶³⁰ Barnard (n 627) 174; Pål Wennerås, ‘The Justification and Proportionality of Certain Administrative, Regulatory and Political Concerns’ in Mads Andenas, Tarjei Bekkedal and Luca Pantaleo (eds), *The Reach of Free Movement* (Springer 2017) 629 ff.

⁶³¹ See section 3.2.2 of the current chapter.

⁶³² Zerbe Jr and McCurdy (n 97) 560 referred to this as the ‘double market failure test’

⁶³³ *ibid.*

⁶³⁴ Weimer and Vinning (n 401) 179 as cited in Zerbe Jr and McCurdy (n 97) 560.

⁶³⁵ The approach of this thesis with regard to the concept of proportionality within the context of market failure is explained in section 3.3 of the current chapter.

⁶³⁶ Marzal (n 504).

⁶³⁷ *ibid.*, 621.

practice, therefore Pareto efficiency has been somewhat loosely interpreted by Marzal as making a preference for the least restrictive measure, albeit it might only offer an inferior level of protection of the invoked legitimate objective.⁶³⁸ Although the proportionality assessment might never be seen as promoting pure Pareto efficiency (since it is impossible in practice), his contribution reveals important insights into the use of proportionality as a measurement of efficiency. In particular, he considered that the Court's proportionality assessment is not a balancing exercise, but solely a factual assessment of the effects of national measures, without any evaluative judgment.⁶³⁹ This is the case since the balancing exercise in the proportionality *stricto sensu* requirement (trade-offs) is replaced by a test of appropriateness and necessity (market diagnostics). The suitability requirement, he argued, would refer to an assessment of the effects and means of the measure in order to determine that it 'produce the beneficial effects invoked by the defendant state or the private party'.⁶⁴⁰ In other words, the measure must be able to produce beneficial effects in relation to the sought aim. This appears a convincing argument as the Court in the past has shown a willingness to consider a measure unsuitable 'because of the rather marginal nature of its effects'.⁶⁴¹ He considered that if the suitability requirement is all about benefits, the necessity condition is an assessment of costs (i.e., could the same result be obtained with fewer costs?).⁶⁴² Such a cost assessment could be considered a strict LRM standard. As for the notion of costs, it seems plausible that costs should reasonably be understood not only as direct or indirect costs but also as tangible (monetary) or intangible costs.⁶⁴³ In such an analysis, it appears that the LRM test usurps any balancing of conflicting interests. Altogether, Marzal claimed that such an efficiency-based proportionality assessment leads to a situation where the Court engages in a purely factual and objective assessment leaving aside evaluative judgments.⁶⁴⁴ Nevertheless, every so often evaluative assessments are inevitable. Where evaluative judgments are required, Marzal argued that the Court's strategy

⁶³⁸ *ibid.*, 646.

⁶³⁹ *ibid.*, 630.

⁶⁴⁰ *ibid.*, 637.

⁶⁴¹ Case C-170/04 *Rosengren* EU:C:2007:313, para 47.

⁶⁴² Marzal (n 548) 639.

⁶⁴³ Aurelien Portuese, 'Principle of Proportionality as Principle of Economic Efficiency' (2013) 19 *European Law Journal* 612, 616.

⁶⁴⁴ Marzal (n 548) 642.

is to defer to the component national authorities.⁶⁴⁵ This is, thus, one explanation of the variety of intensity in the Court proportionality review described above. The distinction between ‘factual/technical assessments’ and ‘value judgments’ determines the intensity of the review.⁶⁴⁶ This then provides a division of competences, ‘[w]hereas the EU ensures that states adopt technically efficient measures (proportionality assessment), national authorities remain competent to make value judgments, based on their own particular cultural references and morality’.⁶⁴⁷

Second, it has been suggested that the Court’s proportionality assessment is best understood as a ‘principle of economic efficiency’.⁶⁴⁸ Portuese, in his mainstream law and economics approach to proportionality, argued that ‘not only does the EU proportionality principle encapsulate an efficiency rationale, but most importantly, it has been interpreted by the ECJ as such’.⁶⁴⁹ Through the adoption of a welfarist approach, he asserted that what makes proportionality all about efficiency is the cost-benefit analysis (CBA) inherent in both welfare economics and the proportionality assessment in EU law. He argued that through a balancing exercise, proportionality should be understood as maximising Kaldor-Hicks efficiency.⁶⁵⁰ However, this argument must address several crucial questions from a descriptive point of view regarding its compatibility with the two-step structure adopted by the Court in its case law.

In conclusion, it is possible to detect two possible uses of proportionality as a market failure test in free movement law. Whilst a LRM standard appears to offer strong protection to the default mode via a strict ‘market diagnostic’, it seems plausible that the *stricto sensu* condition could potentially grant discretion to the Member States when evaluative judgments are required, and even offer trade-offs to be effectuated where necessary. The understanding of proportionality as a catalyst for economic efficiency is important for our analysis when evaluating proportionality within the framework of EU competition law.

⁶⁴⁵ *ibid.*

⁶⁴⁶ *ibid.*, 644.

⁶⁴⁷ *ibid.*

⁶⁴⁸ Portuese (n 643). However, as Kaldor-Hicks efficiency rather than Pareto efficiency.

⁶⁴⁹ *ibid.*, 612.

⁶⁵⁰ *ibid.*, 617.

3.1.3.3 Proportionality in Competition Law

This subsection substantiates that proportionality also holds a crucial role in the assessment under EU competition law, rendering it the core of the analysis of the relevance of market failure. A significant objective of this research is to precisely assess the Commission's and the EU Courts' proportionality assessment. Consequently, this section delineates the general features of that test to construct a workable framework for market failure analysis.

First, the proportionality assessment in substantive antitrust law seems to deviate from what has been considered hitherto. Fundamentally, the rationale of this distinctiveness⁶⁵¹ could be traced back to the fact that the competition law provisions primarily target private restrictions. Whilst the emphasis in free movement law has been placed on market diagnostics via the LRM standard, in competition law, except for the analysis of ancillary restraints,⁶⁵² the proportionality assessment involves a *prima facie* balancing test.⁶⁵³ There is a possibility both in Article 101(3) and 102 TFEU to trade off anticompetitive effects with efficiencies.⁶⁵⁴ Although this thesis intends to delve deeper into the nature of this proportionality in the subsequent chapters, it is possible to offer some initial observations here.

First, the 'efficiency defence' under Article 101(3) TFEU seems to pursue the objective of balancing the anticompetitive effects with the pro-competitive (i.e., narrow efficiencies) effects of an agreement between undertakings.⁶⁵⁵ This test is arguably made on an economic basis via a CBA, taking into account *inter alia* 'cost efficiencies'⁶⁵⁶ and 'qualitative efficiencies'.⁶⁵⁷ The test is then subjected to an additional series of criteria relating to consumer benefit, necessity and non-

⁶⁵¹ (n 618).

⁶⁵² See Chapter 6, section 6.1.1.

⁶⁵³ Sauter, 'Proportionality in EU Competition Law' (n 616) 328. We add '*prima facie*' since this claim will be more closely examined throughout this thesis.

⁶⁵⁴ Although this thesis only investigates Article 101 TFEU and not Article 102 the Court has recognised that the latter also include an efficiency justification based on premises of the former. See to this effect, Case C-209/10 *Post Danmark* (n 99), para 41. Article 102 TFEU also includes a justification based on objective necessity, see Case 311/84 *CBEM v CLT and IPB* EU:C:1985:394.

⁶⁵⁵ Guidelines on the application of Article 81(3) of the Treaty (n 364), para 11.

⁶⁵⁶ *ibid.*, paras 64-68.

⁶⁵⁷ *ibid.*, paras 69-72. Explained in para 54 as 'new or improved products, greater product variety etc.'.

elimination of competition.⁶⁵⁸ This thesis must, in the subsequent chapter, deconstruct the Commission's and the EU Courts' proportionality assessment under Article 101(3) for the purpose of determining whether it can be understood as a market failure test.

Second, through cases such as *Wouters*⁶⁵⁹ and *Meca-Medina*,⁶⁶⁰ the Court forged what has been termed a 'European Rule of Reason'.⁶⁶¹ This exception has been considered to constitute 'a generic public interest justification'.⁶⁶² Under this exception agreements of certain non-state bodies⁶⁶³ have been found not to violate Article 101(1) provided that they are based on legitimate objectives and are proportionate.⁶⁶⁴ The anticompetitive restrictions must be 'inherent in the pursuit of those objectives'.⁶⁶⁵ It has been suggested that such a test is mainly based on a LRM standard.⁶⁶⁶ It is, however, unclear if such a proportionality test involves a proper balancing exercise.⁶⁶⁷ The rule of reason is highly interesting insofar as it applies *mutatis mutandis* to State action falling under the antitrust provisions read in conjunction with the loyalty clause in Article 4(3) TFEU. The Court has applied its objective justification-test from *Wouters* as a means to recognise the pursuit of public policy via regulatory intervention.⁶⁶⁸ It is submitted that such a transplant is logical. An extension of the scope of the provisions of EU antitrust law to public

⁶⁵⁸ The exception is then further subjected to the criteria of indispensability, consumer benefits and non-elimination of competition. See, e.g., Brenda Sufrin, 'The Evolution of Article 81(3) of the EC Treaty' (2006) 55(4) Antitrust Bull 915, 933.

⁶⁵⁹ Case C-309/99 *Wouters and others* EU:C:2002:98.

⁶⁶⁰ Case C-519/04 *P Meca-Medina and Majcen v Commission* EU:C:2006:492. Also confirmed in Case C-1/12 *Ordem dos Técnicos Oficiais de Contas* EU:C:2013:127; Case C-136/12 *Consiglio Nazionale dei Geologi and Autorità Garante della Concorrenza e del Mercato* EU:C:2013:489.

⁶⁶¹ e.g., Julian Nowag, 'Wouters, When the Condemned Live Longer: A Comment on OTOC and CNG' (2015) 36 (1) European Competition Law Review 39, 43; Monti (n 62) 1086.

⁶⁶² Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (n 558) 258.

⁶⁶³ Nevertheless, despite their private nature, these entities were vested with regulatory powers over their respective members. *Wouters* concerned the Dutch bar, *Meca-Medina* involved the international Olympic committee and *Ordem dos Técnicos* was an association of chartered accountants.

⁶⁶⁴ Case C-519/04 *P Meca-Medina* (n 660), para 42.

⁶⁶⁵ *ibid.*; Case C-136/12 *Consiglio Nazionale dei Geologi* (n 660), para 53.

⁶⁶⁶ Sauter, 'Proportionality in EU Competition Law' (n 616) 329.

⁶⁶⁷ Therefore, Chapter 6 provides an in-depth analysis of this case law of the Court to determine if it can be explained by the concept of market failure.

⁶⁶⁸ Jones and Sufrin (n 351) 591.

measures should be accompanied by adequate justificatory grounds. In *CHEZ Elektro Bulgaria*, which involved national legislation setting minimum tariffs for lawyers that were fixed by a professional organisation for lawyers, the concept of ‘mandatory’ fell in principle under Article 101. However, the Court with reference to its ruling in *Meca-Medina* held that those professional rules, fixing a minimum fee, may escape the prohibition if they are ‘limited to what is necessary to ensure the implementation of legitimate objectives’.⁶⁶⁹

Third, in State aid law the assessment seems more like the test under the free movement rules. State aid is a peculiar legal field in comparison with the antitrust provisions. As shall be explored in the compatibility assessment of aid under Article 107(3) TFEU, the Commission has a large margin of discretion.⁶⁷⁰ By exercising that discretion the Commission has adopted a large amount of soft law regimes relating to specific areas of state aid. Therefore, in principle, a distinction must be made between sectorial soft law regimes and direct assessment under Article 107(3). Nevertheless, it is arguably possible to identify commonalities in the respective assessments.⁶⁷¹ Following the modernisation of EU state aid law, the focus was placed on a ‘refined economic approach’ (REA). The balancing test set out in the State Aid Action Plan (SAAP)⁶⁷² forms non-binding general principles of assessment.⁶⁷³ Further, the 2012 State Aid Communication set out an agenda to streamline the different sectorial guidelines to comply with the common assessment principles (CAP) developed by the Commission.⁶⁷⁴ The CAP lay down the following test:⁶⁷⁵

1. Is the aid measure aimed at a well-defined objective of common interest?
2. Is the aid well designed to deliver the objective of common interest i.e., does the proposed aid address the market failure or other objectives?

⁶⁶⁹ Joined Cases C-427/16 and C-428/16 *CHEZ Elektro Bulgaria* (n 42), para 55; Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40), para 48.

⁶⁷⁰ See Chapter 7, section 7.3.2.2.

⁶⁷¹ Kelyn Bacon, *European Union Law of State Aid* (3rd edn, OUP 2017) 99 ff. Also, as is explored in Chapters 7 and 8, both Article 107(3)(c) and (d) contain explicit proportionality requirements.

⁶⁷² SAAP (n 20), paras 11 and 19.

⁶⁷³ Bacon (n 671) 100.

⁶⁷⁴ Communication on State aid modernisation (n 20), para 8.

⁶⁷⁵ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454).

- i) Is the aid an appropriate policy instrument to address the policy objective concerned?
 - ii) Is there an incentive effect, i.e., does the aid change the behaviour of the aid recipient?
 - iii) Is the aid measure proportionate to the problem tackled, i.e., could the same change in behaviour not be obtained with less aid?
3. Are the distortions of competition and effect on trade limited, so that the overall balance is positive?

An analysis of the CAP will be provided in Chapter 7.⁶⁷⁶ However, it can be concluded that the proportionality assessment in state aid is the most sophisticatedly framed. A remarkable feature is the inclusion of the notion of market failure as a direct condition (yet not exclusive) in the text. It appears that the market failure condition goes directly to the question of the necessity of aid,⁶⁷⁷ allowing to bridge between market failure and proportionality. The test also provides for an explicit balancing exercise between the benefits created by intervention and the adverse effects on trade and competition. This might be conceived of, where required, as a trade-off scenario between efficiency and equity objectives.⁶⁷⁸ However, whilst the proportionality assessment appears sophisticated and rigid in the soft law, it is yet to be analysed if that is also the case in practice.

3.1.3.4 Conclusions: Market Diagnostics and Trade-offs

In conclusion, building an understanding of the role of market failure in EU competition law requires more than simply identifying situations and placing them in the ‘market failure box’. To properly understand its value and function, the proportionality assessment of public policy intervention must be thoroughly dismantled.

⁶⁷⁶ See Chapter 7, section 7.4.2

⁶⁷⁷ For an analysis see Hjærtström (n 20).

⁶⁷⁸ See, Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 12, ‘[a]pplying concepts developed in the economic theory, whether a measure contributes to an objective of common interest can be understood either in terms of its contributions to overall welfare and efficiency (does the State aid allow to remedy a market failure) or in terms of equity (i.e. how is welfare distributed). All objectives of common interest can thus be described as contributing to efficiency and/or equity. [...] Contributions to efficiency are analysed in the framework of market failures’.

This section has introduced the essential role of proportionality in EU economic law in general, and competition law in particular. It has underscored that an analysis of the principle of proportionality is quintessential to determining the role of market failure within the context of competition law analysis. The proportionality assessment of the Commission and the EU Courts is posited to hold significant relevance for this research in two respects.

First, a bifurcated suitability-necessity test could reveal insights as to the existence of any market diagnostics and, thereby, market failure, considerations in the decisional practice of the Commission and case law of the Courts. Despite the wide-ranging intensity of proportionality analysis across the different fields, a common denominator for the examined variations is the existence of a suitability-necessity test. It could be argued that a blended appropriateness-necessity standard is capable of verifying both the existence of a market failure, along with the appropriate remedy (double market failure). This market diagnostic test can be described as *formal proportionality*.⁶⁷⁹

Second, proportionality *stricto sensu* is of importance for assessing potential trade-offs between efficiency and external objectives on one hand, and competition and other efficiencies on the other. This facet of the test can be described as *substantive proportionality*. Whilst a proportionality assessment incorporating external objectives seems, *prima facie*, to be applied sparingly, the recognition of public policy exceptions in competition law inherently constitutes a trade-off between the status quo of competition and other efficiencies or even external objectives. Figure 3.1. synthesises the potential relevance of market diagnostics and trade-offs within the different standards of proportionality.

⁶⁷⁹ Although not based on the same criteria as employed by this research, the distinction between *formal* and *substantive* proportionality has been used in different jurisdictions. See, e.g., Moshe Cohen-Eliya, 'The Formal and the Substantive Meanings of Proportionality in the Supreme Court's Decision Regarding the Security Fence' (2005) 38(1) Israel Law Review 262.

Figure 3.1/The assessment of proportionality from a market failure perspective

<i>Appropriateness/Necessity</i>	<i>Stricto sensu</i>
<i>Formal Proportionality</i>	<i>Substantive Proportionality</i>
Is it possible to identify any market failure considerations/market ‘diagnostics’?	Is it possible to identify any trade-off/balancing exercise between economic and external objectives?

3.2 Conceptual Difficulties

Before establishing the analytical framework that will guide the remainder of this thesis, it is necessary to grapple with two unique challenges associated with market failure that are intricately connected to market diagnostics.

Firstly, as explained in the previous section, market failure is a ubiquitous notion, seemingly without boundaries.⁶⁸⁰ Consequently, the omnipresence of market failure culminates in a scenario wherein every piece of regulation (or even private remedies) dealing with a given market transaction could, at least potentially, remedy a market failure by internalising an externality.

Secondly, the combination of market failure’s ubiquity and the lack of boundaries of market failure makes it paramount to identify principles capable of distinguishing between ‘good’ and ‘bad’ public policy intervention. In this regard, a double market failure test conceived of as a normative and a dual diagnostic tool might coincide with the measurement of public policy intervention in the sense of the theory of government failure (at least when there is State involvement, as under the State aid rules). Therefore, it is necessary to distinguish and draw a line between these two theories. The following two subsections address these difficulties respectively and explain how they will be dealt with within the subsequent analysis.

⁶⁸⁰ See section 3.2.1 of the current chapter.

3.2.1 Ubiquity and Threshold Identification

One of the main difficulties of market failure is its ubiquity.⁶⁸¹ The omnipresence of market failure stems from the roots of the theory. The first section of this chapter explored how a general economic equilibrium in the sense of allocative efficiency is hardly attainable in practice.⁶⁸² Market failure is the mirror of that equilibrium. Buchanan summarised welfare economic theory of the mid-20th century as ‘theories of market failure’.⁶⁸³ From that perspective, market failure is based on an ‘idealized system of price-market institutions’.⁶⁸⁴ Zerbe Jr and McCurdy considered that:

[A]nalysts in search of externalities and market failures can find them anywhere they look, providing a universal justification for any sort of government intervention that one might want to undertake.⁶⁸⁵

If there is no such thing as perfect markets, as pointed out by Stiglitz, market failure is present ‘in virtually every transaction among private parties in the economy’.⁶⁸⁶ Thus, it becomes ‘a condition rather than an economic phenomenon’.⁶⁸⁷ From a technical point of view, it seems that the ubiquity of market failure can be explained by the ubiquity of externalities.⁶⁸⁸ As seen in Chapter 2, the early works of Bator saw market failures as categories of externalities.⁶⁸⁹ It has been claimed that externalities are present in every transaction, asserting that no transaction exists in isolation; there will always be at

⁶⁸¹ See for strong critiques, Nelson (n 98); Zerbe Jr and McCurdy (n 97).

⁶⁸² (n 393).

⁶⁸³ Buchanan (n 333) 1.

⁶⁸⁴ Bator (n 21) 351, Bator pointed out that by market failure, ‘at least in allocation theory, we mean the failure of a more or less idealized system of price-market institutions to sustain “desirable” activities or to estop “undesirable” activities. The desirability of an activity, in turn, is evaluated relative to the solution values of some explicit or implied maximum-welfare problem’. See also, e.g., Spulber (n 418) xiv, who also argued that market failure is invoked when ‘government regulation might enhance allocative efficiency’.

⁶⁸⁵ Zerbe Jr and McCurdy (n 97) 564.

⁶⁸⁶ Joseph E Stiglitz, ‘Keynesian Economics and Critique of First Fundamental Theorem of Welfare Economics’ in Tyler Cowen and Eric Crampton, *Market Failure or Success* (Edward Elgar 2002) 43, 59.

⁶⁸⁷ Marciano and Medema (n 10) 4.

⁶⁸⁸ Zerbe Jr and McCurdy (n 97).

⁶⁸⁹ See Chapter 2, section 2.2.1.

the very least a remote impact on a third party.⁶⁹⁰ Moreover, there is a constant discovery of new market failures adding to an already endless list that can be expanded until infinity.⁶⁹¹ Whilst there seems to be consensus on the fact that market failure is ubiquitous, there is no consensus on the consequences of such a finding.⁶⁹²

In essence, this ubiquity critique relates directly to the *measurability* of market failure. If failure is present virtually everywhere, there is a certain subjectivity in identifying what is considered a ‘true’ failure and ‘acceptable’ market performance. In practice, it is difficult to distinguish a market failure from minor distortions, ‘let alone, to identify the precise boundaries of the market failure’.⁶⁹³ Thus, the determination of the tipping point where a distortion develops into a failure involves a degree of evaluative judgment. As pointed out by Faulhaber, public intervention in the market is devoid of economic rationale ‘unless we can identify market failure’.⁶⁹⁴ Yet, he considered that ‘[t]he point is not that market failure exist, but how serious are those market failures’.⁶⁹⁵ However, developing a concept of workable market failure seems impossible. In contrast to competition law and the notion of ‘workable competition’, equilibrium theory does not include any theory of ‘workable equilibrium’ as a sort of second-best solution. In other words, there is no ‘objective’, or even established, notion of ‘workable efficiency’ being able to apprehend government intervention as a remedy to eliminate efficiency distortions. Rather, it appears that the significance of market failure is determined by policymakers on a case-by-case basis.

Nevertheless, in the default mode of EU competition law that role might be shouldered by the principle of proportionality. In this legal framework, it may be that the assessment of the significance of the market failure inserts itself directly into the core of the legal justification. Two observations can be made.

⁶⁹⁰ Zerbe Jr and McCurdy (n 97) 563; Nelson (n 98) 557 pointed out that the nature of market failures ‘is extremely deponent upon the assumptions governing the actual situation’.

⁶⁹¹ (n 412).

⁶⁹² Zerbe Jr and McCurdy (n 97) 561.

⁶⁹³ Pelkmans (n 418) 4. For Similar view see Friederiszick, Röller and Verouden (n 340).

⁶⁹⁴ Gerald R Faulhaber, ‘The Role of Government in a Mixed Economy: Reprise’ (1987) 6(4) *Journal of Policy Analysis and Management* 557, 558.

⁶⁹⁵ *ibid.*

First, there have been discussions on the identification of such a threshold in State aid law. In particular, the CAP considers that '[g]enerally, any market failure needs to be significant for state aid to improve efficiency'.⁶⁹⁶ 'Analysing the presence and magnitude of market failures is, therefore, necessary to identify the effect of State aid on efficiency'.⁶⁹⁷ The well-known 'CRA report' proposed in its economic analysis of state aid to '[r]equire Member States to show significant market failure and to demonstrate that the instrument is targeted [to remedy that failure]'.⁶⁹⁸ Friederiszick Röller and Verouden considered that although it is impossible to measure the exact size of a market failure, it is 'possible to investigate whether a market failure is likely to exist at all and whether it is significant'.⁶⁹⁹ This implies that a qualitative assessment of the existence and significance of a market failure is possible, whilst a precise quantitative assessment most likely will be unreliable.⁷⁰⁰ It could be argued that in State aid this task would then be performed by the Commission in the exercise of its scrutiny, subject to judicial review by the EU Courts.⁷⁰¹

Second, under the antitrust provisions, there is naturally no discussion or guidance concerning the measurement of market failure. However, in the previous section it was explored how the proportionality principle might be able to function as a tool for 'market diagnostics' in order to identify market failures. Using the same logic, it may be that the principle could also be used to discern 'necessary' intervention from 'unnecessary' public policy intervention.

In essence, the proportionality assessment must be analysed from the perspective of identifying the formulation of an 'intervention-threshold'. Therefore, a qualitative assessment of suitability-necessity must be analysed from two angles. Firstly, it must be analysed whether such an assessment is capable of verifying the existence of market failure. Secondly, it must be assessed if that test

⁶⁹⁶ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), point 19.

⁶⁹⁷ *ibid.*

⁶⁹⁸ Nitsche and Heidhues (n 457) 3.

⁶⁹⁹ Friederiszick, Röller and Verouden (n 340) 637.

⁷⁰⁰ *ibid.*

⁷⁰¹ The assessment of compatibility of state aid is the exclusive competence of the Commission, subject to review by the EU Courts, see e.g., Case C-284/12 *Deutsche Lufthansa* EU:C:2013:755, para 28; Case C-574/14 *PGE Górnictwo i Energetyka Konwencjonalna SA* EU:C:2016:686, para 32; Case C-150/16 *Fondul Proprietatea* EU:C:2017:388, para 42.

can be employed in order to assess if the failure is worth remedying (in terms of an increase in welfare). It has been shown that under the free movement provisions, appropriateness is measured by the *beneficial effects* of measures in relation to a specific objective (a possible market failure), excluding measures with merely marginal effects.⁷⁰² This suggests that frivolous interventions in response to insignificant market failures might not be appropriate and/or necessary. In this sense, it might be possible to identify a similar threshold for market failure in the analysis of EU competition law.

Overall, building a threshold of market failure is closely connected to market diagnostics as it seems plausible that insignificant market failure might be dealt with through conventional market mechanisms, rather than public policy intervention. In reality, the difficulties arising from the ubiquity of market failure relate directly to the nature of the intervention. If market failure can be conceived of as a general justification for intervention, there is a danger that insignificant failures might prompt intervention entailing further market distortions, making the status quo the most efficient outcome, whether conceived of narrowly or from a broader perspective.

3.2.2 Market Failure or Government Failure?

This subsection briefly explains the notion of government failure in order to distinguish it from the analysis of market failure advanced in this thesis. A description of government failure analysis provides the basis for clarifying the scope of market failure as a tool to measure government intervention. In economic theory, the danger resulting from the absence of clear boundaries of market failure is unnecessary public intervention resulting in a potential worsening of social welfare. This has been referred to as a ‘nonmarket failure’⁷⁰³ or ‘government failure’.⁷⁰⁴ Indeed, Nelson, after considering that market failure is ubiquitous, concluded that ‘the presence of market failure does not necessarily mean that government intervention will do better’.⁷⁰⁵ Within the scope of this thesis, a nonmarket failure can be induced by intervention of both a public and private

⁷⁰² See section 3.1.3.2 of the current chapter.

⁷⁰³ Wolf Jr (n 549).

⁷⁰⁴ Julian Le Grand, ‘The Theory of Government Failure’ (1991) 21(4) British Journal of Political Science 243.

⁷⁰⁵ Nelson (n 98) 557.

nature. Logically, to the extent that private remedies are accommodated within the legal framework, it is imperative that they also undergo an assessment of their efficiency. It is suggested that whilst these theories must be distinguished based on their respective functions, a broad market failure test, serving both as a normative rationale and a diagnostic tool, includes an assessment of any nonmarket failure induced by the public policy intervention. Nonetheless, although certain facets of market failure and government failure fuse, the scope of the matter is much more expansive, encompassing inquiries that exceed the boundaries of this research.

In basic terms, Burke defined government failure as ‘concerned with how government interventions in any sphere of its activities are ineffectual or suboptimal. In the economic sphere, it may result in avoidable inefficiencies [...]’.⁷⁰⁶ Government failure is a broad and multifaceted theory focusing on inefficiencies of government intervention. Government failure has usually been described as the antipole of market failure,⁷⁰⁷ and the two theories are often presented in conjunction.⁷⁰⁸ However, other economists claim that it ‘is not necessarily the flip-side of the coin of market failure’, and that there is a need to conceptualise government failure in its own terms.⁷⁰⁹ At any rate, it is submitted that the theories are interconnected. The link between the two theories is two-folded.

On one hand, the theories are intertwined in so far as market failure might be the rationale of a government failure. If the State intervenes to remedy a market failure, it must not result in a ‘nonmarket failure’ understood as a non-optimal outcome created by the actual government intervention.⁷¹⁰ Simply put, the correction of inefficiency requires an efficient solution. As previously indicated,

⁷⁰⁶ Burke (n 294) 21.

⁷⁰⁷ *ibid.*, 188.

⁷⁰⁸ e.g., Timothy Besley, *Principled Agents: The Political Economy of Good Government* (OUP 2007) 45.

⁷⁰⁹ Dolfsma Wilfred, ‘Government Failure — Four Types’ 2011(3) *Journal of Economic Issues* 593, 594; William R Keech and Michael C Munger, ‘The Anatomy of Government Failure’ (2015) 164 *Public Choice*. 1, 1. See also for a similar position in legal science, Burke (n 294).

⁷¹⁰ e.g., Wolf Jr (n 549) 107 wrote that, ‘[p]olicy formulation properly requires that the realized inadequacies of market outcomes be compared with the potential inadequacies of market outcomes be compared with the potential inadequacies of nonmarket efforts to ameliorate them’.

there are no factors suggesting that this efficiency evaluation would be excluded from being applied *mutatis mutandis* to private remedies.

On the other hand, there is a link between the theories in that they both provide ground for efficiency considerations in a public policy intervention. Yet, government failure does not appear to necessarily be limited to correcting market failures but concerns every intervention of the government in the market; the focus appears to be placed on the efficacy of intervention. In stark contrast to the orthodox definition of market failure, from the very outset government failure goes beyond Pareto inefficiency to include distributional failures.⁷¹¹ Hence, government failure corresponds to a more general failure due to suboptimal regulation. Dolfisma developed a concept of government failure, ‘inspired by insights from the philosophy of law’ to identify four different failures based on the nature of legal rules.⁷¹² The first instance of government failure occurs when rules are ‘too specific’.⁷¹³ The second, conversely, is produced by ‘too broad rules’.⁷¹⁴ The third occurs when rules are arbitrary and the fourth when they are conflicting.⁷¹⁵ As such, these types of failures do *not only* occur when there is public policy intervention to correct a market failure. However, government failure suffers from the same laxity as market failure in that it does not have a fixed definition⁷¹⁶ and can occur on multiple and unaccountable levels.

The preceding description of government failure serves as a basis for delineating the role of market failure in this thesis, particularly regarding the analysis of the remedies taken to remedy the market failure. The role of market failure as a measurement of the effectiveness of government (and private) intervention is ambiguous. Firstly, it appears that certain scholars consider market failure analysis and government failure to fuse. In particular, it is possible to conceive an overlap between government failure and the double market failure test.⁷¹⁷ It has been shown that market failure has been presented critically as a dual

⁷¹¹ e.g., Wolf Jr (n 549) 107-139 who identifies ‘distributional inequality’ as a source of government failure. See also, Le Grand (n 704) who includes equity in his government failure analysis.

⁷¹² Wilfred (n 709) 596.

⁷¹³ *ibid.*, 597.

⁷¹⁴ *ibid.*, 598.

⁷¹⁵ *ibid.*, 598-599.

⁷¹⁶ See the contrasting definition of e.g., Besley (n 708) 45, Wolf Jr (n 549); Le Grand (n 704).

⁷¹⁷ See section 3.3.2 of the current chapter.

tool, not only normatively prescribing when States should intervene (the rationale) in the market, but also analytically prescribing the scope of such intervention (remedy).⁷¹⁸ Thus, market failure ‘provides a necessary, not a sufficient justification for public policy interventions’.⁷¹⁹ The analytical part of a double market failure test is conceived of as a measurement of the efficiency of public policy intervention in order to correct a market failure.

In EU competition law, it seems that the appropriateness-necessity limb of proportionality assessment is capable of encompassing considerations of the efficiency of public policy intervention. A CBA necessarily covers both efficiencies and inefficiencies. Consequently, in any proportionality assessment, there is inevitable interconnection between the objective (market failure) and the means (of intervention). An LRM-type of review clearly incorporates efficiency concerns of a public policy intervention merging market failure with nonmarket failure analysis. As put by Zerbe and McCurdy:

If a market failure can be resolved with the creation of an incentive that will allow the market to correct itself, such as a tax expenditure, this is to be favoured over more aggressive treatments [...].⁷²⁰

A parallel can be drawn to free movement law where a LRM standard is often affirmed, the necessity limb could potentially operate as a safety net for nonmarket failure. By way of illustration, in *SWA*, the Court held that, under the principle of proportionality, tax incentives are to be preferred over direct intervention in market prices.⁷²¹ In essence, the proportionality assessment (market diagnostics) is capable of steering clear of the most obvious government failures that could be caused by the intervention.

However, it appears important to distinguish these two theories in terms of the question they pose. Market failure asks the question of the scope of public policy intervention in the market. Government failure on the other hand, as being part of the broader school of public choice theory,⁷²² asks the question of the extent

⁷¹⁸ *ibid.*

⁷¹⁹ Wolf Jr (n 549) 138.

⁷²⁰ Zerbe Jr and McCurdy (n 97) 560.

⁷²¹ Case C-333/14 *The Scotch Whiskey Association* EU:C:2015:845, paras 44-49. For an earlier ruling see, Case 82/77 *Van Tiggele* EU:C:1978:10.

⁷²² Buchanan (n 333) 1.

to which all kind of state intervention is inefficient. From that perspective, government failure analysis does not appear to be limited to a proportionality assessment of measures remedying a market failure but analyses both the direct and side effects of public intervention in the market in a broader inquiry. In conclusion, although the government failure aspect is present in a double market failure test, the scope of the two sets of analyses differs.

3.3 The Proposed Framework: A Systematic Analysis of Market Failure Theory in EU Competition Law

This section establishes a framework, under which the traditional two-step approach⁷²³ in justification under EU competition law will be analysed in order to determine the role of market failure theory. Chapter 1 defined the aim of this thesis as:

To explore and clarify the role of market failure theory in EU competition law, specifically within the assessment of measures derogating from that framework on the basis of public policy ('public policy intervention').

This aim was then translated into the overall research question:

What role and value, if any, does market failure hold within legal analysis of public policy intervention on markets in EU competition law?

The framework developed in this section, together with the methodology defined in the Chapter 1, is formulated in a way to satisfactorily answer the research question. In addition, it also provides an analysis capable of providing answers to the following sub-research questions:

- (c) *What type of framework can be developed to assess the relevance of market failure analysis within EU competition law?*
- (d) *Can the legal framework of EU competition law be understood through the lens of a mainstream economic conception of market failure?*

⁷²³ i.e., (i) the existence of a legitimate objectives and (ii) the proportionality of the intervention.

- (e) *If not, can an alternative approach to market failure be identified?*
- (f) *Can an EU competition law concept of market failure be discerned?*
- (g) *What is the role of economic efficiency as a justificatory ground within EU competition law?*
- (h) *Does the test based on economic efficiency differ fundamentally from the assessment of so-called external objectives?*

With these research questions in mind, the framework presented below is used in order to, first, identify the rationales of intervention and, second, to analyse the existence of (or lack of) a market failure test in the reasoning of the EU Courts. The framework can be deconstructed into three components:

- i) Identifying the rationale of intervention;
- ii) Identifying any market failure test/‘market diagnostics’;
- iii) Identifying potential trade-offs/balancing between, competition, broader efficiencies and external objectives.

3.3.1 Identifying the Rationale of Intervention

The first step of the analysis is to assess the different objectives capable of justifying public policy intervention. By describing and systematising the rationales for intervention, a first step has been taken to explore the meaning of market failure in EU competition law. The previous chapter has shown that market failure remains an undefined concept without clear boundaries. However, two alternative understandings of market failure were presented: a narrow efficiency-based model (a mainstream approach) and a broader definition taking into account external objectives. These two understandings of the concept must be kept in mind when determining the role and legal value of market failure in EU competition law. An analysis which comprises a broad and a narrow concept of market failure enables the analysis to provide a foundation to answer the sub-research questions (d) (e) (f) and (g).

Further, reflecting on the distinction between narrow efficiencies, broader efficiencies and external objectives in light of market failure theory could provide new insights into the extent that objectives other than the promotion of competition are accepted within the framework.

3.3.2 Proportionality I: Identifying a Market Diagnostics Test

A fundamental step in exploring the legal value of market failure in EU competition law is to analyse the Court's proportionality assessment and, to some degree, that of the Commission. The purpose of the analysis is to reveal any underlying considerations or insights related to market failure. Market failure is not simply a question of the rationale of public policy intervention but should also encompass the application of a legal test.

This section has established that in order to explore the role of market failure, the analysis should go beyond a simple identification of the objectives of public policy intervention and include an assessment of a market failure test, labelled 'market diagnostics'. The concept of 'market diagnostics' has previously been explained as an evaluation of the *need* and *extent* of public policy intervention.⁷²⁴ However, for the sake of clarity, this assessment is further divided into two limbs. The assessment of the need for intervention as such is referred to as merely 'market diagnostics', or 'prima facie proportionality' (i.e., is the market failing?). The ensuing assessment of the extent of the intervention (i.e., the proportionality of the actual measure) is termed a 'double market failure' test.

The market diagnostic test can be further deconstructed into two branches:

- i) Is the market failing?
- ii) Is the market failure significant?

Under the first branch, it is assessed whether it is possible to detect any considerations of market conditions prior to recognising the existence of a market failure. In other words, is there an assessment of the incapacity of the market to correct itself without any public policy intervention? Although it is difficult to know in advance how/if such a test would fit under the proportionality principle, it appears, *prima facie*, that it could fit under the combination of the appropriateness-necessity limbs. Sections 3.1.3.2 and 3.1.3.3 described how the appropriateness standard has been used to assess the beneficial effects of public policy intervention. If the appropriateness standard determines the welfare-enhancing effects of public policy intervention, this could indirectly serve as an indicator of a market failure in an economic sense (an increase in welfare). The second branch analyses whether the appropriateness-necessity test can be used to deal with the problem of ubiquity by implicitly or explicitly considering a

⁷²⁴ See section 3.2.1 of the current chapter.

threshold for public policy intervention. In other words, is the market failure ‘worthy’ enough of remedying? The crux of this assessment is to examine the feasibility of defining a threshold for public policy intervention by evaluating the magnitude of the market failure.

Furthermore, this second step of the analysis is important for replying to the overarching research question by assessing the existence of market failure reasoning in the case law. In addition, it is also important for replying to sub-questions (d), (g) and (h) by analysing the case law of the Court from a market failure perspective in order to detect any consideration of efficiency.

3.3.3 Proportionality II: Identifying a Double Market Failure Test

The second phase of a ‘legal’ market failure test marks a shift in focus from the initial question of the appropriateness/necessity of intervention to an assessment of the measure itself (the extent of the intervention). This exercise, which can be conceptualised as a ‘double market failure’ test, places a particular emphasis on examining the efficiency of the remedial measure. It seeks to ensure that the intervention, whilst aiming to rectify a market failure, does not inadvertently instigate nonmarket failures (thus creating a ‘double market failure’). Taking the shape of a (one-sided) CBA, the necessity review via a LRM standard could potentially reveal alternative methods of intervention that are as efficient or more efficient in addressing the failure, resulting in a greater increase in welfare. In this context, the market failure test might take on the nature of a double market failure standard, assessing the efficiency of the public policy intervention. This step evaluates the efficiency of the intervention and its potential impact on welfare, indirectly addressing sub-research questions (g) and (h).

3.3.4 Proportionality III: Identifying Trade-offs

This last step is a substantial proportionality assessment (*stricto sensu*) which can incorporate both efficiency balancing and welfare balancing depending on the scope of the test. As stated above, a market failure test, whether narrow or broad, can only be applied by admitting trade-offs either between efficiencies and/or between efficiencies and external objectives. This analysis goes beyond the formal proportionality assessment of the measure. The extent to which trade-offs are accepted is a key factor in determining the level of market failure analysis in EU

competition law, as well as its nature. The *stricto sensu* analysis allows for a two-fold examination of the level of balancing in EU competition law.

Firstly, it enables an assessment of the level of efficiency balancing in order to determine whether efficiency and market failure are part of the analysis in EU competition law and whether there is a preference for the status quo of efficiencies promoting competition over more general efficiency gains. Accordingly, it can determine the nature and content of ‘efficiency’ in EU competition law.

Secondly, this limb can assess the extent to which external objectives beyond efficiency are incorporated into the analysis, thereby defining the contours of external public policy intervention in EU competition law.

3.3.5 Determining the Level of Discretion

In all these steps of the analysis, the level of discretion afforded to national authorities must be analysed. Although this analysis is not strictly part of the framework for identifying the relevance of market failure it is necessary in order to analyse the relationship between the different rationales of intervention. In particular, possible variations in the discretion for the promotion of external objectives are indirectly determinant for the role of market failure in EU competition law. As explained, the *stricto sensu* test appears to be carried out rarely, and could potentially demonstrate a certain degree of deterrence of the Court toward the national policies of the Member States. Beyond discretion, in the legal assessment, there might also be variations in terms of discretion (steps 2 and 3). Therefore, the intensity of the potential market diagnostics and double market failure tests, together with the discretion left to national authorities, must be systematised and interpreted. Moreover, the level of discretion might vary depending on the legal framework and the type of failure identified. These potential factors require closer examination, which is carried out in subsequent chapters.

3.3.6 The Synthesised Framework

This subsection provides a table of the suggested framework. The test consists of four steps. Each limb of the test is divided into two columns: (i) aim; and (ii) question. The first column establishes the purpose of the limb. The second then

elaborates a question for each limb to provide an answer in order to affirm the relevance of the test in light of the overall research question.

Figure 3.2/The Market Failure Test

	<i>Aim</i>	<i>Question</i>
STEP 1	<i>Determining the grounds of intervention /rationale of public policy intervention</i>	Are the legal objectives compatible with market failure theory? Efficiency or broader standard?
STEP 2.1	<i>Identify any market diagnostics in the proportionality assessment</i>	Is it possible to detect a ‘market diagnostics’ test determining the desirability of public policy intervention?
STEP 2.2	<i>Assessing the means of intervention/possible double market failure test</i>	Is there an assessment of the efficiency of the intervention? Are certain means preferred in relation to others?
STEP 3	<i>Identify any balancing/trade-offs between conflicting objectives</i>	Are there any trade-offs between efficiencies or between efficiencies and external objectives?

3.4 Conclusions

This chapter has situated the theory of market failure in the context of both economic theory and the framework of EU economic law in order to construct a methodological framework that underpins the remainder of this thesis.

Against the economic theory provided in the previous chapter, this chapter has reframed market failure theory within the constitutional environment of EU economic law. Within this context, a default mode emerges wherein public policy interventions are conceived of as deviations from this normative setting. However, the default mode is not absolute but retains a qualified character. It has been asserted that the single market, steeped in the ethos of a ‘social market economy’, is founded on a constant and dynamic balancing act between economic integration and unfettered competition on one end, and national social objectives on the other.

In order to thoroughly analyse the role and value of market failure within EU competition law, merely assessing the objectives of public policy in relation to the applicable legal provisions is insufficient. An evaluation of the proportionality assessment of these measures also becomes necessary. In this respect, it has been argued that similarities between market failure and proportionality render the proportionality principle the central instrument in the analysis. At one end of the spectrum, it is via the proportionality assessment of public policy measures, according to a suitability-necessity yardstick, that market failure could potentially assume a judicial function – labelled ‘market diagnostics’. On the other end, in light of the balancing act described above, the constitutional framework provides the foundation for a broad market failure analysis via the study of potential trade-offs between efficiency and external objectives. Such trade-offs can be made via a *stricto sensu* proportionality assessment of public policy measures.

Moreover, in order to conduct a fruitful analysis, the problems of ubiquity and double market failure have been exposed. To counter the ubiquity critique, it is essential to incorporate considerations of the degree of market failure into the analysis of the proportionality assessment through ‘threshold identification’. It has further been established that a ‘double market failure test’, measuring the effectiveness of public policy intervention to tackle a market failure, might overlap with government failure analysis. Nevertheless, a pure government failure analysis can be distinguished from market failure based on its underlying purpose. In the context of this thesis, a double market failure test serves the purpose to explicate the role of market failure as a justificatory ground for intervention, rather than providing an examination of inefficiencies engendered by regulation.

Finally, an analytical framework for the remainder of this thesis has been crafted. The following chapters dissect the various domains of EU competition law in light of that framework. The proposed framework is based on a three-tiered

structure. The first tier delves into the objectives of the public policy measures by scrutinising the underlying rationale. The second tier analyses the existence of a market failure test within proportionality assessment. The third and final tier examines any trade-offs between efficiencies or between efficiencies and external objectives.

PART III

Market Failure – The Antitrust Story

4. MARKET FAILURE IN ANTITRUST LAW: INTRODUCTION AND THEORY

4.1 Introduction

Chapters 4, 5 and 6 of this thesis examine the role and value of market failure theory under the framework of EU antitrust law.

Market failure analysis within the realm of antitrust law is closely associated with the influence of neo-classical economics in the legal field.⁷²⁵ The post-modernisation era has witnessed a strong emphasis on adopting a more economic approach, leading to an effect-based analysis of the welfare consequences arising from anticompetitive measures.⁷²⁶ This shift towards an effect-based approach engendered a transformation in the interpretation of antitrust provisions, resulting in a less formalistic and more outcome-oriented analysis.⁷²⁷ The substitution of legal presumptions with ‘sound economic principles’⁷²⁸ necessitates a focus on efficiency through a CBA as a proxy for achieving the desired welfare standard.⁷²⁹

⁷²⁵ See Chapter 2, section 2.1.

⁷²⁶ (n 7).

⁷²⁷ For an outcome-oriented approach see e.g., Witt, ‘Public Policy Goals Under EU Competition Law - Now Is the Time to Set the House in Order’ (n 55) 443. The modernisation of the antitrust provisions touched upon the objectives, theories of harm and CAB analysis within articles 101 and 102 TFEU.

⁷²⁸ For an analysis see e.g., Monti (n 62).

⁷²⁹ This approach has been gradually developed in Commission documents such as Commission, ‘White Paper on modernisation of the rules implementing Articles 85 and 86 of the EC Treaty’ COM (99) 0101 final; See also e.g., Alison Jones (n 7) 783-784; Pieter van Cleynenbreugel, ‘Article 101 TFEU and the EU Courts: Adapting Legal Form to the Realities of Modernization?’

Yet, in the context of public policy interventions, the impact of the modernisation process and the more economic approach on the use of the normative economic theory of market failure remains ambiguous. Antitrust itself is perceived as a mechanism for addressing both market and non-market failure arising from private restrictions on competition, to ‘the extent that these affect social welfare’.⁷³⁰ The nature of antitrust law itself as a remedy for market failure, namely market power/imperfect competition, renders the potential application of a general market failure analysis in antitrust law intricate.

The primary issue seems to lie in the potential conflict between other policy areas and the EU antitrust provisions. In particular, there is no consensus on the role of antitrust law, or competition law generally in relation to other instruments of regulation.⁷³¹ Whilst the Union is obliged to ensure a system of effective competition to the extent that agreements or practices impact trade, the Treaty objectives must be interpreted within their systemacy (internal coherence).⁷³² Concerning public policy measures specifically, various sensitive issues related to competence and subsidiarity emerge. At the national level, a policy conflict might prompt Member States to adopt a public policy measure that distorts competition whilst simultaneously remedying a market failure in an adjacent market. In this context, both Member States and private firms have access to different grounds of justification within the antitrust framework.

This chapter starts by delineating the legal framework of the antitrust provisions, a critical foundation for understanding the prevailing norms. As is clear from the delimitations, Article 102 TFEU is not directly examined.⁷³³ The focus is placed on two distinct levels: the personal scope of the provisions (level 1 – legal qualification) and the applicable framework for justifications (level 2 – legal justification). This analysis sets the scene for further analysis in the ensuing chapters. The subsequent section is devoted to an exploration of the theoretical underpinnings and objectives of EU competition law. Initially, the examination

(2014) 51 *Common Market Law Review* 1381, 1381-1382; Witt, ‘Public Policy Goals Under EU Competition Law - Now Is the Time to Set the House in Order’ (n 55). The modernisation of the antitrust provisions touched upon the objectives, theories of harm and CAB analysis within Articles 101 and 102 TFEU.

⁷³⁰ Ioannis Lianos, ‘Polycentric Competition Law’ (2018) 71(1) *Current Legal Problems* 161.

⁷³¹ For an analysis see e.g., Dunne (n 212).

⁷³² See Chapter 1, section 1.3.3.1.

⁷³³ See Chapter 1, section 1.2.6.

reveals that competition law embodies a multitude of diverse objectives, interlocking and interacting with each other in a complex matrix. However, within the framework of antitrust modernisation, particular emphasis is placed on the intertwined objectives of consumer welfare and economic efficiency. Yet, even assuming an acceptance of the more economic view that competition law's primary *raison d'être* is the attainment of consumer welfare and economic efficiency, a salient ambiguity persists. This opacity emanates from a lack of consensus within both antitrust law specifically and competition law more broadly, concerning the appropriate welfare standard to be employed.

4.2 The Legal Framework of EU Antitrust Law: Content and Scope

Articles 101 and 102 TFEU are the Treaty antitrust provisions. These Articles lay down two prohibitions central to antitrust law in the EU.

The first of these provisions, Article 101(1), provides that:

1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market [...].

Article 101(1) prohibits any manner of anticompetitive collusion between firms. The notions of 'agreements', 'decisions by associations of undertakings' or 'concerted practices' can be understood as different degrees of collusion that can be more or less formal.⁷³⁴ The Article continues by providing a non-exhaustive list of types of collusion that are prohibited:

⁷³⁴ In Case 48/69 *Imperial Chemical Industries Ltd v Commission (Dyestuffs)* EU:C:1972:70, para 64, the Court held that that Article 101 TFEU draws a distinction between the concept of 'concerted practices' and that of 'agreements between undertakings' or of 'decisions by undertakings'; 'the object is to bring within the prohibition of that Article a form of coordination between undertakings which, without having reached the stage where an agreement properly so-called has been concluded, knowingly substitutes practical cooperation between them for the risk of competition'. Confirmed in Case C-382/12 P *MasterCard* (n 593), para 63: 'it is settled case-law, that although [Article 101] distinguishes between 'concerted practices', 'agreements between undertakings' and 'decisions by associations of undertakings', the aim is to have the prohibition of

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development, or investment;
- (c) share markets or sources of supply;
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

In order for an agreement to fall under the prohibition in Article 101 TFEU a number of conditions need to be fulfilled:⁷³⁵

- (a) First, there must be an agreement between undertakings, a decision by an association of undertakings or a concerted practice. In other words, there must be collusion between actors in the market;
- (b) Second, the measure must have as its object or effect the prevention, restrictions or distortion of competition within the internal market;
- (c) Third, the measure must affect trade between Member States.

The second of these provisions, Article 102, provides that:

Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.

that article catch different forms of coordination between undertakings of their conduct on the market’.

⁷³⁵ e.g., Ariel Ezrachi, *EU Competition Law: An Analytical Guide to the Leading Cases* (Hart 2014) 53-54.

In contrast to Article 101(1), Article 102 does not prohibit collusion between firms but applies to unilateral behaviour of an undertaking, or a so-called ‘single economic unit’.⁷³⁶ Similar to Article 101, Article 102 solely applies to ‘undertakings’ and only to the extent that the anticompetitive behaviour affects trade between Member States. It is important to highlight two further noteworthy characteristics of Article 102. Firstly, the ambit of this provision is limited to undertakings occupying a ‘dominant position’. Secondly, the anticompetitive behaviour in question must constitute an ‘abuse’ of that position. In other words, the mere assessment of a firm’s economic strength does not itself give rise to any legal implications.

The following subsections provide a closer examination of two core concepts of these articles: (i) the criterion requiring that the entity responsible for the anticompetitive measure must be an ‘undertaking’; and (ii) that criterion works as a delimitation tool for the application of EU antitrust law. After exploring that notion, the attention will shift to the inquiries surrounding the potential justification of anticompetitive measures.

4.2.1 Casting the EU Antitrust Net: Private Undertakings and Beyond

4.2.1.1 Economic Activity as a Divider Between Private and Public Spheres

In contradistinction to free movement law or international trade regulation, the antitrust provisions apply solely to undertakings and, in principle, not State action. This section shows that these provisions are capable of prohibiting both private and indirect forms of public intervention under the aegis of firms, authorities, or any other entity involved in the provision and distribution of goods or services. Hence, the concept of an ‘undertaking’ represents a pivotal instrument in delineating both the *ratione personae* scope of the Treaty provisions and the boundaries between the realms of private and public spheres in the realm of EU antitrust law. Chapter 6 delves into this topic in greater detail by examining market failure in legal qualification/categorisation under Article 101(1).

⁷³⁶ Case 170/83 *Hydrotherm Gerätebau GmbH v Compact de Dott Ing Mario Adredi & CSAS* EU:C:1984:271, para 11; Case C-231/14 P *InnoLux v Commission* EU:C:2015:451, para 65.

It is clear that the notion of an ‘undertaking’ defines the scope of antitrust law. Nevertheless, due to the lack of precise criteria that notion must be inferred from the case law, which is not always clear-cut.⁷³⁷ The first case that shaped the notion of an undertaking is *Höfner and Elser v Macroton*.⁷³⁸ The case involved a dispute between private employment recruitment agencies and the German Federal Office for employment, which at the time had a monopoly in the sector of employment procurement. It had to be determined whether or not the entity could be qualified as an undertaking for the purpose of the antitrust provisions, which it ultimately was. In its judgment, the Court stated that:

[...] in the context of competition law [...] the concept of an undertaking encompasses every entity engaged in economic activity, regardless of the legal status of the entity and the way in which it is financed.⁷³⁹

It follows from *Höfner* that at the heart of the notion of an undertaking is the concept of ‘economic activity’.⁷⁴⁰ What is of relevance is whether the entity is engaged in economic activity; its legal status or mode of financing are not pertinent factors when establishing whether or not the entity is an undertaking.⁷⁴¹ The *Höfner* case paved the way for a broad interpretation of the notion of an undertaking. Subsequently, a diverse array of entities including trade associations,⁷⁴² football clubs,⁷⁴³ public post offices,⁷⁴⁴ or non-profit

⁷³⁷ Kloosterhuis, (n 298) 117.

⁷³⁸ Case C-41/90 *Höfner* (n 35).

⁷³⁹ *ibid.*, para 21.

⁷⁴⁰ This is today well established in the case law, e.g., Joined Cases C-262/18 P and C-271/18 *Commission v Dôvera zdravotná poisťovňa* EU:C:2020:450, para 28; Case C-327/12 *SOA Nazionale Costruttori* EU:C:2013:827, para 27. See also, Sauter, *Coherence in EU Competition Law* (n 6) 76; Whish and Bailey (n 440) 85; Alison Jones, Brenda Sufrin and Niamh Dunne, *Jones & Sufrin’s EU Competition Law: Text, Cases, and Materials* (7th ed, OUP 2019) 142.

⁷⁴¹ An exception might be pointed out under the solidarity doctrine, which is further examined in Chapter 6, section 6.1.3.2.

⁷⁴² e.g., Case 71/74 *FRUBO v Commission* EU:C:1975:61.

⁷⁴³ Case T-193/02 *Piau v Commission* EU:T:2005:22.

⁷⁴⁴ e.g., Case C-320/91 *Corbeau* EU:C:1993:198, see also for a recent confirmation Case C-293/15 *Slovenská pošta v Commission* EU:C:2016:511.

organisations⁷⁴⁵ have been considered to be undertakings for the purposes of EU competition law.⁷⁴⁶

It is important to note that the concept of an undertaking is a relative one, meaning that an entity may operate as an undertaking solely in relation to some of its activities – which are then qualified as economic – whilst other non-economic activities fall outside the scope of the competition law provisions.⁷⁴⁷

The concept of ‘economic activity’ is, however, nebulous. At first glance, the ‘economic nature’ of an activity would seem to relate to its objective. This would suggest that the activity should have an economic purpose, i.e., an objective of ‘making a profit, or likely to make a profit’.⁷⁴⁸ However, according to the Court, the economic nature of an activity is not an obstacle to finding that non-profit activity is economic.⁷⁴⁹ The formulation of the concept of economic activity, and its limitations, is not grounded on the pursuit of an ‘economic purpose’. Rather, it has been devised in terms of a distinction between what can be termed the ‘hardcore public sphere’ and the ‘private sphere’. In its case law, the Court distinguishes between two types of activities:

The State may act either by exercising public powers or by carrying on economic activities of an industrial or commercial nature by offering goods and services on the market.⁷⁵⁰

Accordingly, what constitutes the ‘economic’ nature of an activity is the offering of goods and services on a market.⁷⁵¹ By placing the emphasis on the ‘offering of goods and services’, individual professionals such as doctors⁷⁵² or customs agents⁷⁵³ are undertakings for the purpose of the EU competition law provisions.

⁷⁴⁵ e.g., such as the German Red Cross when carrying out non-profit emergency ambulance services in Case C-475/99 *Ambulanz Glöckner* EU:C:2001:577.

⁷⁴⁶ Whish and Bailey (n 440) 86-89.

⁷⁴⁷ e.g., Case C-49/07 *MOTOE* (n 35), para 25.

⁷⁴⁸ On the meaning of the term ‘economic’ in the sense of profitability see, <<https://dictionary.cambridge.org/dictionary/english/economic>>

⁷⁴⁹ Case C-41/90 *Höfner* (n 35), para 21.

⁷⁵⁰ Case 118/85 *Commission v Italy* EU:C:1987:283, para 75.

⁷⁵¹ Case C-35/96 *Commission v Italy* EU:C:1998:303, para 36.

⁷⁵² Joined Cases C-180/98 to C-184/98 *Pavlov and Others* EU:C:2000:428.

⁷⁵³ Case 118/85 *Commission v Italy* EU:C:1987:283 (n 750).

In *FENIN*⁷⁵⁴ the Court had to answer the question of whether various entities managing the Spanish national health care system were acting as undertakings in the context of their procurement of medical equipment through a sole purchasing function. In this criticised judgment,⁷⁵⁵ the Court rejected the appeal and held that ‘the nature of the purchasing activity must be determined according to whether or not the subsequent use of the purchased goods amounts to an economic activity’.⁷⁵⁶ Consequently, the sole purchasing of goods (procurement) by an entity that does not carry out an economic activity falls outside the scope of the competition law provisions.⁷⁵⁷

Whilst there may not be any precise parameters for determining the content of economic activity, the Court appears to emphasise the need for a potentially competitive market, thereby indirectly distinguishing between private and public activities.

Although a necessary requirement, it is not enough that the activity consists of the offering of goods or services in the market. Case law also requires that the activity ‘could, at least in principle, be carried on by a private undertaking in order to make profits’.⁷⁵⁸ Nevertheless, the profitability of the activity is not, in itself, an obstacle to qualifying the activity as economic. This ‘market-requirement’ could be understood as a direct limitation of the potential spheres where competition law applies. The Court in *Höfner* stressed that the activities must be undertaken, at least potentially in competition with others.⁷⁵⁹ Yet again, the existence of a natural monopoly is not an obstacle to finding potential competition. Therefore, the non-fulfilment of the ‘market requirement’ is not enough in itself if the entity is offering goods and services that could in principle be offered by private undertakings. The superfluous nature of any conditions relating to a market

⁷⁵⁴ Case C-205/03 *FENIN v Commission* (n 490).

⁷⁵⁵ e.g., Roth Wulf-Henning, ‘Case C-205/03 P, Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v. Commission, Judgment of the Grand Chamber of 11 July 2006, [2006] ECR I-6295’ (2007) 44(4) Common Market Law Review 1131.

⁷⁵⁶ Case C-205/03 *FENIN v Commission* (n 490), para 26.

⁷⁵⁷ In this sense the economic activity is ancillary to a non-economic activity, see Whish and Bailey (n 440) 91.

⁷⁵⁸ Opinion of AG Jacobs in Case C-67/96 *Albany* EU:C:1999:28, para 311; Joined Cases C-180/98 to C-184/98 *Pavlov and Others* (n 752), para. 201.

⁷⁵⁹ Case C-41/90 *Höfner* (n 35), para 22.

becomes clear when analysing activities which do not constitute economic activity.⁷⁶⁰

In sum, the precise limits of potential competition are difficult to define. Rather than being based on a key criterion it appears that a myriad of corroborating evidence is relied upon by the Court.

4.2.1.2 Striking Down Public Measures Beyond the Public/Private Dichotomy

In principle, Articles 101 and 102 TFEU only apply to the conduct of undertakings and, as a consequence, not State regulation. If national legislation requires an undertaking to breach EU antitrust rules, the undertaking may invoke a ‘State action defence’ to evade liability for past conduct.⁷⁶¹ Subsequently, the Member State may face sanctions under the infringement procedure. Even if Articles 101 and 102 are addressed to undertakings, it has long been settled in case law of the Court of Justice that State regulation is not shielded from the application of EU antitrust law. Whilst the following case law applies to both Articles 101 and 102,⁷⁶² it primarily concerns Article 101(1).

Member States have a duty of sincere cooperation, also referred to as the loyalty clause. Article 4(3) TEU reads as follows:

Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties.

The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union.

The Member States shall facilitate the achievement of the Union’s tasks and refrain from any measure which could jeopardise the attainment of the Union’s objectives.

⁷⁶⁰ See Chapter 6, section 6.1.3.

⁷⁶¹ Case C-198/01 *Consortio Industrie Fiammiferi* EU:C:2003:430, para 53. Conversely, the NCAs are obliged, by virtue of the principle of supremacy, to disapply any contrary national legislative provisions. For an academic discussion on this defence see, e.g., Castillo de la Torre, ‘State Action Defence in EC Antitrust Law’ (2005) 28 *World Competition* 407.

⁷⁶² Whish and Bailey (n 440) 182.

Accordingly, the duty of sincere cooperation imposes both positive and negative duties on Member States.⁷⁶³ In *GB-INNO*⁷⁶⁴ the Court forged a principle known as the *effet utile* doctrine.⁷⁶⁵ The case concerned, inter alia, legally fixed retail prices on tobacco.⁷⁶⁶ Belgian tax law laid down a tax scheme in which the price of tobacco was set by the manufacturer or the importer.⁷⁶⁷ A national supermarket chain sold tobacco at a price below the price set on the tax label.⁷⁶⁸ Bridging between the free movement and the antitrust provisions⁷⁶⁹ the Court held that:

[W]hile it is true that [...] [Article 102 TFEU] is directed at undertakings, nonetheless it is also true that the Treaty imposes a duty on Member States not to adopt or maintain in force any measures which could deprive that provision of its effectiveness.⁷⁷⁰

There are several instances where a Member State may infringe the antitrust provisions. The Court summarised its case law in *Van Eycke v ASPA*: the antitrust provisions, read in conjunction with Article 4(3), require that Member States do not favour the adoption of agreements contrary to Article 101(1), or reinforce their effects or delegate to private undertakings the responsibility for taking such decisions.⁷⁷¹ The *effet utile* doctrine only applies if there is a violation of Article 101(1) i.e., all its criteria are met.⁷⁷²

In sum, State regulation may fall under the antitrust provisions when it requires or reinforces the effects of an antitrust infringement or when there is

⁷⁶³ *ibid.*, 226.

⁷⁶⁴ Case 13/77 *INNO v ATAB* (n 40).

⁷⁶⁵ Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (n 102), 49 ff.

⁷⁶⁶ Case 13/77 *INNO v ATAB* (n 40), para 10.

⁷⁶⁷ *ibid.*, para 12.

⁷⁶⁸ *ibid.*, para 10.

⁷⁶⁹ See Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (n 102) 49 ff.

⁷⁷⁰ *ibid.*, para 31. See also, e.g., Case C-266/96 *Corsica Ferries* EU:C:1998:306, para 35; Case C-94/04 *Cipolla* EU:C:2006:758, para 47; Case C-327/12 *SOA Nazionale Costruttori* (n 740), para. 37.

⁷⁷¹ e.g., Case C-267/86 *Van Eycke v ASPA* EU:C:1988:427, para 16; Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40), para 29.

⁷⁷² Whish and Bailey (n 440) 228. As a result, ‘there must be an agreement contrary Article 101(1) before a Member State can be found to have infringed Article 4(3)’.

delegation. Therefore, this chapter analyses to what extent public policy exceptions may also apply to these ‘pure’ public measures.

4.2.2 The Exclusion of Certain Restrictions

This section addresses the ubiquity problem of restrictions of competition. In practice, virtually all agreements or market regulations may have an impact on competition to a certain degree, even if that impact is trivial.

The Court has developed the doctrine of *de minimis* restrictions in order to safeguard minor restrictions from falling within the scope of Article 101(1) TFEU and from being subjected to public intervention through antitrust proceedings. In the case of *Völk v Vervaecke*,⁷⁷³ the Court affirmed that the agreement in question must impede competition to an ‘appreciable extent’ in order to be deemed a restriction under Article 101(1).⁷⁷⁴ Article 101(1) has been construed in a manner that requires the restriction to satisfy two distinct criteria of ‘appreciability’.

First, the text of Article 101(1) imposes a ‘jurisdictional limit’⁷⁷⁵ by requiring that the agreement ‘affect trade between Member States’. This criterion ensures that the EU has no competence over conduct in which the effects are entirely confined to one Member State.⁷⁷⁶ In *L’Oréal*, the Court expounded upon the meaning of the term ‘may affect’, affirming that the notion denotes a situation in which it is possible, ‘based on objective factors of law or fact’, to predict ‘with a sufficient degree of probability that the agreement in question may have an influence, direct, actual or potential, on the pattern of trade between the Member States’.⁷⁷⁷

⁷⁷³ Case 5/69 *Völk v Vervaecke* EU:C:1969:35; Case C-411/11 P *Commission v Verhuizingen Coppens N* EU:C:2012:778, para 63.

⁷⁷⁴ *ibid.*, p. 300; Case C-172/14 *ING Pensii* EU:C:2015:484, para 30 Case C-228/18 *Budapest Bank* EU:C:2020:265, para 38;

⁷⁷⁵ Commission Notice, ‘Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty’ (2004/C 101/07), para 12.

⁷⁷⁶ *ibid.*, para 29.

⁷⁷⁷ Case 31/80 *NV L’Oréal v PVBA “De Nieuwe AMCK* EU:C:1980:289, para 18; Case 319/82 *Kerpen & Kerpen* EU:C:1983:374, p. 4178; Case C-700/19 P *Toshiba Samsung Storage Technology and Toshiba Samsung Storage Technology Korea v Commission* EU:C:2022:484, para 142; Commission Notice, ‘Guidelines on the effect on trade concept contained in Articles 81 and 82’ (n 775), para 23.

Second, whilst not required by the Treaty, in addition to having an appreciable effect on trade between Member States, the agreement must affect ‘the free play of competition to an appreciable extent’.⁷⁷⁸ The reasoning of the Court in *Völk v Vervaecke* centres on the degree of market power held by the firms involved:

[A]n agreement falls outside the prohibition in Article [101] when it has only an insignificant effect on the markets, taking into account the weak position which the persons concerned have on the market of the product in question.⁷⁷⁹

Accordingly, this criterion is a threshold excluding minor market failures in terms of market power. The Commission provided guidance on the *de minimis* concept in its Notice on Agreements of Minor Importance (‘the De Minimis Notice’).⁷⁸⁰ The threshold is constructed around market share as a proxy for measuring market power.⁷⁸¹ The Commission, therefore, commits to not institute proceedings against undertakings that in good faith followed the methodology of the notice to calculate market share.⁷⁸²

The threshold set by the De Minimis Notice is an aggregated 10% of share by the parties on any relevant market affected by the agreement for vertical agreements between potential competitors.⁷⁸³ In the case of horizontal agreements between firms, which are not potential or actual competitors, the share is increased to 15%. In line with the *Expedia* case law of the Court of Justice,⁷⁸⁴ an object restriction is assumed to affect competition to an appreciable extent and cannot be exempted under the *de minimis* doctrine.⁷⁸⁵

⁷⁷⁸ Case 22/71 *Béguelin Import Co v SAGL Import Export* EU:C:1971:113, para. 16

⁷⁷⁹ Case 5/69 *Völk v Vervaecke* (n 773), para 5/7.

⁷⁸⁰ Communication from the Commission, ‘Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the Treaty on the Functioning of the European Union (De Minimis Notice)’ (2014/C 291/01).

⁷⁸¹ *ibid.*, para 3.

⁷⁸² *ibid.*, para 5.

⁷⁸³ *ibid.*, para 8.

⁷⁸⁴ Case C-226/11 *Expedia Inc* EU:C:2012:795, paras 50-53.

⁷⁸⁵ ‘Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) (De Minimis Notice)’ (n 780), para 13.

It is important to note, however, that market share is not the sole means by which market failure, or the gravity of the restriction, can be determined. As pointed out in EU antitrust scholarship, a restriction may also be considered minor and insignificant from an antitrust law enforcement standpoint based on qualitative factors.⁷⁸⁶

This was precisely the scenario in *Pavlov and Others*.⁷⁸⁷ The applicants (who were doctors) refused to pay compulsory membership fees to a pension fund, arguing that that pension scheme was in breach of Articles 101, 102 and 106 TFEU by having an impact on the costs of the services provided. Advocate General Jacobs advanced a series of arguments relating to the non-appreciable effect of the restriction,⁷⁸⁸ which was ultimately followed by the Court.⁷⁸⁹ In particular, the agreement only restricts one cost factor, insignificant in relation to others such as medical fees or costs of equipment, without determining the price of services, and the cost itself being unimportant for the final remuneration of medical specialists.⁷⁹⁰ All factors taken together, the effect of the agreement of competition was seen as minimal.

In sum, these two limitations work differently. The effect on trade criterion works as a jurisdictional limit and a divider between national competition law and EU competition law. The *de minimis* doctrine functions as a threshold in terms of market diagnostics. Only restrictions of a certain gravity are prohibited by Article 101(1), leaving minor competitive distortions outside of its scope.

4.2.3 The Exceptions to the Prohibitions

As Articles 101 and 102 TFEU are addressed to undertakings and not to Member States, the leeway for exceptions provided by the Treaty is generally limited. The sole provision in the Treaties providing for justification is Article 101(3), which allows for an exemption from the prohibitions set forth in Article 101(1) provided that a series of criteria are met. Since 1 May 2004, Article 101(3) has been directly

⁷⁸⁶ Whish and Bailey (n 440) 148.

⁷⁸⁷ Joined Cases C-180/98 to C-184/98 *Pavlov and Others* (n 752).

⁷⁸⁸ Opinion of AG Jacobs in Joined Cases C-180/98 to 184/98 *Pavel Pavlov and Others v Stichting Pensioenfonds Medische Specialisten* (n 484), paras 138-151.

⁷⁸⁹ Joined Cases C-180/98 to C-184/98 *Pavlov and Others* (n 752), para 94.

⁷⁹⁰ Opinion of AG Jacobs in Joined Cases C-180/98 to 184/98 *Pavel Pavlov and Others v Stichting Pensioenfonds Medische Specialisten* (n 484), paras 140-141.

applied on a case-by-case basis by the Commission, NCAs and national courts.⁷⁹¹ Article 101(3) provides that:

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

The final limb of Article 101(3) appears to entail a CBA couched in economic terms, which is not entirely dissimilar to a welfare economic market failure analysis. However, the actual test set forth in that provision appears to be much more limited, as it, according to the Commission, primarily focuses on the anti- and pro-competitive effects rather than a general equilibrium analysis.⁷⁹² The extent to which exceptions to the prohibitions laid down in Articles 101 and 102 are recognised is directly dependent upon the welfare standard adopted, a matter discussed in the following section of this chapter.

As is examined subsequently,⁷⁹³ the Court of Justice has also developed a particular exception regime under Article 101(1), directed towards measures of

⁷⁹¹ Article 3 of Regulation 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 (n 6).

⁷⁹² Guidelines on the application of Article 81(3) of the Treaty (n 364), para 11.

⁷⁹³ See Chapter 6, section 6.1.2.

public policy. Given that the room for public policy under Article 101(3) appears narrow and as the antitrust rules also apply to public or semi-public measures, complementary regimes might be necessary. It should be noted, however, that since antitrust provisions are not directly addressed to the Member States, potential exceptions based on public policy are not a given. From that perspective, the fact that the prohibitions set forth in Articles 101 and 102 are aimed at private restrictions may limit the extent to which public policy considerations can be incorporated into antitrust welfare analysis under Article 101(3). However, as noted previously, the increasing reliance on private implementation of public policy and the submission of regulation to the antitrust provisions provides an argument for including public policy in the analysis, either under Article 101(3) or via the development of a stand-alone basis for justification covering public policy measures. Both these possibilities are explored in the subsequent chapters.

To summarise, the interplay between competition policy and other policy areas through exception regimes is problematic and requires further research,⁷⁹⁴ which is the purpose of the subsequent chapters.

4.3 Market Failure and the Normative Framework of EU Antitrust Law

In order to examine the relevance of market failure within the EU antitrust law provisions, it is essential to describe the objectives of the relevant Treaty provisions. Generally, the objectives of any legal provision, whether ultimate or operational, are determinants for both policy and enforcement.⁷⁹⁵ Whilst it is well-established that Articles 101 and 102 TFEU pursue the same legal objectives,⁷⁹⁶ the kaleidoscope of objectives advanced in the scholarship makes the subject perplexing and difficult to navigate. As is shown throughout this chapter, the ‘multi-valued tradition of [EU] competition law’ gives rise to difficult trade-offs

⁷⁹⁴ Andreas Heinemann, ‘Social Considerations in EU Competition Law: The Protection of Competition as a Cornerstone of the Social Market Economy’, in Delia Ferri and Fulvio Cortese, *The EU Social Market Economy and the Law: Theoretical Perspectives and Practical Challenges for the EU* (Routledge, 2019) 123, 139.

⁷⁹⁵ Parret, ‘Shouldn’t We Know What We Are Protecting?’ (n 9) 362-366.

⁷⁹⁶ They seek to achieve the same objectives on different levels, see e.g., Witt, ‘The European Court of Justice and the More Economic Approach to EU Competition Law – Is the Tide Turning?’ (n 7) 174; Case 6/72 *Continental Can* EU:C:1973:22, para 11.

when there are inconsistencies.⁷⁹⁷ A traditional distinction is made in EU antitrust law between economic objectives and non-economic objectives.⁷⁹⁸ Generally, consumer welfare and economic efficiency are seen as economic objectives,⁷⁹⁹ whilst non-economic objectives involve justifications beyond these economic considerations. However, as previously noted, the distinction between economic and non-economic objectives is not clear-cut, and there are diverging views in scholarship.⁸⁰⁰

The first of the following subsections describes the multiple legal objectives present in EU antitrust law beyond consumer welfare and economic efficiency.⁸⁰¹ It highlights that EU competition law may encompass legal objectives beyond the narrow definition of welfare maximisation. In the second subsection, the welfare function in the EU is analysed to evaluate the potential meanings of consumer welfare and efficiency.⁸⁰² Beyond describing these objectives, the different approaches proposed in antitrust scholarship are analysed in order to provide a normative foundation for the subsequent market failure analysis. This subsection demonstrates that whilst consumer welfare has propelled antitrust modernisation in the EU, its definition remains ambiguous due to a lack of consensus on the appropriate welfare standard to adopt.

4.3.1 The Multiplicity of Normative Goals in EU Antitrust Law

As the EU competition provisions do not lay down any explicit policy goal, their normative foundations have been subject to extensive development by competition

⁷⁹⁷ Van den Bergh and Camesasca (n 321) 17.

⁷⁹⁸ e.g., Geradin, Layne-Farrar and Petit (n 315) 19-20. Damian Chalmers, GT Davies and Giorgio Monti, *European Union Law: Text and Materials* (CUP 2014) 942-943.

⁷⁹⁹ e.g., Sauter, *Coherence in EU Competition Law* (n 6) 65. Most scholars support the view that EU antitrust law is founded upon a myriad of possible goals of both economic and non-economic nature. Although there are different understandings as to the 'economic' nature of certain objectives, a general understanding is that these include economic efficiency and consumer welfare.

⁸⁰⁰ See e.g., Geradin, Layne-Farrar and Petit (n 315) 19-24 who considered economic freedom, plurality, consumer choice and fairness as equally economic goals.

⁸⁰¹ This nature of economic efficiency and welfare in economics has been extensively developed in Chapter 2, section 2.1.

⁸⁰² Given their overarching significance, it is widely acknowledged that these objectives exert a direct and pivotal influence on the determination of the applicable welfare standard. See section 4.3.2

law scholarship, yet without any consensus.⁸⁰³ The aim of this section is not to further develop the scholarship in this regard. Nonetheless, outlining the objectives is essential to identify conflicting and contrasting values which might be weighted in the analysis of potential exemptions. Although it is not feasible to give justice to all the possible objectives of EU competition law, it is argued that alongside economic efficiency and consumer welfare, five primary legal goals have been put forward.⁸⁰⁴

First, economic, or market, integration is widely accepted as an EU-specific goal of antitrust policy⁸⁰⁵ and was even previously regarded as the primary goal.⁸⁰⁶ In this context, EU competition law has an integrative effect,⁸⁰⁷ which was emphasised by incorporating undistorted competition among the objectives outlined in the Rome Treaty.⁸⁰⁸ Additionally, it has been asserted that cases such as *Eco Swiss*⁸⁰⁹ or *Courage Ltd v Crehan*,⁸¹⁰ have established convergence between free movement and competition law concerning the substantive

⁸⁰³ On the debate see e.g., Laura Parret, ‘Shouldn’t We Know What We Are Protecting?’ (n 9) 339; Laura Parret, ‘Do We (Still) Know What We Are Protecting?’ (2009) Tilburg Law and Economics Center (TILEC) Discussion Paper No 2009-010; Oles Andriychuk, *The Normative Foundations of European Competition Law: Assessing the Goals of Antitrust Through the Lens of Legal Philosophy* (Edward Elgar 2017). For an empirical study see, Konstantinos Stylianou and Marios Iacovides, ‘The Goals of EU Competition Law: A Comprehensive Empirical Investigation’ (2022) 42(4) Legal Studies 620.

⁸⁰⁴ see e.g., with reservation for divergencies, Geradin, Layne-Farrar and Petit (n 315) 19-26; Conor Talbot, ‘Ordoliberalism and Balancing Competition Goals in the Development of the European Union’ *The Antitrust Bulletin* 2016, Vol. 61(2) 264-289; Jones, Sufrin and Dunne (n 740) 28-35; Lianos, Korah and Sicilliani (n 357) 86-116.

⁸⁰⁵ Ioannis Lianos, ‘Some Reflections on the Question of the Goals of EU Competition Law’ UCL Centre for Law, Economic and Society Research Paper Series 3/2013, I14.

⁸⁰⁶ At this point in time, market integration was an important aim taking precedence over an economic approach prohibiting competitive restrictions, Or Brook, *Non-Competition Interests in EU Antitrust Law: An Empirical Study of Article 101 TFEU* (CUP 2022) 59.

⁸⁰⁷ Petit (n 448) 31.

⁸⁰⁸ Article 3(f) of the Treaty of Rome states that among the goals of the Community was included ‘the institution of a system ensuring that competition in the common market is not distorted’.

⁸⁰⁹ Case C-126/97 *Eco Swiss China Time Ltd v Benetton International NV* EU:C:1999:269, para 36.

⁸¹⁰ Case 453/99 *Courage* (n 80).

assessment of measures, bringing market integration to the forefront of antitrust policy.⁸¹¹

Economic integration is a constitutional goal of competition law which, as put by Sauter, ‘is clearly consistent with a view of the overall external coherence of EU law within the body of EU law as a whole’.⁸¹² However, the interplay between competition and market integration is a complex and multifaceted phenomenon; it could be described as both complementary and interdependent. Within the domain of antitrust law, the internal market aim is particularly evident in relation to barriers to entry, protection against market foreclosure, and prevention of market partitioning. The case law of the Court has shown that the competition provisions not only complement but also expand the objective of creating and maintaining an internal market. Beyond preventing Member States from impeding intra-European trade, it is equally imperative to ensure that firms cannot undermine the internal market objectives by obstructing parallel trade. Although efficiency and consumer welfare have emerged as primary considerations in the Commission’s antitrust enforcement policy, the case law of the Court leaves no doubt that the goal of achieving market integration remains a fundamental tenant of EU antitrust law.

Second, in line with the Ordoliberal heritage, economic freedom has been described as one of the goals of EU antitrust law.⁸¹³ As previously explored in Chapter 3, EU market and competition policy has been significantly shaped by Ordoliberal thinking.⁸¹⁴ From the outset, economic freedom was a pivotal goal as Ordoliberals saw it as complementary to political freedom.⁸¹⁵ In this context, in order for economic freedom to prevail the State must have a strong role in ‘preserving the competitive system’, yet without intrusive government

⁸¹¹ Even if the relationship is far from harmonious, a certain overlap between the objectives of the internal market and competition policy can be observed. See Chapter 1, section 1.2.3.3. On the subject of the question of legal convergence between free movement law and competition law has been subject to extensive research, see, Ehlermann (n 73); Gormley (n 73); Mortelmans (n 29); Nowag, *Environmental Integration in Competition and Free-Movement Laws* (n 73); See also, Protocol n 27 to the Lisbon Treaty.

⁸¹² Sauter, *Coherence in EU Competition Law* (n 6) 73.

⁸¹³ e.g., Nazzini (n 269) 18. For an analysis of the influence of Ordoliberal theories on EU competition law and beyond see, Talbot (n 804).

⁸¹⁴ For an analysis see, e.g., Dale and El-Enany (n 564).

⁸¹⁵ David J Gerber, ‘Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the “New” Europe’ 1993 (42) 1 *The American Journal of Comparative Law* 25, 36.

intervention.⁸¹⁶ Despite its prominence in economic theory, the concept of economic freedom in EU competition law remains elusive. Whilst some scholars, such as Sauter, argue that economic freedom at an individual level relates to promoting some form of choice,⁸¹⁷ its precise meaning is difficult to understand. Economic theory postulates that consumers always act rationally, with the consequence that only one rational choice exists, based on ‘the law of causality, not by the exercise of freedom’.⁸¹⁸ According to Nazzini, economic freedom and the concept of a ‘free market’ is not equivalent to the concept of a competitive market.⁸¹⁹ As such, it would seem that economic freedom alone cannot guarantee the presence of a competitive system. It could, thus, be suggested that whilst economic freedom may facilitate the pursuit of individual preferences and interests, it does not necessarily foster the conditions for unfettered competition and an absence of market failure. In practice, a prioritisation of economic freedom may lead to a broader interpretation of the antitrust provisions, which would encompass virtually all forms of restrictions of competition.⁸²⁰

Third, in alignment with the tenets of economic freedom, an alternative view argues that competition law should safeguard the very structure of competition. This objective might be challenging to distinguish from the welfare objective. The two are deeply intertwined, as a competitive market structure is a fundamental precursor to maximising efficiency and consumer welfare. Thus, the pursuit of a desirable level of workable competition⁸²¹ creates an environment conducive to maximising efficiency and consumer welfare. Market structures are instrumentalised in much the same way as efficiency to achieve the ultimate goal of maximising welfare. However, the key difference between a structure-based approach and an economic efficiency-based approach is rooted in the divergent foci of antitrust policy. Whereas a structure approach prioritises the maintenance of a competitive market structure through the support of market mechanisms, a welfare approach centres on the attainment of optimal outcomes through the

⁸¹⁶ Talbot (n 804) 267.

⁸¹⁷ *Coherence in EU Competition Law* (n 6) 69.

⁸¹⁸ Nazzini (n 269) 18.

⁸¹⁹ *ibid.*, 21.

⁸²⁰ For a similar view see e.g., Parret, ‘Shouldn’t We Know What We Are Protecting?’ (n 9) 348. However, refusal to supply access cases under 102 might also be interpreted as revealing a certain degree of economic freedom.

⁸²¹ See Case 26/76 *Metro I* (n 350), para 20 and Chapter 2, section 2.1.

achievement of efficiency.⁸²² Consequently, under the structure approach, the emphasis is on the process of competition, which is posited to yield optimal social welfare, rather than on individual outcomes. The structure approach has garnered some support in the case law of the ECJ. In cases such as *Continental Can*⁸²³ and *GlaxoSmithKline*,⁸²⁴ the ECJ held that the antitrust provisions are aimed not only at practices which cause direct harm to consumers, but also those which are indirectly detrimental to consumers via their impact ‘on an effective competition structure’.⁸²⁵ These judgments lend credence to the structure approach’s emphasis on preserving competitive market structures as a means of promoting consumer welfare. Nevertheless, other cases have placed the emphasis on prohibiting anticompetitive conduct ‘to the detriment of the public interest, individual undertakings and consumers, thereby ensuring the well-being of the European Union’.⁸²⁶

A fourth proclaimed objective of EU antitrust law is the protection of competitors from undue competitive pressure.⁸²⁷ This objective is far more controversial as it might clash with the efficiency and welfare objectives of competition law. It is important to distinguish between protecting competitors as a proxy for protecting effective competition and economic welfare and simply protecting competitors.⁸²⁸ The latter approach has been rejected by the Court in *Post Danmark I*⁸²⁹ and *Intel*.⁸³⁰ Thus the protection of competitors cannot be

⁸²² Dunne (n 212) 26-29.

⁸²³ Case 6/72 *Continental Can* (n 796).

⁸²⁴ Case C-501/06 P *GlaxoSmithKline Services (GSK) and Others v Commission and Others* (n 78), para 63; Case T-1/16 *Hitachi-LG Data Storage and Hitachi-LG Data Storage Korea v Commission* EU:T:2019:514, para 126.

⁸²⁵ Case 6/72 *Continental Can* (n 796), para 26. That was Article 101 TFEU. But already in Case C-95/04 P *British Airways v Commission* EU:C:2007:166, para 104, the Court held the same with regards to Article 102 TFEU.

⁸²⁶ Case C-52/09 *TeliaSonera AB* EU:C:2011:83, para 22.

⁸²⁷ Eleanor M Fox, ‘We Protect Competition, You Protect Competitors’ (2003) 26(2) *World Competition Law & Economics Review* 149.

⁸²⁸ Jones, Sufrin and Dunne (n 740) 31.

⁸²⁹ Case C-209/10 *Post Danmark* (n 99), para 21, ‘Nor does that provision seek to ensure that competitors less efficient than the undertaking with the dominant position should remain on the market’.

⁸³⁰ Case C-413/14 P *Intel v Commission* EU:C:2017:632, para 133.

interpreted as a shield protecting inefficient firms from the normal course of a market economy.

Nonetheless, a ‘light version’ of the objective of protecting competitors is discernible in the legal framework, specifically in the objective of protecting SMEs. This objective is noticeable in EU competition policy through the Commission Notice on *de minimis* agreements.⁸³¹ Although this objective may conflict with efficiency and economic welfare, this is not necessarily always the case.⁸³² It is suggested that this objective cannot be identified in the case law under Articles 101 and 102.⁸³³

Finally, fairness has been portrayed by some as a goal of EU antitrust law.⁸³⁴ In recent years, Commissioner Vestager has highlighted the significance of fairness as an objective of EU competition policy, stating that ‘there is growing awareness that fairness matters for competition as well as for our societies at large’.⁸³⁵ The fairness objective may be associated with the Ordoliberal perspective of ensuring a level playing field for all undertakings,⁸³⁶ although there is disagreement on the possible link between Ordoliberal values and fairness.⁸³⁷ Parret noted that fairness is a pervasive objective in law as a whole: ‘It is relatively self-evident for a lawyer that fairness or justice is a key driver in any set of legal rules and its application’.⁸³⁸ Whilst fairness may be recognised as a key objective in law, its interpretation and application in specific situations may be complex and

⁸³¹ ‘Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) (De Minimis Notice)’ (n 780).

⁸³² Parret, ‘Do We (Still) Know What We Are Protecting?’ 19 (n 803).

⁸³³ However, in State aid it is a clear policy objective. See e.g., Communication from the Commission, ‘Guidelines on State aid to promote risk finance investments’ (2021/C 508/01).

⁸³⁴ e.g., Geradin, Layne-Farrar and Petit (n 315) 20. Fairness appears also to have been a key-concept in the Treaty of Rome, which in its preamble declare that the Member States recognise the need for ‘fair competition’. In the French version: ‘l’équilibre dans les échanges et la loyauté dans la concurrence’ or in German: ‘Handelsverkehr und einen redlichen Wettbewerb zu gewährleisten’.

⁸³⁵ Margrethe Vestager, ‘Competition policy in a word of fast-evolving technology’, Speech, EUI Florence, May 10 2019; Margrethe Vestager, ‘Competition and fairness in a digital society’ Speech, Brussels, 22 November 2018; Margrethe Vestager, ‘Competition Policy in the Era of Digitisation’ Speech, Chatham House Conference, 3 December 2018. For a deep analysis, see, Niamh Dunne, ‘Fairness and the Challenge of Making Markets Work Better’ (2020) *Modern Law Review* 1.

⁸³⁶ Geradin, Layne-Farrar and Petit (n 315) 20.

⁸³⁷ Jones, Sufrin and Dunne (n 740) 31.

⁸³⁸ Parret, ‘Shouldn’t We Know What We Are Protecting?’ (n 9) 354.

context-dependent. In other words, fairness is not a uniform concept but contextual.⁸³⁹ Fairness might concern both equality in terms of social outcomes and equality of opportunity.⁸⁴⁰ This variability of meaning also applies to EU competition law, where fairness is often limited to the latter. Nazzini defined fairness in competition law as ‘a process in which all participants are given equal opportunities [...]; [w]hat must be fair is the process not the outcome’.⁸⁴¹ This procedural requirement applies to both undertakings, whether as competitors or consumers, as well as to physical consumers.⁸⁴² Procedural fairness, devoid of any redistributive elements (outcome-oriented), appears to overlap, at least partially, with economic freedom. Overall, fairness appears to be narrower than a general distributional policy based on a preconceived notion of fair allocation, although this view may be subject to dispute. Nevertheless, if fairness is understood as the role of distributional concerns in antitrust law, it should be aligned with the promotion of consumer welfare, which we will explore below.

In conclusion, it can be challenging, if not impossible, to determine the significance of all these objectives of EU competition law. It might very well be that all these goals play a part in the EU antitrust ethos through trade-offs and balancing scenarios. The crucial question appears to revolve around the extent to which these objectives can be balanced with consumer welfare and efficiency. To gain a comprehensive understanding of this multifaceted legal field, it is essential to examine the welfare standard in EU competition law, which is the purpose of the following question. The plurality of potential objectives will be borne in mind in the case analysis.

4.3.2 The Multiplicity of Potential Welfare Standards in EU Antitrust Law

This section provides an overview of the normative concepts of welfare and efficiency in EU antitrust law. Such an overview provides the reader with a clarification of the challenges involved in defining a welfare standard in EU antitrust law and the potential implications for a market failure analysis under the antitrust provisions. It is argued that there is no consensus on the appropriate

⁸³⁹ Nazzini (n 269) 21.

⁸⁴⁰ Lianos, Korah and Sicilliani (n 357) 113.

⁸⁴¹ Nazzini (n 269) 22.

⁸⁴² Parret, ‘Shouldn’t We Know What We Are Protecting?’ (n 9) 354.

welfare standard prevailing in EU antitrust law, but there is disagreement between adopting a narrow or a broader standard.⁸⁴³ This disagreement in the scholarship has resulted in divergent interpretations of consumer welfare in EU antitrust law.

The key provision outlining the goals of the EU market project is Article 3(3) TEU:

The Union shall establish an internal market. It shall work for sustainable development of Europe based on a balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.

As highlighted in the above quote, Article 3(3) lacks an explicit welfare objective. However, as previously discussed, despite the absence of a specific welfare goal in the Treaties,⁸⁴⁴ efficiency⁸⁴⁵ and consumer welfare are commonly regarded as chief objectives of EU antitrust law and are at the forefront of the Commission's antitrust policy.⁸⁴⁶ Witt pointed out that the more economic approach is founded upon the premise that consumer welfare is the primary goal of EU antitrust law 'to the exclusion of all other values, save the internal market aim'.⁸⁴⁷ A similar view

⁸⁴³ Anne C Witt, *The More Economic Approach to EU Antitrust Law* (Hart 2016) 80 noted that although most experts would subscribe to the fact that economic welfare is the main objective of antitrust law 'there is some disagreement as to whose welfare'.

⁸⁴⁴ Edith Loozen, 'Strict Competition Enforcement and Welfare: A Constitutional Perspective Based on Article 101 TFEU And Sustainability' (2019) 56 Common Market Law Review 1265, 1271, points out that art 3(3) TEU directly establish a 'market order' without assigning it a specific welfare goal.

⁸⁴⁵ Opinion of AG Wahl in Case C-724/17 *Skanska Industrial Solutions* EU:C:2019:100, para 50: '[...] the real harm caused by illegal restrictions of competition is dead weight loss resulting from such restrictions, that is to say a loss of economic efficiency caused by the anticompetitive conduct in question'.

⁸⁴⁶ e.g., Neelie Kroes, 'European Competition Policy - Delivering Better Markets and Better Choices' Speech of 15 September 2005 (SPEECH/05/512): 'Consumer welfare is now well established as the standard the Commission applies when assessing mergers and infringements of the Treaty rules of cartels and monopolies'. See also Witt, *The More Economic Approach to EU Antitrust Law* (n 843) 80, who noted that '[t]he majority of antitrust experts these days would probably subscribe to the idea that the primary objective of antitrust law is to enhance economic welfare'.

⁸⁴⁷ Witt, 'The European Court of Justice and the More Economic Approach to EU Competition Law – Is the Tide Turning?' (n 7) 177.

of the welfare standard in EU competition law can be seen in the Opinions of former AG, now judge, Wahl:

Fundamentally [...] the realm harm caused by illegal restrictions of competition is the dead weight loss resulting from such restrictions, that is to say a loss of economic efficiency caused by the anticompetitive conduct in question. This means that the harm identified in actions for damages based on an infringement of competition law is in reality a proxy for the economic inefficiencies resulting from the infringement and the corollary loss to society as a whole in terms of reduced consumer welfare.⁸⁴⁸

However, due to the lack of a textual foundation, the legitimacy of a uniform approach based solely on consumer welfare (via the attainment of economic efficiency) has been questioned in scholarship.⁸⁴⁹ This has resulted in a disagreement on the most appropriate welfare standard for EU antitrust law, as well as competition policy more broadly.⁸⁵⁰ There is no unanimous understanding of welfare in EU antitrust doctrine, with several different potential standards proposed. According to Loozen, Article 3(3) TEU gives rise to two divergent interpretations.⁸⁵¹ On one hand, it can be viewed as an implicit reference to a broader welfare standard, encompassing the socio-economic goals of a social market economy, including full employment and environmental sustainability. On

⁸⁴⁸ Opinion of AG Wahl in Case C-724/17 *Skanska Industrial Solutions* (n 845), para 50; Opinion of AG Wahl in Case C-230/16 *Coty Germany GmbH v Parfümerie Akzente GmbH* EU:C:2017:603, para 32. See also Opinion of AG Wahl in Case C-525/16 *MEO - Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência* EU:C:2017:1020, paras 61-62.

⁸⁴⁹ Parret, 'Shouldn't We Know What We Are Protecting?' (n 9), 359 suggested that other goals are still present. For a similar view in more recent scholarship see, e.g., Witt, 'Public Policy Goals Under EU Competition Law - Now Is the Time to Set the House in Order' (n 727), 470; Stylianou and Iacovides (n 803) 620; Christopher Townley, 'Is Anything More Important than Consumer Welfare (in Article 81 EC)? Reflections of a Community Lawyer' (2007) 10 Cambridge YB Eur Legal Stud 345, 346.

⁸⁴⁹ Guidelines on the application of Article 81(3) (n 364), para 7.

⁸⁵⁰ e.g., Or Brook, 'Struggling with Article 101(3) TFEU: Diverging Approaches of the Commission, EU Courts, and Five Competition Authorities' (2019) 56(1) Common Market Law Review 121; Lianos, 'Polycentric Competition Law' (n 730); Townley, 'Is Anything More Important than Consumer Welfare (in Article 81 EC)? Reflections of a Community Lawyer' (n 849); Monti (n 62); Stylianou and Iacovides (n 803).

⁸⁵¹ Loozen (n 844) 1270-1271.

the other hand, a narrower reading, together with Protocol 27,⁸⁵² is possible, which distinguishes the two sentences and prioritises the market order without assigning it to any particular welfare objective.

It is essential to differentiate the meanings of consumer welfare and efficiency in EU antitrust law from their meanings in welfare economics, described in the Chapter 2.⁸⁵³ Antitrust law is not a general tool for regulation but serves a specific purpose, namely to correct market failures relating to market power/imperfect competition.⁸⁵⁴ Therefore, the notion of consumer welfare is correlated to the specific objectives of EU antitrust law. The choice of welfare standard has direct implications for the enforcement of EU antitrust rules. For instance, Article 101(3) includes the vague concept of ‘benefits’, without any definition of which benefits are included.⁸⁵⁵ This vagueness means that the notion can be interpreted differently depending on the welfare standard adopted. This section now explores some possible interpretations of the consumer welfare standard in EU competition law.

The following subsection explicates how the welfare standard in EU antitrust law is conventionally construed in a more limited sense than in welfare economics, primarily due to its narrow focus on short-term price effects in the relevant market. It is examined how a broader welfare standard could better correspond to both a general equilibrium analysis⁸⁵⁶ and a conventional legal balancing test. Finally, the concluding sub-paragraph contextualises these findings within the scope of this research.

4.3.2.1 The Narrow Reading of Welfare in EU Antitrust Scholarship

This subsection explores the legal and theoretical foundations of a narrow reading of consumer welfare in EU antitrust law. The narrow standard of welfare is rooted in a restrictive construal of ‘consumer welfare’. In its Guidelines, the Commission

⁸⁵² Which provides ‘that the internal market as set out in Article 3 [... TEU] includes a system ensuring that competition is not distorted’.

⁸⁵³ See Chapter 2, section 2.1.

⁸⁵⁴ See Chapter 2, section 2.2.1.2; Sauter, *Coherence in EU Competition Law* (n 6) 67-68.

⁸⁵⁵ Brook (n 850) 129. This is further analysed in Chapter 5, section 5.2.2.

⁸⁵⁶ On the notion of a general equilibrium analysis, see Chapter 2 section 2.1.

identifies consumer welfare as the main goal of Article 101 TFEU⁸⁵⁷ – and Article 102 TFEU⁸⁵⁸ – constituting an integral part of a new theory of harm:

The objective of Article 81 is to protect competition on the market *as a means of enhancing consumer welfare* and of ensuring an efficient allocation of resources. Competition and market integration serve these ends since the creation and preservation of an open single market promotes an efficient allocation of resources throughout the Community *for the benefit of consumers*.⁸⁵⁹

Delineating the notion of consumer welfare and its relationship with efficiency is critical. As discussed below, many scholars tend to view efficiency as a derivative of consumer welfare,⁸⁶⁰ albeit an easier one to prove.⁸⁶¹ However, there exists at least a theoretical possibility that these concepts may not always be complementary, resulting in a conflict.⁸⁶² To illustrate this point, Nazzini examined the example of a merger that reduces the costs of the merging undertakings but also enhances their market power.⁸⁶³ Whilst such a merger results in an increase in social or total welfare, it could also lead to a loss of consumer welfare.

Economic efficiency and welfare are not objectives that have been invented by the Commission. As pointed out by Townley,⁸⁶⁴ the ‘unitary objective’ of economic efficiency and welfare is not justified based on any underlying theory,

⁸⁵⁷ Guidelines on the application of Article 81(3) (n 364), point 13; Communication from the Commission, ‘Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements’ (2014/C 89/03), point 5.

⁸⁵⁸ A similar position, placing focus on conduct that harm consumers, has been adopted under Article 102 TFEU, however, without linking the consumer benefit to an efficient allocation of resources. See ‘Guidance on the Commission’s enforcement priorities in applying Article 82’ (n 100).

⁸⁵⁹ Guidelines on the application of Article 81(3) (n 364), para 13.

⁸⁶⁰ e.g., Nazzini (n 269) 33 ‘efficiency is not a stand-alone concept. Efficiency is relative to a given objective. Economic efficiency is relative to the maximization of wealth understood as social welfare’.

⁸⁶¹ e.g., Van den Bergh and Camesasca 43-45 (n 321).

⁸⁶² Motta (n 272) 19; Nazzini (n 269) 38 argued that ‘social’ or total welfare might conflict with consumer welfare.

⁸⁶³ Nazzini (n 269) 38.

⁸⁶⁴ Townley, ‘Is Anything More Important than Consumer Welfare (in Article 81 EC)? Reflections of a Community Lawyer’ (n 849) 346.

rather the Guidelines simply describe the state of the art of the case law.⁸⁶⁵ To understand the concept of welfare in EU antitrust, it is necessary to turn to the case law of the Court. However, the case law appears not to embrace this unitary approach. In cases such as *TeliaSonera*⁸⁶⁶ (Article 101) and *Post Danmark I* (Article 102),⁸⁶⁷ the Court, whilst recognising that direct consumer harm is an important element of antitrust harm, ruled that it cannot be limited to it but must include practices indirectly detrimental to consumers ‘through their impact on competition’ (the competitive structure).⁸⁶⁸ Thus, according to the Court, the relevant welfare standard in EU antitrust law is not limited to direct impact on consumers but encompasses a broader view of indirect impact through distortion of competitive market structures. Whilst the Court appears to reject a singular approach, scholarship suggests that the Court has aligned its case law with the more economic approach and accepts some key principles developed by the Commission in its modernisation framework.⁸⁶⁹

We now shift our focus to examine the theoretical foundations of a narrow approach. The narrow approach to welfare is rooted in traditional neo-classical price theory. The modern ‘mainstream’ approach to competition law largely relies on neoclassical economics and the self-interest paradigm.⁸⁷⁰ If consumer welfare is narrowly viewed as the maximisation of consumer surplus, the analysis is primarily focused on short-term effects on prices in the relevant market. In such a setting, the reliance on economic efficiency as the sole proxy for welfare

⁸⁶⁵ Guidelines on the application of Article 81(3), para 7.

⁸⁶⁶ Case C-52/09 *TeliaSonera AB* (n 826).

⁸⁶⁷ Case C-209/10 *Post Danmark* (n 99).

⁸⁶⁸ *ibid.*, para 20; Case C-52/09 *TeliaSonera AB* (n 826), para 23. This has been reaffirmed by the General Court in Case T-612/17 *Google and Alphabet v Commission (Google Shopping)* EU:T:2021:763, para 153.

⁸⁶⁹ Witt, ‘The European Court of Justice and the More Economic Approach to EU Competition Law – Is the Tide Turning?’ (n 7) 172. To this effect see cases such as, Case C-525/16 *MEO – Serviços de Comunicações e Multimédia SA v Autoridade da Concorrência* EU:C:2018:270; Case C-413/14 P *Intel v Commission* (n 830); Case C-67/13 P *Groupement des cartes bancaires (CB)* EU: C:2014:2204; Case C-32/11 *Allianz Hungária Biztosító and Others* EU: C:2013:160; Case C-209/10 *Post Danmark* (n 99).

⁸⁷⁰ Lianos, ‘Polycentric Competition Law’ (n 730) 170: ‘Modern competition law essentially relies on a theoretical model, that of neoclassical economic, which relies on a de-socialised conception of the individual. In this model the individual loses his emotional and social (professional) identity and is transformed into an automaton operating according to the sole rule-book of self-interest’.

maximisation is the rule.⁸⁷¹ However, it should be noted that consumer welfare is not strictly limited to pure pricing effects,⁸⁷² although this often appears to be prioritised. Instead, consumer surplus is here understood in a tripartite composition from a price, product and innovation standpoint. As put by AG Wahl in his Opinion in *Coty*:

Generally, the competition rules – and Article 101 TFEU in particular – are designed to prevent distortions of ‘competition’, it being understood that competition, which is intended to promote economic efficiency and ultimately the welfare of consumers, must not only permit the introduction of the lowest possible prices but also be a vector for diversity in the choice of goods, the optimisation of the quality of goods and the services provided and also the stimulation of innovation. European competition law does not see price competition as the only possible model.⁸⁷³

Conversely, other scholars maintain that, in practice, the role of non-price values and any trade-offs between these values are purely marginal.⁸⁷⁴ Holmes even characterised a narrow understanding of consumer welfare as essentially based on a ‘neoliberal’ approach and an insufficient analysis rooted in the thinking of the Chicago school, limited to short-term effects on prices.⁸⁷⁵ The narrow approach to welfare is built on two prerequisites.

⁸⁷¹ On the use of efficiency as a proxy for welfare maximization see e.g., Nazzini (n 269) 33.

⁸⁷² This is true for both total and consumer welfare, see e.g., Motta (n 272) 18-19; Bishop and Walker (n 352) 30-32.

⁸⁷³ Opinion of AG Wahl in Case C-230/16 *Coty Germany GmbH v Parfümerie Akzente GmbH* (n 848), para 32.

⁸⁷⁴ For a critique, see Lianos, ‘Polycentric Competition Law’ (n 730) 163-164. who considered that ‘[m]ainstream competition law focuses on consumer welfare, and more specifically the welfare resulting from lower prices, and ignores or only allows a marginal role, for the most part, for the non-price dimensions of competition’. See also, Sauter, *Coherence in EU Competition Law* (n 6) 65, as put by Sauter, ‘if consumer welfare is taken as the pre-eminent value of competition law then the effects of market behaviour on end-user prices are key to demonstrate infringements’.

⁸⁷⁵ Simon Holmes, ‘Climate Change, Sustainability, and Competition Law’ 2020 (8) *Journal of Antitrust Enforcement* 354, 355, 362, 364. However, it should be noted that also scholars in US Antitrust has rejected an overly narrow notion of consumer welfare. See e.g., Eleanor M Fox, ‘The Modernization of Antitrust: A New Equilibrium’ (1981) 66 *Cornell Law Review* 1140, 1174 who argued that contrary to an extremely narrow view of efficiency and consumer welfare, ‘protecting the process of competition among a significant number of rivals in free and open markets, with special regard for long-run consumer interests, is the most appropriate focus for antitrust

The first is a restriction of the scope of consumers to those in the relevant market, including ‘[f]inal and intermediate consumers active in the specific market and affected by the adjudicated transaction’.⁸⁷⁶ A narrow notion of consumers limits the scope of the review, and the potential benefits, to the relevant market. This approach is considered a neoliberal conception, which differs from a more ‘populist’ model of competition law.⁸⁷⁷

The second prerequisite is a general exclusion of external values. Whatever the standpoint on non-price values, a common understanding is that a narrow consumer welfare standard results in the exclusion of any external values to economic efficiency.⁸⁷⁸ In its purest form, consumer welfare in EU antitrust law is a proxy for achieving strict allocative efficiency, meaning that is much more mechanic and static than a broader welfare standard.⁸⁷⁹

However, as highlighted in scholarship,⁸⁸⁰ even a narrow approach to welfare might not be entirely objective in the sense of a Kaldor-Hicks equilibrium. Article 101(3) TFEU directly requires consideration of *consumer* benefits, thereby indicating distributional issues play a key role.⁸⁸¹ Nevertheless, other scholars contend that the notion of consumers makes little difference in respect of maximising consumer and producer surplus. Bishop and Walker, for instance, argued that ‘the welfare standard for [EU] competition law is consumer welfare but that in most cases the distinction is not important because maximizing consumer welfare and maximizing social welfare require the same outcome’.⁸⁸²

economics’. Richard A Posner, *Antitrust Law: An Economic Perspective* (1976) University of Chicago Press) 39-77, 212.

⁸⁷⁶ Lianos, ‘Polycentric Competition Law’ (n 730) 169.

⁸⁷⁷ *ibid.*, 162.

⁸⁷⁸ e.g., Holmes (n 875) 364, Lianos, ‘Polycentric Competition Law’ (n 730) 166-167; Lianos, Korah and Sicilliani (n 357) 92-93.

⁸⁷⁹ Although competition policy can never be something neutral but must be understood with ‘reference to the broader, legal, economic, and social context in which it is applied’, Karel van Miert, ‘Confirmation hearing before the European Parliament (6 January 1995) as described and cited in Brook (n 850) 121.

⁸⁸⁰ Lianos, Korah and Sicilliani (n 357) 93.

⁸⁸¹ *ibid.* See Van den Bergh and Camesasca (n 321) 43 for a similar position. This issue is developed Chapter 5, sections 5.3.1.4, 5.4.1.1.1. and 5.4.1.1.3.

⁸⁸² Bishop and Walker (n 352) 31-32. See also, Motta (n 272) 19.

If these standards most frequently lead to the same outcome, consumer welfare in EU antitrust law can be considered a ‘pragmatic’ criterion. Van den Berg and Camesasca argued that consumer welfare is a pragmatic criterion that is easier to demonstrate than economic efficiency and corresponds neither to Pareto nor Kaldor-Hicks efficiency.⁸⁸³ This perspective almost reverses the conventional relationship between efficiency and welfare,⁸⁸⁴ as it suggests that the sole aim is to achieve an efficient allocation. Such an interpretation of the concept represents a strong form of methodological individualism, yet exclusively from the demand side of the market. In this context, the potential difference between social welfare in the long term and consumer welfare in the short term may precisely stem from a narrow economic focus on preferences. Whilst consumer welfare ignores the welfare produced to the benefit of society and instead primarily focuses on the welfare of consumers, social welfare considers the welfare of all economic agents.⁸⁸⁵ In essence, a narrow standard is based on a more pragmatic or tangible notion of consumer welfare, which focuses on short-term effects and consumer surplus.

A particular problem with an overly narrow standard that is price focused is its tendency to disparage dynamic efficiencies.⁸⁸⁶ To fully understand ‘benefits’ in Article 101(3) from an innovation standpoint, it is imperative to consider dynamic effects and future consumers beyond the relevant market. A narrow view of efficiencies is static, as pointed out by Lianos:

The interest of future ‘consumers’ are assumed to coincide with the revealed preferences of the ‘current consumers’, for instance regarding the direction of innovation that is socially valuable, notwithstanding any evolution of the values presently prevailing in society, the technologies

⁸⁸³ Van den Bergh and Camesasca (n 321) 40–45. In particular, by benchmarking efficiency gains by the requirement that consumer should not be ‘worse off’. However, this is not consistently applied in the policy documents.

⁸⁸⁴ i.e., efficiency serving as a proxy for welfare. See, to this effect, Chapter 2, section 2.1.

⁸⁸⁵ Nazzini (n 269) 40.

⁸⁸⁶ Van den Bergh and Camesasca (n 321) 37 who write ‘If profits are the necessary return on previous innovation or provide the funding for future innovation, consumers will be harmed if antitrust intervention focuses on low consumer prices only’.

available, or of what are the requirements of the rules of the prevailing social contract.⁸⁸⁷

As seen above, the EU judiciary has not yet fully embraced the more economic approach to the antitrust provisions and the primacy of consumer welfare.⁸⁸⁸ Whilst some indications of acceptance, or at very least, adaption, of this approach in new circumstances by the Court have been identified, persistent inconsistencies and challenges remain.⁸⁸⁹ An economic reading of the antitrust provisions focuses on practices detrimental to consumer welfare, with a particular emphasis placed on the anticompetitive impact of such practices, as well as any potential countervailing effects. A narrow conception of consumer welfare within the context of market failure analysis restricts the scope for firms or national authorities to directly, or indirectly, redress market failures beyond those arising from monopolistic or market power dynamics, through the use application of the EU antitrust regime. As a result, such a narrow standard would entail a constrained welfare analysis in the sense of market failure. In such an endeavour, it is virtually impossible to apply a strict general equilibrium analysis in relation to market failure in antitrust law. Adopting a narrow interpretation of consumer welfare as a short-term analysis that disregards factors beyond efficiencies, broader efficiencies beyond the relevant market, distributional improvements, macroeconomic policies and societal benefits beyond price, quality and innovation effects in the relevant market (in particular cross-policy arguments and negative externalities) are excluded.

4.3.2.2 Potential Broader Readings of Welfare in EU Antitrust Scholarship

This subsection delves into the exploration of the legal and theoretical foundations of a broader reading of consumer welfare in EU antitrust law. It is suggested that there are two primary methods for conceptualising a more expansive standard. Firstly, broader efficiencies may be incorporated into antitrust analysis by widening the scope of the provisions (efficiency balancing). Secondly, legal

⁸⁸⁷ Lianos, 'Polycentric Competition Law' (n 730) 175.

⁸⁸⁸ Except for certain specific concepts measuring competitive restrictions such as the as efficient competitor test, see e.g., Case T-286/09 *Intel* EU:T:2022:19, paras 141 and 152 and Case C-209/10 *Post Danmark* (n 99), para 38.

⁸⁸⁹ Witt, 'The European Court of Justice and the More Economic Approach to EU Competition Law – Is the Tide Turning?' (n 7) 172.

balancing can occur outside of the conventional welfare analysis, weighing competition interests against public policy considerations (welfare balancing).

As previously discussed, in terms of its legal foundations EU antitrust law does not explicitly endorse any particular welfare standard. As a result, Article 3(3) TEU could be construed as an implicit reference to a broader welfare standard, one that integrates the socio-economic goals of a social market economy, such as equality and sustainability. The Commission 101(3) Guidelines explicitly state that all public policy goals can only be taken into account ‘to the extent that they can be subsumed under the four conditions of Article [101(3)]’.⁸⁹⁰ However, Townley rightfully argued that there is a general consensus that public policy objectives have been considered within Article 101 and continue to be by the EU judicature and the Commission.⁸⁹¹ The task of outlining the exact legal boundaries of Article 101 falls upon the subsequent chapters. However, it is important to assert that the Treaty foundation for a broad reading stems from an extensive interpretation of Article 3(3).

We now direct our attention toward investigating the theoretical foundations of a broader approach, delving into key scholarly contributions in order to set the scene for the subsequent analysis. Increasingly, the narrow view of consumer welfare is challenged in antitrust scholarship.⁸⁹² As previously discussed, under a narrow reading of competition law, economic efficiency is restricted to the competition-specific vacuum, without taking into account traditional externalities such as pollution. Scholars are now exploring broader perspectives that advocate for a broader consumer welfare standard,⁸⁹³ sometimes pejoratively referred to as ‘hipster antitrust’.⁸⁹⁴ In particular, the issue of incorporating environmental effects

⁸⁹⁰ Guidelines on the application of Article 81(3) (n 364), para 42.

⁸⁹¹ Christopher Townley, *Article 81 EC and Public Policy* (Hart 2009) 346; Heinemann (n 794) 136.

⁸⁹² e.g., Lianos, ‘Polycentric Competition Law’ (n 730) 161.

⁸⁹³ e.g., Townley, *Article 81 EC and Public Policy* (n 891); Lianos, ‘Polycentric Competition Law’ (n 730); Holmes (n 875); Brook (n 850); Monti (n 62).

⁸⁹⁴ A phrase that has emerged fairly recently in Antitrust doctrine to describe a broader standard taking into account objectives beyond efficiency such as privacy or even ‘fake news’, see e.g., Angela Davy, ‘Beyond Hipster Antitrust: A Critical Perspective on the European Commission’s Google Decision’ (2017) 3(1) *European Competition and Regulatory Review* 188; Witt, ‘The European Court of Justice and the More Economic Approach to EU Competition Law – Is the Tide Turning?’ (n 7); Joshua D Wright and others, ‘Requiem for a Paradox: The Dubious Rise and Inevitable Fall of Hipster Antitrust’ (2019) 51(1) *Arizona State Law Journal* 293; Darren Bush,

into Article 101 has been a significant subject of discussion in scholarly literature.⁸⁹⁵ In essence, these broader approaches are based on the premise that it is necessary to broaden the scope to take into account broader social and economic effects beyond short-term price/output effects in the relevant market. Overall, a broader approach could fill ‘the gap in the law’ created by the vague wording of Article 101(3).⁸⁹⁶

First, in some contexts, a broader standard could be understood as a dynamic model of ‘intergenerational’ welfare,⁸⁹⁷ recognising that the benefits of competition extend beyond the present to future generations. One interesting argument for a broader standard is that a narrow approach fails to effectively advance *long-term* social welfare.⁸⁹⁸ Assuming the distinction between short-term and long-term welfare eloquently advanced by Nazzini,⁸⁹⁹ it might very well be that all the alternative goals of competition promote social welfare in the long run through a synergy effect. The emphasis on dynamic efficiency and innovation has sparked discussions regarding the need for a broader approach to address the needs and interests of future consumers,⁹⁰⁰ thereby necessitating a long-term perspective. In contrast, a strictly narrow approach is not conceivable in this respect, to the

‘Consumer Welfare Theory as an Ethical Consideration: An Essay on Hipsters, Invisible Feet, and the “Science” of Economics’ (2018) 63(4) *The Antitrust Bulletin* 509.

⁸⁹⁵ Sustainability and environmental standards are today a well-researched topic in EU antitrust law, see e.g., Holmes (n 875); Nowag, *Environmental Integration in Competition and Free-Movement Laws* (n 73); Giorgio Monti, Jotte Mulder, ‘Escaping the Clutches of EU Competition Law: Pathways to Assess Private Sustainability Initiatives’ (2017) 42(5) *European Law Review* 635; Oles Andriychuk, ‘The Concept of Sustainability in EU Competition Law: A Legal Realist Perspective’ (2021) 23 *Yearbook of Antitrust and Regulatory Studies* 11; J Malinauskaite, ‘Competition Law and Sustainability: EU and National Perspectives’ (2022) 13 *Journal of European Competition Law and Practice* 336; Idris Abdelkhalek, ‘Sustainable Development in the EU - Which State of Play in Competition Law?’ (2022) 18 *European Competition Journal* 532; Cento Veljanovski, ‘The Case against Green Antitrust’ (2022) 18 *European Competition Journal* 501; Simon Holmes and Michelle Meagher, ‘A Sustainable future: how can control of monopoly power play a part? Part1. Monopoly power: a barrier to a sustainable future’ *European Competition Law Review* (2023) 44(1) 16; Mariska van de Sanden and Wolf Sauter, ‘Greening Antitrust: The Dutch and EU Assessment of Sustainability Agreements’ (2023) 37(2) *Antitrust* 32.

⁸⁹⁶ Brook (n 850) 129.

⁸⁹⁷ Christopher Townley, ‘Inter-Generational Impacts in Competition Analysis: Remembering Those Not Yet Born’ 2011(11) *European Competition Law Review* 580.

⁸⁹⁸ e.g., Nazzini (n 269) 33.

⁸⁹⁹ *ibid.*, 39.

⁹⁰⁰ Townley, ‘Inter-Generational Impacts in Competition Analysis: Remembering Those Not Yet Born’ (n 897). See also Julian Nowag, ‘Competition Law’s Sustainability Gap? Tools for an Exemption and Brief Overview’ (2019) *Lund University Legal Research Papers Series*.

extent that short-term price effects are prioritised without including trade-offs between static and dynamic efficiency. A truly narrow approach, therefore, fails to promote the tripartite notion of efficiency as presented above.

Second, in other contexts, such a standard could offer a framework to tackle market failures beyond market power, such as broader efficiencies. This matter is explored in greater detail below.

However, a broader understanding of consumer welfare presents a multitude of both methodological and substantive obstacles. The legitimacy of private implementation, and to a certain extent even formulation, of public policy remains unresolved. In addition, one key issue is that a broader standard could be seen as a means of promoting specific public policy, carrying the risk of undermining the effectiveness of the antitrust provisions. As seen above, there is a recognition of the potential relevance of public policy in the Guidelines on Article 101(3).⁹⁰¹ However, the challenge lies in the unclear relationship between public policy and the realisation of narrow competition law-specific efficiencies. Loozen captured this tension when distinguishing between *competition* policy and *public* policy within antitrust analysis.⁹⁰² Whilst the exclusion of non-competition values from the analysis might appear to align with legitimacy expectations and institutional balance, the presence of a non-competition market failure provides an argument for including non-competition values in the analysis in order to maximise consumer welfare. Nevertheless, the challenge lies in maintaining the integrity of the competition regime, making sure that antitrust law does not become ‘the law of everything’.⁹⁰³

On a methodological level, there is a lack of consensus on how a broader standard could be formulated. It is suggested that current scholarship presents two alternative views, each with several variations.

The first perspective entails a ‘simple’ broadening of the consumer welfare standard allowing the inclusion of non-pricing objectives or even public policy (e.g., equality or sustainability). This approach involves integrating non-pricing concerns in the overall efficiency assessment, with a particular emphasis on

⁹⁰¹ Guidelines on the application of Article 81(3) (n 364), para 42.

⁹⁰² Loozen (n 844) 1278-1279.

⁹⁰³ Lianos, ‘Polycentric Competition Law’ (n 730) 212.

dynamic efficiency, which is achieved through the quality assessment of the improvement of competition.

The second perspective suggests a broader test that would take the shape of a trade-off scenario between consumer welfare on one hand and non-competition values on the other (which are not subsumed within the concept of efficiency). This standard would enable the expansion of the test beyond the improvement of efficiencies and encompass other societal objectives, such as public policy considerations. Whilst there may be some overlap between efficiency and other goals from an economic perspective,⁹⁰⁴ a broad interpretation would include objectives beyond efficiency as understood in EU antitrust law.

It is argued that both tests require a trade-off exercise reminiscent of a market failure, achieved via different forms of balancing. The first perspective employs an efficiency balancing mechanism, whilst the second involves a welfare-balancing approach. However, both perspectives are extremely difficult to put into practice. For instance, which parameters can be used to balance between environmental externalities and consumer surplus? Even if we conceive a broader notion of consumer welfare encompassing broader efficiencies, a balancing exercise, often including qualitative parameters,⁹⁰⁵ is required.

In sum, a common element among the different perspectives is that a broader standard would extend beyond the traditional focus on improving competition efficiencies within the relevant market and instead provide a tool for crossing policies. This would involve an examination of both positive (e.g., innovation, sustainability) as well as negative externalities (e.g., pollution, inequality). These views represent a shift from a singular view of efficiency and welfare, as well as competition policy in general, towards a diversification of values and inevitable trade-off scenarios. From a welfarist perspective, such an interpretation is justifiable. This section now highlights some key scholarly contributions suggesting a broader approach to antitrust analysis.

Lianos convincingly captured the shortcomings of a narrow view and proposed various strategies for a model of ‘polycentric competition law’, as

⁹⁰⁴ Lianos, Korah and Sicilliani (n 357)114 ff: This can go for the internal market objective if it is to be understood as efficient trade; even fairness might be incorporated under Bergson and Samuelson’s social welfare function if we understand it as distributive justice.

⁹⁰⁵ On qualitative efficiencies see, Guidelines on the application of Article 81(3) (n 364), paras 69-72.

opposed to a monocentric vision of competition law.⁹⁰⁶ These different strategies capture the tensions between non-competition and competition values within the monocentric model. A monocentric vision largely corresponds to the narrow view of consumer welfare described above. It generally excludes values such as sustainability or social welfare and employment.⁹⁰⁷ Other areas are in the ‘grey zone’, such as fairness or privacy.⁹⁰⁸ The argument is that a monolithic model of competition law is insufficient for adequately addressing issues such as innovation, privacy or environmental protection. He argued that:

[O]ne needs to adopt a broader perspective than the specific ‘game’, a perspective that integrates other considerations, and goes beyond those generally considered to be of direct interest to the ‘representative consumer.’⁹⁰⁹

Polycentric competition law has been described by Lianos as follows:

Behind this epithet lies a twofold strategy: (i) enhancing the cognitive openness of competition law so that it can address the multilevel strategies to restrict competition that are expected to unfold in a complex economy, and (ii) accounting for the diversity of values or orders of worth in productive friction in society by preserving and promoting spaces of polycentricity (or polyarchy).

The second strategy involves reconsidering competition law in a manner that better reflects the idea of polycentricity.⁹¹⁰ This approach would abandon consumer welfare as the sole criterion ‘determined by a narrow price-based revealed preferences approach’.⁹¹¹ Instead, it would replace the focus on efficiency with a focus on ‘systemic resilience’,⁹¹² which refers to a competition system that

⁹⁰⁶ Lianos, ‘Polycentric Competition Law’ (n 730).

⁹⁰⁷ *ibid.*, 178, to the extent that they can be subsumed under the four conditions of Article 101(3) TFEU.

⁹⁰⁸ *ibid.*

⁹⁰⁹ *ibid.*, 185.

⁹¹⁰ *ibid.*, 208.

⁹¹¹ *ibid.*, 209.

⁹¹² *ibid.*, 210.

focuses ‘on the structural position of the various stakeholders across fields’.⁹¹³ This would provide competition authorities with a wider margin to include values beyond short-term price effects in their analysis. This model can be implemented either by a trade-off scenario between competition interest and other values or by integrating a multi-value function into antitrust analysis itself, thereby extending the scope of antitrust analysis.

Similarly, Holmes argued for a broad, or ‘maximalist’, standard of consumer welfare that takes into account environmental benefits based on different possible strategies.⁹¹⁴ According to him, consumer welfare should be given a broad interpretation as part of a wider set of objectives promoting both the competitive process and the chief objectives of the Treaty, including sustainability.⁹¹⁵ He presented several options for achieving this objective in the context of exempting an agreement falling under Article 101(1) that promotes sustainability. The most obvious way, according to Holmes, is to exempt it under Article 101(3) by adopting a broad consumer welfare standard.⁹¹⁶ This approach requires a balance of interest beyond consumer surplus and short-term price effects through the proportionality assessment contained in Article 101(3).⁹¹⁷

Nowag proposed two different modes of integrating external objectives, using sustainability measures as an example.⁹¹⁸ Public policy measures can be integrated by either excluding them from (referred to as a ‘shield’ or ‘supportive integration’) or including them within (referred to as a ‘sword’ or ‘preventive integration’) the scope of competition law.⁹¹⁹ When falling within its scope, these measures can be either exempted or prohibited via a balancing exercise. Nowag argued that sustainability is only relevant where it ‘fits within [the] consumer welfare framework [...] [which] it does to a considerable extent’.⁹²⁰ Thus, rather

⁹¹³ *ibid.*

⁹¹⁴ Holmes (n 875).

⁹¹⁵ *ibid.*, 364.

⁹¹⁶ *ibid.*, 371-382.

⁹¹⁷ *ibid.*

⁹¹⁸ Nowag, ‘Competition Law’s Sustainability Gap? Tools for an Exemption and Brief Overview’ (n 900). See also, Nowag, *Environmental Integration in Competition and Free-Movement Laws* (n 73).

⁹¹⁹ *ibid.*, 5.

⁹²⁰ *ibid.*, 10.

than balancing between consumer welfare on the one hand and short-term effects on the other, sustainability measures are incorporated within the same set of analyses through an extension of the quality parameter of consumer welfare,⁹²¹ as a benefit under Article 101(3). However, beyond environmental integration, such a model may face certain difficulties as it leaves little room for exemption under Article 101(3) for non-competition values, as alternative modes of integration are given priority.

Townley suggested two different methods of balancing. The first method involves a legal balancing test, rather than integrating a broader consumer welfare standard into the competition assessment. In this respect, Townley proposed a more straightforward trade-off model, allowing for the balancing of public policy and competition ‘outside’⁹²² of the consumer welfare and economic efficiency analysis (‘mere balancing’).⁹²³ However, the tension between a broader trade-off assessment and the consumer welfare test in Article 101(3) is not ignored. Townley also proposed that an internal method on the basis of consumer welfare (‘market balancing’) is, to a certain extent, possible under either 101(1) or 101(3), in particular by adopting a general equilibrium analysis beyond the relevant market.⁹²⁴

In summary, this section highlights that there is no consensus on the shape of a broader welfare analysis in EU antitrust law. The proposed strategies range from broadening consumer welfare to adopting a trade-off scenario between competition and non-competition values or even adopting a polycentric model of competition law. Additionally, the section has shown that the proposed approaches vary in their level of integration of non-competition values and the extent to which they depart from the traditional narrow view of consumer welfare. Given these doctrinal disagreements, it is clear that there is a lack of consensus on the contours

⁹²¹ i.e., consumer welfare understood as an improvement of prices, quality (improved product) or variety of products. This is the approach taken by the Guidelines on the application of Article 81(3) (n 364) when determining both quantitative and qualitative benefits, see Chapter 5, section 5.2.2.2.1.

⁹²² i.e., the balancing does not take place within the parameters of Article 101(3) according to a cost-and-benefit model.

⁹²³ See, Townley, *Article 81 EC and Public Policy* (n 891) 175.

⁹²⁴ *ibid.*, 177 ff. See also, Townley, ‘Is Anything More Important than Consumer Welfare (in Article 81 EC)? Reflections of a Community Lawyer’ (n 849).

of a broader welfare analysis in EU antitrust law. However, it is important to contextualise these findings within the market failure framework of this research.

4.4 Conclusions: The Impact of the Narrow-Broad Spectrum on Market Failure Analysis

This chapter has described and analysed both the legal and theoretical framework of the EU antitrust provisions. By examining the legal framework, it has established two distinct avenues for justification of policy intervention: legal qualification and legal justification. Specifically, whilst the primary provision for exemption is anchored in Article 101(3) TFEU, the chapter has identified possibilities for exemption beyond this provision, including exemptions for entities not qualified as undertakings under Article 101(1). Further, the ECJ has elaborated a specific doctrine under Article 101(1) that contributes to a nuanced dual regime, which will be explored in detail in subsequent chapters focusing on Articles 101(3) and 101(1) respectively.

This chapter has also analysed the theoretical foundations of EU antitrust law, with particular emphasis on the various proposed welfare standards in EU competition law scholarship. It is now important to encapsulate and contextualise these standards within the scope of this research. It is clear from the above that the relationship between market failure and consumer welfare remains enigmatic. As put by Esposito:

What is the relation between consumer sovereignty and market failures? The answer to this question is important since the perfect competition model is used as a benchmark to assess what happens when one or more of its assumptions do not hold.⁹²⁵

It would appear that an approach exclusively based on consumer welfare cannot sufficiently account for market failures beyond imperfect competition, at least not if the notion is narrowly construed. The analysis above has identified two prevailing standards of consumer welfare in EU antitrust scholarship.

⁹²⁵ Fabrizio Esposito, *The Consumer Welfare Hypothesis in Law and Economics: Towards a Synthesis for the 21st Century* (Edward Elgar 2022) 33.

First, some scholars have suggested a narrow consumer welfare standard for EU competition law,⁹²⁶ which tends to focus on short-term price effects. Loozen defended this narrow welfarist reading by arguing that ‘the market’ and ‘the state’ are separate institutions used to enhance welfare,⁹²⁷ and thus public policy intervention should take place outside of antitrust law. However, this claim is not necessarily based on the possibility of competition law to maximise welfare in the sense of market failure theory. Rather, it would appear to be based on a conceptual separation between the market and the State, and the idea that competition law only applies to the former.⁹²⁸ However, this claim can be debunked since the Court does apply Articles 101 and 102 TFEU in conjunction with the loyalty clause to state legislation.⁹²⁹ It is suggested that the notion that the market and the State are separate and mutually exclusive entities with distinct competences in terms of welfare enhancement is flawed. This is not to suggest that there is no separation between the market and the State, but rather that this separation is not absolute and can sometimes be blurred. As discussed earlier, these institutions are often conceived as complementary social orders within the promotion of economic welfare.⁹³⁰ The default mode of EU competition law reflects this approach,⁹³¹ wherein the market institutions maximise economic welfare once market failures have been remedied (by public policy intervention).⁹³² Additionally, Loozen suggested establishing a separation between market power and other market failures, with the latter being addressed primarily through sectorial regulation (a ‘dualistic’ institutional balance.)^{933, 934} In sum, a narrow welfarist approach restricts the role of antitrust to the remedy of market power with the exclusion of any broader market failure analysis. Within that approach, there is no room for public policy interventions beyond the enforcement of the antitrust provisions.

⁹²⁶ e.g., Loozen (n 844); Odudu (n 298).

⁹²⁷ Loozen (n 844) 1273.

⁹²⁸ *ibid.*, 1278.

⁹²⁹ See Chapter 4, section 4.2.1.2.

⁹³⁰ See Chapter 2, section 2.1.

⁹³¹ See Chapter 3, section 3.1.2.

⁹³² The role of remedying market failure is also recognised by Loozen (n 844) 1273.

⁹³³ *ibid.*, 1275.

⁹³⁴ *ibid.*, 1274.

Thus, any market failure considerations would be limited to the remedy of market power/imperfect competition.

Second, antitrust scholarship has suggested a broader welfare standard for EU competition law.⁹³⁵ This claim is supported by the argument that public policy objectives have been considered in the case law of the Court.⁹³⁶ Whilst a counterargument could be that these are specific State-like exceptions outside the general framework of competition law, the increasing reliance on private actors to implement public policy supports the need to bridge between State exceptions and antitrust law balancing.

A broad consumer welfare standard can take different shapes: it can incorporate public policy perspectives in an internalised analysis or provide a broad balancing test between competition and non-competition values. In an internalised analysis, broader market failures can be remedied on the basis of an overall increase in economic welfare. For instance, Townley took the example of supermarkets entering into a price-fixing agreement to reduce the availability of alcohol based on public health,⁹³⁷ which constitutes a market failure resulting in negative externalities. An internalised analysis would incorporate public health considerations into the efficiency assessment going beyond short-term price effects in the relevant market. The positive effects of the price-fixing agreement on public health would be balanced against the negative effects on competition, in order to determine whether overall welfare is improved. Under this approach, a market failure test is applied through an efficiency-based balancing of various factors to maximise overall welfare.

The shape of a broader external analysis is less defined. Such an approach involves balancing the restriction of competition with public policy intervention outside of the scope of a welfare analysis. As it balances goals beyond welfare maximisation with consumer welfare, any market failure test would only be implicit. Nonetheless, a broader standard has its shortcomings, primarily due to

⁹³⁵ e.g., Townley, 'Is Anything More Important than Consumer Welfare (in Article 81 EC)? Reflections of a Community Lawyer' (n 849); Holmes (n 875); Lianos, 'Polycentric Competition Law' (n 730); Nowag, 'Competition Law's Sustainability Gap? Tools for an Exemption and Brief Overview' (n 900).

⁹³⁶ This issue is further analysed in Chapter 5, section 5.2.2.1.2.

⁹³⁷ Townley, 'Is Anything More Important than Consumer Welfare (in Article 81 EC)? Reflections of a Community Lawyer' (n 849) 348.

the uncertainty and fragmentation created by the imprecise delineation of such a public policy framework.⁹³⁸

In conclusion, the determination of the appropriate welfare standard for EU antitrust policy is a highly political and ideological choice. This research does not argue for either approach, but instead describes and analyses the current framework. It is evident that the choice between a welfarist approach and a balancing approach has direct consequences for the relevance of market failure theory and the role of public policy intervention in EU competition law. Furthermore, it should be noted that the choice of a broad versus a narrow standard is not necessarily a choice between the market and the State, but rather a choice of how these two institutions interact with each other.

The following chapters examine the antitrust provisions within the framework defined in Chapter 3, taking into account the issues of a broad or narrow reading and the divide between the State and the market. These considerations are crucial not only to determine whether these provisions contain a market failure analysis but also to reveal any potential differences in treatment between public and private measures implementing public policy.

⁹³⁸ In particular, it is argued that this might light to fragmented competition law framework with national divergencies. On the autonomous development of national competition law regimes in this regard see e.g., Malinauskaite (n 895).

5. MARKET FAILURE IN ANTITRUST LAW: ARTICLE 101(3) TFEU

This chapter analyses the existence of a potential market failure test under Article 101(3) TFEU. The central argument is that failure can offer a partial explanation for public policy intervention under Article 101(3) TFEU. However, due to certain limitations inherent in competition law analysis, Article 101(3) cannot be considered as incorporating a proper market failure test as outlined in Chapter 3. Instead, the test under Article 101(3) encompasses a competition-oriented partial market failure test.

In the previous chapter, it was established that Article 101(3) TFEU provides a means to justify agreements that would otherwise be prohibited under Article 101(1) TFEU.⁹³⁹ Contrary to the legal qualification exercise under Article 101(1),⁹⁴⁰ Article 101(3) constitutes a true legal exception for anticompetitive agreements.⁹⁴¹ As such, Article 101(3) functions as a tool of *justification* rather than *qualification*, requiring a balancing exercise. As Brook noted, it is within the framework of Article 101(3) that non-competition interests (broader efficiencies or external objectives) have traditionally been considered (and *a fortiori* competition interests).⁹⁴² The preceding chapter analysed the theoretical foundations of Article 101(3) with the aim to determine whether justification could potentially include a broader welfare analysis. This chapter shifts focus to the interpretation and application of Article 101(3) by the Commission and the Courts.

⁹³⁹ Thus, it does not cover de minimis or block-exempted agreements which are seen as not contrary to Article 101(1) TFEU. See Chapter 4, section 4.2.2.

⁹⁴⁰ Which is examined in Chapter 6.

⁹⁴¹ e.g., Whish and Bailey (n 440) 155.

⁹⁴² Brook (n 806) 93. See e.g., Case C-243/83 *Binon* EU:C:1985:284, para 43-46 and Case C-382/12 *P MasterCard and Others v Commission* (n 593), para 181.

Additionally, it examines the evolution of this Article and its potential to incorporate a market failure analysis in practice.

This chapter starts with a description of the text and theory of Article 101(3), followed by an investigation of its application in practice. This process involves an overview of how the EU Courts and the Commission have applied the criteria of Article 101(3). Subsequently, the findings from that analysis are evaluated to determine whether Article 101(3) incorporates a market failure analysis and to understand the value of such an analysis under this provision.

These findings ultimately suggest that whilst Article 101(3) cannot include a proper market failure test, such an analysis nonetheless holds relevance in interpreting and understanding a broader application of the provision. Furthermore, there are indications of a potential paradigm shift with respect to certain efficiencies, which were previously excluded from the analysis under Article 101(3). Evidence of this shift can be discerned in the soft law.

5.1 Article 101(3) in Theory: The Text and Criteria

According to Article 101(3) TFEU:

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Constituting an exception to the principal prohibition, Article 101(3) corresponds to a concern of overenforcement,⁹⁴³ or so-called type I errors.⁹⁴⁴ The underlying rationale of Article 101(3) is rooted in economic principles. It recognises that certain agreements or clauses that restrict competition may still be seen as efficiency-enhancing and should therefore be excepted from the application of Article 101(1).

Four criteria can be deducted from the text of Article 101(3). Firstly, justification is possible for an agreement ‘which contributes to improving the production or distribution of goods or promoting technical or economic progress’ (the ‘benefit criterion’). Secondly, the agreement(s) or the clause(s) must provide the ‘consumers’ with a ‘fair share of the benefits’ (the ‘fair share criterion’). Thirdly, the restrictions of competition must be indispensable in order to obtain these benefits (the ‘necessity criterion’). Finally, the agreement cannot lead to an elimination of competition in a substantial part of the relevant market (the ‘no elimination criterion’). These criteria are systematically dismantled and analysed in the upcoming sections. They largely correspond to three fundamental issues for the purpose of a market failure analysis.

The first issue revolves around determining what type of benefits can be invoked under Article 101(3) (its material scope). This issue is examined through a description and analysis of the notion of ‘benefits’ under Article 101(3) in section 5.2.2.

The second issue pertains to the boundaries of Article 101(3), i.e., its potential to incorporate a broader analysis for market failure. In essence, the question is whether the analysis is confined to the relevant market (partial equilibrium) or whether a broader test can encompass other or all market failures (general equilibrium). In Section 5.2.3 this issue undergoes examination from the perspectives of both the benefit criterion and the fair share criterion.

The importance of the fair share criterion in the analysis calls for further explanation. In one aspect, this criterion corresponds to the ‘functional scope’ of Article 101(3). This functional scope determines the utilitarian function of Article 101(3): either as a welfare economic balancing act or as a mechanism that includes redistributive aspects, essentially the transfer of wealth between producers and consumer groups. On the flip side, the scope of the fair share criterion itself is also

⁹⁴³ Geradin, Layne-Farrar and Petit (n 315) 62.

⁹⁴⁴ Friederiszick, Röller and Verouden (n 340) 631, ft. 27.

important for defining the precise boundaries of the analysis under Article 101(3). Here, it becomes curial to establish how the consumer receives this fair share (directly or indirectly) and in which capacity (as a consumer of a product/service or as a citizen?). A pivotal issue to address is whether this criterion is restricted to the consumers in the relevant market alone. Given the ambiguity surrounding the precise meaning of the fair share criterion, it is more closely examined in Section 5.2.4.

The third and final issue relates to determining the existence of a market failure test under Article 101(3) via the analysis of the proportionality principle in the legal field. As explained in Chapter 3, it is via the principle of proportionality that market failure can take the shape of a legal principle. This issue will be examined from the lens of the ‘necessity’ and the ‘no elimination’ criteria in Section 5.2.5.

5.2 Article 101(3) in Practice: Case Law and Decisional Practice of the Commission

This section provides an examination and analysis of the application of Article 101(3) by both the Commission and the EU Courts.

The first subsection delineates the limited nature of review under Article 101(3) and outlines the requirements imposed by the Court within that provision. For our analysis, it is important to ascertain the precise powers of the Commission under Article 101(3) TFEU. The second subsection delves into the description and analysis of the ‘benefit criterion’. Followingly, the boundaries of the analysis under Article 101(3) are explored via both the benefit criterion and the ‘fair share criterion’. Thirdly, the functional scope of Article 101(3) is studied through the notion of ‘fair share’. Finally, the proportionality analysis is examined to determine the existence of a legal market failure test under Article 101(3).

5.2.1 Legal Requirements and Discretionary Ambit of Article 101(3)

In assessing the role of market failure, a vital factor is to determine the level of discretion and judicial scrutiny involved.⁹⁴⁵ Even if the Commission possesses a large margin of discretion under Article 101(3),⁹⁴⁶ the Court of Justice has formulated a set of principles for the balancing exercise.⁹⁴⁷ These principles, whilst minimal in nature, work as constraints on the Commission's discretion when undertaking complex economic assessments under Article 101(3) TFEU.

5.2.1.1 Case Law Paralysis under Article 101(3)?

First, when analysing the legal requirements, it becomes apparent that the development of case law principles under Article 101(3) TFEU is limited, also at the national level of Member States.⁹⁴⁸ Lianos, Petit and Walle de Ghelcke explained that this lack of judicial guidance in the national legal orders is based on two factors: (i) the competences given by Article 5 of Regulation 1/2003; and (ii) the nature of private enforcement before national courts.⁹⁴⁹ In particular, Article 5 prevents so-called 'positive decisions', i.e., exemption decisions, and in private enforcement, despite the full jurisdiction given to national courts, the provisions of Article 101(3) will only be invoked as a defence.⁹⁵⁰ However, it would appear that the rationale for this void is more extensive. The case law of the CJEU also remains relatively sparse, providing national courts and NCAs with only minimal guidance on the application of Article 101(3). Moreover, in contrast to the internal market provisions, the development of EU competition policy remains within its exclusive competence.⁹⁵¹ Consequently, the Court of Justice's guidance is indispensable for national courts and authorities in determining *which* objectives may be considered under that provision and *how* to perform the

⁹⁴⁵ See Chapter 3, section 3.3.5.

⁹⁴⁶ e.g., Case 26/76 *Metro I* (n 350), paras 45 and 50.

⁹⁴⁷ Brook (n 806) 55.

⁹⁴⁸ Which in turn leads to less case law development by the Court of Justice via the preliminary ruling procedure.

⁹⁴⁹ Ioannis Lianos Nicolas Petit and B Walle de Ghelcke, 'The Effects-Based Approach in Article 101 TFEU' in Massimo Merola and Denis Waelbroeck (Eds), *Towards an Optimal Enforcement of Competition Rules in Europe* (Bruylant 2010) 467.

⁹⁵⁰ *ibid.*

⁹⁵¹ Article 3(1)(b) TFEU. The Union shall have exclusive competence for 'the establishing of the competition rules necessary for the functioning of the internal market'.

balancing act. Despite the significant discretion afforded to national courts and authorities when applying Article 101(3),⁹⁵² the lack of guidance may be detrimental to the effective application of this provision.

Second, the limited scope of review entails that the CJEU may only intervene in the case of manifest error of appreciation, given the high margin of discretion afforded to the Commission.⁹⁵³ This suggests that the substantive assessment of Article 101(3) is largely based on economic reasoning, thereby leaving less room for the development of legal principles.⁹⁵⁴

5.2.1.2 The Key Requirements in Legal Review

The broad notions in Article 101(3) TFEU reinforces the Commission's discretion when applying that provision. In particular, the first criterion of Article 101(3), namely that 'the agreement must lead to an improvement in the production or distribution of goods or the promotion of technological or economic progress', has been subjected to a plethora of interpretations regarding the nature of benefits and the role of economic efficiency.⁹⁵⁵ As previously highlighted, this condition can be interpreted as implying either a narrow or a broad assessment.⁹⁵⁶ However, two minimum criteria can be observed in the case law of the Court of Justice.

First, the Court of Justice has abstained from providing a material definition of 'benefits', offering only minimal guidance on its *objectivity*. What is unambiguous from case law is the exclusion of subjective benefits.⁹⁵⁷ This implies that any benefits under Article 101(3) must demonstrate 'appreciable objective advantages of such character as to compensate for the disadvantages which they cause in the field of competition'.⁹⁵⁸ Subjective benefits can be interpreted as objectives benefiting exclusively the parties to the agreement. For instance, in *Mastercard*, one argument put forward was that the measure under scrutiny optimised the card payment system itself, to which the parties were connected, by rendering it more efficient for the connected banks (i.e., the parties to the

⁹⁵² Lianos, Korah and Sicilliani (n 357) 641.

⁹⁵³ This was recognised early in Case C-56/64 *Consten and Grundig* (n 946), para 347.

⁹⁵⁴ For an analysis see e.g., Hjältström and Nowag (n 618).

⁹⁵⁵ Lianos, Korah and Sicilliani (n 357) 645-646.

⁹⁵⁶ See Chapter 4, section 4.3.2.

⁹⁵⁷ Case C-56/64 *Consten and Grundig v Commission* (n 946), para 49.

⁹⁵⁸ *ibid.*, 13; Case T-705/14 *Unichem Laboratories* EU:T:2018:915, para 418.

agreement).⁹⁵⁹ The Court clarified that the identification of the benefit cannot be based on the advantages that the agreement produces to its parties regarding production or distribution activities.⁹⁶⁰ The objective benefit must generate effects beyond those procured by the parties to the agreement, in line with the fair share criterion.⁹⁶¹ Additionally, the causality requirement is rather stringent as the burden of proof invariably rests on the party claiming the application of Article 101(3).⁹⁶²

Second, there are more tangible limitations to the discretion of the Commission when assessing potential benefits. In *GSK*,⁹⁶³ the General Court held that the Commission must examine ‘whether the factual arguments and the evidence submitted to it, show, in a convincing manner, that the agreement’ enables objective advantages.⁹⁶⁴ The General Court continued:

That approach may entail a prospective analysis, in which case it is appropriate to ascertain whether, in light of the factual arguments and the evidence provided it seems more likely either that the agreement in question must make it possible to obtain appreciable advantages or that it will not.⁹⁶⁵

Thus, it is not mandatory to irrefutably demonstrate that objective benefits will arise; the *likelihood* of benefits is sufficient. This can be contrasted with the ECJ’s ruling in *Grundig & Consten*, where the Court required the ‘advantages [... to be] generally indisputable’.⁹⁶⁶

However, even if the Court has shown a certain flexibility concerning the certainty of the production of the benefits, Article 101(3)(b) requires that the restriction must be strictly indispensable for the realisation of the benefits, which

⁹⁵⁹ Case C-382/12 P *MasterCard* (n 593), para 233.

⁹⁶⁰ *ibid.*, para 234.

⁹⁶¹ An issue closer examined in section 5.2.4 of the current chapter.

⁹⁶² e.g., Case T-472/13 *Lundbeck* EU:T:2016:449, para 709.

⁹⁶³ Case T-168/01 *GlaxoSmithKline Services Unlimited v Commission* EU:T:2006:265 upheld by the ECJ in Case C-501/06 P *GSK* (n 78).

⁹⁶⁴ Case C-501/06 P *GSK* (n 78), para 248.

⁹⁶⁵ *ibid.*, para 249.

⁹⁶⁶ Case C-56/64 *Consten and Grundig* (n 946), para 49.

must produce an overall net surplus of positive effects (double market failure).⁹⁶⁷ In this perspective, Article 101(3) assumes the form of a traditional CBA.

In conclusion, the case law requirements are minimal. It is apparent that Article 101(3) only covers ‘objective’ benefits, which must extend beyond mere advantages for the agreement’s parties to also benefit consumers, consistent with the fair share criterion. Whilst not explicitly clarified in case law, the likelihood of benefits is arguably sufficient to meet the requirements of Article 101(3).

5.2.2 The Material Scope and Reach of Article 101(3)

From the discussion above, it is clear that uncertainty pervades the understanding of what benefits can be taken into account under Article 101(3) TFEU.⁹⁶⁸ The interpretation of the benefit criterion has evolved over time. In particular, the modernisation process following Regulation 1/2003 marks a clear shift in the interpretation of this criterion. In this section, two time periods are described and discussed separately.

Initially, the approach taken by the Commission and the EU Courts preceding the modernisation process is explored. It is determined that a broad approach to the exemption regime was preferred, which fell within the exclusive competence of the Commission. Subsequently, the methodology adopted post-modernisation is described and analysed. It is demonstrated that with the advent of decentralisation and shared competences between the EU and Member States’ institutions, a significantly narrower approach is now favoured. Lastly, it is discussed whether we are on the cusp of a third era. The new Commission Draft Guidelines seem to signal a resurgence of a broader approach, albeit with certain limitations.

5.2.2.1 Pre-Modernisation Era: A Broad Approach

From the text of Article 101(3) TFEU, it can be inferred that the benefit criterion encompasses four distinct types of benefits: namely improving production; improving distribution; promoting technical progress; and fostering economic progress. Whilst the first two types appear to align neatly with a consumer welfare concept based on allocative efficiency, the latter two seem broader and their

⁹⁶⁷ *ibid.*

⁹⁶⁸ For a similar view see, e.g., Brook (n 850) 128.

meaning is ambiguous. It proves challenging, if not entirely impossible, to assign a definition to each of these categories given the absence of such and, in addition, the Commission and the EU Courts frequently refer to these types of benefits jointly without assigning a meaning to the individual categories of benefits.⁹⁶⁹ Therefore, the type of benefit must be assessed within a market failure standard without attaching importance to the precise category of Article 101(3) to which it may be grouped.

In the next section, a narrower view of Article 101(3) is described, followed by an exploration of an emerging broader view, encapsulating not only allocative and dynamic efficiencies but also public policy broadly construed.

5.2.2.1.1 *A Conventional View of Efficiency-Enhancing Benefits*

A multitude of benefits included under Article 101(3) TFEU can be interpreted as economic improvements fitting into a narrow welfare approach. In this respect, all categories of Article 101(3) are traditionally efficiency-enhancing.

The two first categories, the improvement production and/or distribution, could cover any ‘improvement to the operation of an industry or trade’.⁹⁷⁰ It appears indisputable that by refining production processes or distribution methods, resources can be used more effectively thereby leading to a more efficient allocation of these resources in the economy. This, in turn, can result in lower prices, better quality or more innovative products for consumers, improving the tripartite notion of conventional consumer welfare seen above.⁹⁷¹ Consequently, these two benefits cover all improvements of allocative efficiency assessable in the relevant market.

The category of promoting technical progress can be viewed as furthering innovation, often in the form of licensing agreements or R&D ventures.⁹⁷² In this

⁹⁶⁹ Brook (n 806) 99 Also, the Commission prefers the term ‘efficiencies’ after the modernisation process, see section 5.2.2.2.1 of the current chapter.

⁹⁷⁰ *ibid.*

⁹⁷¹ Opinion of AG Wahl in Case C-230/16 *Coty Germany GmbH v Parfümerie Akzente GmbH* (n 848), para 32.

⁹⁷² e.g., Case T-168/01 *GlaxoSmithKline Services Unlimited v Commission* (n 963), paras 247-252; Case T-17/93 *Matra Hachette v Commission* EU:T:1994:89, para 110.

connection, the soft law instruments of R&D promotion⁹⁷³ are aligned with the primary law. Innovation, in this context, can be a significant driver of dynamic efficiency. R&D promotion as such addresses a problem of externalities,⁹⁷⁴ thereby remedying market failures by its very nature.

The final category, economic progress, is the most expansive and can encompass any kind of efficiency consideration for the purpose of a narrow market failure analysis.⁹⁷⁵

In essence, each of these categories of benefits under Article 101(3) can be understood as tools for promoting various forms of economic efficiency, each contributing to the overall goal of ensuring a narrow standard of consumer welfare.⁹⁷⁶ To further illustrate, the Commission itself relates economic progress to the correction of market failures:

[For] the agreements to contribute to the improvement of production or distribution, or to promote technical or economic progress, they must objectively constitute an improvement on the situation that would otherwise exist. The fundamental principle in this respect, established at the time the common market was formed, lays down that fair and undistorted competition is the best guarantee of regular supply on the best terms. Thus the question of a contribution to economic progress within the meaning of Article 85 (3) *can only arise in those exceptional cases where the free play of competition is unable to produce the best result economically speaking*.⁹⁷⁷

⁹⁷³ This is regulated by Commission Regulation (EU) No 1217/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of research and development agreements.

⁹⁷⁴ On externalities, see Chapter 2, section 2.2.1.1.

⁹⁷⁵ See Brook (n 806) 100 who considered that this includes examples such as 'patent and know-how licensing'; (Commission decision (90/186 EC) of 23 March 1990 (Case IV/32736 - Moosehead/Whitbread), para 16); coordination of systems for payment (Commission Decision (85/77/EEC) of 10 December 1984 (Case IV/30717 - Uniform Eurocheques), para 45); Communication systems (Commission Decision (91/562/EEC) of 18 October 1991 (Case IV/32737 - Eirpage), para 15).

⁹⁷⁶ On the narrow notion of consumer welfare see Chapter 4, section 4.3.2.1.

⁹⁷⁷ Commission Decision (76/172/EEC) of 15 December 1975 (Case IV/27073 - Bayer/Gist-Brocades), para III(1) (emphasis added).

Despite the Commission and the EU Courts not explicitly adopting a market failure analysis when applying Article 101(3) in the pre-modernisation era, its categories appear to be intrinsically linked to remedying negative externalities or introducing positive ones. As such, any of the categories of benefits under Article 101(3) can be interpreted as promoting allocative efficiency. The above quote also shows that the Commission recognises that Article 101(3) can only be applicable in the case of market failure. Such an approach appears to transcend the pursuit of narrow consumer welfare. The application of a narrow market failure theory of the benefits included in Article 101(3) is studied further when examining the Guidelines of the Commission.⁹⁷⁸

5.2.2.1.2 *A Multilevel Endorsement of Public Policy Goals*

A broader approach to Article 101(3) TFEU could potentially elevate this provision to a proper market failure tool, encompassing external objectives beyond the mere improvement of competition. A complex question arises as to whether such an approach could recognise the positive externalities produced by an agreement that extends beyond those bestowed upon the parties to the agreement and their customers, i.e., bystanders. This issue is partially addressed in this subsection and is further explored when examining the scope of the analysis.⁹⁷⁹ The reason for addressing this issue in multiple segments is that given the inherent characteristics of broader benefits, disentangling their conceptualisation from their scope is difficult.⁹⁸⁰

Historically, both the Commission's practice and the case law of the EU Courts have demonstrated a propensity towards a broader interpretation of benefits. During the pre-modernisation era, the Commission ostensibly acknowledged that a relatively lax standard of workable competition could be

⁹⁷⁸ See section 5.2.2.2 of the current chapter.

⁹⁷⁹ See section 5.2.3 of the current chapter.

⁹⁸⁰ As an illustrative example, consider the endeavour to mitigate negative externalities caused by pollution. Environmental protection is an objective that transcends the confines of allocative efficiency, at least in the sense of narrow consumer welfare. The objective of environmental protection exerts its influence on agents beyond the relevant market. The same can be said regarding various broader efficiencies such as employment or public health, wherein the accrual of benefits extends well beyond the immediate interest of the parties involved and the consumer consumers in the relevant market.

balanced against other kinds of market failures.⁹⁸¹ From this perspective, a broad reading of Article 101(3) does not manifest as an innovative occurrence.

These broader objectives were either integrated into the logic of Article 101(3), particularly through the category of ‘economic progress’, or the Courts and the Commission simply did not specify the category under which these objectives fell. The Treaties do not contain any provision prohibiting such an interpretation, and it is well-established case law that it falls under the Commission’s discretion to consider public policy goals under Article 101(3), subject to a proportionality test (necessity and no elimination). This question of including broader non-competition objectives under Article 101(3) was explicitly addressed in *Metro I*, where the Court found that:

The powers conferred upon the Commission under [Article 101(3)] show that the requirements for the maintenance of workable competition may be reconciled with the safeguarding of objectives of a different nature and that to this end certain restrictions on competition are permissible, provided that they are essential to the attainment of those objectives and that they do not result in the elimination of competition for a substantial part of the common market.⁹⁸²

This ruling thus explicitly recognises that the working competition standard can be balanced against non-competition interests within a proportionality analysis, safeguarding competition from total elimination.

In *Métropole Télévision*,⁹⁸³ the General Court was confronted with the question of whether the Commission could rely on public policy considerations as a basis to grant exemption under Article 101(3) for a sub-licencing system enacted by the European Broadcasting Union (the EBU) to enable non-affiliated broadcasters to distribute some of its sports events.⁹⁸⁴ The appellant *in casu* was the EBU, which is a non-profit organisation, membership to which is conditioned by, inter alia, nationwide accessibility, public service obligation, and elements of

⁹⁸¹ For a similar view on the use of more flexible workable competition standard see e.g., Brook (n 806) 59-62; 105-107.

⁹⁸² Case 26/76 *Metro I* (n 350), para 43, para 21.

⁹⁸³ Joined Cases T-528/93, T-543/93 & T-546/93 *Métropole Télévision and Others v Commission* EU:T:1996:99, paras 1-6. The case was rendered pre-Regulation 1/2003 and concerned an exemption decision under Article 101(3) TFEU.

⁹⁸⁴ *ibid.*, paras 17-28.

non-profitability.⁹⁸⁵ Despite the undertaking being charged with a public service obligation the case was decided under Article 101(3). The Commission, in its decision, identified the public mission as characterised by, in particular, ‘the obligation to provide varied programming including cultural, educational, scientific and minority programmes without any commercial appeal and to cover the entire national population irrespective of the costs’.⁹⁸⁶

In its judgment, the General Court explicitly referred to public policy by holding that ‘the Commission is entitled to base itself on considerations connected with the pursuit of the public interest to grant exemption under [Article 101(3)]’.⁹⁸⁷ Nevertheless, when applying the proportionality test as set out in *Metro I*, the Court found that the Commission had failed to adequately demonstrate how the exclusivity rights were necessary for the attainment of these public interest objectives.⁹⁸⁸

In *Laurent Piau*, the Commission rejected a complaint pertaining to FIFA’s (Fédération Internationale de Football Association) Players’ Agents Regulations, which were deemed a decision by an association of undertakings. The dismissal was grounded on the lack of community interest in pursuing the procedure.⁹⁸⁹ However, the Commission did consider that the agreements could, at any rate, be exempted under Article 101(3), based on their capacity to protect football players, who have short careers, and clubs from risks associated with poorly negotiated transfers.⁹⁹⁰ Rather than considering public policy separately from the analysis in Article 101(3), the Commission considered that the restrictions contributed to ‘a better operation of the market and therefore contributes to economic progress’.⁹⁹¹ From this standpoint, the Commission found that the restriction was ‘proportionate

⁹⁸⁵ Commission Decision (93/403/EEC) of 11 June 1993 (Case IV/32150 - EBU/Eurovision System), point 3.

⁹⁸⁶ *ibid.*, point 5.

⁹⁸⁷ Joined Cases T-528/93 etc. *Métropole* (n 983), para 118.

⁹⁸⁸ *ibid.*

⁹⁸⁹ Case T-193/02 *Piau v Commission* (n 743), paras 1-22. The ruling was upheld by the ECJ in Case C-171/05 P *Piau v Commission* EU:C:2010:188.

⁹⁹⁰ *ibid.*, para 100.

⁹⁹¹ *ibid.*, para 62.

and essential'.⁹⁹² The proportionality analysis was ultimately upheld by the EU Courts.⁹⁹³

In *VBBB/VBVB*, the Commission refused to grant exemption for an agreement between associations of undertakings in the book sector.⁹⁹⁴ It found that, in terms of efficiency arguments, the collective resale price maintenance at stake did not contribute to an improvement of the production of the covered products. Whilst the Commission did not explicitly refute the parties' argument that the agreement could be upheld on the basis of public policy considerations, such as the protection of smaller and specialised publishers,⁹⁹⁵ it nonetheless concluded that the resale price maintenance clause constituted such a significant restriction that the benefits derived from the agreement were outweighed by the disadvantages for the competition in the sector.⁹⁹⁶

Environmental policy has consistently been an important public policy ground for derogation in the decisional practice of the Commission. In *Philips/Osram*, two firms sought to enter a joint venture for the manufacturing and sale of certain lamp components.⁹⁹⁷ The agreement was found to infringe competition due to the inclusion of non-compete clauses, certain obligations pertaining to the parent companies and preferential treatment afforded to the latter in case of shortages.⁹⁹⁸ However, the agreement showcased certain energy-saving processes and thereby the capacity to internalise negative externalities in terms of energy reduction. The Commission found that the joint venture would decrease energy usage, resulting in a reduction of emissions.⁹⁹⁹ Furthermore, '[t]he use of cleaner facilities will result in less air pollution, and consequently in direct and indirect benefits for consumers from reduced negative externalities'.¹⁰⁰⁰ The notion of indirect benefits introduced in this case seemingly allows for non-competition effects beyond the relevant market to be indirectly taken into account

⁹⁹² *ibid.*

⁹⁹³ See Case C-171/05 P *Piau v Commission* (n 989).

⁹⁹⁴ Commission Decision (82/123/EEC) of 25 November 1981 (Case IV/428 - VBBB/VBVB).

⁹⁹⁵ *ibid.*, paras 49-53.

⁹⁹⁶ *ibid.*, para 53.

⁹⁹⁷ Commission Decision (94/986/EC) of 21 December 1994 (Case IV/34252 - Philips-Osram).

⁹⁹⁸ *ibid.*, para 19.

⁹⁹⁹ *ibid.*, para 25.

¹⁰⁰⁰ *ibid.*, para 27.

under analysis.¹⁰⁰¹ Brook defined indirect economic benefits as ‘cost and qualitative efficiencies that do not occur in the market in which the agreement takes place or has a direct impact’.¹⁰⁰² The Commission’s usage of the term remains ambiguous. However, it does not, as such, appear to be limited to ‘economic benefits’ in the sense of competition law scholarship.

In a similar vein, in *CECED*, an agreement between manufacturers of domestic appliances established anticompetitive under Article 101(1) was found to cut emissions via energy conservation. The Commission stated that the agreement would ‘reduce the potential energy consumption in new [washing] machines by at least 15 to 20%’.¹⁰⁰³ In this instance, Article 101(3) was not interpreted in a legal vacuum. The Commission noted that according to the Treaties, ‘environmental damage should be rectified at source’ and that ‘[the EU] pursues the objective of a rational utilisation of natural resources taking into account the potential benefits and costs of action’.¹⁰⁰⁴ The Commission proceeded with carrying out a CBA in order to ensure that the positive effects outweigh the negative effects taking into account the ‘cost of pollution’:

The Commission reasonably estimates the saving in marginal damage from (avoided) carbon dioxide emissions (the so-called “external costs”) at EUR 41 to 61 per ton of carbon dioxide. On a European scale, avoided damage from sulphur dioxide amounts to EUR 4000 to 7000 per ton and EUR 3000 to 5000 per ton of nitrous oxide. On the basis of reasonable assumptions, the benefits to society brought about by the *CECED* agreement appear to be more than seven times greater than the increased purchase costs of more energy-efficient washing machines. Such environmental results for society would adequately allow consumers a fair share of the benefits even if no benefits accrued to individual purchasers of machines.¹⁰⁰⁵

¹⁰⁰¹ This will be further discussed in sections 5.2.2.2.3 and 5.2.3 of the current chapter.

¹⁰⁰² Brook (n 806) 41.

¹⁰⁰³ Commission Decision (2000/475/EC) of 24 January 1999 (Case IVF1/36718 *CECED*), para 47.

¹⁰⁰⁴ *ibid.*, para 55.

¹⁰⁰⁵ *ibid.*, para 56.

Furthermore, the Commission did not only find that the agreement produced individual economic benefits for the consumers, but also ‘collective environmental benefits’.¹⁰⁰⁶ These collective benefits can be interpreted as extending beyond market boundaries and thus benefiting *all* consumers. In this particular case, the reduction in carbon dioxide emissions benefits society as a whole, rather than merely consumers in the relevant market. From this perspective, the analysis transcends the partial market equilibrium generally preferred.

In *DSD*,¹⁰⁰⁷ an agreement between packing manufacturers and distributors that generated scale and scope advantages could be exempted, as it was established that:

[i]t can be accepted that the cost savings made over the lifetime of the agreement will be passed on to consumers, and also that consumers will likewise benefit as a result of the improvement in environmental quality sought, essentially the reduction in the volume of packaging.¹⁰⁰⁸

In this case, the agreement also generated efficiency gains,¹⁰⁰⁹ which coupled with the environmental benefits directed towards consumers satisfied the four criteria under Article 101(3). As seen above, efficiencies cannot be internal to the parties to the agreement; any benefit must therefore be adequately distributed among consumers to allow a ‘fair share’. In this case, the environmental improvement, together with certain cost savings passed on to consumers, was sufficient to establish that a fair share was afforded to consumers.

In addition to environmental protection, the Commission has considered other external goals under Article 101(3). In *Ford/Volkswagen*, the Commission exempted an agreement between Ford and Volkswagen setting up a joint venture for the creation of a new multi-purpose vehicle in Portugal, on the basis of, inter alia, regional, social and employment policy.¹⁰¹⁰ Similar to environmental

¹⁰⁰⁶ *ibid.*, paras 55-57.

¹⁰⁰⁷ Commission Decision (2001/837/EC) of 17 September 2001 (Cases COMP/34493 - DSD etc).

¹⁰⁰⁸ *ibid.*, para 148.

¹⁰⁰⁹ *ibid.*, para 145.

¹⁰¹⁰ Commission Decision (93/49/EEC) of 23 December 1992 (Case IV/33814 - Ford Volkswagen), para 23.

protection, regional policy and the reduction of regional disparities ‘is one of the basic aims of the Treaty’.¹⁰¹¹

Social policy as a ground for derogation was reaffirmed in *Stichting Baksteen*, where several firms in the brick industry entered into an agreement to reduce output via quotas to combat, inter alia, overcapacity in the industry.¹⁰¹² The Commission’s reasons for exempting the agreement included that ‘because the closures are coordinated, restructuring can be carried out in acceptable social conditions, including the redeployment of employees’.¹⁰¹³ That fact that social policy serves as a ground for exemption aligns with the Treaties, which established ‘a highly competitive social market economy, *aiming at full employment and social progress* [...]’.¹⁰¹⁴

The matter of employment as a ground for exemption was highlighted in *Metro I*, where the Court asserted that ‘the provision of employment [...] comes within the framework of the objectives to which reference may be had under [Article 101(3)]’.¹⁰¹⁵ The issue of employment as a ground for derogation was revisited in *Remia v Commission*.¹⁰¹⁶ However, in this case, the negative effects of the long duration of the non-competition clause in the agreement were found to outweigh the positive effects that the agreement would have on employment.¹⁰¹⁷ Moreover, the Court specified that employment falls within Article 101(3) since ‘it improves general conditions of production, especially when market conditions are unfavourable’.¹⁰¹⁸

Other less conventional public policy objectives have also been recognised. In *Pasteir-Mériuex/Merck*, the Commission relied on the protection of public

¹⁰¹¹ *ibid.*, para 36. Territorial cohesion is a core aim of the TFEU, see Articles 3 TEU and 174 TFEU: ‘In order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion. In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions’.

¹⁰¹² Commission Decision (94/296/EC) of 29 April 1994 (Case IV/34456 - Stichting Baksteen).

¹⁰¹³ *ibid.*, para 27.

¹⁰¹⁴ Article 3 TEU.

¹⁰¹⁵ Case 26/76 *Metro I* (n 350), para 43.

¹⁰¹⁶ Case 42/84 *Remia BV and others v Commission of the European Communities* EU:C:1985:327.

¹⁰¹⁷ *ibid.*, para 42.

¹⁰¹⁸ *ibid.*

health.¹⁰¹⁹ The case involved a series of agreements between vaccine manufacturers that breached Article 101(1). Concerning consumer benefits, the Commission found that the technical progress and improvement of distribution resulting from the agreements ‘responds to a genuine public health concern’.¹⁰²⁰ It continued, ‘[n]umerous organizations, including the World Health Organization and the European Parliament, have underlined the benefits of accurate, stable and easy-to-administer vaccines for public health, and therefore also for consumers’.¹⁰²¹

There are also cases appearing to adhere to a broader *general* welfare analysis.¹⁰²² In *Metro I*, besides employment as an improvement to production, the Court stated that:

[...] The conclusion of supply contracts for six months taking account of the probable growth of the market should make it possible to ensure both a certain stability in the supply of the relevant products, which should allow the requirements of persons obtaining supplies from the wholesaler to be more fully satisfied, and, since such supply contracts are of relatively short duration, a certain flexibility, enabling production to be adapted to the changing requirements of the market.¹⁰²³

In sum, in the pre-modernisation era, both the Commission and the EU Courts adopted a broad approach, granting exemption based on broader public policy goals beyond the relevant market. This demonstrates that from the outset, the Commission conceived Article 101(3) to be broader in scope than a narrow construct centred solely around consumer welfare and efficiency.

Nonetheless, the precise methodology employed to integrate these broader objectives into the framework of antitrust law remains somewhat ambiguous. In certain cases, these objectives were incorporated into the efficiency-logic of Article 101(3). In this sense, the creation of positive externalities, or inversely the

¹⁰¹⁹ Commission Decision (94/770/EC) of 6 October 1994 (Case IV/34776 - Pasteur Mérieux-Merck), para 36, 108.

¹⁰²⁰ *ibid.*, para 88.

¹⁰²¹ *ibid.*

¹⁰²² As pointed out by Brook (n 806) 100: ‘competition enforcers have taken into account not only improvements to the production or distribution of the goods or services subject to the specific agreement but also improvements to the economy as a whole’.

¹⁰²³ Case 26/76 *Metro I* (n 350), para 43.

mitigation of negatives ones, may be deemed to contribute to economic efficiency. However, in many of these cases the public policy concerns also resulted in efficiencies or could be categorised under the broader umbrella of economic progress. This raises questions as to whether these objectives can independently justify an agreement or whether they must be accompanied by some efficiency claim.¹⁰²⁴

5.2.2.1.3 *The Exclusion of Non-Efficient Public Policy?*

Ambiguity persists regarding the extent to which external objectives/benefits must also align with the criteria stipulated under Article 101(3) TFEU. As observed in the previous sections, when qualifying these benefits, external objectives – i.e., non-competition objectives – generally fall within the broad category of ‘economic progress’. Several of the cases above presented both broader objectives and narrow efficiency gains in the sense of Article 101(3), thereby posing the question as to whether these broader benefits must also contribute ‘to improving the production or distribution of goods or to promoting technical or economic progress whilst allowing consumers a fair share of the resulting benefit’.¹⁰²⁵ Such an approach would require the Commission to systematically categorise each benefit within the parameters of Article 101(3).

This particular argument was advanced during the appeal of the *Ford/Volkswagen* decision, in *Matra Hachette*, where the applicants claimed that the ECJ only considers the promotion of employment ‘to the extent to which it is a factor of economic efficiency’, which must be ‘objective and real’.¹⁰²⁶ In this case, the applicants contended that employment cannot be construed as a factor of efficiency. The Commission’s assertion that the agreement fosters economic and social cohesion via the creation of employment in certain regions was challenged, given the simultaneous closure of numerous industrial sites in Europe, signifying mere geographic relocation of employment. The applicants claimed that, in this case, the relocation results in the transfer of employment from an area where unemployment is high and labour is costly to a zone with higher employment and

¹⁰²⁴ The ambiguity regarding the extent of significance to attribute to employment in the analysis has also been duly noted by Monti (n 62), 1070. See also quoted therein Giuliano Amato, *Antitrust and the Bound of Power* (Hart, 1997) 61.

¹⁰²⁵ Article 101(3) TFEU.

¹⁰²⁶ Case T-17/93 *Matra Hachette v Commission* (n 972), para 89.

cheaper labour, thus not contributing to economic and social cohesion.¹⁰²⁷ However, the General Court found that the Commission had adequately motivated how the agreement contributes to technical progress in the form of know-how, technical improvements of the product and the manufacturing processes.¹⁰²⁸ By doing so, the General Court side-stepped adjudicating on the matter of whether employment as a benefit can be taken into account, despite it not contributing to efficiency. Instead, the existence of efficiencies, concomitant with other considerations, suggests that the agreement contributes to the ‘improvement of the production or distribution of products or to the promotion of technical or economic progress’.¹⁰²⁹

The General Court’s judgment does not shed light on the relationship between narrow efficiencies, in the sense of Article 101(3), and broader efficiencies or benefits, such as those related to employment or environmental protection. This case underscored the complexity of ascribing any definitive value to factors beyond the creation of mere narrow economic efficiency. Although the Court abstained from ruling on this particular question, it would appear that employment can indeed be considered solely to the extent that it constitutes a ‘factor of economic efficiency’. However, as noted earlier, nothing in the Treaties restricts the analysis under Article 101(3) to allocative efficiency. Furthermore, the Court’s case law in *Metro* has not been overruled, leaving it within the discretion of the Commission to consider public policy goals under Article 101(3), without requiring that these contribute to economic efficiency in the sense of Article 101(3).

5.2.2.2 Post-Modernisation Era: A Focus on Efficiency-Based Benefits?

The essence of modernisation within EU antitrust law has been outlined earlier.¹⁰³⁰ In the context of Article 101 TFEU, the modernisation process brought about a more economic approach, focusing on the effects of an agreement rather than its form.¹⁰³¹ The implication of the modernisation process must be contextualised in the findings in the previous sections. To that end, this section examines the

¹⁰²⁷ *ibid.*

¹⁰²⁸ *ibid.*, paras 106-111.

¹⁰²⁹ *ibid.*, para 111.

¹⁰³⁰ See Chapter 1, section 1.1 and Chapter 4, section 4.1.

¹⁰³¹ (n 6); Whish and Bailey (n 440) 53.

Commission Guidelines on Article 101(3), which operationalise the more economic approach of the modernisation.¹⁰³² It is suggested that antitrust modernisation engendered a paradigm shift, moving away from the previous inclination to rely upon broader objectives. However, this paradigm shift should not be understood as a total rejection of these broader goals. As evidenced in the recent Draft Guidelines on Horizontal Cooperation, the modernisation approach has not abandoned these objectives altogether; rather, it has nuanced the focus, shifting from a legal balancing act to a more economically oriented CBA. This transition, however, has proven to be fraught with methodological complexities. The integration of broader objectives into economic analysis has resulted in numerous inconsistencies, posing challenges to legal coherence and raising, once again, questions about the underlying principles that govern contemporary antitrust enforcement.

The more economic approach, and modernisation in general, has driven the Commission's competition policy towards an efficiency-based short and medium-term analysis under Article 101(3). In the white paper on modernisation of the rules implementing Articles 85 and 86 of the EC treaty (today, Articles 101 and 102), it is stated that:

[The purpose of Article 101(3)] is to provide a legal framework for the economic assessment of restrictive practices and not to allow application of the competition rules to be set aside of political considerations.¹⁰³³

As their name implies, the Guidelines are intended to provide national courts, legal practice and NCAs with guidance, and they should be applied 'reasonably and flexibly' on a case-by-case basis rather than in a mechanical manner.¹⁰³⁴ In essence, they outline the Commission's interpretation of Article 101(3) as a means to provide flexible guidance for the substantive assessment of individual cases.¹⁰³⁵ Therefore, whilst the Guidelines are not binding on Member States, they do bind the Commission, which cannot deviate from them without breaching general

¹⁰³² Guidelines on the application of Article 81(3) (n 364).

¹⁰³³ The Commission's White Paper on modernisation of the rules implementing Articles 85 and 86 of the EC Treaty, (COM(99) 0101) (n 729), para 57.

¹⁰³⁴ Guidelines on the application of Article 81(3), para 6.

¹⁰³⁵ *ibid.*, para 3.

principles of law.¹⁰³⁶ This means that, in each case, the EU Courts must verify that the Commission has complied with its Guidelines.¹⁰³⁷ Thus, the Guidelines constitute an important (quasi-legal¹⁰³⁸) source for the application of Article 101(3), and can be understood as an ‘analytical framework’.¹⁰³⁹

This section initially describes the 2004 Guidelines on Article 81(3) (Article 101(3) today, hereafter referred to as the ‘Guidelines on Article 101(3)’). Secondly it is argued that in the aftermath of these Guidelines, it appears that the Commission’s post-modernisation practice has realigned the focus towards short to medium-term direct efficiencies. However, the final subsection reveals a potential departure from this trend in the new Draft Guidelines on Horizontal Cooperation Agreements. Despite the Commission sitting on the fence, these Guidelines seem to diverge from the previous approach, possibly heralding a re-introduction of broader goals into the domain of antitrust analysis.

5.2.2.2.1 *Decoding the Guidelines on Article 101(3) and ‘Efficiencies’*

Viewed in isolation, the more economic approach to EU antitrust law appears to severely restrict the possibility to consider external objectives under Article 101(3) TFEU. The Guidelines on Article 101(3) take a narrow approach to the criteria within that Article, to the point that the legality of the first set of Guidelines, in relation to the prevailing case law of the Court, has been questioned within legal doctrine.¹⁰⁴⁰

¹⁰³⁶ Case C-226/11 *Expedia Inc.* (n 784), para 28; Joined Cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P *Dansk Rørindustri and Others v Commission* EU:C:2005:408, para 211.

¹⁰³⁷ Case T-380/94 *AIUFFASS and AKT v Commission* EU:T:1996:195, para 57.

¹⁰³⁸ Although their non-binding nature is a topic of discussion see, e.g., Zlatina Georgieva, ‘Soft Law in EU Competition Law and Its Judicial Reception in Member States: A Theoretical Perspective’ (2015) 16(2) German Law Journal 223, 259 who argued that ‘a legal dimension to competition soft law should be judicially acknowledged’. See further on the use of EU soft law as a legal basis for national decision, e.g., Leander Stähler and Mariolina Elantonio, ‘The Legal Effects of EU Competition Law Soft Law in the Decisions of National Competition Authorities’ (2020) 4 European Competition and Regulatory Law Review 274.

¹⁰³⁹ Guidelines on the application of Article 81(3) (n 364), para 5.

¹⁰⁴⁰ Townley, ‘Inter-Generational Impacts in Competition Analysis: Remembering Those Not Yet Born’ (n 897) 588.

As a key element of the Commission's modernisation package, the Guidelines on Article 101(3) unmistakably adopt an economic approach.¹⁰⁴¹ At the very core of Article 101(3) lies a balancing test, weighing competitive restraints against pro-competitive effects,¹⁰⁴² the latter being interpreted as narrow competition-specific efficiencies.

The Guidelines reaffirm the case law that the benefits under Article 101(3) must be objective, which means that they cannot be assessed from the subjective view of the parties.¹⁰⁴³ According to the Commission, this implies that the benefits must generate a pro-competitive effect in the market in terms of creating value through the integration of assets and activities (i.e., the combination of assets in order to achieve results that they could not obtain on their own).¹⁰⁴⁴ Four factors must, therefore, be verified: the nature of the efficiencies; the link between the agreement and the efficiencies; 'the likelihood and magnitude of each claimed efficiency'; and the time and manner in which these efficiencies are achieved.¹⁰⁴⁵

In line with the case law of the Court of Justice, the type of efficiencies mentioned in Article 101(3) are, despite being broadly construed, limited to objective economic efficiencies.¹⁰⁴⁶ The Commission categorises the efficiencies into two major groups: *cost efficiencies* and *qualitative efficiencies*.¹⁰⁴⁷ Cost efficiencies can stem from various sources, such as cost cuts in terms of development of new production technologies, or integration of existing assets resulting in synergies.¹⁰⁴⁸ Besides cost efficiencies, agreements may also generate various qualitative efficiencies, which may have an even greater impact than cost

¹⁰⁴¹ Guidelines on the application of Article 81(3) 97 (n 364), para 5.

¹⁰⁴² *ibid.*, para 33; Case C-132/19 P *Canal +* EU:C:2020:1007, para 58.

¹⁰⁴³ *ibid.*, para 49. For instance, eventual cost cuts that are produced as a mere result of market power cannot be taken into account. Examples given by the Commission include the situation where a cartel fixing prices or market shares results in lower output and thus lower production costs, or reduced sales and marketing costs due to lessened competition.

¹⁰⁴⁴ *ibid.*

¹⁰⁴⁵ *ibid.*, para 51.

¹⁰⁴⁶ *ibid.*, para 59; See also, Case C-56/64 *Consten and Grundig* (n 946), para 13 where the ECJ referred to 'objective advantages'.

¹⁰⁴⁷ *ibid.* Qualitative efficiencies are defined as 'efficiencies of a qualitative nature whereby value is created in the form of new or improved products, greater product variety etc'.

¹⁰⁴⁸ *ibid.*, para 64. The Commission considers that it is in general 'when technological leaps are made that the greatest potential for cost savings is achieved'.

efficiencies.¹⁰⁴⁹ These include quality improvements of goods or services and different innovative developments.¹⁰⁵⁰ Thus, efficiencies in the Guidelines are not only static but also dynamic.¹⁰⁵¹

Following the modernisation process, the term ‘benefits’ under Article 101(3) was re-interpreted to mean ‘objective economic efficiencies’.¹⁰⁵² There is a stronger emphasis on the economic net improvement of the benefits, either through quantitative or qualitative efficiencies (particularly dynamic efficiencies). However, this does not necessarily mean that broader efficiencies are excluded. In fact, efficiencies generated by sustainability enhancing measures or the reduction of negative externalities could, in principle, fall under the material scope of ‘objective economic efficiencies’. However, the test adopted is of a narrow character and it appears that by ‘positive economic effects’, the Commission refers to short and medium-term ‘efficiency gains’.¹⁰⁵³ In this sense, the Guidelines state that the aim of EU competition law ‘is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources’.¹⁰⁵⁴ The focus on short-term price effects is affirmed as the Commission considers that ‘the very essence of competitive process [...] is] to win consumers by offering better products or better prices than those offered by rivals’.¹⁰⁵⁵

In subsequent Guidelines from the Commission, the benefits under Article 101(3) appear to be limited to two types of market failures. As is shown below, externalities play an important role in the Commission Draft Guidelines on Horizontal Cooperation Agreements of 2022.¹⁰⁵⁶ The older Guidelines on Horizontal Agreements issued in 2010 recognised that information exchange agreements can be sources of efficiency gains in the sense of Article 101(3).¹⁰⁵⁷ Agreements that remedy information asymmetries could generate efficiencies in

¹⁰⁴⁹ *ibid.*, para 69.

¹⁰⁵⁰ *ibid.*, para 70.

¹⁰⁵¹ For a discussion on static and dynamic efficiencies see Chapter 4, section 4.3.2.

¹⁰⁵² Guidelines on the application of Article 81(3) 97 (n 364), para 59.

¹⁰⁵³ Lianos, Korah and Sicilliani (n 357) 648.

¹⁰⁵⁴ Guidelines on the application of Article 81(3) (n 364), para 33.

¹⁰⁵⁵ *ibid.*

¹⁰⁵⁶ See section 5.2.2.2.3 of the current chapter.

¹⁰⁵⁷ Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (n 6), paras 95-100.

various ways. For example, an agreement between insurance firms could identify risk profiles of users, avoiding adverse selection,¹⁰⁵⁸ or information transmitted to consumers regarding quality improvement reflecting the price of a given product.¹⁰⁵⁹

5.2.2.2.2 *Moving Beyond Soft Law: The Contemporary Relevance of Public Policy*

The Guidelines illuminate that the primary objective of Article 101(3) TFEU is to provide a balancing mechanism, juxtaposing unfettered competition on one side against static and dynamic efficiency improvements on the other. From this perspective, the modernisation process is guided by a sole focus on short and medium-term analysis.

This transition towards a narrower position regarding the benefits under Article 101(3) coincides with the entry into force of Regulation 1/2003 and the decentralisation of EU competition law.¹⁰⁶⁰ This development might be deemed necessary by the Commission to ensure rigorous consistency in interpretation, given that the enforcement is now delegated to the NCAs and the national courts.¹⁰⁶¹ Consequently, there is no post-modernisation case law, or Commission decision, that explicitly considers external objectives beyond short to medium-term direct efficiencies.¹⁰⁶² This makes it difficult to draw any conclusion other than the externalities objective does not align with the Commission's more economic approach. However, this does not imply that there have been no cases invoking non-economic objectives, but rather that the Commission appears to prefer and prioritise efficiency, and these external objectives are subsumed within

¹⁰⁵⁸ Ibanez Colomo (n 297) 544.

¹⁰⁵⁹ Barbara Baarsma and Nicole Rosenboom, 'A Veritable Tower of Babel: On the Confusion between Legal and Economic Interpretations of Article 101(3) of the Treaty on the Functioning of the European Union' (2015) 11 *European Competition Journal* 402, 408.

¹⁰⁶⁰ On the diminished case law and application of Article 101(3) see e.g., Lianos, Korah and Sicilliani (n 357) 638 ff.

¹⁰⁶¹ For a similar opinion see, Geradin, Layne-Farrar and Petit (n 315) 167: 'The Guidelines' orthodox interpretation of Article 101(3) TFEU is wholly based on the fear that the abolition of the Commission's exemption monopoly would induce NCAs and/or national courts to exempt unlawful agreements on national public policy grounds thereby bringing about an increased degree of legal uncertainty/inconsistency'.

¹⁰⁶² e.g., Brook (n 806) 120.

the categories of Article 101(3). This is also the stance adopted by the Guidelines on Article 101(3):

[...] The four conditions of Article [101(3)] are also exhaustive. When they are met the exception is applicable and may not be made dependent on any other condition. Goals pursued by other Treaty provisions can be taken into account to the extent that they can be subsumed under the four conditions of Article [101(3)].¹⁰⁶³

Thus, the Commission's practice diverges from the earlier, broader approach by explicitly limiting any public policy objective under Article 101(3). Public policy considerations are tolerated when they generate efficiency, but they are insufficient alone to justify a restriction on competition.

5.2.2.2.3 *Unlocking Opportunities: The New Draft Guidelines and Collective Benefits*

The Commission Draft Guidelines on Horizontal Cooperation Agreements (the 'Draft Guidelines') marks a pivotal juncture, being the first policy document adopted within EU antitrust law that adopts a market failure test. This signifies a transplant of the concept of market failure from State aid law, underscoring a continued juridification of the notion.

The Draft Guidelines have been received by legal practice as an attempt to adopt a greener EU-wide competition policy.¹⁰⁶⁴ The revision of the Guidelines was prompted by stakeholders who considered that the current Horizontal Guidelines did not adequately reflect the economic and societal changes that have occurred over the previous decade.¹⁰⁶⁵ This subsection aims to determine whether

¹⁰⁶³ Guidelines on the application of Article 81(3), para 42.

¹⁰⁶⁴ e.g., 'Linklaters, "Greening EU Competition Law: Commission Invites Comments on Draft Revised Rules on Horizontal Cooperation" (2022)' <https://www.linklaters.com/sv-se/insights/blogs/linkingcompetition/2022/march/greening-eu-competition-law_commission-invites-comments-on-draft-revised-rules-on-horizontal-coop>; 'Bird&Bird, "Greening Competition Law – The European Commission's Draft Horizontal Guidelines and Sustainability Agreements" (2022)' <<https://www.lexology.com/library/detail.aspx?g=1c943ab0-3488-4ed2-8c26-8dfc073df246>>; De Brauw, Blackstone, Westbroek, 'Commission Takes a Long-Awaited Stance on Sustainability' (2022) available at: <<https://www.debrauw.com/articles/commission-takes-long-awaited-stance-on-sustainability-agreements-between-competitors>>.

¹⁰⁶⁵ Martin Gassler, 'The New Sustainability Chapter in the Draft Revised Horizontal Guidelines of the European Commission' (*eulawlive.com*) <<https://eulawlive.com/analysis-the-new->

the conditions set out in the Guidelines on Article 101(3) can now be applied differently in certain situations. It is argued that although this acknowledges the imperative necessity to include broader efficiencies under Article 101(3) TFEU, such as sustainability enhancements, the reconciliation of such a broader approach with the conventional parameters underlying antitrust analysis poses intricate and multifaceted challenges.

Whilst addressing various issues related to horizontal cooperation, the Draft Guidelines include a chapter dedicated to sustainability agreements.¹⁰⁶⁶ Sustainability is, unquestionably, a ‘priority objective’ of the Union.¹⁰⁶⁷ Therefore, the Draft Guidelines specifically deal with the assessment of sustainability objectives under Article 101(3) TFEU.¹⁰⁶⁸ The aim of the Draft Guidelines is to facilitate cooperation between undertakings that are ‘economically desirable and thereby, for example, contribute to the green and digital transitions and to fostering the resilience of the internal market’.¹⁰⁶⁹

Chapter 9 of the Draft Guidelines, on sustainability agreements, defines these broadly as ‘agreements between competitors that pursue one or more sustainability objectives’.¹⁰⁷⁰ As explained below, environmental agreements, intrinsically, imply positive externalities beyond the relevant market:

In broad terms, sustainable development refers to the ability of society to consume and use the available resources today without compromising the ability of future generations to meet their own needs. It encompasses activities that support economic, environmental and social (including labour and human rights) development. The notion of sustainability objective therefore includes, but is not limited to, addressing climate change (for instance, through the reduction of greenhouse gas emissions), eliminating pollution, limiting the use of natural resources, respecting human rights, fostering resilient infrastructure and

[sustainability-chapter-in-the-draft-revised-horizontal-guidelines-of-the-european-commission-by-martin-gassler/](#)>.

¹⁰⁶⁶ Chapter 9 of the Draft Guidelines on Horizontal Co-operation Agreements (n 49).

¹⁰⁶⁷ *ibid.*, para 541. See also Article 3 TEU.

¹⁰⁶⁸ *ibid.*, para 3.

¹⁰⁶⁹ *ibid.*, para 1.

¹⁰⁷⁰ *ibid.*, para 541.

innovation, reducing food waste, facilitating a shift to healthy and nutritious food, ensuring animal welfare, etc.¹⁰⁷¹

With regard to the benefit criterion, the Commission merely reasserts the older Guidelines. It is clear that sustainability agreements can generate a variety of qualitative efficiency gains as described.¹⁰⁷² For instance, the Commission cites ‘cleaner production or distribution technologies, less pollution, improved conditions of production and distribution, more resilient infrastructure or supply chains, better quality products’.¹⁰⁷³ Hence, the material scope of Article 101(3) is not problematic as it broadly encompasses any cost or qualitative efficiency.

However, sustainability benefits frequently produce positive externalities that benefit not only consumers within the definition of the EU competition law¹⁰⁷⁴ but also society as a whole. This generates complications both at the level of the benefit criterion and the fair share criterion.¹⁰⁷⁵ In connection with this, the Draft Guidelines distinguish between two types of benefits: individual benefits and collective benefits.¹⁰⁷⁶

Firstly, individual benefits can either be use benefits or non-use benefits.¹⁰⁷⁷ Use benefits are simply derived from the use or consumption of the product and benefit the consumers of the product.¹⁰⁷⁸ These include ‘improved product quality or product variety resulting from qualitative efficiencies [...] or price decrease’.¹⁰⁷⁹ Non-use benefits are indirect benefits ‘resulting from the consumer’s appreciation of the impact of their sustainable consumption on

¹⁰⁷¹ *ibid.*, para 543.

¹⁰⁷² It appears that the Commission sees sustainability benefits as qualitative efficiencies rather than cost efficiencies.

¹⁰⁷³ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 578.

¹⁰⁷⁴ See the definition of consumers in para 84 of the Guidelines on the application of Article 81(3) (n 364), which is reaffirmed in para 588 of the Draft Guidelines on Horizontal Co-operation Agreements (n 49).

¹⁰⁷⁵ On the fair share criterion see section 5.2.4 of the current chapter.

¹⁰⁷⁶ This is in line with the Commission practice regarding environmental agreements examined in section 5.2.2.1.2 of the current chapter.

¹⁰⁷⁷ Draft Guidelines on Horizontal Co-operation Agreements (n 49), paras 590-600.

¹⁰⁷⁸ *ibid.*, para 590.

¹⁰⁷⁹ *ibid.*

others'.¹⁰⁸⁰ Here, the benefit is not characterised by the use experience of the consumers, but rather by the consumers' willingness to pay more¹⁰⁸¹ for a sustainable product in order to produce societal benefits.¹⁰⁸² Therefore, this type of benefit is equated to a quality improvement as the consumers perceive these products, by benefiting others, to be of higher quality.¹⁰⁸³

Secondly, collective benefits 'occur irrespective of the consumers' individual appreciation of the product and objectively can accrue to the consumers in the relevant market if the latter are part of the larger group of beneficiaries'.¹⁰⁸⁴ As for collective benefits, contrary to the older Guidelines, the consumer is part of the positive side of the balancing exercise in its function as a citizen in society rather than a consumer in the relevant market. The Draft Guidelines also appear to accord lesser importance to the willingness-to-pay as the Commission states that voluntary actions might not be enough, and it might be necessary to internalise negative externalities even if consumers are not willing to pay a higher price for new greener technology.¹⁰⁸⁵ Whilst this makes sense in terms of benefits, the balancing exercise appears challenging to carry out if it is then limited to the relevant market. It could be argued that collective benefits of this kind cannot be confined to the relevant market as they are received by all consumer-citizens, irrespective of the market definition given to the agreement.

Nonetheless, the Commission asserts that whilst normally the analysis is limited to the relevant market, it may be necessary to consider other markets, provided these are related to the relevant market, as long as the group of consumers affected by the restraint is substantially the same as the one receiving the benefit.¹⁰⁸⁶ Thus, the key question becomes to identify this substantial overlap between the consumer groups, a concept referred to in this research as the

¹⁰⁸⁰ *ibid.*, para 594.

¹⁰⁸¹ For a critical perspective on willingness-to-pay, see Chapter 1, section 1.3.2.4. See also, Sunstein, 'Willingness to Pay vs. Welfare' (n 223).

¹⁰⁸² Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 596.

¹⁰⁸³ *ibid.*, para 597.

¹⁰⁸⁴ *ibid.*, para 601.

¹⁰⁸⁵ *ibid.* para 601.

¹⁰⁸⁶ *ibid.*, para 602; The Commission relies on the judgments of the EU Courts in Case T-168/01 *GlaxoSmithKline Services Unlimited v Commission* (n 963), paras 248 and 252; Case C-382/12 P *MasterCard and Others v Commission* (n 593), para 242. This issue is further discussed in section 5.2.4 of the current chapter.

‘capacity overlap criterion’. The Commission seems to have a broad view of this criterion. For instance, a car driver purchasing less polluting fuel would, in principle, be substantially the same as the citizen benefiting from the reduction of carbon dioxide.¹⁰⁸⁷ A possible limitation might be a proximity requirement as, conversely, environmental benefits that only occur in a smaller geographical area of production can in principle not be considered to benefit the consumers in their role as citizens and beneficiaries of positive externalities.¹⁰⁸⁸ However, it appears challenging to attach any precise boundaries to this requirement.

Finally, a general limitation exists to the possibility of an agreement being exempted on the basis of collective benefits, as the Draft Guidelines require a high threshold of market coverage for an agreement to be exempted on these grounds.¹⁰⁸⁹ The Commission states that the market coverage will likely need to be ‘significant’.¹⁰⁹⁰ However, the precise method of calculating such significance remains unclear. What can be inferred from the Draft Guidelines is that consumers should not be able, on a large scale, to free-ride and easily consume equivalent products that are not as environmentally effective.¹⁰⁹¹

Numerous unresolved issues persist, and in terms of legal certainty the Draft Guidelines provide little assurance. In particular, the quantification of qualitative collective benefits remains intangible, a concern acknowledged by the Commission itself.¹⁰⁹² Whilst consumers might theoretically receive a portion of collective benefits as a citizen – extending beyond their role of consumers in the

¹⁰⁸⁷ *ibid.*, para 604.

¹⁰⁸⁸ *ibid.*

¹⁰⁸⁹ *ibid.*, para 605.

¹⁰⁹⁰ *ibid.*

¹⁰⁹¹ *ibid.* The Commission takes the example of washing machine producers: ‘For collective benefits to materialise, the market coverage of the agreement may often need to be significant. If, for example, only two out of ten washing machine producers agree to abandon the more polluting variants, then the agreement will unlikely be able to prevent free-riding and hence will unlikely sufficiently reduce pollution, since self-interested consumers could still purchase the polluting variants from one or more of the remaining suppliers.’

¹⁰⁹² *ibid.*, para 608: ‘When there is no data available allowing for a quantitative analysis of the benefits involved, it must be possible to foresee a clearly identifiable positive impact on consumers, not a marginal one. The current experience with measuring and quantifying collective benefits remains scarce. The Commission will be able to provide further guidance on this matter after accumulating experience in dealing with concrete cases, which could allow the development of methodologies of assessment’.

relevant market – the exact measure of that portion appears challenging to quantify, if not outright impossible.

Consider, for instance, an agreement between automobile manufacturers aimed at phasing out older technology, such as plug-in hybrid engines in favour of pure electric motors.¹⁰⁹³ This agreement would involve technology sharing in terms of battery technology and the development of a shared vehicle platform for the mass production of future electric cars. It would also involve substantial upfront investment in terms of R&D. On one side, this could be perceived as restricting competition as it practically fixes prices for these core components of electric cars by standardising production costs across the manufacturers. In particular, it could lead to higher prices for the end consumer of the now-enhanced product.¹⁰⁹⁴ However, on the flip side, beyond cost reductions and a shared technological platform, the agreement may generate considerable collective benefits due to the reduction of fossil-fuel vehicles in the EU market.

The first issue to determine in the proposed hypothetical scenario pertains to the combined market coverage of the firms involved, which must be significant. The Draft Guidelines do not offer further guidance beyond the assertion that 20% market share is inadequate to prevent freeriding by consumers.¹⁰⁹⁵ The exact threshold appears difficult to assess due to its highly contextual nature, depending on a multitude of parameters influencing consumer choices, preferences, and willingness-to-pay.

Should the market share be deemed significant, the subsequent issue entails quantifying the precise volume of individual and collective benefits accruing to the consumers in the relevant market. These benefits should then be juxtaposed

¹⁰⁹³ This scenario is by no means implausible. The ‘Fit for 55’ package approved by the European Parliament in February 2023 includes a goal of ‘zero CO₂ emissions for new cars and vans in 2035’ prohibiting the sale of internal combustion engine vehicles, available at: <https://ec.europa.eu/commission/presscorner/detail/en/ip_22_6462>.

¹⁰⁹⁴ Assuming that the costs of producing cars powered by electric engines are higher than those powered by traditional combustion engines. This conclusion seems overall plausible based on five factors: R&D costs (might involve substantial upfront investment); production costs (electric vehicles might require different components, in particular expensive rechargeable lithium-ion batteries); economic of scale (traditional internal combustion engines have been in production for over a century, allowing manufacturers to achieve significant economies of scale); supply chains structure (these are already established for manufacturing internal combustion engines); and regulatory costs (regulation around safety, emissions and disposal of battery components may also contribute to higher costs).

¹⁰⁹⁵ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 605.

with the negative effects (restriction of competition) to assert a positive balance.¹⁰⁹⁶

Firstly, ‘individual use benefits’¹⁰⁹⁷ are accrued to the consumers in their capacity as electric vehicle purchasers. Potential benefits in this category may include the acquisition of a technologically superior product; diminished noise pollution resulting from the vehicles; and reduced inhalation of pollutants emitted from the vehicles.¹⁰⁹⁸ Moreover, they could also enjoy ‘individual non-use benefits’,¹⁰⁹⁹ such as the ‘appreciation of the impact of their sustainable consumption on others’, notably through the operation of less polluting vehicles.¹¹⁰⁰

Secondly, indirectly, consumers, in their role as citizens, reap collective benefits from the resulting environmental improvement (less pollution). However, it remains unresolved whether this adequately fulfils the consumer overlap criterion. The exact allocation of these benefits to each group of consumers remains unclear and, further, it seems virtually impossible to determine this with any degree of certainty. For instance, suppose it is possible to quantify the overall emission reduction to 300 million kilograms of carbon dioxide. The question then arises: how should this figure be distributed? Should it be divided by the number of purchasers (direct consumers), the population of the EU (indirect consumer-citizens), or by the population on the territory corresponding to the geographical market definition (consumer-citizens in the relevant market)? The complexity of this allocation is readily apparent. Yet, even if this issue was resolved and precise figures established, a significant hurdle persists. Neither the Commission nor the Courts quantify restrictions of competition under Article 101(1). Consequently, this leaves the interpretation with two entirely unintelligible numbers due to the lack of a comparable benchmark in terms of the harm caused to competition.

In conclusion, the Guidelines seem to deliberately leave certain issues unresolved, consistent with the Commission’s approach favouring flexibility.¹¹⁰¹

¹⁰⁹⁶ *ibid.*, para 19.

¹⁰⁹⁷ *ibid.*, para 590.

¹⁰⁹⁸ For examples see *ibid.*, paras 590-593.

¹⁰⁹⁹ *ibid.*, para 594.

¹¹⁰⁰ *ibid.*

¹¹⁰¹ (n 1034).

However, it remains highly uncertain how these principles will be implemented in individual cases. Moreover, the reference to a ‘significant’ market share is not easily discernible and seems analytically unjustified, particularly when considering the potential impact that the agreement may still exert, regardless of the market share held.¹¹⁰² However, on the whole, the Draft Guidelines appear to embrace a broader approach than the Guidelines on Article 101(3). They deviate from a strictly partial analysis of the relevant market, thereby extending the category of ‘consumers’, merging with the broader category of consumer-citizens through an analysis of societal impact. This shift is welcomed, as it acknowledges that consumers’ preferences and behaviour exist beyond the realms of the geographical and material area where demand for a specific product or service meets supply.

In addition, the Commission underscores the importance of future consumers, acknowledging that sustainability requires an inter-generational analysis of benefits.¹¹⁰³ The concept of sustainability itself is expansive, encompassing a variety of qualitative parameters such as greening food habits and animal welfare. Notably, the Commission expressly uses the term ‘benefits’ rather than ‘qualitative efficiencies’, which could be seen as an emblematic shift in focus. However, as outlined above, there remain issues that are problematic. At its core, the notion of collective benefits, which requires a broadening of the established, partial analysis, poses considerable challenges in achieving a consistent and coherent reconciliation with the inherent limitations endemic to contemporary antitrust analysis. As a result, it would seem that the Guidelines do not provide the clarity concerning the scope of Article 101(3) that legal practice has been seeking.¹¹⁰⁴

5.2.3 Market Boundaries: Article 101(3) and the Cross-Aggregation Challenge

The boundaries of the analysis under Article 101(3) TFEU must be defined. A key factor to consider is whether benefits can occur in markets other than the one in

¹¹⁰² No evidence exists to suggest that a company that, even if it holds 20% of the market, cannot be responsible for a much larger part of the pollution within its respective industry.

¹¹⁰³ Townley, ‘Inter-Generational Impacts in Competition Analysis: Remembering Those Not Yet Born’ (n 897) 584.

¹¹⁰⁴ (n 1065).

which the agreement is concluded (the relevant market). The argument for an encompassing cross-market analysis is reinforced by the concept of collective benefits, i.e., wider societal objectives. As seen previously, certain non-competition objectives that Commission and the Courts have acknowledged have effects that radiate far beyond the confines of the relevant market.¹¹⁰⁵ Hence, limiting the assessment to the relevant market is not entirely without controversy when an agreement generates positive societal externalities, such as reducing carbon dioxide emissions by the development of a more environmentally friendly production technique. This argument also applies to dynamic efficiency improvements, where not only current consumers can benefit, but also (and sometimes primarily) future consumers.¹¹⁰⁶ A dynamic approach requires the aggregation of benefits across generations and sometimes markets – so-called ‘inter-generational’ benefits.¹¹⁰⁷

As a rule, the Commission has taken a more stringent approach, rejecting the possibility of cross-subsidisation of pro-competitive effects or other benefits across different markets.¹¹⁰⁸ The fair share criterion requires that the consumers in the relevant market are adequately compensated for any potential adverse effects. The Guidelines define consumers as:

[t]he concept of ‘*consumers*’ encompasses all direct or indirect users of the products covered by the agreement, including producers that use the products as an input, wholesalers, retailers and final consumers, i.e. natural persons who are acting for purposes which can be regarded as outside their trade or profession.¹¹⁰⁹

Consequently, the concept of consumers extends beyond the immediate customers to the parties involved in the agreement to also encompass subsequent

¹¹⁰⁵ See section 5.2.2.1.2 of the current chapter.

¹¹⁰⁶ e.g., Townley, ‘Inter-Generational Impacts in Competition Analysis: Remembering Those Not Yet Born’ (n 897).

¹¹⁰⁷ *ibid.*

¹¹⁰⁸ Guidelines on the application of Article 81(3) (n 364), para 43: ‘The assessment under Article [101(3)] of benefits flowing from restrictive agreements is in principle made within the confines of each relevant market to which the agreement relates. The [EU] competition rules have as their objective the protection of competition on the market and cannot be detached from this objective [...]’.

¹¹⁰⁹ *ibid.*, 84.

purchasers.¹¹¹⁰ Notably, there is no reference to consumers beyond the relevant market defined for the purposes of Article 101(1). This notion of consumer directly limits the scope of market failure analysis by focusing on a partial, market-specific equilibrium, particular to the transaction realised by the agreement. As per the Guidelines, ‘consumers’ are not merely equated to ‘citizens’ – as would be the case in a larger general equilibrium analysis – but are construed as consumers within the relevant market, or in adjacent markets in the case of subsequent buyers.

By expanding the consumer notion to include subsequent buyers, the Guidelines do not appear to strictly prohibit aggregation of consumer benefits across different markets. Under the section ‘General principles’, the Commission states that the analysis under Article 101(3) ‘is in principle made within the confines of each relevant market to which the agreement relates’.¹¹¹¹ Furthermore, the Commission’s theory of harm appears to transcend mere consumer protection via the fair share criterion as it asserts that ‘[...] society as a whole benefits where the efficiencies lead either to fewer resources being used to produce the output consumed or to the production of more valuable products and thus to a more efficient allocation of resources’.¹¹¹² However, broader societal benefits are merely incidental to the agreement and cannot alone justify an agreement where consumers (in the relevant market) do not receive a fair share of the benefits.

The narrow approach of limiting the analysis to the relevant market stands in stark contrast with the case law of the EU Courts, which appear to explicitly argue for the inclusion of effects produced by the agreement in other markets, external to the agreement, within the analysis under Article 101(3).¹¹¹³

The earlier case law is from the General Court. In *Compagnie générale maritime and Others*,¹¹¹⁴ an association of liner companies entered into a price-fixing agreement which was found to breach Article 101(1). The applicants argued that the Commission breached 101(3) when refusing to grant the agreement

¹¹¹⁰ *ibid.* See e.g., *Case C-501/06 P GSK* (n 78), where the EU Courts took into account not only the final consumers but also the healthcare funds covering the expenses related to pharmaceuticals.

¹¹¹¹ *ibid.*, para 43.

¹¹¹² *ibid.*, para 85.

¹¹¹³ See section 5.2.2.1.2 of the current chapter. For a similar view and a critical analysis of the Commission’s approach see Christopher Townley, ‘The Relevant Market: An Acceptable Limit to Competition Analysis?’ (2011) 32 *European Competition Law Review* 490, 493; Townley, *Article 81 EC and Public Policy* (n 891) 186-193 and references therein.

¹¹¹⁴ *Case T-86/95 Compagnie générale maritime and Others v Commission* EU:T:2002:50.

exemption.¹¹¹⁵ Notably, this case exhibited benefits emerging in multiple markets – specifically, in the markets for inland and maritime transport and transport services. The Commission, in its decision, found that the benefits accruing on different markets must be analysed separately depending on the market in which they occur.¹¹¹⁶ The General Court found that:

For the purposes of examining the merits of the Commission’s findings [...] regard should naturally be had to the advantages arising from the agreement in question, not only for the relevant market, namely that for inland transport services provided as part of intermodal transport, but also, in appropriate cases, for every other market on which the agreement in question might have beneficial effects, and even, in a more general sense, for any service the quality or efficiency of which might be improved by the existence of that agreement. [...] Article 101(3) TFEU [envisage] exemption in favour of, amongst others, agreements which contribute to promoting technical or economic progress, without requiring a specific link with the relevant market.¹¹¹⁷

In a subsequent case, *CMA CGM*,¹¹¹⁸ the Commission assessed another agreement within the ship liner industry. Reiterating the findings of *Compagnie générale maritime and Others*, the General Court ruled that Article 101(3) provides for justification for agreements without it being necessary that the analysis of benefits is limited to the relevant market on which the agreement takes place.¹¹¹⁹

Moreover, the narrow approach of limiting the analysis to the relevant market has not been consistently applied by the Commission, which has exceptionally appeared inclusive towards third markets and other consumer

¹¹¹⁵ *ibid.*, paras 278-399.

¹¹¹⁶ *ibid.*, para 342.

¹¹¹⁷ *ibid.*, para 343.

¹¹¹⁸ Case T-213/00 *CMA CGM and Others v Commission* EU:T:2003:76.

¹¹¹⁹ *ibid.*, para 227.

groups.¹¹²⁰ A notable example is the *Star Alliance* case,¹¹²¹ where the Commission assessed a joint venture agreement concluded between airlines, encompassing coordination on pricing, capacity, revenue-sharing and scheduling.¹¹²² After finding a potential breach of Article 101(1), the Commission shifted its assessment to Article 101(3). It found that, whilst efficiencies could, in principle, be identified within the relevant market, so-called ‘in-market efficiencies’,¹¹²³ there are also certain ‘out-of-market efficiencies’.¹¹²⁴ Yet, these broader efficiencies do not appear sufficient on their own. In its decision, the Commission stated:

This broadened test does not, however, replace the test under paragraph 43 [of the Guidelines on Article 81(3)]. It is used in the specific circumstances of this case, in addition to the test under paragraph 43.¹¹²⁵

The Commission further clarified, ‘[u]nder this broadened test, the Commission credits the out-of-market efficiencies only to the extent that they accrue to the customer group in the relevant market at issue’ – ‘this assessment does not balance competitive harm to one customer group against benefits to another group’.¹¹²⁶

Despite evidence of a broader approach in practice, the soft law consistently limits the analysis to the relevant market. In the Draft Guidelines explored in the previous section, the Commission, referring to the case law of the EU Courts, requires that third markets can only be considered so far as the consumer group is substantially the same.¹¹²⁷ To support this conclusion, the Commission cites two

¹¹²⁰ Lianos, Korah and Sicilliani (n 357) 658. Townley, *Article 81 EC and Public Policy* (n 891)187. As Townley noted the Commission has considered third markets and consumer groups in its decisional practice, see e.g., Commission Decision (94/384/EC) of 6 June 1994 amending Decision 88/330/EEC (Case IV/32075 - Bayer/BP Chemicals), paras 32-34; Commission Decision (88/555/EEC) of 11 October 1988 (Case No IV/32173 - Continental/Michelin), para 27; Commission Decision (91/38/EEC) of 12 December 1990 (Case No IV/32363 - KSB/Goulds/Lowara/IT), para 27; Commission Decision (1999/329/EC) of 12 April 1999 (Cases No IV/D-1/30373 P & I Clubs, IGA and No IV/D-1/37143 P & I Clubs, Pooling Agreement).

¹¹²¹ Commission Decision of 25 May 2013 (Case COMP/AT39595 *Star Alliance*), paras 57-58.

¹¹²² *ibid.*, para 2.

¹¹²³ Jacques Bulhart and David Henry, ‘Think Green Before You Apply: EU Competition Law and Climate-Change Abatement’ (2021) 44(2) *World Competition Law and Economics Review* 147, 158.

¹¹²⁴ Commission Decision (COMP/AT.39595) ‘*Star Alliance*’ (n 1121), paras 56-57.

¹¹²⁵ *ibid.*, para 57.

¹¹²⁶ *ibid.*, para 61.

¹¹²⁷ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 602.

cases. First, the General Court's judgment in *GSK*.¹¹²⁸ However, the General Court considers cross-aggregation to be a possibility without requiring the two consumer groups to be substantially the same:

It is therefore for the Commission, in the first place, to examine whether the factual arguments and the evidence submitted to it show, in a convincing manner, that the agreement in question must enable appreciable objective advantages to be obtained [...], it being understood that these advantages may arise not only on the relevant market but also on other markets (Case T-86/95 *Compagnie générale maritime and Others v Commission* [...]).¹¹²⁹

The second case referenced is *MasterCard*.¹¹³⁰ In the context of the case, involving dual markets within card payment systems, the Court found that the benefits could not compensate for the disadvantages since the consumer groups were not substantially the same.¹¹³¹ Nevertheless, it is important to note that the judgment does not require such a correlation as a legal requirement:

However, as is recalled in paragraph 234 of the present judgment, examination of the first condition laid down in Article 81(3) EC raises the question of whether the advantages derived from the measure at issue are of such a character as to compensate for the disadvantages resulting therefrom. Thus, where, as in the present case, restrictive effects have been found on only one market of a two-sided system, the advantages flowing from the restrictive measure on a separate but connected market also associated with that system cannot, in themselves, be of such a character as to compensate for the disadvantages resulting from that measure in the absence of any proof of the existence of appreciable objective advantages attributable to that measure in the relevant market, *in particular*, as is apparent from paragraphs 21 and 168 to 180 of the

¹¹²⁸ Case T-168/01 *GlaxoSmithKline Services Unlimited v Commission* (n 963).

¹¹²⁹ *ibid.*, para 248.

¹¹³⁰ Case C-382/12 *P MasterCard and Others v Commission* (n 593), para 242.

¹¹³¹ *ibid.*, paras 240-244.

judgment under appeal, where the consumers on those markets are not substantially the same.¹¹³²

As a result, as of today there is no general legal requirement limiting the analysis under Article 101(3) to benefits exclusively produced in the relevant market(s). Considering this, there exists a potential framework wherein broader efficiencies may be balanced within a market failure analysis. Despite the Court's disapproval in *Mastercard* of benefits exclusively accruing to consumers on one side of a dual market system, it is argued that this verdict should not be regarded as an exception that proves the rule. Instead, it appears that, in the absence of collective benefits, it is imperative for benefits to be produced for consumers in all relevant markets harmed by the restriction of competition, ensuring a fair share.

5.2.4 The Functional Scope of Article 101(3): the Fair Share Criterion

From a market failure perspective, the fair-share criterion within Article 101(3) TFEU appears to depart from a total welfare approach, instead highlighting its potential distributional effect by reallocating wealth from producers to consumers. This criterion is mainly clarified in the Guidelines of the Commission, which this subsection now examines.

To satisfy this criterion, the benefits generated by the agreement must result in, 'at least', a net neutral effect from the point of view of the affected consumers.¹¹³³ This requirement is sometimes labelled the 'pass-on' requirement¹¹³⁴ as the effects must be balanced to achieve neutrality from a consumer welfare standpoint rather than a total welfare perspective.

However, despite the wording,¹¹³⁵ the analysis remains objective, devoid of any fairness consideration in the distribution of benefits between producers and

¹¹³² *ibid.*, para 242 (emphasis added).

¹¹³³ Guidelines on the application of Article 81(3) (n 364), para 85.

¹¹³⁴ *ibid.*, para 104., see also e.g., Geradin, Layne-Farrar and Petit (n 315) 169; Whish and Bailey (n 440) 170.

¹¹³⁵ The fairness element is even stronger in the French version of the Treaty which refers to 'partie équitable du profit'.

consumers.¹¹³⁶ Irrespective of profits on the supply side, a strict net effect of positive benefits ensures that consumers are better by the agreement. This neutrality requirement introduces a ‘sliding scale’¹¹³⁷ that varies based on the gravity of the restriction, seeking a Pareto improvement in the market from a welfare economics perspective.¹¹³⁸ Such an interpretation suggests no interpersonal value-judgments are involved in the CBA.¹¹³⁹ Furthermore, this interpretation is supported by the fact that there is no need that consumers benefit equally from each efficiency gain, as long as they receive a fair share of the overall benefits, thereby enlarging the metaphorical ‘cake’.¹¹⁴⁰

The precise definition of what falls within the ‘fair share’ category remains unclear, in particular regarding out-of-market efficiencies. Generally, the negative effects of an anticompetitive agreement entail lessened competition, and, consequently, higher prices. In *MasterCard*, the Commission considered that any price increases, even those only likely to occur, must be offset by increased quality or other compensatory benefits.¹¹⁴¹ In *Synthetic Fibers*, the Commission found that a ‘short-term increase in prices to the user’ could be compensated as ‘consumers stand to gain from the improvement in production, in that the industry which eventually emerges will be healthier and more competitive and able to offer them better products [...]’.¹¹⁴²

Finally, as highlighted in the previous section, in the context of multisided markets and out-of-market benefits, it is crucial for efficiency gains to at least compensate consumers on the side of the market that is harmed by the

¹¹³⁶ Although fairness has been stressed by the Commission in EU antitrust law, see Chapter 4, section 4.3.1.

¹¹³⁷ Geradin, Layne-Farrar and Petit (n 315) 171.

¹¹³⁸ On the nature of Pareto improvements see Chapter 2, section 2.1.

¹¹³⁹ In contrast to value judgments, a net positive effect is required. Of course, the test itself is an expression of a value judgment; however, its application remains objective.

¹¹⁴⁰ Guidelines on the application of Article 81(3) (n 364), para 86.

¹¹⁴¹ Commission Decision (2009/C 264/04) of 19 December 2007 (Case COMP/34579 MasterCard, etc), para 734. Upheld in, Case T-111/08 MasterCard v Commission EU:T:2012:260 and Case C-382/12 P MasterCard and Others v Commission (n 593), para 234.

¹¹⁴² Commission Decision (84/380/EEC) of 4 July 1984 (IV/30810 - Synthetic fibres), paras 39-41.

restriction.¹¹⁴³ In *Asnef-Equifax*,¹¹⁴⁴ the ECJ recognised that ‘[i]t is the beneficial nature of the effect on all consumers *in the relevant market* that must be taken into consideration’.¹¹⁴⁵ Finally, the burden of proof of substantiating pass-on to consumers of benefits falls on the undertakings.¹¹⁴⁶

In conclusion, the fair share criterion underscores the importance of considering consumer welfare, rather than total welfare, in assessing the effects of the agreement, influencing the dynamic of market failure. However, defining a ‘fair share’ for the purpose of out-of-market efficiencies remains ambiguous.

5.2.5 The Proportionality Principle as a Legal Test under Article 101(3)

Chapter 3 demonstrated that the principle of proportionality could potentially shoulder a market failure test.¹¹⁴⁷ This subsection argues that whilst necessity, particularity, and proportionality, generally, constitute crucial concepts for market failure analysis, EU antitrust law does not provide substantial guidance on Article 101(3) aside from the requirement of a strict balancing of a net positive effect. The principle of proportionality finds limited application in EU antitrust law, primarily its procedural shape.¹¹⁴⁸ Essentially, proportionality can be broken down into three components: suitability, necessity and *stricto sensu* balancing,¹¹⁴⁹ with the latter components manifesting proportionality in substantive EU antitrust law. Article 101(3) provides that agreements can be exempted if they do not:

¹¹⁴³ Case C-382/12 P *MasterCard and Others v Commission* (n 593), para 225: ‘As regards the substance, the Commission considers that the existence of efficiency gains on several markets does not guarantee a fair share of the benefit to consumers, in accordance with the second condition laid down in Article 81(3) EC. The lack of a fair share of the benefit is a finding of fact, which is not amenable to appeal. In any event, LBG did not explain how the General Court’s finding in relation to the accrual of a fair share of the benefit to customers is legally wrong. The interrelated nature of the markets in the two-sided scheme does not weaken the general rule that a fair share of efficiency gains must at least accrue to the customers harmed by the restriction in question.’

¹¹⁴⁴ Case C-238/05 *Asnef-Equifax, Servicios de Información sobre Solvencia y Crédito SL v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* EU:C:2006:734.

¹¹⁴⁵ *ibid.*, para 70.

¹¹⁴⁶ *ibid.*, para 84.

¹¹⁴⁷ See the framework in Chapter 3, section 3.3.

¹¹⁴⁸ See e.g., Hjærtström and Nowag (n 618).

¹¹⁴⁹ See Chapter 3, section 3.1.3.1.

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

In line with the Treaty, the Commission in its Guidelines on Article 101(3) describes proportionality as comprising a ‘two-fold test’.¹¹⁵⁰

First, the indispensability criterion assumes the form of a necessity test,¹¹⁵¹ albeit incorporating a suitability assessment of the measure to some extent.¹¹⁵² According to this criterion, the restriction must be indispensable for attaining the derived objective benefits. The Guidelines further specify that necessity entails that the restriction must be ‘reasonably necessary’ for achieving the efficiencies.¹¹⁵³ The Commission describes the test in its Guidelines:

According to the third condition of [Article 101(3)] the restrictive factor is whether or not the restrictive agreement and individual restrictions make it possible to perform the activity in question more efficiently than would likely have been the case in the absence of the agreement, or the restriction concerned.¹¹⁵⁴

Although the contemporary approach predominantly focuses on narrow efficiencies, this test should equally apply to broader efficiencies or even external objectives under Article 101(3). Two observations can be made. First, the wording ‘more efficiently’ appears to deviate from the terminology of the Treaty, which is ‘indispensable’. Second, according to the Commission, the test is based on a counterfactual scenario¹¹⁵⁵ for the sake of determining whether ‘there are no other

¹¹⁵⁰ Guidelines on the application of Article 81(3) (n 364), para 73.

¹¹⁵¹ This is explicitly stated in the ‘Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty’ (n 100) which equates this test with the identical LRM standard applied under Article 101(3) TFEU.

¹¹⁵² Geradin, Layne-Farrar and Petit (n 315) 172 suggested that ‘This condition confers a large margin of appreciation to competition authorities, when negotiating amendments to an agreement. Often, competition authorities will go beyond a mere ‘necessity’ test and seek to perform a ‘suitability’ assessment’.

¹¹⁵³ Guidelines on the application of Article 81(3) (n 364), para 73.

¹¹⁵⁴ *ibid.*

¹¹⁵⁵ *ibid.*, para 74.

economically practicable and less restrictive means of achieving the efficiencies'.¹¹⁵⁶ Nevertheless, an assessment of 'the market conditions and business realities' is indispensable, without it being necessary for the parties 'to consider hypothetical or theoretical alternatives'.¹¹⁵⁷

The application of the indispensability criterion appears to give the Commission and NCAs a large amount of discretion.¹¹⁵⁸ As seen in the quote above, the Commission seems to interpret the indispensability requirement broadly, equating it with achieving outcomes 'more efficiently'. However, this is contrary to the EU Court's case law, which suggests a more stringent understanding of the indispensability criterion grounded in a strict necessity test, akin to an LRM-standard. The *Lundbeck* case exemplifies this disparity, wherein a series of patent settlement agreements were found to be non-compliant with the criteria of Article 101(3) TFEU, primarily due to the existence of 'other types of settlement agreements, with no anticompetitive aspects'.¹¹⁵⁹ An LRM-standard is also visible in *Slovenská sporiteľňa*.¹¹⁶⁰ This case concerned an agreement that sought to exclude competitors operating in the banking sector without a valid license. The parties to the agreement contended that such exclusion was necessary in order to achieve efficiency gains and to protect 'healthy competition'.¹¹⁶¹ However, the Court found the agreement not to be indispensable since less restrictive means were available. Specifically, the parties could have lodged a complaint with the relevant authorities rather than eliminating these competitors themselves via a contractual agreement.¹¹⁶² Accordingly, the Court approach appears more rigorous than the Commission Guidelines, which tend to lean

¹¹⁵⁶ *ibid.*, para 75.

¹¹⁵⁷ *ibid.*: 'The Commission will not second guess the business judgments of the parties. It will only intervene where it is reasonably clear that there are realistic and attainable alternatives. The parties must only explain and demonstrate why such seemingly realistic and significantly less restrictive alternatives to the agreement would be significantly less efficient'.

¹¹⁵⁸ In contrast, Geradin, Layne-Farrar and Petit (n 315) have noted instances where the EC adopted a less restrictive approach. However, the cases cited are pre-modernisation and date from the 1970s.

¹¹⁵⁹ Case T-472/13 *Lundbeck* (n 962), para 719, upheld on appeal Case C-591/16 P EU:C:2021:243.

¹¹⁶⁰ Case C-68/12 *Protimonopolný úrad Slovenskej republiky v Slovenská sporiteľňa a.s* EU:C:2013:71.

¹¹⁶¹ *ibid.*, para 31.

¹¹⁶² *ibid.*, para 35.

towards a broader notion of indispensability, encapsulating the concept of performing an activity ‘more efficiently’.

Moreover, it is important to acknowledge that certain restrictions cannot be considered indispensable. Generally, the Commission considers hardcore restrictions or object restrictions to fall short of meeting the indispensability requirement.¹¹⁶³ Hardcore restrictions are typically perceived as object restrictions, making any efficiency gains secondary to the object of restricting competition.¹¹⁶⁴

The second proportionality test under Article 101(3) is the ‘no elimination of competition’ criterion, which entails a *stricto sensu* proportionality assessment. This criterion aligns with the status quo of EU competition law, demonstrating that, in certain cases, competition through rivalry is protected as such, even if potential efficiency gains can theoretically justify the restriction.¹¹⁶⁵ In other words, priority is given to preserving the competitive process over mere efficiency improvements.¹¹⁶⁶ This assessment revolves around the presence of actual or potential competition,¹¹⁶⁷ involving a comparison of the level of competition before and after the agreement.¹¹⁶⁸ With regard to potential competition, the defendant must demonstrate that there are low entry barriers in the market and substantiate how ‘a real competitive pressure’ is exercised by potential competitors.¹¹⁶⁹

As explained previously, EU antitrust law is not solely driven by a welfare economic concept of efficiency but is based on a myriad of objectives.¹¹⁷⁰ The rationale of Article 101 appears to go beyond short to medium-term efficiency and consumer welfare and aligns itself with the protection of competitive structure:¹¹⁷¹

¹¹⁶³ Guidelines on the application of Article 81(3) (n 364), para 46; Case C-179/16 *F.Hoffman-La Roche* EU:C:2018:25, para 98.

¹¹⁶⁴ ‘Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) (De Minimis Notice)’ (n 780), para 13.

¹¹⁶⁵ For a similar view see, Lianos, Korah and Sicilliani (n 357) 673.

¹¹⁶⁶ Guidelines on the application of Article 81(3) (n 364), para 105.

¹¹⁶⁷ *ibid.*, para 108.

¹¹⁶⁸ Guidelines on the application of Article 81(3) of the Treaty (n 364), para 107.

¹¹⁶⁹ *ibid.*, para 14.

¹¹⁷⁰ See Chapter 4, section 4.3.1.

¹¹⁷¹ As a proxy for long-term consumer welfare.

105. [...] The last condition of [Article 101(3)] recognises the fact that rivalry between undertakings is an essential driver of economic efficiency, including dynamic efficiencies in the shape of innovation. In other words, the ultimate aim of [Article 101] is to protect the competitive process. When competition is eliminated the competitive process is brought to an end and short-term efficiency gains are outweighed by longer-term losses stemming inter alia from expenditures incurred by the incumbent to maintain its position (rent seeking), misallocation of resources, reduced innovation and higher prices.

The Guidelines further provide insights into the assessment of this condition. The analysis is contextual and depends on the pre-existing market structure and the impact of the agreement on that structure.¹¹⁷² It extends beyond a mere consideration of market shares, requiring a quantitative and qualitative analysis.¹¹⁷³ Therefore, the lower the level of pre-existing actual or potential competition in a given market, the lower the threshold for considering that elimination has occurred.¹¹⁷⁴ High market shares and foreclosure of competitors are factors that have led the Commission to reject exemptions based on the grounds that the agreements eliminated ‘external competition’.¹¹⁷⁵ However, EU antitrust scholarship highlights the ambiguity surrounding the precise boundaries of ‘elimination of competition’, as ‘its contours remain nebulous’.¹¹⁷⁶ The mere creation of a dominant position through an agreement is insufficient grounds for determining the existence of an elimination of competition.¹¹⁷⁷

In conclusion, the necessity test, through the indispensability criterion, could serve as a double market failure safeguard by ensuring that restrictions are

¹¹⁷² Guidelines on the application of Article 81(3) (n 364), para 108. ‘The application of the last condition of Article 81(3) requires a realistic analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties to the agreement and the impact of the agreement on this competitive constraint. Both actual and potential competition must be considered’.

¹¹⁷³ *ibid.*, para 109.

¹¹⁷⁴ *ibid.*, para 107.

¹¹⁷⁵ Geradin, Layne-Farrar and Petit (n 315) 172; Commission Decision (93/406/EEC) of 23 December 1992 (Case IV/34072 Langnese-Iglo GmbH), paras 19–37; Commission Decision (93/405/EEC) of 23 December 1992 (Cases IV/31533 and IV/34072 Schöller Lebensmittel GmbH ‘Co KG), paras 1–18.

¹¹⁷⁶ Lianos, Korah and Sicilliani (n 357) 674.

¹¹⁷⁷ *ibid.*, 673.

limited to those imperative for realising the associated benefits. Simultaneously, the no elimination of competition-requirement could contribute to the *stricto sensu* analysis by placing a ceiling on the level of competition that can be eliminated to the benefit of efficiency gains. Consequently, the principle of unfettered competition, inherent in the default mode of EU competition law, can only be outweighed by efficiency gains, or benefits, allowing a certain level of workable competition to persist in the market.

5.3 Article 101(3): A Market Failure Analysis

This section aims to apply the criteria defined in Chapter 3¹¹⁷⁸ to the material described above in order to determine whether a market failure test can be identified within Article 101(3) TFEU. The test is based on four components:

- i) Identifying the rationale of intervention;
- ii) Identifying any market failure test/ ‘market diagnostics’;
- iii) Identifying double market failure test
- iv) Identifying potential trade-offs/balancing between competition, economic and external objectives.¹¹⁷⁹

The first subsection applies these components to Article 101(3). By examining the material through the lens of these four components, it is possible to determine if, and to what extent, Article 101(3) encompasses a market test. Beyond exploring the role of market failure, this section analyses the legal value of market failure. Consequently, the second subsection provides a summary of the findings from the first one, explicitly determining the presence and the nature of market failure analysis under Article 101(3). Finally, some conclusions are provided.

¹¹⁷⁸ See Chapter 3, section 3.3.3.

¹¹⁷⁹ *ibid.* Which aims at replying to the main research question, which is: *What role and value, if any, does market failure hold within legal analysis of public policy intervention on markets in EU competition law?*

5.3.1 Applying the Criteria to Article 101(3)

The application of the market failure framework to Article 101(3) TFEU involves an examination of its four key components. First, it is essential to examine the rationale behind public policy intervention under Article 101(3). This step aims to identify the type of market failure considerations that may be relevant to the analysis conducted under Article 101(3).

Second, the existence of a legal test, so-called ‘market diagnostics’, is assessed. This step is a logical extension of the first one. Whilst the rationale determines the ground for derogation, market diagnostics is used to verify the existence of market failure *in casu* as well as any threshold for intervention.

Third, an examination of the double market failure limb entails an efficiency analysis of the measures themselves. This facilitates a better understanding of the efficiency/external improvements allowed under Article 101(3), as well as the level of judicial scrutiny applied to such measures.

Finally, the *stricto sensu* proportionality and trade-offs are analysed, which brings clarity to the balancing process between narrow and broad market failure considerations as well as the EU antitrust status quo. This final step is crucial in order to determine the legal value of market failure in EU antitrust law.

5.3.1.1 The Rationale of Public Policy Intervention: Efficiency or Broader?

As seen in Chapter 2, market failure has numerous definitions, depending on whether a narrow or a broad approach is adopted.¹¹⁸⁰ The narrow approach focuses on ‘economic’ objectives,¹¹⁸¹ or ‘efficiency rationales’.¹¹⁸² In contrast, the broader standard could be based on macroeconomic considerations,¹¹⁸³ extending beyond a rupture of static economic efficiency. Additionally, an even broader approach could incorporate external or equity objectives, demanding a trade-off scenario.¹¹⁸⁴

¹¹⁸⁰ See Chapter 2, sections 2.2.1 and 2.2.2.

¹¹⁸¹ e.g., Ogus (n 18) 29-46.

¹¹⁸² e.g., Friederiszick, Röller and Verouden (n 340) 632. For an analysis of a narrow market failure standard see Chapter 2 section 2.2.1.

¹¹⁸³ Marciano and Medema (n 46) 4. For an analysis see Chapter 2 section 2.2.2.1.

¹¹⁸⁴ e.g., Friederiszick, Röller and Verouden (n 340). For an analysis see Chapter 2 section 2.2.2.2.

It is important to note that a broad standard may involve a combination of these elements, creating a multifaceted framework for analysis.

It is clear from the discussions in the current chapter that this distinction stands apart from the debate surrounding narrow versus broad benefits under Article 101(3) TFEU. Whilst broader market failure standards diverge from the confines of a utilitarian general equilibrium analysis, the discourse under EU antitrust law seems to revolve around the conflict between competition interests and a broader welfare standard that incorporates efficiency considerations beyond those arising solely from unfettered competition (i.e., broader efficiencies).¹¹⁸⁵ Furthermore, the debate in EU antitrust law indirectly centres around the choice between a partial or a general equilibrium analysis (out-of-market efficiencies), with the latter representing a broad standard capable of accommodating benefits that extend beyond short-term efficiency.¹¹⁸⁶

However, the dichotomy between a partial and a general equilibrium analysis is not a central concern in market failure theory in the sense of welfare economics, as the analysis inherently adopts a broader perspective. Therefore, a broad market failure standard truly emerges only when an objective transcends the mere improvement of dynamic or static efficiency in the sense of Pareto or Kaldor-Hicks optima. The subsequent analysis demonstrates that, more often than not, the benefits encompassed by Article 101(3) are narrower than those considered within a traditional market failure analysis. The narrower focus stems from the limitations of the analysis to the relevant market and/or the consumers of the relevant market. Nonetheless, there are occasional instances where out-of-market efficiencies align with conventional market failure theory. Moreover, broader macroeconomic market failure or stability failure considerations can exceptionally come into play within the realm of Article 101(3). Finally, in exceedingly rare circumstances, there exists a theoretical possibility for equity/external considerations to be integrated into the analysis under Article 101(3).

¹¹⁸⁵ See scholarly contributions discussed in Chapter 4, section 4.3.2.2.

¹¹⁸⁶ Townley, *Article 81 EC and Public Policy* (n 891) writes that a general equilibrium (or ‘total equilibrium’) ‘gives the Commission more flexibility to assess the economic welfare (and other) effects as a whole’.

The traditional narrow definition of market failure includes four distinct categories: externalities; imperfect competition (market power); information asymmetries; and public goods.¹¹⁸⁷ However, since competition law itself is a remedy to imperfect competition,¹¹⁸⁸ the question here is to establish to what extent other market failures can be included in the analysis under Article 101(3) TFEU. It is worth noting that not all market failures are fit for private remedies as public goods, which require state intervention, generally fall outside of the scope of Article 101(3).¹¹⁸⁹ From the perspective of a narrow view of market failure, the benefits covered by Article 101(3) can primarily be understood as externalities,¹¹⁹⁰ with information asymmetries being a less common occurrence.¹¹⁹¹

From the outset, the very existence of Article 101(3) denotes that EU antitrust law acknowledges the potential for other market failures. This provision facilitates the recognition of efficiencies beyond those engendered from unfettered competition, thereby necessitating a balancing act between positive effects and negative effects on competition. Nevertheless, the extent to which these efficiencies can justify anticompetitive agreements or clauses is limited. The efficiency-based test in Article 101(3) is distinctively narrower than a conventional theory of market failure in terms of both nature and scope. Whilst, *prima facie*, the questions of the scope and nature of the benefits are distinct, their interrelation is notable, as both these parameters influence the type of benefits that can be considered under Article 101(3). Considering the Commission's Guidelines on Article 101(3), the test is essentially a partial market failure test,¹¹⁹² limited to certain specific efficiencies.

¹¹⁸⁷ See Chapter 2, Section 2.2.1.

¹¹⁸⁸ See Chapter 2, Section 2.2.1.2.

¹¹⁸⁹ Baarsma and Rosenboom (n 1059) 407.

¹¹⁹⁰ Typically, in the shape of a benefit procured to the consumers in the light of the 'fair share' criterion. On externalities under Article 101(3) TFEU see, e.g., Baarsma and Rosenboom (n 1059) 407.

¹¹⁹¹ See section 5.2.2.2.1 of the current chapter.

¹¹⁹² See, e.g., Motta (n 272) 28: '[e]conomic welfare is the standard concept used in economics to measure how well an industry performs. It is a measure which aggregates the welfare (or surplus) of different groups in the economy' (p 28); Townley, *Article 81 EC and Public Policy* (n 891) 186: the answer might lay in the distinction between partial and a 'total equilibrium approach'.

In this partial analysis, the traditional categories of market failure do not fit very well. In such an analysis, any market failure considerations are internalised within the context of Article 101(3) and are solely based on the improvement of allocative, productive, or dynamic efficiency within a given market. Consequently, societal effects of benefits falling under Article 101(3) are disregarded. This implies that no general market failure analysis is undertaken, and the same applies to the restriction of competition. Any potential negative externalities beyond the relevant market, or even potential information asymmetries, are ignored in this analysis. This overly narrow approach deviates from economic theory by neglecting externalities produced for society.¹¹⁹³

However, this should not be interpreted to mean that market failure is irrelevant under Article 101(3). The above analysis shows that there have been exceptional instances where both the Commission and the EU Courts have accepted a true general equilibrium analysis when internalising externalities under Article 101(3).¹¹⁹⁴ This can be executed under either limb of Article 101(3).¹¹⁹⁵ These benefits could either foster positive externalities for non-users (and society) by optimising resources or mitigate negative externalities resulting from production or distribution. Traditional examples include pollution reduction, as was evidenced in cases such as *CECED*¹¹⁹⁶ or *Phillips/Osram*,¹¹⁹⁷ where the Commission first recognised ‘collective environmental benefits’.¹¹⁹⁸ Beyond out-of-market efficiencies, taking into account negative externalities necessarily brings the framework of the analysis beyond the relevant market.

Moreover, moving beyond static efficiency, the promotion of technological progress embodies the dynamic efficiency component of EU antitrust law. As put by the Commission in the Guidelines on Article 101(3):

¹¹⁹³ On the nature of externalities, see Chapter 2, section 2.2.1.1.

¹¹⁹⁴ See the cases on indirect benefits sections 5.2.2.1.2 and 5.2.3 and the notion of collective benefits in the Draft Guidelines on Horizontal Co-operation Agreements (n 49).

¹¹⁹⁵ However, they do appear to fit best within the even broader category of promoting economic progress (by a more efficient allocation of resources).

¹¹⁹⁶ Commission Decision (2000/475/EC) ‘CECED’ (n 1003).

¹¹⁹⁷ Commission Decision (94/986/EC) ‘Philips-Osram’ (n 997).

¹¹⁹⁸ *ibid.*, para 292, however the Commission refers to ‘indirect benefits’ resulting from a reduction of pollution.

Technical and technological advances from an essential and dynamic part of the economy, generating significant benefits in the form of new or improved goods and services. By cooperating undertakings may be able to create efficiencies that would not have been possible without the restrictive agreement or would have been possible only with substantial delay or higher cost.¹¹⁹⁹

This provision has been used to exempt licensing and R&D agreements.¹²⁰⁰ As noted earlier, due to the concept of future consumers, dynamic efficiency requires a broader analysis and cannot simply be assessed in the relevant market with its current consumers.¹²⁰¹ Whilst dynamic efficiency concerns frequently coincide with allocative efficiency, there are instances where they diverge, necessitating trade-offs.¹²⁰² However, because they most commonly lead to allocative efficiency, it is difficult to extract any criteria from the case law. This issue was raised in *GSK*.¹²⁰³ In this case, the Commission argued that the General Court could not simply infer technological progress from increased profits (an instance of allocative efficiency).¹²⁰⁴ The Commission maintained that ‘it is necessary to determine whether the restriction actually does contribute to the promotion of technical progress and not whether it gives rise to increased profits which may, if the undertakings wish, be invested in R&D’.¹²⁰⁵ The Court, however, dismissed the argument.¹²⁰⁶ This case exemplifies how the Court does not disassociate dynamic efficiencies (innovation) by the creation of new technology from allocative efficiencies resulting from the innovation (increased profits). The Draft Guidelines equally merge these two concepts of ‘efficiency gains’:

R&D agreements may also lead to a wider dissemination of knowledge, which may trigger further innovation. R&D agreements may also give rise to cost reductions and reduce dependencies on a too limited number

¹¹⁹⁹ Guidelines on the application of Article 81(3) (n 364), para 70.

¹²⁰⁰ (n 972); Case T-17/93 *Matra Hachette v Commission* (n 972), para 110.

¹²⁰¹ See section 5.2.2.2.3 of the current chapter.

¹²⁰² See Chapter 2, section 2.1. and section 2.2.2.3.

¹²⁰³ Case C-501/06 P *GSK* (n 78).

¹²⁰⁴ *ibid.*, para 112.

¹²⁰⁵ *ibid.*

¹²⁰⁶ *ibid.*, para 120.

of suppliers of certain technologies, products and services. These efficiency gains can contribute to a resilient internal market.¹²⁰⁷

Nonetheless, it seems completely possible to grant exemption to an agreement on the basis of dynamic efficiencies via a Kaldor-Hicks standard, even when there is no contribution to allocative efficiency.

This subsection has shown that whilst the Commission's orthodox view of efficiencies and out-of-market benefits generally limits the use of a general market failure analysis, there are circumstances where it is relevant. The Draft Guidelines, particularly within the context of sustainability agreements, have bolstered the pertinence of a general market failure analysis by acknowledging that antitrust law plays a role in mitigating broader societal effects of business practices.

5.3.1.1.2 *Stability Failure and Macroeconomic Standards*

A broader Musgravian market failure analysis has the capacity to include both macroeconomic factors (Keynesian stability failure) and equity considerations (i.e., transfer of wealth in order to divide the cake better).¹²⁰⁸

In certain cases, prior to the modernisation process, it seems that broader economic considerations have factored into the assessment under Article 101(3) TFEU, sometimes via the limb of economic progress. However, a similar issue as encountered with dynamic efficiencies arises, as these also generate efficiencies in a narrow sense, blurring the distinction between broad and narrow consideration. For instance, in *Remia v Commission*,¹²⁰⁹ the Court explicitly held that the objective of employment falls under Article 101(3) as 'it improves general conditions of production, especially when market conditions are unfavourable'.¹²¹⁰ Accordingly, two interpretations are possible: (i) either the promotion of employment as a goal falls under the limb of production improvements; or (ii) employment is a proxy for achieving narrow efficiency via the optimisation of production. In the latter interpretation, employment is internalised within the efficiency analysis, whilst in the first it operates as a stand-alone rationale. Only

¹²⁰⁷ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 188.

¹²⁰⁸ See Chapter 2 section 2.2.2.

¹²⁰⁹ Case 42/84 *Remia BV and others v Commission of the European Communities* (n 1016).

¹²¹⁰ *ibid.*, para 42.

within the framework of the first interpretation is a broad market failure standard adopted.

There are instances where employment as a societal goal/benefit is apparent in the Commission practice. In *Stichting Baksteen*, the emphasis was not on the improvement of production as a result of employment, but rather on ‘acceptable social conditions’.¹²¹¹ The reference to ‘acceptable social conditions’ appears to be more related to an equity improvement rather than efficiency. Similarly, in *Ford/Volkswagen*, the emphasis was on the creation of employment and the contribution it makes to the ‘promotion of the harmonious development of the [EU] and the reduction of regional disparities which is one of the basic aims of the Treaty’.¹²¹² Such an approach appears to align with a macroeconomic approach to market failure, incorporating elements like GDP, employment rate and inflation control. In this regard, scholars have noted that during this period the Commission was guided by Keynesian theories.¹²¹³ The Keynesian element of a broader macroeconomic market failure, understood as a stability failure approach, has been explained previously.¹²¹⁴

The case law also provides some evidence of a broader macroeconomic/stability approach. In *Metro I*, the Court of Justice reviewed a Commission decision granting exemption to an agreement implementing a selective distribution system.¹²¹⁵ Several macroeconomic considerations were taken into account. Initially, the Court held that the obligations in the contract take into account the ‘probable growth of the market’, which might ensure ‘stability in the supply’.¹²¹⁶ Further, a supply forecast ‘constitutes a stabilizing factor with regard to the provisions of employment’.¹²¹⁷ Although the Court referred to employment improving ‘the general conditions of production’,¹²¹⁸ it seems to accommodate wider societal concerns within that analysis.

¹²¹¹ Commission Decision (94/296/EC) ‘*Stichting Baksteen*’ (n 1012), para 27.

¹²¹² Commission Decision (93/49/EEC) ‘*Ford Volkswagen*’ (n 1010), para 36.

¹²¹³ Wolf Sauter, *Competition Law and Industrial Policy in the EU* (n 561) 1-2; Brook (n 806) 60.

¹²¹⁴ Chapter 2, section 2.2.2.1. See also e.g., Bateman (n 5).

¹²¹⁵ Case 26/76 *Metro I* (n 350).

¹²¹⁶ *ibid.*, para 43.

¹²¹⁷ *ibid.*

¹²¹⁸ *ibid.*

Hence, despite the lack of recent case law, both the practice of the Commission and the case law of the Court permit the inclusion of broader macroeconomic concerns, beyond the relevant market, under Article 101(3). However, such an approach is not frequently adopted. As evidenced by the prevailing soft law and the dearth of cases post-modernisation, a narrower approach is generally favoured in the present context.

5.3.1.1.3 *Equity and External Objectives*

Determining the place of external objectives/equity under Article 101(3) TFEU is less clear-cut. As seen previously, external objectives typically refer to equity or so-called distributional failures.¹²¹⁹ It seems that due to the lack of cases and the emphasis on efficiency (in a narrow sense), equity is not viewed as a goal that can be balanced against competition under Article 101(3). This is not surprising, as Article 101(3) addresses private restrictions emanating from undertakings and the distribution of wealth is generally a responsibility allocated to the public via the use of tax measures.¹²²⁰

Beyond equity via the distribution of resources, other ‘external’ public policy goals are also imaginable. Public health has been referred to by the Commission in conjunction with technical progress. In *Pasteur-Mérieux/Merck*, the Commission noted that technical progress and the improvement of distribution in the vaccine sector ‘responds to a genuine public health concern’.¹²²¹ The precise implications of this statement remain unclear, as the benefits put forward involved both efficiency-based and external ones.¹²²²

¹²¹⁹ Chapter 2, section 2.2.2.3.

¹²²⁰ This results from the second welfare paradigm explained in Chapter 2, section 2.1. See, e.g., Joseph E Stiglitz (n 300) 5.

¹²²¹ Commission Decision (94/770/EC) ‘Pasteur Mérieux-Merck’ (n 1019), para 88.

¹²²² *ibid.*, para 13: ‘The benefits of such, ideally heat-stable, vaccines would include: fewer injections; fewer clinic visits; increased family acceptance, resulting in better coverage; cost savings with regard to necessary supplies (e.g., needles, syringes, vials), cold chain storage space and administration by medical personnel; greater ease of delivery; simplified record keeping and more efficient post-administration monitoring services.’

The protection of smaller and specialised book publishers in *VBBB/VBVB* serves as another example of an external objective being recognised.¹²²³ It has been suggested that this signifies recognition of ‘cultural policy’¹²²⁴ in antitrust law.

Whilst examples where external objectives have been recognised are quantitatively less frequent, the EU Courts have left the inclusion of public policy objectives under Article 101(3) to the discretion of the Commission.¹²²⁵ Despite this potential, over the past two decades the Commission has focused on narrow efficiency and reinforced the trend to exclude broader efficiencies, and *a fortiori* external objectives, from the analysis under Article 101(3).¹²²⁶

The Draft Guidelines appear to break new ground by reintroducing the notion of broader public policy concerns into the realm of Article 101(3). When sustainability measures extend beyond internalising pollution, they can be considered broader than the traditional neo-classic utilitarian approach. In the Draft Guidelines the Commission provides a wide definition of sustainability agreements, going beyond just internalising pollution externalities and including human rights, reducing food waste, animal welfare, and more.¹²²⁷ Although these matters are, in principle, left to regulation, the Commission acknowledges that ‘[t]here may be other instances where, due to market failures, sustainability benefits cannot be achieved if left to the free interplay of market forces or can be achieved more cost efficiently if undertakings cooperate’.¹²²⁸ It also recognises that sustainability objectives can be pursued by agreements falling outside of this definition.¹²²⁹

In conclusion, whilst voices in legal scholarship have maintained the position that the Commission may consider public policy under Article 101(3), the

¹²²³ Commission Decision (82/123/EEC) ‘VBBB/VBVB’ (n 994), paras 52-53. Although the agreement ultimately did not qualify for exemption, it is noteworthy that the Commission did not dismiss the argument of the parties but instead rejected their defense on the grounds that they had failed to demonstrate the indispensability of the restriction. Moreover, the benefits, in any case, were deemed to be outweighed by the disadvantages (*proportionalitas stricto sensu*).

¹²²⁴ Monti (n 62) 1083.

¹²²⁵ Most notably see Case 26/76 *Metro 1* (n 350) and Joined Cases T-528/93 etc. *Métropole* (n 983).

¹²²⁶ See sections 5.2.2.2.1 and 5.2.2.2.3 of the current chapter.

¹²²⁷ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 543.

¹²²⁸ *ibid.*, para 584.

¹²²⁹ *ibid.*, para 547.

Commission itself has significantly narrowed the scope of public policy post-modernisation. The potential implications of the Draft Guidelines are uncertain at this time, although they appear to hold the capacity to reintroduce broader objectives into the analysis under Article 101(3). However, it is crucial to note that sustainability presents a peculiar objective, given the urgency surrounding the environmental crisis and the EU's sustainability agenda.¹²³⁰ Consequently, it is possible that this 'new' approach may not be a paradigm shift, but rather the creation of a *sui generis* position regarding sustainability.

5.3.1.2 Identifying a Market Diagnostic Test: Is the Market Failing?

This step involves formulating a legal test for market failure. Within the framework of this thesis, the proportionality principle plays a crucial role in identifying 'market diagnostics' (or 'prima facie proportionality') as a legal test.¹²³¹ Going beyond the rationale of intervention, this step is deconstructed into two limbs:

Is the market failing?

Is the market failure significant?¹²³²

Under the first limb of the test, it must be established whether the detection of failure of ideal market conditions – presumed to be attained in the competition law status quo – is a condition for recognising a market failure.¹²³³ This test occurs under a proportionality analysis via a necessity and appropriateness assessment. The second limb functions as a threshold to identify a sufficient level of failure requiring intervention. It is argued here that the 'appreciability' requirements of the Court are the closest test in EU antitrust law to a proper market diagnostics tool for assessing the desirability of public policy intervention.

Regarding the first limb, there is no direct test under Article 101(3) TFEU for determining the suitability or need for an agreement to be exempted. From this perspective, Article 101(3) lacks a tool for market diagnostics assessing market

¹²³⁰ e.g., Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 'Stepping up Europe's 2030 climate ambition - Investing in a climate-neutral future for the benefit of our people' COM (2020) 562 final.

¹²³¹ See Chapter 3, section 3.3.2.

¹²³² *ibid.*

¹²³³ *ibid.* See also Chapter 3, section 3.1.2 on competition law's status quo.

conditions. Instead, the potential for an efficiency improvement, via a Kaldor-Hicks standard,¹²³⁴ appears sufficient to consider a market failure at one end of the spectrum without further assessment of market conditions. An issue here is the ubiquity of externalities,¹²³⁵ suggesting that the provision itself is redundant as all markets present some degree of externalities and, hence, could potentially be improved. Such a finding is directly contrary to the decisional practice of the Commission, which has taken a narrow approach to the scope of Article 101(3) post-modernisation. As seen above, the Commission considers that Article 101(3) can only be applicable ‘in those *exceptional cases* where the free play of competition is unable to produce the best result economically speaking’.¹²³⁶ Article 101(3) thus finds itself situated at the intersection of a theoretical-empirical dichotomy. From one perspective, competition law is viewed as the most efficient mechanism for market organisation within society through the attainment of perfect competition. Conversely, empirical evidence from economic theory unequivocally suggests that all markets endure some degree of market failure. This clash between economic theory and legal reality brings to the fore the inherent tensions within the application and interpretation of Article 101(3).

Moving onto the second limb of market diagnostics, a threshold based on the significance of a market failure could be a strategy to overcome the ubiquity problem. Nevertheless, the above examination suggests that there is an absence of an explicit market failure threshold. Indirectly, however, the strict balancing of net positive effects and the exclusion of *de minimis* restrictions work as a threshold. As seen previously, certain restrictions which do not appreciably affect competition are excluded from Article 101(1).¹²³⁷ This rule serves as a market diagnostic test for the market failure of market power (or competition) under Article 101(1). Since only significant market failures in terms of competition can be captured by Article 101(1), the balancing requirement has the effect that minor efficiency improvements cannot be considered sufficient under Article 101(3). Consequently, Article 101(3) indirectly requires a certain level of market failure. The ‘appreciability’ of restrictions and, conversely, benefits, ensures a minimum

¹²³⁴ The improvement is predicated on a cost-and-benefit analysis, which requires a net positive effect without requiring a Pareto optimum (i.e., absence of adverse effects on any parties).

¹²³⁵ On the ubiquity of market failure, see Chapter 3, section 3.2.1.

¹²³⁶ Commission Decision (76/172/EEC) ‘Bayer/Gist-Brocades’ (n 977), para III(1) (emphasis added).

¹²³⁷ See Chapter 4, section 4.2.2.

threshold. This point is demonstrated in the case law of the Court when appreciably measuring the objective benefits, which is mirrored in the case law on *de minimis* restrictions. Drawing from the case of *Völk v Vervaecke*,¹²³⁸ and subsequent case law,¹²³⁹ it has been established that the agreement must restrict competition to an ‘appreciable extent’. In parallel, any derived under Article 101(3) must show ‘appreciable objective advantages of such character as to compensate for the disadvantages which they cause in the field of competition’.¹²⁴⁰ In conjunction with the causality requirement,¹²⁴¹ these parameters culminate in a market diagnostic tool. This tool effectively excludes minor market failures in terms of market power, and minor efficiency improvements that extend beyond market power respectively.

5.3.1.3 Identifying Double Market Failure: Indispensability of the Restriction

This step involves the application of ‘double market failure proportionality’, i.e., the proportionality principle is applied internally to the measure at stake through a double market failure test. As explained previously,¹²⁴² the term ‘double market failure’ denotes a ‘full-scale diagnostic tool frequently employed by policy analysts to determine the exact scope and nature of [public policy] intervention’.¹²⁴³ This concept encompasses an analysis of the intervention itself, safeguarding against the emergence of a ‘nonmarket failure’, otherwise referred to as ‘government failure’.¹²⁴⁴ Within the context of EU antitrust law, the double market failure test analysis is shouldered by the necessity criterion, encapsulated in the notion of ‘indispensability’.¹²⁴⁵ That criterion mandates that any restriction

¹²³⁸ Case 5/69 *Völk v Vervaecke* (n 773).

¹²³⁹ See Chapter 4, section 4.2.2.

¹²⁴⁰ Case C-56/64 *Consten and Gründig v Commission* (n 946), para 13.

¹²⁴¹ Case T-472/13 *Lundbeck* (n 962), para 709.

¹²⁴² See Chapter 3, section 3.2.1.

¹²⁴³ (n 400).

¹²⁴⁴ See Chapter 3, section 3.2.2.

¹²⁴⁵ In EU antitrust law, the indispensability criterion can be construed as a necessity test, see to this effect e.g., Case C-258/78 *LC Nungesser KG and Kurt Eisele v Commission* EU:C:1982:211, paras 76-78; Jacques Steenbergen, ‘Proportionality in Competition Law and Policy’ (2008) 35(3) *Legal issues of Economic Integration* 259, 265.

must be strictly indispensable to achieving the intended objective, meaning no other restrictions can be justified under Article 101(3).

The indispensability test rests fundamentally on two core requirements. The first necessitates a substantiated direct link between the restrictive agreement and the benefit accrued. The second requirement comprises an assessment of whether restrictive means to achieve these benefits exist in the context of the given restrictive agreement in question.¹²⁴⁶ In essence, it must be conclusively demonstrated that more benefits ‘are produced with the agreement or restriction than in the absence of the agreement or restriction’.¹²⁴⁷ This requirement implicitly establishes a double market failure standard, ensuring that the intervention does not result in a nonmarket failure, or at the very least, any nonmarket failure is outweighed by the resultant net positive effects.

Within its Guidelines, the Commission establishes a link between indispensability and efficiency by requiring that the individual restriction must demonstrably amount to an increase in efficiency, as assessed through a counterfactual scenario.¹²⁴⁸ From that perspective, the efficiency of the measure becomes inextricably intertwined with its efficacy. Therefore, EU antitrust law adopts a cautious stance towards inefficient public policy intervention that could potentially trigger a double market failure. By contrast, the Court of Justice does not explicitly link indispensability to efficiency. However, as has been seen, it seems to require a strict review of the measure via a LRM standard.¹²⁴⁹ This approach adopted by the Court is more stringent; it is insufficient for the agreement to achieve the benefits ‘more efficiently’, it must be proven beyond doubt no other conceivable means that are less restrictive exist. Thus, in practice, the case law of the Court also applies a double market failure standard, albeit stricter than that applied by the Commission.

5.3.1.4 Identifying Trade-Offs: *Stricto Sensu* Proportionality

The final limb of the proportionality test (*stricto sensu*) is examined to reveal any trade-offs between competition, narrow efficiencies and broader efficiencies or external objectives. This concluding stage offers insight into the boundaries of the

¹²⁴⁶ Guidelines on the application of Article 81(3) (n 364), para 73.

¹²⁴⁷ *ibid.*

¹²⁴⁸ *ibid.*

¹²⁴⁹ On the LRM standard, see Chapter 3, sections 3.1.3.2 and 3.1.3.3.

‘efficiency concept’ and clarifies the manner in which trade-offs with external objectives are executed. Ultimately, it enables an understanding of the extent to which a market failure analysis is admissible under EU antitrust law.

The presumption that EU antitrust law fosters the most optimal and efficient solution for society is powerful.¹²⁵⁰ Therefore, the scope for efficiency improvements via restrictions of competition within EU antitrust law seems far more restricted than it would be under a conventional narrow concept of market failure. As seen above, a basic principle of EU antitrust law is that not all efficiencies can justify a restriction of competition, and those efficiencies must further benefit the consumers.¹²⁵¹ Save exceptional cases, where the dynamic facet of efficiency is also taken into consideration,¹²⁵² efficiencies are predominantly assessed based on short to medium-term price effects (allocative efficiency) via cost and quality efficiencies.¹²⁵³

The impediment to incorporating broader efficiencies can largely be ascribed to the market-governed approach of EU antitrust law. Moreover, the no elimination criterion serves as an additional control mechanism, potentially limiting even substantial efficiency improvements derived from lessened competition in a given market. This engenders a predilection for the status quo even to the detriment of larger efficiency improvements. Consequently, Article 101(3) cannot be said to constitute a CBA in the sense of Pareto or Kaldor-Hicks efficiency. Thus, it would appear that the competitive structure triumphs over efficiency and consumer welfare.

Furthermore, the fair share criterion instigates a redistribution function, further limiting abstract efficiency improvements that do not directly benefit consumers in the relevant market in a quantitative manner. This is applicable in cases where consumer welfare, within the meaning of EU antitrust law, is not aligned with economic efficiency.¹²⁵⁴ This is evident from the Draft Guidelines, which require the quantification of collective benefits emanating from sustainability agreements, such as a reduction in pollution, to ascertain the

¹²⁵⁰ See, e.g., Commission Decision (76/172/EEC) ‘Bayer/Gist-Brocades’ (n 977), para III(1).

¹²⁵¹ E.g., Hjärtström and Nowag (n 618) 434.

¹²⁵² On dynamic efficiencies see the Guidelines on the application of Article 81(3) (n 364), paras 102-103.

¹²⁵³ See sections 5.2.2.2.1 5.2.2.2.2 of the current chapter.

¹²⁵⁴ Motta (n 272) 19. The meaning of welfare in economics is explained in Chapter 2, section 2.1.

fulfilment of the fair share criterion.¹²⁵⁵ There are three factors that impede the utility of such quantification.¹²⁵⁶ Firstly, the complexity of such an analysis is magnified when one considers that the restriction of competition is not typically quantified in terms of costs. In other words, anticompetitive restrictions are not quantified, rendering any quantification of the benefits nebulous. Secondly, the process for precisely quantifying broader efficiencies lacks comprehensive guidance. When considering environmental benefits, one could theoretically measure the value of cutting CO2 against price increases.¹²⁵⁷ However, even this type of analysis requires more detailed guidance from the Commission.¹²⁵⁸ If we extend the scope beyond environmental benefits, the complexity of such an exercise could exponentially increase. As previously highlighted, economists have long acknowledged the formidable challenge involved in quantifying market failure – a task that, in many cases, may verge on the impossible.¹²⁵⁹ Thirdly, such an analysis falls short when the price is not a determining factor.¹²⁶⁰ As a result, the quantification approach appears difficult to implement and inappropriate when the price is not a decisive factor.

In summary, the trade-off mechanism within EU antitrust law obstructs full consideration of broader efficiencies, even in cases where out-of-market efficiencies are taken into account.

5.3.2 The Existence of a Market Failure Test under Article 101(3)

Article 101(3) TFEU does not incorporate a clear market failure test. This section posits two claims, each of which is elaborated upon in separate subsections. First,

¹²⁵⁵ Draft Guidelines on Horizontal Co-operation Agreements (n 49), paras 606-608.

¹²⁵⁶ See section 5.2.2.2.3 of the current chapter.

¹²⁵⁷ For instance, this figure could be derived by considering the price of a metric ton of CO2 on the EU ETS market.

¹²⁵⁸ Which the Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 608, states that the Commission will be able to provide.

¹²⁵⁹ Friederisick, Röller and Verouden (n 300) 637. See Chapter 3, section 3.2.1.

¹²⁶⁰ For an analysis proposing sustainability as part of quality improvement see e.g., Cristina A Volpin, ‘Sustainability as a Quality Dimension of Competition: Protecting Our Future (Selves)’ (2020) Competition Policy International, available at: <<https://www.competitionpolicyinternational.com/wp-content/uploads/2020/07/02-Sustainability-as-a-Quality-Dimension-Cristina-A.-Volpin.pdf>>.

the test under Article 101(3) may be more accurately characterised as a limited partial equilibrium competition law test. Second, elements of a general market failure test are only sporadically integrated into the analysis under Article 101(3). This suggests that whilst a clear-cut market failure test does not exist, facets of market failure can still be relevant in explaining certain public policy interventions under Article 101(3). Thus, considerations regarding market failure maintain a degree of legal value under Article 101(3), albeit limited.

5.3.2.1 The Dominant Paradigm: A Limited Partial Competition Law Test

The preceding analysis shows that there is no general market failure test in EU antitrust law.¹²⁶¹ The test under Article 101(3) TFEU is better perceived as a narrow competition law balancing test, markedly more limited than a traditional market failure test in welfare economics. Three legal obstacles prevent the recognition of a general market failure test under Article 101(3).

First, barring exceptional circumstances, the analysis is based on a partial equilibrium. This confines the scope of the analysis and obstructs a broader economic approach. A market-governed approach, wherein effects beyond the relevant market hold limited relevance, curtails the scope for policy interventions unless they directly improve the allocation of resources in the given market or enhance its dynamic efficiency. In essence, competition, viewed as a catalyst for economic efficiency and welfare maximisation, is protected within individual markets.¹²⁶² Irrespective of whether a total (Pareto efficiency) or broader social welfare (via Kaldor-Hicks efficiency) standard is adopted, the analysis remains primarily partial as the criterion of efficiency only relates to a set of economic agents on a given market.¹²⁶³ Consequently, the preferences of other agents potentially affected by the measure/conduct are disregarded.¹²⁶⁴ A plausible explanation for the limited role of market failure analysis and restricted use of efficiencies is the private nature of restrictions under Article 101(3). Traditionally, private undertakings lack the legitimacy to implement public policy goals which,

¹²⁶¹ i.e., within the sense of the framework established in Chapter 3, section 3.3.

¹²⁶² Lianos, Korah and Sicilliani (n 357) 90.

¹²⁶³ *ibid.*, 94. See also, Motta (n 272) 28 ‘e]conomic welfare is the standard concept used in economics to measure how well an industry performs. It is a measure which aggregates the welfare (or surplus) of different groups in the economy’. Townley, *Article 81 EC and Public Policy* (n 891) 186 ‘the answer might lay in the distinction between partial and a ‘total equilibrium approach’.

¹²⁶⁴ Lianos, Korah and Sicilliani (n 357) 90.

according to EU law, are more effectively achieved by State aid under Article 107 TFEU.¹²⁶⁵

Second, since the justificatory possibilities are limited, there is no proper market diagnostic tool under Article 101(3). As previously seen, the scarcity of instances of application of Article 101(3) post-modernisation reveals a strong preference for the preservation of competition law's status quo. Therefore, the legal architecture of Article 101(3) lacks a proper test to identify whether markets are truly failing from an economic perspective. This conclusion suggests that Article 101(3) is unsuited as a tool for implementing public policy.

Third, the cost-based efficiencies advocated by the Commission are narrower than those relevant to economic theory. The notion of efficiency, as used to justify anticompetitive conduct, is understood to be narrower than the traditional categories of allocative, productive, and dynamic efficiencies.

The status quo is resilient, and the no elimination criterion reveals a preference for a system where competition remains intact. Hence, Article 101(3) cannot incorporate a general market failure test, despite the relevance of some elements in explaining intervention under Article 101(3). It would appear that the personal scope of Article 101(3), which applies to private undertakings, renders a full market failure test inappropriate.

5.3.2.2 The Atypical Paradigm: A (Partially) Broader Market Failure Test

However, as noted, certain elements incorporate a broader view, echoing aspects of a market failure analysis. This suggests that various types of balancing can take place under Article 101(3) TFEU.¹²⁶⁶ In these instances, the analysis extends beyond merely considering cost-efficiencies accrued to the consumers within the relevant market.

The realm of public policy beyond competition interests does find some resonance in Article 101(3). In practice, both the Commission and the Courts have

¹²⁶⁵ However, as pointed out in Chapter 1, section 1.2.3.1, this perspective may be outdated in its understanding of market organisation, as it increasingly neglects to acknowledge the complementary roles played by both the public and private spheres.

¹²⁶⁶ As seen in Chapter 4, section 4.3.2 different types of balancing have been proposed by EU antitrust law scholarship see e.g., Townley, *Article 81 EC and Public Policy* (n 891) and his distinction between 'market' and 'mere' balancing under Article 101(3); Loozen (n 844); Brook (n 806). For an economic perspective see, Baarsma and Rosenboom (n 1059).

acknowledged instances where that competition can be balanced against other market failures. Although Article 101(3) cannot be construed as a ‘gateway to general policy reflections’, the institutions have occasionally given weight to objectives reflecting public policy.¹²⁶⁷ Furthermore, certain cases expand beyond the relevant market, thus implementing a broader analysis of so-called out-of-market efficiencies. In these instances, a broader market failure analysis remains relevant in explaining the rationales of public policy intervention under Article 101(3). However, this approach is the exception rather than the rule, and the precise scope of the analysis remains nebulous.

As observed, since the mitigation of market power is an economic value intrinsic to competition law, a market failure test only gains relevance to the extent that it allows Member States, public entities or even undertakings under Article 101(3) to deviate from competition rules to remedy a non-competition market failure. Nevertheless, it appears challenging to integrate other market failures into competition law’s status quo, which is presumed to yield the most optimal result. This creates a quandary when trying to incorporate broader efficiencies or external objectives into the CBA under Article 101(3). Legal scholarship has argued for placing it outside of the efficiency analysis.¹²⁶⁸ However, the notion of collective benefits and the Draft Guidelines seem to run counter to such scholarship, pulling these broader considerations into the efficiency analysis. It is within this context that market failure could be instrumental in explaining the balancing act between broader efficiencies and the preservation of competition.

5.4 Conclusions

This chapter has conducted a market failure analysis of Article 101(3) TFEU. The findings of this chapter are further elaborated upon in Chapter 10. Drawing upon the previous examination, four overarching conclusions can be formulated.

¹²⁶⁷ Heinemann (n 794) 136.

¹²⁶⁸ For instance, Townley, *Article 81 EC and Public Policy* (n 891) 175, 177 ff., considered that two types of balancing are presents in EU antitrust law: ‘mere balancing’ and ‘market balancing’. Whilst the former is present in Article 101, Article 103 TFEU incorporates both approaches. Mere balancing, or ‘external balancing’ entails a balancing of public policy goals external to the assessment of economic efficiency. Market-balancing, on the contrary, captures the trade-offs conducted ‘*within* the economic efficiency test itself’. This suggests that considerations beyond efficiencies in specific markets is limited in scope.

First, it is suggested that Article 101(3) does not embed a general market failure analysis. The restriction of the analysis of benefits to the relevant market and the fair share criterion constitute obstacles to the endorsement of a market failure test. Rather, it is proposed that the analysis is akin to a *partial* and *competition-specific* equilibrium.

The test is deemed partial because it operates, except in exceptional circumstances, within the boundaries of the relevant market – a phenomenon referred to in this research as the ‘market-governed’ approach. The limitation of the test to the relevant market precludes taking into consideration any efficiencies that are not generated therein, for instance, externalities that benefit society at large. However, this limitation has shown some nuances, as both the Commission and the Courts recognise the existence of ‘out-of-market efficiencies’. In this context, the chapter has discussed how the adoption of the Commission Draft Guidelines, which acknowledges ‘collective benefits’, potentially constitutes a step toward broadening the analysis. Nonetheless, whilst the Commission Draft Guidelines ostensibly expand the scope of antitrust analysis toward encompassing market failure,¹²⁶⁹ it has been argued that the insistence on integrating this approach within the market-governed analysis introduces inconsistencies that hinder a balancing exercise in the sense of market failure. The Commission is aware of the challenges in integrating broader sustainability efficiencies under Article 101(3). Even if benefits beyond the relevant market are recognised, the possibility to take into account broader efficiencies is hampered due to the fair share criterion. Therefore, the Commission, in its Draft Guidelines, interprets the case law as including a ‘capacity overlap criterion’, which restricts the inclusion of benefits to those that benefit both society at large and the consumers on the market specifically (directly). However, it is argued that the meaning of this criterion is ambiguous and potentially undermines the coherence of the analysis under Article 101(3). Finally, this chapter has contended that the current case law of the Court does not exclude the possibility to balance broader efficiencies against competition restrictions beyond the limits of the relevant market.

It is competition-specific since efficiencies are interpreted narrowly, primarily as short to medium-term cost efficiencies. Moreover, it reveals a strong predilection, through the no elimination criterion, for maintaining the status quo of competition law, even to the detriment of larger efficiency improvements. This

¹²⁶⁹ Beyond implicitly adopting a market failure-inspired analysis, the Guidelines make explicit reference to market failure a total of eight times.

inclination towards narrow short-term efficiencies is visible both in the soft law of the Commission and in the case law of the EU Courts.¹²⁷⁰ The preservation of the status quo of competition law is further reinforced by the no elimination of competition criterion in Article 101(3)(b) and the exclusion of object restriction from the balancing exercise. However, whilst the focus on narrow efficiencies remains the norm, it has been shown that, in exceptional cases, both the Commission and the EU Courts have taken broader efficiencies and even external objectives into account. Further, the wording of Article 101(3) itself does not explicitly prohibit the adoption of a broader approach. From this perspective, this section has shown that objectives traditionally qualified as ‘non-economic’ are, in fact, aligned with an efficiency-based market failure analysis of Article 101(3). In this sense, there is a discrepancy between what lawyers and economists perceive as ‘economic’ and remediable through efficiency improvements. Thus, incorporating concerns such as sustainability can be seen as a natural fit within the more economic approach, rather a departure from it or a plea for ‘flexible’¹²⁷¹ or ‘hipster’¹²⁷² antitrust. Finally, the application of a broad market failure standard has revealed that there exists a degree of space, albeit limited, for the consideration of external objectives.

Second, it is posited that market failure, nevertheless, holds relevance in the understanding of ‘broader’ efficiencies/benefits under Article 101(3). Despite the legal hurdles and rare applications in practice, it is feasible to conceive broader market failure considerations within the efficiency analysis under Article 101(3). There are also indications that this route is a more viable option today than it has been in the past. In particular, the notion of ‘collective benefits’ and the Draft Guidelines are significant steps in this direction.

Third, analysing Article 101(3) through the lens of market failure contributes to a deeper understanding of the function and scope of that provision. Above all else, the conducted analysis has shed light on what Article 101(3) is *not*. The inherent limitations of Article 101(3) render it impossible to elevate that Article to the standing of a general public policy derogation. Based on this, it

¹²⁷⁰ Guidelines on the application of Article 81(3) (n 364); Draft Guidelines on Horizontal Co-operation Agreements (n 49); Case C-501/06 P *GSK* (n 78), para 120; Case T-17/93 *Matra Hachette v Commission* (n 972), para 89.

¹²⁷¹ A claim explored by Loozen (n 844).

¹²⁷² Witt, ‘The European Court of Justice and the More Economic Approach to EU Competition Law – Is the Tide Turning?’ (n 7) 178.

becomes apparent that competition law cannot be, and indeed is not, ‘the law of everything’.

Fourth, the analysis above casts new light on the debate surrounding broader and narrower approaches to Article 101(3). Traditional market failure theory reveals that even rationales frequently considered as broad in EU antitrust legal scholarship are traditional allocative efficiencies that could be accommodated within efficiency analysis under Article 101(3). The obstacles to a market failure test under Article 101(3) are seemingly not the nature of the benefits, but rather the scope of the analysis.

Furthermore, it is argued that a market failure perspective is useful in explaining externalities that extend beyond the relevant market, for instance, in the case of internalising externalities caused by CO2 emissions. Similarly, rationales such as employment can be clarified by the application of a broad macroeconomic/stability market failure approach. Overall, rather than perceiving these different benefits as ‘non-economic’ objectives, it is argued that it is more logical to analyse these rationales from the standpoint of a market failure theory.

Finally, the rationale for a narrow approach to efficiencies under Article 101(3) seems both ideological and legal. One ideological explanation is that antitrust law aligns with a strong individual methodology and primarily tackles private restrictions of competition. Hence, EU antitrust law is first and foremost preoccupied with private costs and benefits, as opposed to social costs/benefits via the achievement of a general equilibrium. Private actors, therefore, only have a limited capacity to implement public policy in the antitrust realm. A less ideological and more legal explanation, noted in scholarship, is the decentralisation empowering NCAs and national courts to apply Article 101(3).¹²⁷³ In this perspective, there could be apprehension from the Commission, as a driver for EU antitrust policies, about relinquishing the application of Article 101(3) to national instances, which might risk incongruent solutions and weaken the coherence of EU antitrust law.

¹²⁷³ Geradin, Layne-Farrar and Petit (n 315) 168.

6. MARKET FAILURE IN ANTITRUST LAW: ARTICLE 101(1) TFEU

This chapter embarks on an exploration of the implications of a market failure analysis in relation to the disapplication of Article 101(1) TFEU. Within this framework, three distinctive exception regimes under Article 101(1) are analysed through the lens of market failure theory: the doctrine of ancillary restraints; the *Wouters* doctrine; and the boundaries of economic activity.

The analysis leads to the argument that, akin to the findings in relation to Article 101(3), the theory of market failure solely offers a partial explanation for public policy intervention under Article 101(1). There exists a myriad of limitations inherent in these various doctrines, however none can unequivocally be considered to incorporate a market failure test in sense of the framework of Chapter 3. In particular, it is suggested that the assessment under Article 101(1) lacks the essential elements of balancing, thereby rendering a market failure test unattainable.

This chapter is structured into three sections. The first section is devoted to an in-depth case study of the case law of the EU Courts. The three aforementioned regimes are examined. Subsequently, the market failure test defined in Chapter 3 is systematically applied to the various exception regimes under Article 101(1). The chapter then culminates with some conclusions.

6.1 The Case Law Disapplying EU Antitrust Law

This section provides a case study navigating the three exception regimes under Article 101(1) TFEU.

First, it is explored how certain restrictions corollary to a legitimate transaction can be justified under the doctrine of ‘ancillary restrictions’. This section demonstrates that whilst this doctrine incorporates an efficiency-maximising perspective, it does not contribute to the market failure analysis of this research. Rather than applying a balancing exercise, the doctrine of ancillary restrictions merely exempts certain (minor) restrictions that are necessary to enhance competition through an interlinked transaction. Consequently, the key question here is not whether Article 101(1) can be side-lined to promote another value than competition, but whether the ancillary restraint is necessary for a lawful transaction that ultimately increases competition. In this sense, this doctrine always results in a net positive effect in terms of competition.

Second, the so-called ‘rule of reason’ is examined. The Court of Justice, through this rule, has acknowledged that certain constraints are beyond the purview of Article 101(1), provided they are aimed at achieving a legitimate and proportionate objective. It is shown that whilst it comprises a broad justificatory exercise, it lacks an appropriate balancing mechanism.

Third, the exceptions to the notion of an ‘undertaking’ are analysed. This section dissects the Court’s reasoning for excluding certain public entities from the scope of EU competition law. It is shown that whilst these are exercises of legal qualification devoid of any balancing test, market failure may be helpful to understand the rationale of these doctrines.

6.1.1 The Ancillary Problem and Welfare Analysis

The first category of restrictions that are shielded from the application of Article 101(1) TFEU are so-called ‘ancillary’ restrictions.¹²⁷⁴ This doctrine, first recognised by the Court in *Remia and Nutricia*,¹²⁷⁵ is rooted in the legal maxim ‘*accessorium sequitur principale*’,¹²⁷⁶ and is a well-established doctrine in US

¹²⁷⁴ Guidelines on the application of Article 81(3) (n 364), paras 28-31.

¹²⁷⁵ Case 42/84, *Remia BV and others v Commission of the European Communities* (n 1016). However, the case law is frequently applied and confirmed, see e.g., Case C-307/18 *Generics (UK) and Others* EU:C:2020:52, para 96; Case C-333/21 *European Superleague Company* EU:C:2022:993, para 88; paras Case C-883/19 P *HSBC Holdings and Others v Commission* EU:C:2023:11, paras 138-141.

¹²⁷⁶ e.g., Geradin, Layne-Farrar and Petit (n 315) 44.

antitrust law.¹²⁷⁷ In a nutshell, the ancillary restraint doctrine implies that a restriction, liable to affect trade and distort competition in the sense of Article 101(1), that is ancillary to a legitimate main transaction, will not be considered to restrict competition within the meaning of that Article.

In *Remia*, the potential restrictions at issue were non-compete clauses linked to the transfer of an undertaking. The Court adopted a counterfactual test,¹²⁷⁸ concluding that without the clauses, the transfer of the business would likely not materialise if the vendor was going to remain in the market.¹²⁷⁹ Therefore, provided that the clauses are necessary (i) for the transfer and (ii) are limited in time and scope,¹²⁸⁰ they contribute to the promotion of competition by increasing the number of undertakings in the market.¹²⁸¹ However, in this case, the agreement was found to be excessive and, hence, fell foul of Article 101(1).¹²⁸²

The doctrine of ancillary restraints has been particularly used to justify measures restricting the economic freedom of one of the parties in order to safeguard the rights of the other party. Consequently, this doctrine is frequently applied within the legal realm of intellectual property rights licensing.¹²⁸³ Another area where the Court has applied the ancillary restraints doctrine is franchising. In *Pronuptia*,¹²⁸⁴ the Court held that franchise agreements necessarily contain certain restrictions of competition due to their peculiar nature. At stake were numerous common clauses of franchise agreements destined to protect the owner. As a matter of principle, a franchise agreement ‘which allows the franchisor to profit from this success, does not in itself interfere with competition’.¹²⁸⁵ Therefore, Article 101(1) does not prohibit:

¹²⁷⁷ *United States v Addyston Pipe & Steel Co et al*, 85 Fed 271, 282 (6th Cir 1898).

¹²⁷⁸ Case 42/84 *Remia* (n 1016), para 18.

¹²⁷⁹ *ibid.*, para 19.

¹²⁸⁰ *ibid.*, para 20.

¹²⁸¹ *ibid.*, para 20.

¹²⁸² *ibid.*, paras 23-24. In particular the clauses applied to the entire territory of the Netherlands and covered both the production of the product and the sale of similar products imported from other Member States.

¹²⁸³ e.g., Case C-262/81 *Coditel v Ciné-Vog Films* EU:C:1982:334; Case C-258/78 *LC Nungesser* (n 1245).

¹²⁸⁴ Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* EU:C:1986:41.

¹²⁸⁵ *ibid.*, para 15.

Provisions which are strictly necessary in order to ensure that the know-how and assistance provided by the franchisor do not benefit competitors' or those that 'establish the control strictly necessary for maintaining the identity and reputation of the network identified by the common name or symbol'.¹²⁸⁶

On the contrary, object restrictions such as market partitions or fixed prices cannot be seen as strictly necessary for the franchise agreement and thus fall under Article 101(1).¹²⁸⁷

The doctrine of ancillary restriction is subject to two conditions.¹²⁸⁸ First, the main agreement to which the restriction is ancillary must not restrict competition in the sense of Article 101(1). Second, the restrictive measure must be ancillary to the main transaction.¹²⁸⁹ This means that the restriction must be 'subordinate to the implementation of [the main] transaction and [...] inseparably linked to it'.¹²⁹⁰ In line with the case law of the Court, the Commission Guidelines further clarify that for a restriction to be considered ancillary, it must be necessary for, and proportionate to, the implementation of the transaction.¹²⁹¹

From the Court's ruling in *Remia*, it is apparent that ancillary restraints are not a remedy for a market failure. The key question here is not whether Article 101(1) can be side-lined to promote a value other than competition, but rather if the ancillary restraints are necessary for a lawful transaction resulting in an increase in economic efficiency. Thus, ancillary restraints are used to assess the effect on competition of a measure, rather than a tool for deviation from the antitrust provisions. Even though the Commission Guidelines do explicitly not state that the main transaction must result in an increase of competition, this does not imply that ancillarity constitutes a deviation from the antitrust rules, since there is no assessment of broader efficiencies or external objectives. The analysis remains internal to the objective of unfettered competition, with the only assessment being the two aforementioned conditions: (i) legitimate main

¹²⁸⁶ *ibid.*, paras 27(2) and 27(3).

¹²⁸⁷ *ibid.*

¹²⁸⁸ Geradin, Layne-Farrar and Petit (n 315) 144.

¹²⁸⁹ *ibid.*

¹²⁹⁰ Guidelines on the application of Article 81(3) (n 364), para 29.

¹²⁹¹ *ibid.*

transaction and (ii) the ancillary nature of the provisions in question.¹²⁹² The proportionality requirement ensures that only minor restrictions, deemed acceptable, can be upheld. This implies that any restriction, which is accessory and necessary for common commercial practice that promotes economic growth and competition over an extended period, is safeguarded by the doctrine of ancillary restrictions. In turn, such restrictions are not ensnared by Article 101(1).

6.1.2 The Rule of Reason Doctrine

This section demonstrates the gradual broadening of the rule of reason (or *Wouters* rule), which has evolved into a rather expansive public policy exception. Despite the doctrine's deployment to disapply EU antitrust law, it should be interpreted within the context of a justification mechanism. However, its broad nature complicates the pinpointing of a concrete balancing exercise, whether generally or in the context of a market failure test.

This section is structured to provide a comprehensive exploration of the rule of reason doctrine. First, the foundation of the doctrine is established by examining, inter alia, the landmark cases of *Wouters* and *Meca-Medina*. Following this, the evolution and expansion of the doctrine in subsequent case law is explored. Finally, an analysis of the doctrine's nature and meaning is provided. This analysis provides a foundation for the subsequent market failure analysis.

6.1.2.1 Shaping a Rule of Reason in EU Antitrust Law

Article 101(1) TFEU does not apply to restrictions that are inherent in achieving a legitimate objective. This has been interpreted as the integration of an 'objective justification' defence or a so-called rule of reason¹²⁹³ in EU antitrust law.¹²⁹⁴ Some legal scholars claim that the rule of reason doctrine functions as a public policy derogation.¹²⁹⁵

¹²⁹² See e.g., Opinion of AG Rantos in Case C-333/21 *European Superleague Company* EU:C:2022:993, para 87.

¹²⁹³ Monti (n 62) 1086.

¹²⁹⁴ *ibid.*

¹²⁹⁵ e.g., Jones, Sufrin and Dunne (n 740) 252.

The rule of reason was initially recognised in *Wouters*.¹²⁹⁶ This case departed from the previously established view. Traditionally, EU antitrust law only contained an assessment of competitive effects. In this regard, AG Leger in his Opinion in *Wouters* wrote that:

[T]he rule of reason in [EU] competition law is strictly confined to a *purely competitive* balance-sheet of the effect of the agreement. Where, taken as a whole, the agreement is capable of encouraging competition on the market, the clauses essential to its performance may escape the prohibition laid down in Article [101(1)]. The only ‘legitimate goal’ which may be pursued in accordance with that provision is therefore exclusively competitive in nature.¹²⁹⁷

6.1.2.1.1 *The Foundation: Wouters and Meca-Medina*

The *Wouters*. case involved a challenge to a regulation adopted by the Dutch Bar, a regulatory body with public law status, which prohibited its members (the lawyers) from entering into partnerships with other professions, such as accountants. The regulation was challenged by members of the Bar, first by an administrative appeal, and second before the competent national Court. In the first instance, the competent national court found that the Bar association could not be regarded as an undertaking in the sense of Article 101 TFEU since it is a body governed by public law, which has been granted regulatory power in order to further a public interest.¹²⁹⁸ The case was appealed, and the referring court decided to refer a set of questions to the ECJ.

First, related to the nature of the Bar, the Court recalled its position established in *Höfner*.¹²⁹⁹ The ECJ found that in its capacity of a ‘regulatory body of a profession’ whose practices are ‘economic activities’, the Bar engages in an economic activity within the sense of Article 101.¹³⁰⁰ Second, regarding the restriction at issue, the Court found that the regulation, naturally, is capable of restricting competition by limiting production and technical development within

¹²⁹⁶ Case C-309/99 *Wouters* (n 42).

¹²⁹⁷ Opinion of AG Léger in Case 309/99 *Wouters* EU:C:2001:390, para 104.

¹²⁹⁸ *ibid.*, para 32.

¹²⁹⁹ Case C-41/90 *Höfner* (n 35).

¹³⁰⁰ Case C-309/99 *Wouters* (n 42), para 58.

the meaning of Article 101(1).¹³⁰¹ However, the Court noted that every agreement that restricts the freedom of action of the parties does not necessarily fall under the prohibition of Article 101(1):

[...] account must first of all be taken of the overall context in which the decision of the association of undertakings was taken or produces its effects. More particularly, account must be taken of its objectives, which are here connected with the need to make rules relating to organisation, qualifications, professional ethics, supervision and liability, in order to ensure that the ultimate consumers of legal services and the sound administration of justice are provided with the necessary guarantees in relation to integrity and experience (see, to that effect, Case C-3/95 *Reisebüro Broede* [1996] ECR I-6511, paragraph 38). It has then to be considered whether the consequential effects restrictive of competition are inherent in the pursuit of those objectives.¹³⁰²

According to the Court, the objective of ensuring ‘that the ultimate consumer of legal services and the sound administration of justice is provided with the necessary guarantees in relation to integrity and experience’ is capable of justifying a restriction by placing it outside of the scope of Article 101(1). Furthermore, the Court also considered that the Regulation ‘could reasonably be considered necessary’ to achieve that aim.¹³⁰³

Some scholars contend that in *Wouters* the Court, for the first time, recognised the existence of a balancing process within Article 101(1), wherein competition interests are weighed against consumer benefit or other non-competition objectives.¹³⁰⁴ Nevertheless, this case has spawned numerous interpretations, with some scholars arguing that *Wouters* should be understood from a position of efficiency akin to the approach of Article 101(3).¹³⁰⁵

Based on *Wouters* alone, it is difficult to attach any precise meaning to the exception formulated by the Court. One possible interpretation is that it could be construed as a deontological rule of reason, taking into account the unique

¹³⁰¹ *ibid.*, para 90.

¹³⁰² *ibid.*, para 97.

¹³⁰³ *ibid.*, para 107.

¹³⁰⁴ e.g., Whish and Bailey (n 740) 142; Monti (n 62) 1086; Janssen and Kloosterhuis (n 304) 338.

¹³⁰⁵ See, e.g., Ibanez Colomo (n 297); Janssen and Kloosterhuis (n 304).

characteristics of the legal profession. The Court emphasised this aspect, in particular in regard to the requirement of independency vis-à-vis other public bodies, as required by the national law.¹³⁰⁶ The exclusion of these restrictions is predicated on it being ‘necessary for the proper practice of the legal profession as organised in the Member State concerned’.¹³⁰⁷

However, it could also be interpreted more broadly as a general public policy exception and that the Court ruled against the opinion of AG Léger, who argued that without an application of Articles 101(3) or 106(2) TFEU, there is no possibility to justify the restriction.¹³⁰⁸ As the AG recognised in his opinion, these questions of deontological regulation relate to public policy ‘in a State governed by the rule of law’.¹³⁰⁹ Thus independent of the extent of the exception, concluding that the regulation falls outside the ambit of Article 101(1) amounts to introducing, within the Article, objectives distinct from competition, related to the pursuit of other public policy.¹³¹⁰

Additionally, discerning the actual legal ‘technique’ employed in the case proves challenging. Exclusion of agreement under Article 101(1) appears to be grounded in a qualification approach, as this Article does not provide for any exceptions granted that the conditions for its applicability are met. However, the reasoning of the Court, it appears, is based on a justification exercise. In paragraph 94 of the judgment the Court held that:

[...] in so far as the preservation of a sufficient degree of competition on the market in legal services could be guaranteed by less extreme measures than national rules such as the 1993 Regulation, which prohibits absolutely any form of multi-disciplinary partnership, whatever the respective sizes of the firms of lawyers and accountants concerned, those rules restrict competition.

¹³⁰⁶ Case C-309/99 *Wouters* (n 42), paras 90-107.

¹³⁰⁷ *ibid.*, para 107.

¹³⁰⁸ Opinion of AG Léger in Case 309/99 *Wouters* (n 1297).

¹³⁰⁹ *ibid.*, para 105.

¹³¹⁰ *ibid.*

Nevertheless, the Court continued, this does not imply that such measures necessarily fall within the prohibition laid down in Article 101(1).¹³¹¹ With regard to its legitimate objective, the measure under scrutiny:

[...] a national regulation such as the 1993 Regulation adopted by a body such as the Bar of the Netherlands does not infringe Article [101(1)], since that body could reasonably have considered that that regulation, despite the effects restrictive of competition that are inherent in it, is necessary for the proper practice of the legal profession, as organized in the Member State concerned.¹³¹²

The preceding passages demonstrate that the legal technique used is unclear. Most scholars regard the *Wouters* ruling as a balancing exercise,¹³¹³ or in other words, a ‘true’ exception that allows for the balancing of competition interests with other public policy objectives.¹³¹⁴

Interestingly, in paragraph 97, cited above, the Court referred to *Reisebüro Broede*.¹³¹⁵ In that particular case, the Court found that certain rules pertaining to the legal profession, which restricted the freedom to provide services in the sense of Article 49 TFEU, could be justified by imperative requirements in the general interest.¹³¹⁶ Monti asserted that the Court applied the *Cassis* doctrine, which then applied *mutatis mutandis* to Article 101(1) in *Wouters*.¹³¹⁷ If this interpretation is correct, the exercise should be understood as a justification rather than a qualification exercise.

The second case forging the rule of reason is *Meca-Medina*.¹³¹⁸ In this case, the Court had to rule on the application of EU antitrust law to sports regulations. *Meca-Medina* stands as the only instance where the rule of reason has been applied outside of the preliminary ruling procedure. Sports have often been regarded as a

¹³¹¹ *ibid.*, para 97.

¹³¹² *ibid.*, para 110.

¹³¹³ e.g., Whish and Bailey (n 740) 142. Lianos, Korah and Sicilliani (n 357) 618 see it as ‘intuitive balancing’.

¹³¹⁴ Lianos, Korah and Sicilliani (n 357) 620.

¹³¹⁵ Case C-3/95 *Reisebüro Broede v Sandker* EU:C:1996:487.

¹³¹⁶ *ibid.*, para 28.

¹³¹⁷ Monti (n 62) 1087.

¹³¹⁸ Case C-519/04 P *Meca-Medina and Majcen v Commission* (n 660).

‘specificity’ in EU law, which requires a balancing of interests with EU economic law.¹³¹⁹ In this case, the Court affirmed the application of the *Wouters* rule to the sports sector. The measures at stake were certain anti-doping rules adopted by the International Olympic Committee (IOC), which were challenged under Articles 101 and 102. The IOC brings together international sporting federations, including the International Swimming Federation (‘FINA’).¹³²⁰ The applicants had undergone drug testing by the FINA in accordance with the rules of the IOC, and the presence of a prohibited substance was found in their bodies.¹³²¹ As a consequence, the athletes were suspended by FINA’s Doping Panel. This decision was then challenged before the Court of Arbitration and Sports. Following a reduction in their penalties through arbitration, the applicants filed a complaint with the Commission.

The Commission, whose decision was subsequently confirmed by the General Court and ultimately the ECJ, found that there was no breach of the EU antitrust rules. The Court reaffirmed its established case law in *Wouters*:

[...] the compatibility of rules with the Community rules on competition cannot be assessed in the abstract (see, to this effect, Case C-250/92 *DLG* [1994] ECR I-5641, paragraph 31). Not every agreement between undertakings or every decision of an association of undertakings which restricts the freedom of action of the parties or of one of them necessarily falls within the prohibition laid down in Article [101(1)]. For the purposes of application of that provision to a particular case, account must first of all be taken of the overall context in which the decision of the association of undertakings was taken or produces its effects and, more specifically, of its objectives. It has then to be considered whether the consequential effects of competition are inherent

¹³¹⁹ On the sport ‘specificity’ see e.g., Antoine Duval and Ben Van Rompuy, *The Legacy of Bosman: Revisiting the Relationship between EU Law and Sport* (Springer 2016); Robert Siekmann, ‘The Specificity of Sport: Sporting Exceptions in EU Law’ (2012) 49(4) *Zbornik Radova Pravnog Fakulteta u Splitu* 697. Although this is of limited application as sport has to comply with the ‘general EU legal principles’. See to this effect, Ian Blackshaw, ‘How “Special” Is Sport under EU Law in Light of the Court Justice of the European Union’s Recent Decision in the Oliver Bernard Case?’ (2011) 12(2) *Business Law International* 235.

¹³²⁰ Case C-519/04 P *Meca-Medina* (n 660), para 1.

¹³²¹ *ibid.*, para 2.

in the pursuit of those objectives (*Wouters and Others*, paragraph 97) and are proportionate to them.¹³²²

In the case at hand, the objective of the rules, which was uncontested, was ‘to combat doping in order for competitive sport to be conducted fairly’ including ‘the need to safeguard equal chances for athletes, athletes’ health, the integrity and objectivity of competitive sport and ethical values in sport’.¹³²³

The Court continued:

Therefore, even if the anti-doping rules at issue are to be regarded as a decision of an association of undertakings limiting the appellant’s freedom of action, they do not for all that, necessarily constitute a restriction of competition incompatible with the common market, within the meaning of Article [101], since they are justified by a legitimate objective. Such a limitation is inherent in the organisation and proper conduct of competitive sport and falls outside the prohibitions in Article [101].

In paragraph 42, cited above, the Court not only confirmed the *Wouters* case law but also added an explicit proportionality assessment to the rule of reason. The measures were ultimately found proportionate as the applicants failed to demonstrate otherwise.¹³²⁴

The case bears several similarities with *Wouters*. It involved professional rules enforced by a regulatory body vested with the power to adopt sanctions towards its members. However, the Court’s ruling demonstrates that *Wouters* can be applied outside of the scope of liberal professions. The extension of *Wouters* to the field of sports appears to strengthen the notion of a more general public policy derogation under Article 101(1).

¹³²² *ibid.*, para 42.

¹³²³ *ibid.*, para 43. The application of the *Wouters* doctrine to sport federations and the relevance of Article 165 TFEU has recently been discussed see e.g., Opinion of AG Rantos in Case C-333/21 *European Superleague Company* (n 1292), paras 32-43; Opinion of AG Rantos in Case C-124/21 P *International Skating Union* EU:C:2022:988 paras 36-40.

¹³²⁴ *ibid.*, para 50.

Following the modernisation process, the relevance of the *Wouters* and *Meca-Medina* case law became unclear, and with the decentralisation of EU antitrust law, it could have been considered obsolete.¹³²⁵ However, in two cases in 2013 the Court reaffirmed its case law.

The first case, *OTOC*,¹³²⁶ concerned a dispute between the Ordem dos Técnicos Oficiais de Contas (Order of Chartered Accountants: ‘OTOC’), and the Portuguese competition authority regarding the compatibility of a professional regulation with Article 101 TFEU. OTOC, a public law body representing the professional interests of chartered accountants, was bestowed with regulatory powers to oversee ‘all matters relating to the exercise of their functions’.¹³²⁷ Additionally, the law mandated that OTOC should provide training.¹³²⁸ Within this function, OTOC adopted a system of mandatory training for chartered accountants.¹³²⁹ Accountants were required to take a variety of courses of less than 16 hours from OTOC itself,¹³³⁰ so-called ‘institutional training’, distinct from professional training.¹³³¹ Under this system, OTOC had the authority to grant or refuse registration to training bodies, which was required in order to provide professional training.¹³³² The NCA found that OTOC, by adopting the regulation, had infringed Articles 101 and 102. The claim was partially dismissed in the first instance, but an appeal was made to the Lisbon Court of Appeal, which decided to refer a set of questions to the Court of Justice.

First, the ECJ found that the contested regulation constituted a decision by an association of undertakings. OTOC possessed a large margin of discretion, with

¹³²⁵ See e.g., Nowag, ‘Wouters, When the Condemned Live Longer: A Comment on OTOC and CNG’ (n 661). This since now both national courts and the EU courts can apply Article 101(3) TFEU to exempt agreements.

¹³²⁶ Case C-1/12 *Ordem dos Técnicos Oficiais de Contas* (n 660).

¹³²⁷ *ibid.*, paras 3-4.

¹³²⁸ *ibid.*, para 4.

¹³²⁹ *ibid.*, paras 10-17.

¹³³⁰ *ibid.*

¹³³¹ *ibid.*

¹³³² *ibid.*

its powers not being circumscribed by additional criteria and without input from the State.¹³³³

Second, the ECJ had to determine whether the decision amounted to a restriction of competition within the meaning of Article 101(1). Recalling *Wouters*, the Court found that the regulation ‘seeks to guarantee the quality of the services offered by chartered accountants’.¹³³⁴ The regulation was also deemed to effectively contribute to that objective by ensuring ‘further training and continued professional education, thus contributing to the sound administration of undertakings’ accounting and taxation matters’.¹³³⁵

Third, however, despite being based on a legitimate objective, the decision was found to be disproportionate. Training sessions with a duration of fewer than 16 hours could not be regarded as necessary to ensure the quality of the services offered by chartered accountants.¹³³⁶ In addition, the conditions under which undertakings have access to the market are also disproportionate, as a less restrictive system could be put into place by establishing ‘a monitoring system organised on the basis of clearly defined, transparent, non-discriminatory, renewable criteria likely to ensure training bodies equal access to the market in question’.¹³³⁷

The second case, *CNG*,¹³³⁸ arose from a dispute between Consiglio nazionale dei geologi (National Council of Geologists, the ‘CNG’) and the Italian NCA. According to Italian law, geologists were required to register with the CNG,¹³³⁹ which held the responsibility of ensuring compliance with professional regulations and safeguarding the integrity of the profession.¹³⁴⁰ To that end, the CNG had the power to adopt disciplinary measures,¹³⁴¹ including suspension from

¹³³³ *ibid.*, paras 49, 50 and 52.

¹³³⁴ *ibid.*, paras 95-96.

¹³³⁵ *ibid.*, para 95.

¹³³⁶ *ibid.*, para 98.

¹³³⁷ *ibid.*, para 99.

¹³³⁸ Case C-136/12 *Consiglio Nazionale dei Geologi and Autorità Garante della Concorrenza e del Mercato* (n 660).

¹³³⁹ *ibid.*, para 3.

¹³⁴⁰ *ibid.*, para 5.

¹³⁴¹ *ibid.*

professional activity or even removal from the register.¹³⁴² The CNG adopted a code of conduct regulating various aspects, including the determination of geologists' fees through a predetermined scale.¹³⁴³ Although not compulsory, due to the absence of explicit criteria the scale could be assumed to be compulsory by geologists.¹³⁴⁴

Upon establishing that the code of conduct constituted a decision adopted by an association of undertakings and not an act of public authority,¹³⁴⁵ the ECJ turned towards the question of the compatibility of the provisions with Article 101(1). Considering its prior judgments in *Wouters*¹³⁴⁶ and *Meca-Medina*,¹³⁴⁷ the ECJ recognised that the CNG pursued a legitimate objective, namely ensuring that 'the ultimate consumers of the services in question are provided with the necessary guarantees'. Ultimately, the Court left it to the national court to assess the necessity of the provisions of the code.¹³⁴⁸

These two cases reaffirmed the continued validity of the rule of reason following the modernisation process. Just as in previous case law, the undertakings were qualified as public bodies under national law, vested with regulatory powers and the ability to impose sanctions on their members. Beyond simply confirming the established case law, Nowag argued that these cases widened the scope of the rule of reason in two respects.¹³⁴⁹ First, *OTOC* applies the *Wouters* case law to restrictions in the markets where the association of undertakings itself operates.¹³⁵⁰ Second, *CNG* extends the rule of reason to encompass object restrictions¹³⁵¹ (price-fixing). Consequently, if *Wouters* implies a balancing act, it does not favour the

¹³⁴² *ibid.*, para 6.

¹³⁴³ *ibid.*, para 9. The code of conduct encouraged geologists to fix their fees in accordance with the scale established therein, which was based on general standards such as the integrity of the profession, see to this effect *ibid.*, paras 11-12.

¹³⁴⁴ *ibid.*, para 12.

¹³⁴⁵ *ibid.*, paras 41-45.

¹³⁴⁶ *ibid.*, para 53.

¹³⁴⁷ *ibid.*, para 54.

¹³⁴⁸ *ibid.*, paras 55-56.

¹³⁴⁹ Nowag, 'Wouters, When the Condemned Live Longer: A Comment on *OTOC* and *CNG*' (n 661).

¹³⁵⁰ *ibid.*, 43. As opposed to only be applicable 'to cases where the association restricts competition amongst its members'.

¹³⁵¹ *ibid.*, 42.

status quo of competition in the sense of Article 101(3), which has generally been interpreted as excluding object restrictions.¹³⁵² In this sense, the rule of reason appears to permit a broader spectrum of restrictions to escape the application of Article 101(1).¹³⁵³

6.1.2.2 Broadening the Scope of the Rule of Reason

Two subsequent cases have further solidified the *Wouters* rule. It is also argued that these judgments have expanded the scope of the rule of reason doctrine in two aspects: by applying it to the legislation of Member States via the loyalty clause and by extending the objectives recognised under *Wouters*. Rather than exempting regulatory schemes, the Court uses *Wouters* to assess national legislation. As previously seen,¹³⁵⁴ even if the entity in question can be considered an undertaking for the purposes of article 101(1) TFEU, the State can still be liable via the so-called loyalty clause in Article 4(3) TEU.¹³⁵⁵

The first case, *API*,¹³⁵⁶ involved a request for a preliminary ruling from an Italian Court regarding measures fixing fixed minimum operating costs for undertakings operating in the ‘sector of carriage of goods by road for hire and reward’.¹³⁵⁷ Italian law established various public bodies, including the ‘Osservatorio’, primarily composed of representatives from the relevant economic sector. The Osservatorio was responsible for, inter alia, determining practices and customs of the sector.¹³⁵⁸ Within its legislative mandate, the Osservatorio was required to establish minimum charges, at least for contracts orally concluded,¹³⁵⁹ which it duly did. According to the referring court, the purpose of this system of

¹³⁵² These fall short of the indispensability requirement, see Guidelines on the application of Article 81(3) (n 364), para 46.

¹³⁵³ This broad nature is further discussed section 6.1.2.3 of the current chapter.

¹³⁵⁴ See Chapter 4, section 4.2.1.2.

¹³⁵⁵ Articles 4(3) TFEU stipulates: ‘Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties. The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union’s tasks and refrain from any measure which could jeopardise the attainment of the Union’s objectives.’

¹³⁵⁶ Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40).

¹³⁵⁷ *ibid.*, para 2.

¹³⁵⁸ *ibid.*, paras 11-12.

¹³⁵⁹ *ibid.*, para 13.

regulated minimum operating costs is to ensure compliance with safety standards, particularly with regard to road safety.¹³⁶⁰ By its first question, the referring court essentially asked whether Article 101(1), read in conjunction with Article 4(3) TEU, precluded the national legislation at issue.

First, the Court recalled its established case law according to which Member States cannot maintain in force measures which render the rules on competition to be ineffective, by either encouraging or requiring undertakings to infringe Article 101(1) or by delegating such decisional powers to private undertakings.¹³⁶¹

Second, the Court concluded that the Osservatorio is an association of undertakings and not a public authority for the purposes of Article 101(1).¹³⁶² The Court noted that the fixing of minimum operating costs is mandatory by legislation.¹³⁶³

Third, there is no question that these mandatory horizontal price-fixing measures restrict competition.¹³⁶⁴

Fourth, the Court held that:

[T]he legislation at issue in the main proceedings making mandatory a decision of an association of undertakings which has the object or effect of restricting competition or restricting the freedom of action of the parties or of one of them does not necessarily fall within the prohibition laid down in Article 101(1) TFEU, read in conjunction with Article 4(3) TEU.¹³⁶⁵

The Court proceeded to recall its case law in *Wouters* and *CNG*.¹³⁶⁶ It acknowledged that the protection of road safety can be regarded as a legitimate objective in accordance with its previous rulings.¹³⁶⁷ Nevertheless, it found that

¹³⁶⁰ *ibid.*, paras 22-23.

¹³⁶¹ *ibid.*, paras 29-30.

¹³⁶² *ibid.*, para 41.

¹³⁶³ *ibid.*, para 43.

¹³⁶⁴ *ibid.*, para 42.

¹³⁶⁵ *ibid.*, para 46.

¹³⁶⁶ *ibid.*, para 47.

¹³⁶⁷ *ibid.*, para 51.

the legislation at issue is not suitable for achieving that objective.¹³⁶⁸ The Court emphasised the necessity to establish a link between the protection of road safety and the establishment of minimum operating costs.¹³⁶⁹ Furthermore, the national legislation included provisions allowing for exceptions to the fixed cost through sectorial agreements. This aspect indicated that the legislation did not ensure the attainment of the objective ‘in a consistent and systemic manner’ as required by the case law.¹³⁷⁰ In any event, the Court found that the measures exceed what is necessary, by preventing carriers from offering prices lower than the fixed minimum tariff, by proving that they are in full compliance with the safety provisions in force.¹³⁷¹ Finally, numerous rules already exist, including EU law, relating to road safety which were deemed more effective and less restrictive than those imposed by the Osservatorio.¹³⁷²

The most recent case confirming *Wouters*, *Meca-Medina* and *CNG* is *Chez Elektro Bulgaria*.¹³⁷³ The case involved a request for a preliminary ruling from a Bulgarian Court regarding the compatibility of rules adopted by the Bulgarian Supreme Council of the Legal Profession (SCLP), a body composed of lawyers elected by their peers,¹³⁷⁴ with Article 101(1). Within its mandate afforded to it by Bulgarian law, the SCLP adopted a professional regulation that established minimum legal fees for lawyers. Any breach of this regulation was subject to disciplinary sanctions. The referring court sought clarification on whether a national law, making minimum fees mandatory, was precluded by Article 101(1), read in conjunction with Article 4(3) TEU.

First, the Court recalled its case law on Member State liability under Article 101(1), read in conjunction with Article 4(3) TEU.¹³⁷⁵ Similarly to the *API* case, the absence of specific public interest criteria for determining the tariffs defined

¹³⁶⁸ *ibid.*, para 51.

¹³⁶⁹ *ibid.*, para 52.

¹³⁷⁰ *ibid.*, para 53.

¹³⁷¹ *ibid.*, para 54.

¹³⁷² *ibid.*, para 56. e.g., ‘EU rules on the maximum weekly working time, breaks, rest, night work and roadworthiness test for vehicles. Rigorous compliance with those rules can indeed ensure an appropriate level of road safety’.

¹³⁷³ Joined Cases C-427/16 and C-428/16 *CHEZ Elektro Bulgaria* (n 42).

¹³⁷⁴ *ibid.*, para 44.

¹³⁷⁵ *ibid.*, para 40.

in law meant that the decision of the SCLP could not be considered to have the character of legislation.¹³⁷⁶ Therefore, the regulation constituted a decision by an association of undertakings¹³⁷⁷ that restricted competition within the meaning of Article 101(1).¹³⁷⁸

Second, concerning the justification according to the *Wouters* rule, the Court left the determination of a legitimate objective, together with the proportionality assessment, entirely to the national court.¹³⁷⁹

In conclusion, these two cases are noteworthy for two reasons. Firstly, *API* and *Chez Elektro Bulgaria* confirmed that the rule of reason not only applies to the regulatory measures taken by an association of undertakings but also extends legislation enacted by Member States. In this sense, they can be interpreted as expanding the *Wouters* doctrine to encompass ‘pure’ public acts. From a legal standpoint, applying the rule of reason *mutatis mutandis* to legislation appears justifiable when adopting a systemic interpretation of the Treaties. If, under certain circumstances, Member States can be subject to the antitrust provisions by virtue of their duty of loyalty, it is logical that they may also, provided the requirements are met, benefit from the exceptions within that legal framework. The loyalty clause operates reciprocally and affirms itself within a horizontal setup between Member States and the Union.¹³⁸⁰ In other words, the Union also owes loyalty to its Member States.

Additionally, the rule of reason appears to be taking on the form of a regime mirrored on the mandatory requirements in free movement law under EU antitrust law.¹³⁸¹ The deontological considerations present in the earlier case law are replaced by broader public policy, such as the protection of road safety, reminiscent of the *Cassis* doctrine under free movement law.¹³⁸² Whilst that

¹³⁷⁶ *ibid.*, paras 43–49.

¹³⁷⁷ *ibid.*, para 49.

¹³⁷⁸ *ibid.*, para 51.

¹³⁷⁹ *ibid.*, paras 56–58.

¹³⁸⁰ This aligns with the duty of loyalty, which also comprises EU towards the Member States.

¹³⁸¹ See Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* (n 37), para 8. For a similar view, Richard Whish and David Bailey, *Competition Law* (9th ed. OUP 2018) 139 put forward argued that *Wouters* is in essence an application of the techniques in free movement (here services) to the realm of competition law.

¹³⁸² On road safety as a mandatory requirement under Article 34 TFEU see Case C-110/05 *Commission v Italy (Trailers)* EU:C:2009:66, para 60.

finding might not depart from the previous case law, it reinforces the potential of the rule of reason to apply to a variety of public policy objectives.

6.1.2.3 Assessing the Meaning of the Rule of Reason

The rule of reason doctrine has been subject to significant analysis and discussion in EU legal scholarship.¹³⁸³ In order to assess the meaning of the rule of reason the analysis is broken down into two steps. First, the personal scope of the test is explored to determine which entities it encompasses. Second, its nature is examined to determine what kind of exercise it entails.

6.1.2.3.1 *Assessing the Personal Scope of the Wouters Rule*

An important factor in any analysis of the rule of reason is whether it can be invoked by any undertaking. The cases above applying the doctrine can be summarised as follows: an entity qualified as an association of undertakings representing a specific sector of the economy is granted regulatory powers by national law to protect a legitimate interest inherent in that profession/activity (self-regulation).

However, these general points must be nuanced. First, in the *Meca-Medina* case, there was no national law establishing a public policy interest. IOC is a completely private body established under Swiss law and acts as the governing body of national Olympic committees.¹³⁸⁴ Second, the *API* case demonstrates that the rule of reason can apply to broader public policy objectives not related to any self-regulatory aspect of the entity in question.¹³⁸⁵

What is apparent from these cases is that despite the precise composition of these entities, they were regarded as public, or quasi-public in the case of the IOC, representing varying degrees of government involvement. In this sense, it has been suggested that the rule of reason should be restricted to private agreements

¹³⁸³ e.g., Monti (n 62); Ian Forrester, 'Where Law Meets Competition: Is Wouters Like a Cassis de Dijon or a Platypus?' in Claus-Dieter Ehlermann and Isabela (eds) Atanasiu, *European Competition Law Annual 2004: The Relationship Between Competition and the (Liberal) Professions* (Hart 2014) 271; Janssen and Kloosterhuis (n 304); Nowag, 'Wouters, When the Condemned Live Longer: A Comment on OTOC and CNG' (n 661); Johan W van de Gronden, 'Rule of Reason and Convergence in Internal Market and Competition Law' in Annette Schrauwen (ed), *The Rule of Reason: Rethinking Another Classic of European Legal Doctrine* (Europa Law Publishing 2005).

¹³⁸⁴ Case C-519/04 P *Meca-Medina* (n 660), para 2.

¹³⁸⁵ Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40), para 51.

assuming ‘public functions’.¹³⁸⁶ Wish and Bailey proposed distinguishing between ‘commercial ancillarity’ and ‘regulatory ancillarity’.¹³⁸⁷ The rules in *Wouters* are not necessary to execute a commercial agreement or transaction but are deemed ‘ancillary to a regulatory function’,¹³⁸⁸ sometimes as part of self-regulation.¹³⁸⁹ However, other scholars, including Townley, criticise this approach by pointing out that ancillarity follows a ‘fundamentally different logic’.¹³⁹⁰ This critique seems valid since this thesis has argued that ancillary restraints are inherent in the competition status quo and do not include any assessment of other public policy objectives.¹³⁹¹ The rule of reason doctrine does not appear to incorporate a welfare analysis and, in that respect, has a different objective than achieving the most efficient transaction. Furthermore, there is no requirement that the agreement must be ancillary to a main operation.

Monti suggested analysing the rule of reason by reference to its actual objectives. He viewed the *Wouters* rule as a means to balance national interests with competition law in cases of diagonal conflicts between national and EU law.¹³⁹² In this sense, the *Wouters* rule represents a convergence between free movement and competition law.¹³⁹³ However, this approach has also faced critique due to, inter alia, the difficulty in distinguishing between national and EU interests.¹³⁹⁴ This critique also appears justified when analysing the aforementioned. For instance, in *Meca-Medina*, there was no national law

¹³⁸⁶ Christoph U Schmid, ‘“Diagonal Competence Conflicts between European Competition Law and National Regulation – A Conflict of Laws Reconstruction of the Dispute on Book Price Fixing’ (2000) 8(1) European Review of Private Law 155, 167 cited in Monti (n 62) 1089.

¹³⁸⁷ Wish and Bailey (n 1381) 139-144.

¹³⁸⁸ Townley, *Article 81 EC and Public Policy* (n 891) 132.

¹³⁸⁹ *ibid.*

¹³⁹⁰ *ibid.*, 133.

¹³⁹¹ See section 6.1.1 of the current chapter.

¹³⁹² Monti (n 62) 1086. Monti interprets *Wouters* ‘as excluding the application of EC competition law when the agreement is necessary to protect a legitimate national interest’ (p. 1090).

¹³⁹³ *ibid.*, 1087 ‘this is a remarkable *ratio decidendi* for the Court intertwines principles of competition law and free movement’.

¹³⁹⁴ Townley, *Article 81 EC and Public Policy* (n 891) 137; Nowag, ‘Wouters, When the Condemned Live Longer: A Comment on OTOC and CNG’ (n 661) 43.

establishing a national interest. The protection of sports is also an EU value.¹³⁹⁵ Similarly, in *API*, the legitimate objective was road safety, which is equally an EU objective.¹³⁹⁶ These shared values render the distinction challenging, if not impossible, to operate in practice. From that perspective, there is nothing to rule out the possibility that the rule of reason could equally apply to EU measures.

In conclusion, it appears evident that the *Wouters* rule applies to public policy defined at a State level (or international in the case of *Meca-Medina*) and not public policy goals voluntarily undertaken by private firms. Nowag argued that Article 101(1) maintains ‘a strong link to the State’, distinguishing it from the test under Article 101(3).¹³⁹⁷ This state influence is clearly demonstrated in all the cases examined above. Therefore, *Wouters* is an exception applying to (i) undertakings vested with regulatory powers or (ii) to regulatory measures directly enacted by a Member State.

6.1.2.3.2 *Assessing the Nature of the Test in the Wouters Rule*

The precise function of the test in *Wouters* remains unclear. Whilst excluding rules from the scope of Article 101(1) TFEU may seem to align with a qualification approach, the Court’s methodology indicates that the rule of reason is rather a balancing exercise, (i.e., legal justification). It is only once a potential restriction is identified that the Court turns to *Wouters*.¹³⁹⁸ Moreover, the use of the proportionality principle argues in favour of a balancing approach.¹³⁹⁹ This can be

¹³⁹⁵ See Article 165 TFEU. In particular, in relation to the antidoping rules in Case C-519/04 P *Meca-Medina* (n 660). Article 165 provides that the Union shall be aimed at ‘developing the European dimension in sport by promoting *fairness* and openness in sporting competitions and cooperation between bodies responsible for sports, and by protecting the *physical and moral integrity* of sportsmen and sportswomen, especially the youngest sportsmen and sportswomen’ (emphasis added).

¹³⁹⁶ It is also a mandatory requirement under Article 34 TFEU, see, Case C-110/05 *Commission v Italy (Trailers)* (n 1382). Townley, *Article 81 EC and Public Policy* (n 889) 136 argued that many mandatory requirements are EU objectives. The Court also ruled in Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40), para 56, that there are a numbers of EU law rules ‘relating specifically to road safety, which constitute more and less restrictive measures, such as EU rules on the maximum weekly working time, breaks, rest, night work and roadworthiness tests for vehicles’.

¹³⁹⁷ Nowag, *Environmental Integration in Competition and Free-Movement Laws* (n 73) 251.

¹³⁹⁸ In Case C-309/99 *Wouters* (n 42), para 96-97 the Court initially found that the measures constituted a restriction. Subsequently, it proceeded to hold that ‘account must be taken of its objectives [...]’. This ‘justification approach’ is also followed by Opinion of AG Léger in Case 309/99 *Wouters* (n 1297), para 50.

¹³⁹⁹ On the use of proportionality in balancing exercise see e.g., Marzal (n 548); Alexy, ‘Constitutional Rights and Proportionality’ (n 610).

contrasted with a true qualification rule, such as the exclusion of ‘certain selling arrangements’ (CSA) from Article 34 TFEU as developed in *Keck*.¹⁴⁰⁰ The exclusion of CSAs is not dependent on a proportionality assessment.¹⁴⁰¹ Rather, a qualification approach dictates that the outcome follows the taxonomy or classification of a rule. As put by Sullivan, ‘the outcome follows, without any explicit judicial balancing of the claimed right against the government’s justification for the infringement’.¹⁴⁰²

Having established that the exercise is one of justification, the salient question relates to the interests that are balanced within the *Wouters* rule. Although the case law is limited and it is futile to predict any future use of the rule of reason doctrine, three observations can be made.

First, in line with the case law from *Wouters* until *CNG*, the objectives taken into account were closely related to the self-regulatory aspects of entities responsible for the organisation of a specific activity/profession. In *Wouters*, the legitimate interest is of a deontological nature: ‘to ensure that the sound administration of justice is provided with sufficient guarantees in relation to integrity and experience’.¹⁴⁰³ Similarly, in *OTOC*, the legitimate objective sought ‘to guarantee the quality [including ethical considerations] of the services offered by chartered accountants’.¹⁴⁰⁴ In *CNG*, the identified legitimate objective was to ensure that ‘the ultimate consumers of the services in question are provided with the necessary guarantees’.¹⁴⁰⁵

Second, however, in cases directly challenging the legislation of Member States under Article 101(1), read in conjunction with Article 4(3) TEU, more general objectives appear to be admissible. In *API*, the legitimate objective pursued the protection of road safety in general, rather than being centred on ethical considerations or considerations of the quality of the service delivered to

¹⁴⁰⁰ Case C-267/91 *Keck and Mithouard* EU:C:1992:448, para 16.

¹⁴⁰¹ On the distinction between categorisation (qualification) and balancing (justification) see Chapter 1, section 1.2.2.

¹⁴⁰² Sullivan (n 28) 293.

¹⁴⁰³ Case C-309/99 *Wouters* (n 42), para 97.

¹⁴⁰⁴ Case C-1/12 *Ordem dos Técnicos Oficiais de Contas* (n 660), paras 95-96.

¹⁴⁰⁵ Case C-136/12 *Consiglio Nazionale dei Geologi and Autorità Garante della Concorrenza e del Mercato* (n 660), para 53.

the final consumers.¹⁴⁰⁶ Whilst the Court ultimately found the legislation unsuitable, its reasoning suggests that there is at least a possibility that the rule of reason can justify broader public policy considerations. It is worth noting that the Court seems to apply a strict LRM standard of proportionality.¹⁴⁰⁷ Whilst drawing definitive conclusions from a single case would be unwarranted, it is worth considering that the Court may be more stringent in terms of proportionality when assessing broader objectives.¹⁴⁰⁸ Furthermore, with the judgment of the Court in *API*, the link between free movement and antitrust law by the reference to *Reisebüro Broede* in *Wouters* is further reinforced with the inclusion of general mandatory requirements in the *Wouters* toolbox.¹⁴⁰⁹

Third, the scope of the balancing exercise is ambiguous. It appears that these measures can be justified beyond the confines of the relevant market, which runs contrary to the traditional view of Article 101(1). From this perspective, the *Wouters* rule has the potential to shoulder a true market failure test considering not only direct consumer benefits but also broader efficiency enhancements. However, as the doctrine has thus far almost only been applied in preliminary ruling procedures, the proportionality *stricto sensu* is left to the discretion of the national courts. Consequently, there is no clear balance between the consumer welfare generated in the relevant market and the restriction before the ECJ. This finding begs the question of whether a true balancing exercise (trade-off scenario) exists at all under the *Wouters* rule. Based on the above cases, it appears that the answer to that question is negative, as there is no evident balancing exercise conducted by the ECJ.

It follows that the scope of the *Wouters* rule of reason has gradually been broadened. Rather than becoming obsolete in the post-modernisation era, it has reaffirmed itself as a public policy exception to Article 101(1). Whilst the exact extent of its scope is challenging to ascertain, it is evident that the rule of reason extends beyond purely deontological considerations. Some scholars even claim

¹⁴⁰⁶ Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40), para 36.

¹⁴⁰⁷ *ibid.*, paras 55-57.

¹⁴⁰⁸ However, a strict approach is also visible in Case C-1/12 *Ordem dos Técnicos Oficiais de Contas* (n 660) in relation to the quality of the service.

¹⁴⁰⁹ Road safety is a well-established mandatory requirement under free movement law, see e.g., Case C-55/93 *van Schaik* EU:C:1994:363, para 19; Case C-265/06 *Commission v Portugal* EU:C:2008:210, para 38; Case C-110/05 *Commission v Italy (Trailers)* (n 1382), para 60.

that *Wouters* constitutes a ‘generic public interest justification’.¹⁴¹⁰ Competition theory does not provide a clear distinction between ‘legitimate’ and ‘illegitimate’ competition, but instead offers an instrumental definition of competition based on the (perceived) social utility of a practice that is mostly preferred.¹⁴¹¹ Therefore, *Wouters* should be regarded as a departure from the competition law’s status quo, providing a possibility to justify restrictions on competition based on other public policy considerations. However, the Court does not engage in a balancing exercise between the restriction on competition and other broader efficiencies.

6.1.3 The Boundaries of Economic Activity

This section emerges as an atypical feature within the broader analysis of exceptions under EU antitrust law. It deviates from the typical trajectory of public policy justification, focusing instead on legal qualification through the notion of ‘economic activity’ as a requirement within the definition of an ‘undertaking’ in the case law of the Court.¹⁴¹² In this respect, this qualification exercise is not viewed as a ‘true’ exception and does not, *prima facie*, include a balancing test. These non-economic activities fall outside the scope of the antitrust provisions (and 107(1) TFEU as well), thereby positioning the concept of non-economic factors as a limiting factor outside of the reach of these provisions.

The decisive factor in the assessment of whether or not an entity is an undertaking is not its legal form, but whether it exercises an economic activity.¹⁴¹³ Whilst the classification of an undertaking is indisputably an exercise of legal qualification, this section demonstrates that the exclusion of an activity from the antitrust provisions is not dictated by a fixed set of criteria, but rather adjudicated via a sliding scale on a case-by-case basis.

Such an analysis might suggest the necessity of an assessment incorporating a balancing exercise between competition and other factors. However, EU antitrust law veers away from this methodology. Instead, a factual assessment of

¹⁴¹⁰ Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (n 558) 258.

¹⁴¹¹ Meese (n 12) 77. The author argued that ‘[s]uch an approach would treat as “competitive” any practice that, under the circumstances, would seem to further society’s welfare when compared to the *status quo*.’

¹⁴¹² On the notion of undertaking, see Chapter 4, section 4.2.1.1.

¹⁴¹³ Case C-41/90 *Höfner* (n 35), para 21; Case C-222/04 *Cassa di Risparmio di Firenze* EU:C:2006:8, para 107; Case C-237/04 *Enirisorse* EU:C:2006:197, para 28.

contributing elements is carried out, ultimately concluding that certain activities have been withdrawn from the market and are consequently beyond the scope of the antitrust provisions. This segment suggests that, whilst the rationale for non-economic activities can be partially explained by market failure theory, the concept does not encompass a proportionality analysis and, by extension, a market failure test.

The ensuing subsections delve into the Court's case law concerning the exceptions for public authority and solidarity respectfully.

6.1.3.1 The Exercise of Public Authority

This section is organised into two distinct subsections. Initially, we embark on an examination of the Court's case law pertaining to 'public authority'. This is subsequently followed up by an exploration and an analysis of the concept itself.

6.1.3.1.1 *The Case Law on Public Authority*

Certain activities are deemed to be non-economic based on their involvement in the exercise of 'public authority'. If the qualification of an undertaking is contingent on the nature of the activity exercised by that entity, the same logic applies to the exercise of public authority. As put by Sauter and Schepel, 'the decisive criterion remains that a public task, or a policy in the general public interest, should be concerned'.¹⁴¹⁴ Therefore, it is, equally a *functional* criterion.¹⁴¹⁵ This perspective had already been advocated by Advocate General Mischo in 1986 in relation to the Transparency Directive:

[...] I am of the opinion that 'public service' and 'public undertaking' are not mutually exclusive concepts so that a public authority, including the State itself, may in certain cases also be regarded as a 'public undertaking'.¹⁴¹⁶

¹⁴¹⁴ Wolf Sauter and Harm Schepel, *State and Market in European Union Law: The Public and Private Spheres of the Internal Market before the EU Courts* (CUP 2009) 83.

¹⁴¹⁵ On the functional nature of the fair share criterion under Article 101(3) see Chapter 5, section 5.2.4.

¹⁴¹⁶ Opinion of AG Mischo in Case C-118/85 *Commission v Italy* EU:C:1986:413, p 2610.

The first precise notions of public authority in EU competition law manifests within the initial Transparency Directive,¹⁴¹⁷ particularly in Article 2, which made a distinction between ‘public authorities’ and ‘public undertakings’.

The earlier case law is notably vague concerning the boundaries of the antitrust provisions. In *Corinne Bodson*,¹⁴¹⁸ the French Court de Cassation requested a preliminary ruling from the ECJ on the compatibility of the EU provisions on monopolies and competition with a 1904 national legislation granting exclusive concessions for certain funeral services to communal monopolies.¹⁴¹⁹ In this case, the Court held that Article 101 TFEU applies, in its wording, to agreements between ‘undertakings’, and ‘does not apply to contracts for concessions concluded between communes acting in their capacity as public authorities and undertakings entrusted with the operation of a public service’.¹⁴²⁰ However, the Court’s interpretation of ‘public authority’ remains ambiguous.

In *SAT Fluggesellschaft*,¹⁴²¹ the Court excluded the application of Article 101(1) to an international organisation and based its *ratio decidendi* on the public authority. The case concerned measures adopted by Eurocontrol, an international organisation charged with, among other responsibilities, ‘the common organisation of air navigation services within the air space of the contracting parties’.¹⁴²² The litigation arose by SAT (an airline company) refusing to pay charges collected by Eurocontrol from users of air navigation services carried out in the signatory States.¹⁴²³ SAT contended that by fixing differing rates for these charges, varying from State to State and year to year, Eurocontrol had abused its dominant position. The question referred to the Court was whether Eurocontrol could be considered an undertaking for the purposes of the EU antitrust provisions.¹⁴²⁴

¹⁴¹⁷ Commission Directive 80/723/EEC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings.

¹⁴¹⁸ Case 30/87 *Corinne Bodson v SA Pompes funèbres des régions libérées* EU:C:1988:225.

¹⁴¹⁹ *ibid.*, paras 2-3.

¹⁴²⁰ *ibid.*, para 18.

¹⁴²¹ Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* (n 489).

¹⁴²² Opinion of AG Tesauro in Case 364/92 *SAT Fluggesellschaft mbH v Eurocontrol* EU:C:1993:878, para 2.

¹⁴²³ *ibid.*, paras 2-3.

¹⁴²⁴ Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* (n 489), para 7.

By reference to the nature of Eurocontrol's activities,¹⁴²⁵ the Court noted that its primary tasks consist of 'research, planning, coordination of national policies and staff training'.¹⁴²⁶ Besides those functions, Eurocontrol also engages in the operational exercise of air navigation control within the contracting States.¹⁴²⁷ In this capacity, Eurocontrol is exercising 'tasks in the public interest aimed at contributing to the maintenance and improvement of air navigation safety' which cannot be separated from the collection of route charges.¹⁴²⁸ Therefore, 'taken as a whole', the activities of Eurocontrol 'are typically those of a public authority', which means that it is not an undertaking subject to the rules on competition of the Treaties.¹⁴²⁹

At first glance, it might appear that the Court's judgment diverged from the 'functional' nature of economic activity established in its case law.¹⁴³⁰ Particularly, the Court adopted an expansive approach to the activities exercised by Eurocontrol 'taken as a whole'.¹⁴³¹ However, such an interpretation is incorrect. Rather, it seems that the scope of a public authority is determined by the *separability* of those activities from other economic activities performed by the same entity. Although not explicitly stated in the judgment, AG Tesauro put forth an argument based on '*accessorium sequitur principale*'. The AG considered that Eurocontrol could not enjoy absolute immunity from the antitrust provisions. Only typical acts of state power (*imperium*) could be shielded, not acts *jure gestionis*.¹⁴³² Consequently, adhering to the accessory-principal logic, the collection of the

¹⁴²⁵ *ibid.*, para 19.

¹⁴²⁶ *ibid.*, para 22.

¹⁴²⁷ *ibid.*, para 24.

¹⁴²⁸ *ibid.*, paras 27-28.

¹⁴²⁹ *ibid.*, paras 30-31.

¹⁴³⁰ e.g., Case 170/83 *Hydrotherm* (n 736), para 11, 'In competition law, the term "undertaking" must be understood as designating an economic unit for the purpose of the subject-matter of the agreement in question even if in law that economic unit consists of several persons, natural or legal'. See Lianos, Korah and Sicilliani (n 357) 279, who writes that 'This means that, in theory, the same entity may be considered as an undertaking for a specific conduct or context but not an undertaking for another conduct or context'. On the functional approach to economic activity see Chapter 4, section 4.2.1.1.

¹⁴³¹ Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* (n 489), paras 30-31.

¹⁴³² Opinion of AG Tesauro in Case 364/92 *SAT Fluggesellschaft mbH v Eurocontrol* (n 1422), para 6.

charges is also non-economic since the service to which they relate to is of a non-economic nature.¹⁴³³

The public authority notion is problematic due to the lack of clear qualifiers. The Court does not specify its scope beyond tasks which *typically* fall under the responsibility of a public authority. AG Mayras in *Reyners*¹⁴³⁴ offered the following definition of the concept:

Official authority is that which arises from the sovereignty and majesty of the State; for him who exercises it, it implies the power of enjoying the prerogatives outside the general law, privileges of official powers of coercion over citizens.¹⁴³⁵

In *Calì*, the Court reaffirmed its approach to defining public authority.¹⁴³⁶ In this case, a dispute emerged between the applicant and SEPG, a private undertaking which managed anti-pollution surveillance in the oil port of Genoa, a role conferred by the national port authority.¹⁴³⁷ In order to protect against pollution from incidents, the president of the national port authority made the surveillance and intervention services managed by SEPG mandatory, with the costs charged to port users.¹⁴³⁸ The applicant, Calì, refused to pay these charges, asserting that it had never requested the services during its operations in the Genoa harbour.¹⁴³⁹ The Court of Genoa referred a set of questions to the ECJ to establish whether SEPG had abused its dominant position.

The ECJ held that SEPG could not be qualified as an undertaking for the purpose of the antitrust provisions, since:

The anti-pollution surveillance for which the SEPG was responsible [...] is a task in the public interest which forms part of the essential functions

¹⁴³³ *ibid.*, para 14.

¹⁴³⁴ Opinion of AG Mayras in Case C-2/74 *Reyners v Belgian State* EU:C:1974:59.

¹⁴³⁵ *ibid.*, 664.

¹⁴³⁶ Case C-343/95 *Diego Calì & Figli Srl v Servizi ecologici porto di Genova SpA (SEPG)* EU:C:1997:160.

¹⁴³⁷ *ibid.*, paras 1-6.

¹⁴³⁸ *ibid.*, paras 7-11.

¹⁴³⁹ *ibid.*, para 11.

of the State as regards [the] protection of the environment in maritime areas.¹⁴⁴⁰

The ECJ further elaborated:

Such surveillance is connected by its nature, its aim and the rules to which it is subject with the exercise of powers relating to the protection of the environment which are typically those of a public authority.¹⁴⁴¹

Therefore, as SEPG is not engaged in economic activity, it is not subject to the antitrust provisions.¹⁴⁴² Just as in *SAT Fluggesellschaft*, the ECJ found that the imposition and collection of the charge is an integral component of the surveillance task and cannot be distinguished from the exercise of a public authority,¹⁴⁴³ thereby reaffirming the separability criterion. This argument was further buttressed by the fact that the tariffs had been sanctioned by the competent public authority.¹⁴⁴⁴ The Court did not provide any additional guidance on the definition of a public authority beyond the broad statements established in *SAT Fluggesellschaft*: public authority are tasks in the public interest (i), which are ‘typically those of a public authority (ii)’.¹⁴⁴⁵

AG Cosmas took a more active approach to defining the essence of a public authority:

It is clear from the case-law of the Court of Justice [...], that certain bodies that are the instrument of a policy in the (general) public interest and enjoy prerogatives of the public authority, that is to say bodies that exercise an activity typical of a public authority or have an exclusive social function, do not constitute undertakings are not therefore subject to the [EU] rules on competition.¹⁴⁴⁶

¹⁴⁴⁰ *ibid.*, para 22.

¹⁴⁴¹ *ibid.*, para 23. This judgment has been confirmed fairly recently see e.g., Case C-687/17 P *Aanbestedingskalender* EU:C:2019:932, para 15.

¹⁴⁴² *ibid.*

¹⁴⁴³ *ibid.*, para 24.

¹⁴⁴⁴ *ibid.*

¹⁴⁴⁵ Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* (n 489), paras 27, 30; Case C-343/95 *Diego Cali* (n 1436), paras 22-23.

¹⁴⁴⁶ Opinion of AG Cosmas in Case C-343/95 *Diego Cali* EU:C:1996:482, para 41.

To determine whether public authority should prevail, it is necessary to establish whether the entity operates in compliance with the rules of administrative authorities, possesses the capacity to influence the fees charged for the services provided, and whether, or to what extent, it is profit-making.¹⁴⁴⁷ In this case, the AG highlighted that anti-pollution surveillance cannot be carried out under a competitive system, since that would undermine the effectiveness of the system given that the activity must be carried out regardless of the payment of the fees.¹⁴⁴⁸ Furthermore, ‘the maritime zone of the Porto Petroli, that is to say, a public asset, is being protected in the interest of the State and citizens’.¹⁴⁴⁹ As a result, the anti-pollution activities do not operate within a market where supply and demand meet.¹⁴⁵⁰

AG Cosmas further considered that beyond pursuing a public interest, the entity must possess prerogatives of a public authority, i.e., powers that surpass those of private firms operating under normal market conditions. This is noteworthy since it facilitates a clearer distinction between a public authority and undertakings pursuing a task in the public interest.¹⁴⁵¹ In both *SAT Fluggesellschaft* and *Cali*, the entities indeed had the power to charge the users of infrastructure for services they had never solicited. This should be seen as precisely such a public prerogative.

Nevertheless, the Court does not appear to attach the exercise of such powers to a public authority. Moreover, the factors used to determine the existence of a public authority – the aim of the activity, the nature of the rules to which they are subject, and the extent to which they are profit-making – are rather indistinct.¹⁴⁵² Furthermore, these factors appear to be supportive rather than conclusive. For instance, the Court has found that non-profit entities can be

¹⁴⁴⁷ *ibid.*, para 42.

¹⁴⁴⁸ *ibid.*, para 49.

¹⁴⁴⁹ *ibid.*, para 46.

¹⁴⁵⁰ *ibid.*, para 53.

¹⁴⁵¹ For example, undertakings involved in providing a SGEI are still subject to the competition law provisions and must seek derogation under Article 106(2) rather relying on the public authority exception.

¹⁴⁵² For a similar opinion see e.g., Sauter and Schepel (n 1414) 85.

considered to exercise economic activity in the sense of the antitrust provisions.¹⁴⁵³ Conversely, the fact that a service is rendered in return for payment is not enough to conclude that the activity is economic in nature.¹⁴⁵⁴

The expansive approach to activities of a public authority and their separability from interconnected tasks adopted in *SAT Fluggesellschaft* and reaffirmed in *Calì* has perhaps since become more nuanced. In *Aéroports de Paris*, a public undertaking (ADP) tasked with the planning, administration and development of airports in the Paris region, was fined for breaching EU antitrust provisions by charging discriminatory prices.¹⁴⁵⁵ With reference to *Commission v Germany*,¹⁴⁵⁶ the General Court held that: ‘the Treaty provisions on competition are applicable to the activities of an entity which can be severed from those in which it engages as a public authority’.¹⁴⁵⁷ Therefore, the General Court drew a distinction between, on one hand, ADP’s ‘purely administrative activities’, such as supervision, and on the other, the ‘management and operation of the Paris airports’, which is a commercial activity.¹⁴⁵⁸ Consequently, when managing ground handling services, ADP is considered an undertaking in the sense of the antitrust provisions of the Treaty.¹⁴⁵⁹ The case was later confirmed by the ECJ.¹⁴⁶⁰

In *SELEX*, the General Court found that within each of Eurocontrol’s activities, a distinction must be made between those activities that constitute acts of a public authority and those that are economic activities.¹⁴⁶¹ The Court further emphasised that this approach is fully consistent with the ruling in *SAT Fluggesellschaft*, ‘despite the general nature of the wording [therein]’ (the

¹⁴⁵³ Case C-67/96 *Albany* (n 43), para 79. For an application in the sport sector see Commission Decision (92/521/EEC) of 27 October 1992 (Case IV/33384 and IV/33378 - Distribution of package tours during the 1990 World Cup).

¹⁴⁵⁴ Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* (n 489), para 28 et seq. and Case C-343/95 *Diego Calì* (n 1436), paras 22 to 25.

¹⁴⁵⁵ Commission Decision (98/513/EC) of 11 June 1998 (Case IV/35613 - Alpha Flight Services/Aéroports de Paris), paras 1-2, 135.

¹⁴⁵⁶ Case 107/84 *Commission of the European Communities v Federal Republic of Germany* EU:C:1985:332 regarding the VAT directive.

¹⁴⁵⁷ Case T-128/98 *Aéroports de Paris v Commission* EU:T:2000:290, para 108.

¹⁴⁵⁸ *ibid.*, para 112.

¹⁴⁵⁹ *ibid.*, para 120.

¹⁴⁶⁰ Case C-82/01 P *Aéroports de Paris v Commission* EU:C:2002:617.

¹⁴⁶¹ Case T-155/04 *SELEX Sistemi Integrati v Commission* (n 35), para 54.

expansive approach).¹⁴⁶² Accordingly, the Court conducted an in-depth assessment of the activities of standardisation,¹⁴⁶³ R&D,¹⁴⁶⁴ and the provision of technical assistance to national administrations,¹⁴⁶⁵ concluding that only the latter was economic in the sense of the Treaties.¹⁴⁶⁶

The ruling of the General Court can be viewed as closely linked to the broad approach in the *FENIN* case law,¹⁴⁶⁷ where the ECJ found that since economic activity is defined in the case law as the ‘offering of goods and services’,¹⁴⁶⁸ the act of purchasing goods is non-economic if the subsequent use of those goods does not amount to economic activity.¹⁴⁶⁹ As put by the Court in *FENIN*:

There is no need to dissociate the activity of purchasing goods from the subsequent use to which they are put in order to determine the nature of that purchasing activity, and that the nature of the purchasing activity must be determined according to whether or not the subsequent use of the purchased goods amounts to an economic activity.¹⁴⁷⁰

The General Court, referring to the judgment in *FENIN*, deduced that the acquisition of prototypes cannot be separated from its use (standardisation).¹⁴⁷¹

Whilst the ECJ dismissed the appeal, it did not affirm the approach of the General Court, instead holding that the latter had committed several errors of law.¹⁴⁷² In particular, the Court found that the task of assisting national administrations is connected with the exercise of public powers and, thus, is not

¹⁴⁶² *ibid.*, para 54.

¹⁴⁶³ *ibid.*, paras 59-69.

¹⁴⁶⁴ *ibid.*, paras 73-82.

¹⁴⁶⁵ *ibid.*, paras 86-95.

¹⁴⁶⁶ *ibid.*, para 92.

¹⁴⁶⁷ Case C-205/03 *FENIN v Commission* (n 490).

¹⁴⁶⁸ *ibid.*

¹⁴⁶⁹ Case C-205/03 *FENIN v Commission* (n 490), para 26; Joined Cases C-262/18 P etc. *Dôvera zdravotná* (n 740), para 48.

¹⁴⁷⁰ *ibid.*

¹⁴⁷¹ Case T-155/04 *SELEX Sistemi Integrati v Commission* (n 35), para 65.

¹⁴⁷² Case C-113/07 P *SELEX Sistemi Integrati v Commission* (n 43).

economic in nature.¹⁴⁷³ Additionally, it stated that Eurocontrol's task of preparing technical standards could not be separated from its task of managing air space and developing air safety, meaning that they do not constitute economic activity.¹⁴⁷⁴

Although these cases reached different conclusions, they both highlight the importance of assessing the *degree of separability* between the tasks of a public authority and any other commercial tasks that an entity might undertake. Separability is assessed on a case-by-case basis and forms part of the functional approach of the Court. If an activity can be severed from the exercise of public authority, it can be qualified as economic for the purpose of the antitrust provision.

The case law of the Court on public authority has subsequently been reaffirmed. In *Compass-Datenbank*, a private firm, Compass, established under Austrian law, operated a database comprising economic data in order to provide information services.¹⁴⁷⁵ Specifically, Compass required the national company register (Firmenbuch), managed by the Austrian State, to make its data available on a daily basis for the purpose of integrating it into Compass' register.¹⁴⁷⁶ The Firmenbuch is a public authority and, under Austrian law, undertakings are obliged to report their data to its register.¹⁴⁷⁷ This situation led to a judgment of the Austrian Supreme Court, ordering Compass to refrain from using the Firmenbuch database to update its own.¹⁴⁷⁸ Subsequently, a prolonged litigation ensued between Compass and the Austrian State over the issue of Firmenbuch making the national company register available to Compass in return for adequate payment.¹⁴⁷⁹ Finally, the Austrian Supreme Court referred a set of questions to the ECJ, specifically asking if Firmenbuch could be considered an 'undertaking' within the context of the antitrust provisions of the Treaty.¹⁴⁸⁰

The Court reaffirmed the functional approach established in *Aéroports de Paris*, holding that a legal entity 'may be regarded as an undertaking in relation to

¹⁴⁷³ *ibid.*, paras 77-85.

¹⁴⁷⁴ *ibid.*, para 93.

¹⁴⁷⁵ Case C-138/11 *Compass-Datenbank GmbH v Republik Österreich* EU:C:2012:449, para 18.

¹⁴⁷⁶ *ibid.*, para 19.

¹⁴⁷⁷ *ibid.*, para 40.

¹⁴⁷⁸ *ibid.*, para 21.

¹⁴⁷⁹ *ibid.*, paras 24-32.

¹⁴⁸⁰ *ibid.*, para 33.

only part of its activities'.¹⁴⁸¹ The Court also appears to have introduced an explicit legal requirement of separability to the analysis:¹⁴⁸²

In so far as a public entity exercises an economic activity which can be separated from the exercise of its public powers, that entity, in relation to that activity, acts as an undertaking, while, if that economic activity cannot be separated from the exercise of its public powers, the activities exercised by that entity as a whole remain activities connected with the exercise of those public powers (see, to that effect, Case C-113/07 P *SELEX Sistemi Integrati v Commission* [2009] ECR I-2207, paragraph 72 et seq.).

The Court moved on to rule that:

In light of the entirety of that case law [...] a data collection activity in relation to undertakings, on the basis of a statutory obligation on those undertakings to disclose the data and powers of enforcement related thereto, falls within the exercise of public powers.¹⁴⁸³

The Court then applied the requirement of separability. It concluded that the task of maintaining the data and making it available to the public is not economic activity, as that task cannot be separated from the data collection activity.¹⁴⁸⁴ This conclusion was reached on the basis that: '[t]he collection of the data would be rendered largely *useless* in the absence of the maintenance of a database which stores the data for consultation from the public'.¹⁴⁸⁵ The fact that Firmenbuch charged a fee for making such information available to the public had no bearing on the qualification of the exercise as a public authority.¹⁴⁸⁶

Compass-Datenbank reaffirmed the Court's nebulous approach to the concept of public authority. Public authority is not defined by the form of the transaction (for instance, a service provided for payment) but by the nature of the

¹⁴⁸¹ *ibid.*, para 37.

¹⁴⁸² Whilst this has been evident in previous case law, the Court has not explicitly articulated it as a formal requirement before.

¹⁴⁸³ Case C-138/11 *Compass-Datenbank* (n 1475), para 40.

¹⁴⁸⁴ *ibid.*, para 41.

¹⁴⁸⁵ *ibid.* (emphasis added).

¹⁴⁸⁶ *ibid.*, para 42.

tasks. However, the concept remains undefined. To assess separability, the Court refers to the *usefulness* of the task to the exercise of public authority. This notion of usefulness is broad and does not appear to be limited to strictly necessary tasks for the exercise of public authority. This can be contrasted with the approach under Article 106(2) TFEU, where the Court requires the measure or right to be necessary to perform the task of general economic interest.¹⁴⁸⁷ In this sense, the ambit of the exercise public authority is theoretically much broader and can potentially include tasks that are not strictly necessary for the performance of its function. *In casu*, there is no evidence in the Court's reasoning that disclosure of data is strictly necessary for its collection and maintenance. It is argued that the judgment in *Compass-Datenbank* extends the criterion of separability. If the same reasoning would have been applied in *SAT Fluggesellschaft*, it cannot be ruled out that the management of ground hauling services could be seen as *useful* to performing the task of airport security and surveillance.

6.1.3.1.2 *Analysis: What is Public Authority?*

The preceding section has shown that the concept of public authority remains largely undefined and is evaluated on a case-by-case basis. The determinant factor is whether the entity is operating in its capacity as a public authority or as an undertaking. Three necessary conditions can be deducted from the case law.

First, the entity must exercise an activity in the general interest, typically conferred to public authorities.¹⁴⁸⁸ There is no exhaustive list of such public authority activities. In cases such as *SAT Fluggesellschaft*, *Calì* and *Aéroports de Paris*, tasks of security or surveillance have been considered by the Court as exercises of public authority. In *SELEX*, assisting national administration was also seen as an exercise of public authority. Whilst private undertakings often assist public authorities, in the case of Eurocontrol it exercised executive powers through the development of joint activities, the application of common standards and harmonisation instruments, etc.¹⁴⁸⁹ Although not confirmed by the Courts, several AGs have argued that one key element of tasks typically assigned to a public authority is the lack of profitability due to the requirement to provide the services

¹⁴⁸⁷ Case C-320/91 *Corbeau* (n 744), para 14; Case C-157/94 *Commission v Netherlands*: EU:C:1997:499, para 35.

¹⁴⁸⁸ Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* (n 489), paras 27 and 30; Case C-343/95 *Diego Calì* (n 1436), paras 22-23.

¹⁴⁸⁹ Case C-113/07 P *SELEX Sistemi Integrati v Commission* (n 43), paras 70-79.

regardless of payment by the user.¹⁴⁹⁰ This argument suggests that these activities inevitably lead to a market failure resulting in undersupply if left to the private sphere.¹⁴⁹¹

Second, the entity must enjoy prerogatives or rights beyond those conferred on private undertakings. This condition aligns with AG Cosmas' argument in *Cali*, who underscored that the enjoyment of 'prerogatives of the public authority' is a key criterion for public authority.¹⁴⁹² Within the reasoning of the EU Courts, this criterion is often subsumed under the first one, for example, in the contexts of security/surveillance, these activities inherently involve powers beyond those of private undertakings. Beyond the activities assigned to them, the entities in both *SAT Fluggesellschaft* and *Cali* possessed powers beyond ordinary undertakings, enabling them to charge the users of infrastructure for unrequested services. In *Compass-Datenbank*, the Court's recognition of public authority appears rooted in the existence of *sui generis* rights and legal prerogatives,¹⁴⁹³ underscoring the Court's focus on the exercise of public authority as such, rather than the entity's specific task.¹⁴⁹⁴ Consequently, notwithstanding the functional approach of economic activity outlined in *Höfner*, public authority extends beyond the nature of the task to encompass the manner in which it is executed.

Third, it can be inferred from the case law that the entity must be under a legal obligation to perform the task of public authority. The powers and obligations of the entities in *SAT Fluggesellschaft* and *SELEX* stemmed from an international convention, whilst in *Cali* and *Compass-Datenbank*, they were regulated by national law.

¹⁴⁹⁰ Opinion of AG Tesauro in Case 364/92 *SAT Fluggesellschaft mbH v Eurocontrol* (n 1422), para 13, who highlighted that 'that control is exercised in respect of any aircraft, within the air space under the authority of Eurocontrol, irrespective of whether or not the owner has paid the route charges'; Opinion of AG Cosmas in Case C-343/95 *Diego Cali* (n 1446), para 49: 'the surveillance has to be exercised regardless whether the fees owed by any particular vessel have been paid'.

¹⁴⁹¹ This will be developed in section 6.1.1.1.1.1 and 6.1.1.2.1 of the current chapter.

¹⁴⁹² Opinion of AG Cosmas in Case C-343/95 *Diego Cali* (n 1446), para 41. See also Opinion of AG Mayras in Case C-2/74 *Reyners v Belgian State* (n 1434) 664: 'Official authority is that which arises from the sovereignty and majesty of the State; for him who exercises it, it implies the power of enjoying the prerogatives outside the general law, privileges of official power and powers of coercion over citizens'.

¹⁴⁹³ Case C-138/11 *Compass-Datenbank GmbH v Republik Österreich* (n 1475), paras 45-48.

¹⁴⁹⁴ As such collecting data and managing a database is not necessarily a task reserved for the public sphere.

Finally, the scope of public authority can be broad, transcending what is necessary for the entity to perform its task. The Court's ruling in *Compass-Datenbank* suggests that it is sufficient for the task to be merely useful to the exercise of public authority. This interpretation broadens the public authority exception considerably when compared to derogations under Articles 101(1) or 106(2).

6.1.3.2 The Exclusion of Purely Solidary Functions

As noted by AG Cosmas in *Calì*, the case law of the Court implies that not only actions of public authority escape the purview of the antitrust provisions, but also those having 'an exclusive social function'.¹⁴⁹⁵ This exception has been particularly prevalent in the domain of social security, where the Court has been met with criticism for 'eroding Member States' socio-economic policies'.¹⁴⁹⁶ The sphere of social security is of particular sensitivity, as the application of the antitrust provisions within this area could have significant consequences for the organisation of national social security systems. Hence, already in *Duphar*, the Court explicitly clarified that that '[EU law] does not detract from the powers of the Member States to organize their social security systems'.¹⁴⁹⁷

This section is divided into two subsections. To begin, an investigation of the Court's case law concerning the principle of 'solidarity' is undertaken. This initial exploration is followed by a critical assessment of the underpinning concept itself.

6.1.3.2.1 The Case Law on Solidarity

In the landmark case of *Poucet and Pistre*, the Court first recognised solidarity as an inherent limitation to the application of the antitrust provisions.¹⁴⁹⁸ This case arose from a dispute between the applicants and the Case Mutuelle Régionale du Languedoc-Roussillon ('the fund'), a fund managing a sickness and maternity

¹⁴⁹⁵ Opinion of AG Cosmas in Case C-343/95 *Diego Calì* (n 1446), para 41.

¹⁴⁹⁶ Sauter and Schepel (n 1414) 85.

¹⁴⁹⁷ Case 238/82 *Duphar BV and others v The Netherlands* EU:C:1984:45, para 16. See also, *Joined Cases C-352/07 to C-356/07, C-365/07 to C-367/07 and C-400/07 IFB Stroder* EU:C:2007:627, para 19; Case C-503/09 *Stewart* EU:C:2011:500, para 75.

¹⁴⁹⁸ *Joined Cases C-159/91 and C-160/91 Christian Poucet v Assurances Générales de France and Caisse Mutuelle Régionale du Languedoc-Roussillon* EU:C:1993:63.

insurance scheme for self-employed people in certain sectors.¹⁴⁹⁹ The applicants contested the compulsory payment of social security contributions to the fund,¹⁵⁰⁰ arguing that the fund had abused its dominant position.¹⁵⁰¹ Ultimately, the Tribunal des Affaires de Sécurité Sociale de l'Hérault requested a preliminary ruling from the ECJ, asking, *inter alia*, if the social security fund is to be regarded as an undertaking for the purposes of the antitrust provisions of the Treaty.¹⁵⁰²

The Court ruled, in line with the Opinion of AG Tesouro,¹⁵⁰³ that by virtue of the principle of solidarity, the social security schemes at issue are not subject to antitrust provisions of the Treaty since 'those schemes pursue a social objective and embody the principle of solidarity'.¹⁵⁰⁴ Factors contributing to that concluded the universal access to the schemes, regardless of the financial situation or state of health of persons at the time of affiliation,¹⁵⁰⁵ and the proportionate nature of contributions in relation to the income of the affiliated.¹⁵⁰⁶ Furthermore, the benefits were identical for all recipients, bearing no relation to the amount of contributions paid (principle of equality).^{1507,1508} In light of these factors, the Court held that 'there is solidarity between the various [schemes], in that those in surplus contribute to the financing of those with structural financial difficulties'.¹⁵⁰⁹ It further stressed that the activities of the fund were 'entirely non-profit making'.¹⁵¹⁰ Notably, the Court appeared to emphasise the compulsory nature of affiliation and contributions¹⁵¹¹ as well as the distributive function of the schemes.¹⁵¹² Ultimately, the Court concluded that '[s]ickness funds, and the organisations involved in the

¹⁴⁹⁹ *ibid.*, para 2.

¹⁵⁰⁰ *ibid.*, para 3.

¹⁵⁰¹ *ibid.*

¹⁵⁰² *ibid.*, paras 3-4.

¹⁵⁰³ Opinion of AG Tesouro in Joined Cases C-159/91 and C-160/91 *Poucet* EU:C:1992:358.

¹⁵⁰⁴ Joined Cases C-159/91 and C-160/91 *Poucet* (n 1498), para 8.

¹⁵⁰⁵ *ibid.*, paras 9-10.

¹⁵⁰⁶ Opinion of AG Tesouro in Joined Cases C-159/91 etc. *Poucet* (n 1503), paras 8-11.

¹⁵⁰⁷ See Opinion of AG Colomer in Case C-265/08 *Federutility* EU:C:2009:640, para 55.

¹⁵⁰⁸ Opinion of AG Tesouro in Joined Cases C-159/91 etc. *Poucet* (n 1503), paras 8-11.

¹⁵⁰⁹ Joined Cases C-159/91 and C-160/91 *Poucet* (n 1498), para 12.

¹⁵¹⁰ *ibid.*, para 18.

¹⁵¹¹ *ibid.*, para 13.

¹⁵¹² *ibid.*, para 12.

management of the public social security system, fulfil an exclusively social function',¹⁵¹³ and were not undertakings in the meaning of the antitrust provisions of the Treaties.¹⁵¹⁴

Overall, the Court relied on a multitude of different evidence to reach the conclusion that the activity was exclusively based on solidarity. In this sense, the interpretation of the Court's judgment poses challenges in distinguishing key factors from circumstantial evidence.

In the subsequent case of *FFSA*, the Court came to the opposite conclusion, finding that a French association managing a supplementary social security scheme was an undertaking for the purposes of EU antitrust law.¹⁵¹⁵ Despite the French government's assertions that the scheme pursued a 'social purpose' and was not 'competitive in nature',¹⁵¹⁶ especially given its target demographic of segments of the population whose income is lesser than the national average and whose age is also higher than the average. The Court, however, disagreed. Whilst acknowledging the presence of certain elements of solidarity,¹⁵¹⁷ the Court held that the scheme functioned according to the 'principle' of capitalisation due to its optional membership, diverging from the principle of solidarity.¹⁵¹⁸ Additionally, the benefits were not identical for all affiliated but determined on the basis of the sum of contributions paid,¹⁵¹⁹ further distinguishing it from the social security scheme considered in *Poucet and Pistre*.

Whilst such a scheme might be less competitive than private insurance schemes, that element alone is not sufficient to exclude it from application of EU antitrust law.¹⁵²⁰ Consequently, solidarity is not defined negatively by reference to

¹⁵¹³ *ibid.*, para 18.

¹⁵¹⁴ *ibid.*, para 19.

¹⁵¹⁵ Case C-174/97 P *FFSA and Others v Commission* EU:C:1998:130, para 22.

¹⁵¹⁶ *ibid.*, para 12.

¹⁵¹⁷ *ibid.*, para 18.

¹⁵¹⁸ *ibid.*, para 17.

¹⁵¹⁹ *ibid.*

¹⁵²⁰ For a similar outcome see Joined Cases C-180/98 to C-184/98 *Pavlov and Others* (n 752), para 79: '[t]he medical specialist's membership of such a scheme stems from the practice of his profession'. And at para 80: '[t]he link between the payment of contributions by every self-employed medical specialist to the same supplementary occupational pension scheme and professional practice is also especially close for the reason that the scheme is characterised by a high degree of solidarity between all medical practitioners'.

the *lack of competition* in a sector; rather it is delineated positively through the identification of certain key elements. In the context of a social security scheme, it appears that two critical elements emerge as decisive factors. First, the mandatory nature of participation in the scheme, which underscored the universal applicability and inclusiveness of such programs. Second, the scheme's redistributive function, particularly as demonstrated by the equality of benefits, which reflects the scheme's intrinsic objective of promoting social equity and mitigating socio-economic disparities. This conclusion is also in line with the Opinion of AG Fennelly in *Sodemare v Regione Lombardia*,¹⁵²¹ who contended that '[s]ocial solidarity envisages the inherently uncommercial act of involuntary subsidization of one social group by another'.¹⁵²²

Post *FFSA*, the Court has adjudicated several cases where national social security schemes were found to operate within the principle of capitalisation, as opposed to solidarity, thereby rendering them subject to the antitrust provisions. In *Albany*, a Dutch sectorial pension fund was qualified as an undertaking, given that the fund itself determined the quantum of contributions and benefits.¹⁵²³ This judgment suggests that the principle of capitalisation overrides any solidarity objectives. even when affiliation to the fund is ostensibly compulsory. Furthermore, the Court has examined additional factors when determining whether an entity serves a purely social function. In *AG2R Prévoyance*, the Court held that a non-profit legal person in charge of a scheme for supplementary reimbursement of healthcare costs could qualify as an undertaking, despite being 'characterised by a high degree of solidarity'.¹⁵²⁴ The Court urged consideration of 'the scope of the State's control over how the scheme in question functions', beyond a mere assessment of the scheme's characteristics.¹⁵²⁵ Notably, the entity might be considered an undertaking if it enjoys autonomy from the state, implying that it is selected by social partners based on financial and economic considerations, amongst other undertakings, competing within the market of the provided services.¹⁵²⁶ Thus, solidarity, akin to public authority, must be defined on a public

¹⁵²¹ Opinion of AG Fennelly in Case C-70/95 *Sodemare and Others v Regione Lombardia* EU:C:1997:55.

¹⁵²² *ibid.*, para 29. See also, Case C-219/97 *Drijvende Bokken* EU:C:1999:437.

¹⁵²³ Case C-67/96 *Albany* (n 43), paras 81-85.

¹⁵²⁴ Case C-437/09 *AG2R Prévoyance* EU:C:2011:112, para 52.

¹⁵²⁵ *ibid.*, para 53.

¹⁵²⁶ *ibid.*, para 65.

level. EU antitrust law does not grant private undertakings immunity from the application of Articles 101, 102 and 107 solely on the basis of the social aim of their activities.¹⁵²⁷

Subsequent case law has further affirmed the application of the principle of solidarity within the field. In *Cisal*, which involved a compulsory insurance scheme against accidents at work,¹⁵²⁸ the Court reiterated that several elements are indicative of a scheme's operation based on the principle of solidarity.¹⁵²⁹ First, the fact that benefits are not proportionate to the contributions entails solidarity.¹⁵³⁰ Second, the compulsory affiliation¹⁵³¹ to the scheme underscores its inclusive, universal character. Third, the scheme is subject to supervision of the State which, as a last resort, can determine the amount of contributions and benefits.¹⁵³² These elements collectively establish that the scheme fulfils an 'exclusively social function',¹⁵³³ thereby shielding it from the application of EU antitrust law.

In *AOK*, German sickness funds, despite having the ability to determine maximum amounts of reimbursement, were not qualified as undertakings since they were simply performing 'a task for management of the German social security system imposed upon them by legislation'.¹⁵³⁴ Notably, these activities were deemed non-profitmaking, and the statutory benefits provided bore no correlation to the amount of contributions.¹⁵³⁵ These factors led the Court to conclude that the funds fulfilled 'an exclusively social function'.¹⁵³⁶

The *FENIN* case represents the latest confirmation of the principle of solidarity.¹⁵³⁷ As seen previously,¹⁵³⁸ the Court held that the purchasing activities

¹⁵²⁷ *ibid.*, para 45.

¹⁵²⁸ Case C-218/00 *Cisal* EU:C:2002:36, para 3.

¹⁵²⁹ *ibid.*, para 38.

¹⁵³⁰ *ibid.*, para 42.

¹⁵³¹ *ibid.*, para 44.

¹⁵³² *ibid.*, para 43.

¹⁵³³ *ibid.*, para 45.

¹⁵³⁴ Case C-264/01 *AOK-Bundesverband and Others* EU:C:2004:150, para 64.

¹⁵³⁵ *ibid.*, para 47.

¹⁵³⁶ *ibid.*, para 51.

¹⁵³⁷ Case C-205/03 *FENIN v Commission* (n 490).

¹⁵³⁸ See section 6.1.3.1.1 of the current chapter.

are deemed non-economic if the subsequent use does not amount to economic activity (the principle of association or separability),¹⁵³⁹ thereby broadening the separability criterion to exclude any prior purchasing activities. In this case, FENIN, an association composed of companies marketing medical goods and equipment used in Spanish hospitals, brought a case before the EU courts against a Commission decision. The Commission had dismissed its complaints directed towards public bodies that managed the Spanish national health system (SNS) on the grounds that these bodies were not undertakings since they operated according to the principle of solidarity.¹⁵⁴⁰ Whilst it was undisputed that the SNS operated according to the principle of solidarity when delivering universal health care,¹⁵⁴¹ the EU Courts extended the principle of solidarity to also exclude from competition law any purchasing activities related to the exercise of solidarity.¹⁵⁴² As pointed out by scholarship, this interpretation of the solidarity exception appears more robust than the public authority exception.¹⁵⁴³ However, it is crucial to note that the broad interpretation of the separability criterion in *FENIN* is not necessarily confined to the realm of solidarity.¹⁵⁴⁴ In this light, the application of the separability criterion could potentially have far-reaching implications in defining the scope of economic activity and thereby determining the applicability of the EU antitrust provisions.

The Opinion of Advocate General Poiares Maduro is particularly interesting for the definition of solidarity. The AG stressed the *distributional function of the State*:

It is true that to introduce a requirement of competition in sectors which have no market characteristics would be meaningless [...]. Above all, the State does not primarily act as an operator on the market, since one of its main roles is to put in place systems for redistribution. In that context, since action by the State is governed only by an objective of

¹⁵³⁹ Case C-205/03 *FENIN v Commission* (n 490), para 26.

¹⁵⁴⁰ *ibid.*, paras 1-9.

¹⁵⁴¹ *ibid.*, para 39.

¹⁵⁴² *ibid.*, para 26.

¹⁵⁴³ Sauter and Schepel (n 1414) 89.

¹⁵⁴⁴ In this context, it is logical that the principle of solidarity applies *mutatis mutandis* to public authority. This argument gains further support from the fact that the General Court in Case T-128/98 *Aéroports de Paris v Commission* (n 1457) and Case T-155/04 *SELEX Sistemi Integrati v Commission* (n 35) referred to *FENIN*.

solidarity, it bears no relation to the market. Competition law applies to it only in so far as the bodies responsible for achieving the objectives of solidarity are to be treated as undertakings. By contrast, that law will not apply if the exercise of the activity does not involve the pursuit of an objective of capitalisation in any way, with the result that there can be no market. The State is none the less under a duty to act consistently: it is free to withdraw certain activities from the market only on the condition that it effectively implements the principle of solidarity and gives effect to redistribution policies. In effect, the State assumes two distinct roles, depending on whether it is acting as an operator on a market or whether it is acting for political purposes, inspired by considerations of solidarity. But it cannot shelter behind the pretext of solidarity in order to avoid economic operators being subject to competition law.¹⁵⁴⁵

The AG's Opinion underscores that the concept of solidarity, rather than being a robust criterion, functions more as a sliding scale.¹⁵⁴⁶ The inherent fluidity necessitates a case-by-case analysis, making it difficult to discern any precise criteria. Nonetheless, most cases are rendered within the field of the insurance sector, and here the AG identified three key criteria for discerning the degree of solidarity:¹⁵⁴⁷ (i) compulsory membership; (ii) a link between the contributions and the risk or conversely, the income of the insured; and (iii) the relationship between the contributions paid and the benefits received.¹⁵⁴⁸ It should be noted that these criteria may differ when applied to other sectors.¹⁵⁴⁹ Yet, generally, a guarantee of universal access suggests a high degree of solidarity.¹⁵⁵⁰ Equally, if the service is free of charge, this could be taken as a sign of solidarity.¹⁵⁵¹ Finally, an examination of whether both private and public entities provide the same

¹⁵⁴⁵ Opinion of AG Poiares Maduro in Case C-205/03 P *FENIN v Commission* EU:C:2005:666, para 27.

¹⁵⁴⁶ *ibid.*, para 30.

¹⁵⁴⁷ *ibid.*, para 30.

¹⁵⁴⁸ *ibid.*

¹⁵⁴⁹ *ibid.*, para 31.

¹⁵⁵⁰ *ibid.*

¹⁵⁵¹ *ibid.*

services in a given market may also shed light on the degree of solidarity at play.¹⁵⁵²

6.1.3.2.2 *Analysis: What is Solidarity?*

In light of the above examination, three key observations can be made.

First, the case law is not absolute; there is no overarching exemption based on solidarity but rather an assessment conducted on a case-by-case basis.¹⁵⁵³ The application of a sliding scale allows the Court the necessary flexibility to ensure that EU antitrust law does not adversely impact the social systems of redistribution of Member States. As articulated by AG Póiares Maduro, when determining whether a State's activity is economic, 'the Court is entering dangerous territory, since it must find a balance between the need to protect undistorted competition on the common market and respect for the powers of the Member States'.¹⁵⁵⁴ Therefore, the solidarity exception has been construed widely via the broadening of the criterion of separability in *FENIN*.

Second, the qualification of solidarity bears similarities with the identification of a service of general economic interest (SGEI) under Article 106(2) TFEU. In particular, the analysis of AG Póiares Maduro in *FENIN* aligns closely with the Opinion of AG Colomer in *Federutility*, who defined SGEIs as embodying *universality*, *continuity* and *equality*.¹⁵⁵⁵ However, these two concepts are fundamentally different in nature. Article 106(2) applies only to entities that are qualified as undertakings,¹⁵⁵⁶ whereas solidarity, in and of itself, can exclude an activity from the scope of EU antitrust law. In this regard, solidarity is viewed as a principle inherently incompatible with the competition law order.

¹⁵⁵² *ibid.*

¹⁵⁵³ Heinemann (n 794) 131.

¹⁵⁵⁴ Opinion of AG Póiares Maduro in Case C-205/03 P *FENIN* (n 1545), para 26.

¹⁵⁵⁵ Opinion of AG Colomer in Case C-265/08 *Federutility* (n 1507), para 54. 'In the search for a common thread, one might look to Rolland's famous laws, to which the judgments in *Corbeau* [...] and *Almelo and Others* [...] indirectly refer in setting out the conditions for the provision of services of general economic interest: the service should be uninterrupted (continuity); for the benefit of all consumers throughout the relevant territory (universality); at uniform tariff rates and of similar quality, irrespective of specific situations or of the degree of economic profitability of each separate transaction (equality).'

¹⁵⁵⁶ Article 106(2) TFEU applies to '[u]ndertakings entrusted with the operation of services of general economic interest [...]'. See also, e.g., Sauter, 'Services of General Economic Interest and Universal Service in EU Law' (n 288).

Third, it is evident from the case law and the element of equality that solidarity is intimately tied to the redistributive activities of the State. Particularly, important elements in the case law, which is centred on social security schemes, include compulsory membership, equality in benefits and the absence of a relationship between the contributions and the risk, or conversely, an established link between the contributions and the income of the insured. Activities characterised by solidarity are thus perceived as remedying a *distributional failure* that extends beyond the deliverance of a service in the general economic interest. By virtue of the second welfare theorem, equity can be separated from efficiency¹⁵⁵⁷ – and, by extension, the application of the EU antitrust provisions. This leads to the conclusion that solidarity is strictly assessed in relation to the nature of the service provided.

6.2 Article 101(1): A Market Failure Analysis

This section, akin to the one on Article 101(3) TFEU, applies the criteria outlined in Chapter 3¹⁵⁵⁸ to the material described above in order to determine whether a market failure test can be identified within Article 101(1). The test is based on four components:

- i) Identifying the rationale of intervention;
- ii) Identifying any market failure test/ ‘market diagnostics’;
- iii) Identifying double market failure test;
- iv) Identifying potential trade-offs/balancing between competition, economic and external objectives.¹⁵⁵⁹

This test facilitates determining the existence and the extent of a market failure test under Article 101(1). Thus, in addition to applying the criteria, this section analyses the legal relevance of market failure under Article 101(1).¹⁵⁶⁰

¹⁵⁵⁷ Friederiszick, Röller and Verouden (n 340) 632. Stiglitz, ‘The Invisible Hand and Modern Welfare Economics’ (n 340) 5. See Chapter 2, section 2.1.

¹⁵⁵⁸ See, Chapter 3, section 3.3.

¹⁵⁵⁹ *ibid.*

¹⁵⁶⁰ Which replies to the main research question, which is: *What role and value, if any, does market failure hold within legal analysis of public policy intervention on markets in EU competition law?*

6.2.1 Applying the Criteria to Article 101(1)

The four limbs of the market failure framework are now applied to Article 101(1) TFEU. First, it is crucial to analyse the rationale of public policy intervention. This phase facilitates the identification of the types of market failure considerations, if any, present in the analysis under Article 101(1). Second, the existence of a legal test – so-called ‘market diagnostics’ – is assessed to gauge the existence and extent of market failure analysis. This step is essentially an extension of the first. Whilst the rationale establishes the ground for derogation, market diagnostics is used to verify the existence of market failure *in casu* as well as any threshold for intervention. Third, the double market failure component introduces an efficiency analysis of the measures themselves. This step helps us to understand the role of efficiency (as a fundamental objective of EU competition policy) under Article 101(1). Lastly, the limb of proportionality *stricto sensu* can help identify trade-offs between competition and other market failures.

6.2.1.1 The Rationale of Public Policy Intervention

This subsection initially explores traditional efficiency rationales under Article 101(1) TFEU. It is shown that under the *Wouters* rule, some cases can potentially be perceived as remedies to a market failure in the conventional sense. However, it remains uncertain whether this provides any analytical value capable of explaining the case law of the Court. Similarly, the rationale behind the exercise of public authority as a non-economic activity can potentially be better comprehended by linking it to the theory of public goods.

After exploring efficiencies in the sense of a narrow market failure theory, rationales in the sense of a broader market failure theory are examined. It is argued that the *Wouters* case law is much broader than Article 101(3) and conventional market theory. As for non-economic activities, the doctrine of solidarity can be interpreted as a remedy to distributional failures.

6.2.1.1.1 *Efficiency and Narrow Market Failure Rationales*

6.2.1.1.1.1 The *Wouters* Rule of Reason, Economic Efficiency and Narrow Market Failure

Whilst the rule of reason is generally understood as a balancing act between economic and non-economic objectives, many of the cases can be placed within the traditional market failure approach. EU antitrust scholarship has noted that

various objectives, traditionally perceived as non-economic, can be interpreted as remedies for a perceived market failure.¹⁵⁶¹ It has even been posited that the rationale underlying the rule of reason is not that different from the analysis conducted under Article 101(3) TFEU.¹⁵⁶² This subsection focuses on two conventional market failures: information asymmetries and externalities. As previously argued, public goods generally fall outside of the scope of Article 101,¹⁵⁶³ thereby excluding them from the *Wouters* rule.

The first market failure which has been debated in legal scholarship¹⁵⁶⁴ under the rule of reason doctrine is *information asymmetries*. Information asymmetries often manifest in markets where the buyer and the seller of a transaction do not possess equivalent knowledge about the quality of the product or service.¹⁵⁶⁵ Arguments have been advanced suggesting that these market failures are more likely to transpire in markets for liberal professions since they require training ‘in the liberal arts or sciences’.¹⁵⁶⁶ The necessity for regulatory intervention in these professions in order to remedy these market failures was (implicitly) highlighted by AG Jacobs in his Opinion in *Pavlov*.¹⁵⁶⁷ The AG underscored that for certain professions such as doctors, architects or lawyers, the consumer ‘might never fully understand whether or not the professional [...] provided a high quality service’.¹⁵⁶⁸ This could potentially lead to ‘adverse selection’,¹⁵⁶⁹ culminating in incomplete or missing markets,¹⁵⁷⁰ especially when lower quality services or goods drive out their higher quality counterparts by offering lower prices.¹⁵⁷¹

¹⁵⁶¹ Ibanez Colomo (n 297) 554; Janssen and Kloosterhuis (n 304) 338.

¹⁵⁶² Ibanez Colomo (n 297) 562.

¹⁵⁶³ Baarsma and Rosenboom (n 1059) 407.

¹⁵⁶⁴ Janssen and Kloosterhuis (n 304) 335; Ibanez Colomo (n 297) 5, 47.

¹⁵⁶⁵ See Chapter 2, Section 2.2.1.3.

¹⁵⁶⁶ Janssen and Kloosterhuis (n 304) 338. See also cited therein, Commission, ‘Report on Competition in Professional Services’ COM(2004) 83 final, paras 1 and 25.

¹⁵⁶⁷ Opinion of AG Jacobs in Joined Cases C-180/98 to 184/98 *Pavlov* (n 484).

¹⁵⁶⁸ *ibid.*, para 86.

¹⁵⁶⁹ On the concept of adverse selection see Chapter 2, section 2.2.1.3

¹⁵⁷⁰ Chapter 2, Section 2.2.1.3. See also, Wilson (n 455) in Blume and Durlauf (eds) (n 15) 25.

¹⁵⁷¹ Opinion of AG Jacobs in Joined Cases C-180/98 to 184/98 *Pavlov* (n 484), para 86.

As argued by Janssen and Kloosterhuis, cases such as *Wouters*, *OTOC* and *CNG* precisely pertain to these types of services, and it could be assumed that these markets may be afflicted by information asymmetries.¹⁵⁷² The regulation of lawyer fees in *Chez Elektro Bulgaria*,¹⁵⁷³ even though no legitimate interest was identified by the Court, could possibly be justified on the same basis. AG Léger in *Wouters* indeed argued that these rules could have pro-competitive effects by correcting information asymmetries.¹⁵⁷⁴ It has been argued that ethical or deontological considerations exist precisely to prevent behaviour that abuses knowledge at the expense of consumers.¹⁵⁷⁵ Although not explicitly discernible from the Court's analysis, it could be inferred that the objectives in *Wouters*, *OTOC*, *CNG* and possibly *Chez Elektro Bulgaria* align with the category of information asymmetries.

The next category of market failure is *externalities*. These market failures are the most significant under Article 101(3). However, it is submitted that the creation of positive externalities, or conversely the reduction of negative ones, is not apparent in the analysis of the Court under the rule of reason. Furthermore, externalities pose challenges to the understanding of the rationale of intervention due to their ubiquitous nature.¹⁵⁷⁶ If one was to seek out, it is possible to identify externalities in all the above cases, including *Wouters*, *OTOC*, *CNG* and *Chez Elektro Bulgaria*. For instance, in *OTOC* the Court found that quality considerations can be considered under Article 101(1).¹⁵⁷⁷ Now, quality is in itself a factor of competition, not a non-competition market failure.¹⁵⁷⁸ However, it seems that in cases where it is relied upon under the *Wouters* rule, the quality factor must be based on elements other than those of perfect competition.¹⁵⁷⁹ Moreover, in *OTOC*, the training of accountants generates positive externalities by leading to economic efficiency for society at large, as there is nothing in the Court's case law

¹⁵⁷² Janssen and Kloosterhuis (n 304) 338.

¹⁵⁷³ Joined Cases C-427/16 and C-428/16 *CHEZ Elektro Bulgaria* (n 42). See section 6.1.2.2 on the current chapter.

¹⁵⁷⁴ Opinion of AG Léger in Case 309/99 *Wouters* (n 1297) para 112.

¹⁵⁷⁵ Janssen and Kloosterhuis (n 304) 338.

¹⁵⁷⁶ See Chapter 3, section 3.2.1.

¹⁵⁷⁷ Case C-1/12 *Ordem dos Técnicos Oficiais de Contas* (n 660), para 94; Nowag, 'Wouters, When the Condemned Live Longer: A Comment on OTOC and CNG' (n 661) 43.

¹⁵⁷⁸ See Case 26/76 *Metro 1* (n 350), para 6.

¹⁵⁷⁹ Otherwise, there would not be a restriction of competition to begin with.

limiting the analysis to the effects in the relevant market. Similarly, the protection of road safety in *API* could easily be perceived as generating positive externalities for society, which may manifest through the reduction of accidents, medical expenses, reparation costs, reduction of congestion, etc.

In conclusion, most of the above-cited cases could be interpreted as remedying some form of market failure in the narrow sense, at least indirectly. However, as elaborated upon in subsequent sections, the absence of any clear efficiency criterion or any other criterion for the balancing exercise suggests that market failure offers minimal, if any, explanation for the Court's case law. This arises since market failures are ubiquitous, therefore requiring a threshold for intervention.¹⁵⁸⁰

6.2.1.1.1.2 Economic Efficiency and Narrow Market Failure in the Qualification of Non-Economic Activities

EU antitrust scholarship has explored market failure as a potential explanation for non-economic activities. Odudu argued that *Poucet et Pistre*, *Eurocontrol* and *Cali* can be explained through the lens of public goods.¹⁵⁸¹ Kloosterhuis posited that non-economic activities can be understood as 'social goods', including public goods, common resources as well as social insurance schemes based on solidarity.¹⁵⁸² Nevertheless, when considering conventional market failure and efficiency, only public goods are recognised as market failures warranting public policy intervention via exemptions from antitrust rules.

As outlined earlier, public goods fall outside the scope of competition law.¹⁵⁸³ Thus, non-economic activities may be analysed from the angle of public goods. As elaborated in Chapter 3, the theory of public goods is vast and the concept has received a multitude of interpretations.¹⁵⁸⁴ A common thread of the different theories is the distinction of public goods from 'normal' or 'private goods', typically characterised by two main features.¹⁵⁸⁵ First, they are non-

¹⁵⁸⁰ See Chapter 3, section 3.2.1.

¹⁵⁸¹ Odudu (n 298) 42-45.

¹⁵⁸² Kloosterhuis, (n 298) 137.

¹⁵⁸³ (n 1189).

¹⁵⁸⁴ Chapter 2, section 2.2.1.4.

¹⁵⁸⁵ *ibid.*

rivalrous, implying that their provision to additional consumers incurs no additional cost.¹⁵⁸⁶ Second, they are non-excludable, indicating that it is impossible to exclude individuals from enjoying the good.¹⁵⁸⁷ This second characteristic has been depicted as an extreme form of externalities.¹⁵⁸⁸ Most goods, even those provided by the public, are ‘impure’ public goods as they fall short of one of the two aforementioned features. As a result, pure public goods must be distinguished from merit goods producing positive externalities¹⁵⁸⁹ and club goods, which are non-rivalrous but not non-excludable.¹⁵⁹⁰ Three observations can be made regarding the relationship between non-economic activities and public goods theory.

First, a similarity between the case law on non-economic activities and the theory of public goods is the low market incentives for carrying out the activity in question. It has been argued that the Court, in its *Wouters* case law, recognised that certain activities cannot be undertaken with profit and thus under normal market conditions.¹⁵⁹¹ At least, as pointed out by Odudu, this fact was recognised by AG Tesauro, who considered that non-economic activities are those that ‘can only be performed by or on behalf of a public body’.¹⁵⁹² If this interpretation is to be followed, a link can be established between non-economic activities and public goods. The non-excludable nature of public goods gives rise to a ‘free-rider’ problem,¹⁵⁹³ leading to inefficiency due to undersupply.¹⁵⁹⁴ Consequently, the private sector lacks financial incentives to provide these goods. Theory holds that,

¹⁵⁸⁶ Stiglitz and Rosengard (n 95) 86.

¹⁵⁸⁷ *ibid.*

¹⁵⁸⁸ e.g., Ogus (n 18) 35.

¹⁵⁸⁹ See Chapter 2 sections 2.2.1.1 and 2.2.1.4.

¹⁵⁹⁰ Kloosterhuis, (n 298) 135.

¹⁵⁹¹ Odudu (n 298) 42-45. Odudu referred to Jose Luis Buendia Sierra, *Exclusive Rights and State Monopolies under EC Law* (OUP 1999) 48, who draws a distinction between ‘diffuse activities’ (benefits of which are distributed amongst all society) and ‘specific activities’. The former being non-economic.

¹⁵⁹² Opinion of AG Tesauro in Joined cases C-159/91 and C-160/91 *Poucet* (n 1503), para 12. For a similar view see also Opinion of AG Jacobs in Case C-67/96 *Albany* (n 758), para 20.

¹⁵⁹³ i.e., the phenomenon that consumers deliberately do not pay for a good, which is non-excludable, in knowledge that others will.

¹⁵⁹⁴ Perloff (n 336) 638.

as a result, only government intervention can enforce mandatory payments via taxation.¹⁵⁹⁵

Second, upon a close examination, many of these non-economic activities exhibit the characteristic of non-excludability. The non-excludable character of non-economic activities has been highlighted by scholarship as the critical criterion.¹⁵⁹⁶ Even goods that are solely non-excludable, yet rivalrous, suffer from a degree of market failure due to the free-rider problem and lack of profitability. It is argued that non-excludability is a matter of degree, encompassing both the excludability and the benefits enjoyed by non-paying consumers. For instance, numerous goods are merit goods that generate positive externalities beyond the users who pay for them. Nevertheless, this does not necessarily imply that they are non-excludable in the sense of a public good. These goods are often provided by private firms, for example, education or training. Yet, the positive externalities are only indirect,¹⁵⁹⁷ as it is possible to exclude non-paying consumers from receiving education or training. Furthermore, these firms would typically operate in competition with other undertakings and are subject to the antitrust provisions. Hence, restrictions resulting from merit goods need to be justified under either the *Wouters* doctrine or Article 101(3) TFEU. On the contrary, pure non-excludable goods can, arguably, be directly enjoyed by any user without payment, for example, air pollution surveillance.¹⁵⁹⁸ Therefore, these activities are excluded from the antitrust provisions.

Upon examining the case law, it becomes evident that social security schemes generally fall short of the non-excludability criterion as it is technically possible to exclude individuals from benefiting from any social security scheme.¹⁵⁹⁹ The provision of social insurance schemes by the private market does not *per se* lead to a market failure in the sense of a narrow market failure theory. In contrast, the case law on public authority has been considered to generally correspond to non-excludable goods.¹⁶⁰⁰ In *SAT Fluggesellschaft*, air navigation

¹⁵⁹⁵ Odudu (n 298) 42.

¹⁵⁹⁶ Odudu (n 298); Kloosterhuis, (n 298).

¹⁵⁹⁷ *Indirectly* society benefit from an educated population, which ultimately results in a better allocation of knowledge and resources.

¹⁵⁹⁸ As was the case in Case C-343/95 *Diego Cali* (n 1436).

¹⁵⁹⁹ Kloosterhuis, (n 298) 135.

¹⁶⁰⁰ See *ibid.* and Odudu (n 298).

control can be perceived as a non-excludable good ‘intended to ensure public safety’,¹⁶⁰¹ since it is not feasible to exclude consumers from benefiting from it. Odudu contends that Eurocontrol’s services must, in order to be carried out effectively, be provided to airlines irrespective of whether they have paid for them.¹⁶⁰² In *Cali*, regarding mandatory pollution surveillance in the oil port of Genoa, AG Cosmas followed the same reasoning.¹⁶⁰³

Third, the non-rivalrous nature of goods does not appear to be a relevant factor in the qualification of non-economic activities. Rather than being viewed as non-economic activities, the non-rivalrous character of certain goods, such as media and software, is indicative of a greater likelihood of dominant positions forming in these sectors.¹⁶⁰⁴ Therefore, these activities fall under the purview of the EU antitrust provisions. In the case of non-economic activities within the case law, there is no example of non-rivalrous goods in the sense of zero, or close to zero, marginal costs.

From this, it can be inferred that non-economic activities can be regarded as ‘impure public goods’. Despite their rivalrous nature, the non-excludable characteristic of these goods induces a market failure, potentially leading to undersupply of the goods if left to the market forces alone.

6.2.1.1.2 *Broader Market Failure Rationales*

This section investigates broader market failure rationales within the context of the *Wouters* rule and the qualification of non-economic activities. The argument posits that the *Wouters* rule aligns with objectives broader than simple economic efficiency, thus making an analysis from the perspective of broader market failure relevant. As for non-economic activities, the principle of solidarity exhibits elements of distributional failure.

¹⁶⁰¹ Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* (n 489), para 16.

¹⁶⁰² Odudu (n 298) 43. See also Opinion of AG Tesouro in Case 364/92 *SAT Fluggesellschaft mbH v Eurocontrol* (n 1422), para 13 who highlighted that ‘that control is exercised in respect of any aircraft, within the air space under the authority of Eurocontrol, irrespective of whether or not the owner has paid the route charges’.

¹⁶⁰³ Opinion of AG Cosmas in Case C-343/95 *Diego Cali* (n 1446), para 49 argued that ‘the surveillance has to be exercised regardless of whether the fees owed by any particular vessel have been paid’.

¹⁶⁰⁴ Kloosterhuis, (n 298) 136.

6.2.1.1.2.1 Broader Market Failure Rationales in the Wouters Case Law

The contention here is that, whilst information asymmetries may frequently exist in markets for liberal professions, the deontology underlying such regulation transcends the narrow definition of market failure as it incorporates ethical and moral reasons beyond economic efficiency with a direct consumer benefit. In this light, a narrow market failure analysis is insufficient in explicating the rule of reason. As seen, a broader market failure concept could represent the failure of the market to generate optimal outcomes from a societal point of view,¹⁶⁰⁵ which may or may not align with the achievement of narrowly construed economic efficiency.

Beyond protecting clients, the *Wouters* case referred to the ‘sound administration of justice’.¹⁶⁰⁶ Deontological regulation exists not only to protect the client from harmful practices arising from information asymmetries, but also to safeguard the integrity of the profession as lawyers serve as ‘contributors to justice and, as such, have special responsibilities not only to their clients, themselves and their organization but also some say, primarily – to justice’.¹⁶⁰⁷

A case that affirms these broader ethical considerations is *Meca-Medina*, where the Commission took the view that the regulation served a general objective:

[T]o combat doping, in order for competitive sport to be conducted fairly and that it included the need to safeguard equal chances for athletes, athletes’ health the integrity and objectivity of competitive sport and ethical values in sport.¹⁶⁰⁸

Nothing in the case indicates that these ethical considerations are founded on the maximisation of economic efficiency, at least not in the sense of a narrow market failure theory. Instead, it appears more appropriate to refer to an *ethical failure*.¹⁶⁰⁹ Whilst scholarship acknowledges that not everything can be classified as a market failure in a narrow sense, this is often attributed to rare instances since public

¹⁶⁰⁵ *ibid.*

¹⁶⁰⁶ Case C-309/99 *Wouters* (n 42), para 97.

¹⁶⁰⁷ Daniel M Campagne, ‘Deontology for Lawyers in Europe’ (1995) 20(2) *International Legal Practitioner*, 62-63.

¹⁶⁰⁸ Case C-519/04 P *Meca-Medina* (n 660), para 43.

¹⁶⁰⁹ See, e.g., Mark P Pritchard and Rick Burton, ‘Ethical Failures in Sport Business: Directions for Research’ (2014) 23 *Sport Marketing Quarterly*, 86.

policy (beyond efficiency¹⁶¹⁰) is a responsibility of the public and not private firms.¹⁶¹¹ However, as described above, all these cases include some type of government involvement, mostly by direct legislation in the area. Accordingly, the *Wouters* rule of reason appears significantly broader than the efficiency approach taken under Article 101(3) TFEU. Although potential parallels between *Wouters* and Article 101(3) have been highlighted in legal scholarship,¹⁶¹² the argument here is that these are two fundamentally different justification regimes. Due to the element of government involvement under *Wouters*, efficiency does not seem to be the sole reason for excluding these restrictions from the purview of the EU antitrust provisions. If *Wouters* corresponds to the remedy of market failures, the latter must be understood as a broad market failure standard encompassing objectives that surpass the maximisation of economic efficiency.

6.2.1.1.2.2 Broader Market Failure Rationales in the Analysis of Non-Economic Activities

The case law on solidarity, due to its redistributive character as opposed to the maximisation of economic efficiency, does not fit within a narrow market failure concept. The argument here posits that solidarity aligns with a *distribution failure*, understood as a failure to maximise social welfare from a broad perspective, including a society's preferences for distributions of income and/or wealth.¹⁶¹³ Naturally, the EU lacks both competence and legitimacy to organise the distribution of wealth in Member States. A certain degree of self-restraint from the Court is necessary to reconcile efficiency and consumer welfare with national objectives of equity. Accordingly, the Court held in *Duphar* that: '[EU law] does not detract from the powers of the Member States to organize their social security systems'.¹⁶¹⁴

Nonetheless, the Member States cannot have their cake and eat it too. The EU must ensure the proper functioning of the internal market, and firms operating

¹⁶¹⁰ An argument in this sense is that a narrow market failure approach also requires a value judgment, which would extend beyond the scope of what under firms' business practices.

¹⁶¹¹ Janssen and Kloosterhuis (n 304) 339.

¹⁶¹² Ibanez Colomo (n 297).

¹⁶¹³ Marciano and Medema (n 46) 4. See Chapter 2, section 2.2.2.2.

¹⁶¹⁴ Case 238/82 *Duphar BV and others v The Netherlands* (n 1497), para 16; Case C-29/17 *Novartis Farma* EU:C:2018:931, para 48; Case C-345/09 *J.A. van Delft and Others v College voor zorgverzekeringen* EU:C:2010:610, para 84.

in the welfare sector are, in principle, subject to the antitrust provisions.¹⁶¹⁵ For this reason, the Court has developed the principle of solidarity as a tool designed to measure the degree to which national equity-based activities have been retracted from the competitive system. Solidarity cannot shield entities operating in competition with the private sphere according to the principle of capitalisation.¹⁶¹⁶ As observed, three criteria are of main importance when assessing the level of solidarity of an activity: (i) universal access through compulsory membership; (ii) equality in contributions independently of risk profile; and (iii) the absence of a relationship between the contributions paid and the benefits received.¹⁶¹⁷

6.2.1.2 Identifying a Market Diagnostic Test: Is the Market Failing?

As previously elucidated, this stage of a prospect market failure test encompasses a legal assessment of two key aspects: first, the determination of the existence of a market failure, and second, the assessment of the significance of that market failure (establishing a threshold to counteract the ubiquity of market failure).¹⁶¹⁸ This test has been referred to as ‘market diagnostics’ or ‘market failure proportionality’.¹⁶¹⁹ It is crucial to recollect that whilst the limb of market diagnostics verifies the appropriateness and necessity of the intervention itself, the double market failure limb relates to the proportionality of the measure itself.

It is argued that neither the *Wouters* rule nor the doctrine of non-economic activities includes any market diagnostics identifying a market failure.

6.2.1.2.1 *Market Diagnostics under the Wouters Rule of Reason*

First, under the *Wouters* rule, there generally exists no proper assessment of market conditions – i.e., ‘is the market failing’? As previously explained, a market diagnostic test would appear best suited to assume the shape of a suitability test.¹⁶²⁰

Apart from the case of *Meca-Medina*, the rule of reason has only been recognised in preliminary rulings, which may explain the absence of a market

¹⁶¹⁵ See Article 3 TEU and Protocol no 27.

¹⁶¹⁶ Case C-174/97 P *FFSA and Others v Commission* (n 1515), para 17; Opinion of AG Poiares Maduro in Case C-205/03 P *FENIN* (n 1545), para 27.

¹⁶¹⁷ Opinion of AG Poiares Maduro in Case C-205/03 P *FENIN* (n 1545), para 30.

¹⁶¹⁸ See Chapter 3, section 3.3.2.

¹⁶¹⁹ *ibid.*

¹⁶²⁰ *ibid.*

failure assessment in the evaluation of market conditions. It appears that Member States are accorded discretion in determining whether the market fails to produce a socially desirable outcome.

However, evidence from the domain of free movement indicates that the Court is often inclined to shoulder the proportionality test in preliminary ruling procures.¹⁶²¹ In *API*, the Court did take it upon itself to conduct both a suitability and a necessity test.¹⁶²² The Court concluded that the national legislation was unsuitable for achieving the objective of protecting road safety.¹⁶²³ However, this conclusion was revised from an assessment of the efficacy of the measure, not an evaluation of the market's capacity to achieve the same result.¹⁶²⁴ The Court required a link between the protection of road safety and fixing minimum operating costs,¹⁶²⁵ illustrating an emphasis on the efficacy of the measure in the sense of double market failure rather than a tool of market diagnostics.

Second, considerations of the significance of the proclaimed market failure are notably absent. However, much like under Article 101(3), the *de minimis* doctrine operates as an indirect threshold.¹⁶²⁶ However, a proper market diagnostic tool would require Article 101(1) to encompass a proper balancing act similar to the one found under Article 101(3). Whilst the general principle of proportionality seems to indicate that such a balancing must transpire, it is, in most cases, entirely conducted within the national jurisdiction.

6.2.1.2.2 *Market Diagnostics and the Doctrine of Non-Economic Activities*

Since the qualification approach is devoid of any proportionality test, it does not include a market diagnostic analysis in the strict sense. Nevertheless, a market diagnostic test indirectly plays a significant role in the qualification of non-economic activities. As explained above, the determinative factor in the

¹⁶²¹ e.g., David Edward, 'The Exceptions to the Four Freedoms: The Historical Context' in Panos Koutrakos, Shuibhne Niamh Nic and Philip Syrpis (eds), *Exceptions from EU Free Movement Law: Derogations, Justification and Proportionality* (Hart 2016) 1, 10.

¹⁶²² Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40).

¹⁶²³ *ibid.*, para 51.

¹⁶²⁴ *ibid.*, paras 51-52.

¹⁶²⁵ *ibid.*, para 52.

¹⁶²⁶ See Chapter 5, section 5.3.1.2.

assessment of several Advocate Generals has been the market's inability to perform the activity.

In *SAT* and *Calì*, the AGs placed considerable weight on the non-excludability of the services, implying that the activities could not be carried out under normal market conditions.¹⁶²⁷ Yet, the Court did not confirm this approach, instead reversing the reasoning: the activities fall outside of the scope of EU antitrust law precisely because they are characteristic of those performed by the State.¹⁶²⁸ In that analysis, there is no assessment of the incapacity of the private sphere to exercise those functions. Rather, these activities are, by their nature, acts of public authority.¹⁶²⁹

Even within the solidarity case law, it seems that the incapacity of the private market to perform the activity is an important factor. AG Tesauro in *Poucet et Pistre* noted that:

The organizations in question seek to perform, for the common good, a task of a social nature, on the basis of solidarity. However, such a task, unlike the placing of job-seekers with which *Höfner* was concerned can only be performed on behalf of a public body, and is not comparable to the insurance business transacted by private undertakings.¹⁶³⁰

AG Jacobs in *Albany* also emphasised the incapacity of private undertakings to carry out the activity:

It seems to follow from paragraph 22 of the judgment in *Höfner* that the competition rules do not apply if the activity in question has always been and is necessarily carried out by public entities.¹⁶³¹

However, such an approach is reflected in the Court's judgments. The Court seems to focus more on the nature of the activity through an analysis of the degree of

¹⁶²⁷ Opinion of AG Tesauro in Case 364/92 *SAT Fluggesellschaft mbH v Eurocontrol* (n 1422), para 13; Opinion of AG Cosmas in Case C-343/95 *Diego Calì* (n 1446), para 49.

¹⁶²⁸ Case C-364/92 *SAT Fluggesellschaft v Eurocontrol* (n 489), paras 27, 30; Case C-343/95 *Diego Calì* (n 1436), paras 22-23.

¹⁶²⁹ *ibid.*

¹⁶³⁰ Opinion of AG Tesauro in Joined Cases C-159/91 and C-160/91 *Poucet* (n 1503), para 12.

¹⁶³¹ Opinion of AG Jacobs in Case C-67/96 *Albany* (n 758), para 314.

solidarity present, rather than a market diagnostic.¹⁶³² Nevertheless, it is suggested that through cases such as *FFSA* or *Albany*, the ECJ has clarified that solidarity cannot be exercised in competition with private undertakings.¹⁶³³ Accordingly, the existence of a market failure is not a relevant question as, according to the case law, no market can exist.

In sum, the analysis of non-economic activities does not include any market diagnostics for the purpose of identifying a market failure. Consequently, the case law of the Court does not consider the significance of such market failures (the second step of market diagnostics). In line with the logic of a qualification approach, non-economic activities are defined with reference to their inherent nature and characteristics rather than the competitive environment within which they may or may not operate.

6.2.1.3 Identifying Double Market Failure: LRM as Guaranteeing Efficiency?

This subsection posits that the *Wouters* doctrine is capable of shouldering a double market failure test. On the contrary, the assessment of non-economic activities does not include such a test. Moreover, it is argued that the doctrine of non-economic activities is construed in a way that may precipitate government failures in adjacent markets.

6.2.1.3.1 Double Market Failure under the *Wouters* Case Law

As previously stated, apart from *Meca-Medina*, the rule of reason has only been recognised in preliminary rulings. Consequently, the proportionality assessment, requiring interpretation of national law, is typically left to the national court.¹⁶³⁴ In this context, parallels can be drawn to the application of the principle of proportionality in the field of free movement.¹⁶³⁵ This subsection shows that within the preliminary rulings the Court intermittently implements a double market failure test, albeit without consistent application. Since the *Wouters* rule expressly contains a proportionality assessment,¹⁶³⁶ necessity is an integral part of the

¹⁶³² See cases discussed in section 6.1.3.2.1 of the current chapter.

¹⁶³³ *ibid.*

¹⁶³⁴ See section 6.1.2.3 of the current chapter.

¹⁶³⁵ See Chapter 3, section 3.1.3.2.

¹⁶³⁶ Case C-519/04 P *Meca-Medina* (n 660), para 42.

measures justified thereunder.¹⁶³⁷ Although the Court has rarely examined the appropriateness of the measures, it appears more willing to take on the necessity test itself.

In earlier case law, the Court adopted a more lenient necessity test. In *Wouters*, the Court briefly held, after assessing the requirements of independence and secrecy in the Netherlands, that the regulation could ‘reasonably’ be deemed necessary.¹⁶³⁸ In *Meca-Medina*, without a thorough examination, the Court stated that the doping rules could be considered excessive to its objectives, depending on both the factors identified as doping and the severity of the penalties.¹⁶³⁹ However, the Court ruled, *non ultra petita*, that the applicants had failed to demonstrate the disproportionate nature of the rules.¹⁶⁴⁰

In subsequent cases, the Court has demonstrated a willingness to conduct a formal proportionality analysis in the sense of a LRM standard. In *OTOC* the Court concluded that eliminating competition regarding training sessions lasting less than 16 hours – so-called ‘institutional training’¹⁶⁴¹ – to ensure the quality of the services of accountants was unnecessary.¹⁶⁴² Furthermore, rather than limiting training to OTOC, a less restrictive measure would be to grant other undertakings access to the market by establishing ‘a monitoring system organised on the basis of clearly defined, transparent, non-discriminatory, renewable criteria likely to ensure training bodies equal access to the market in question’.¹⁶⁴³ The Court, in *API*, although finding the measure unsuitable, also held that it went beyond what was necessary.¹⁶⁴⁴ The Court applied a LRM standard, finding that numerous other rules were more effective and less restrictive, including EU legislation ‘on maximum weekly working time, breaks, rest, night work and roadworthiness tests for vehicles’.¹⁶⁴⁵ Strict adherence to those rules is sufficient to achieve the

¹⁶³⁷ On the general nature of proportionality see Chapter 3, section 3.1.3.1.

¹⁶³⁸ Case C-309/99 *Wouters* (n 42), para 107.

¹⁶³⁹ Case C-519/04 P *Meca-Medina* (n 660), para 48.

¹⁶⁴⁰ *ibid.*, para 50.

¹⁶⁴¹ Case C-1/12 *Ordem dos Técnicos Oficiais de Contas* (n 660), para 2.

¹⁶⁴² *ibid.*, para 98.

¹⁶⁴³ *ibid.*, para 99.

¹⁶⁴⁴ Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40), para 55.

¹⁶⁴⁵ *ibid.*, para 56.

objective of road safety.¹⁶⁴⁶ On the contrary, in *CNG*¹⁶⁴⁷ and *Chez Elektro Bulgaria*,¹⁶⁴⁸ the Court left the necessity assessment entirely to the national courts.

As discussed in Chapter 3, the principle of proportionality in free movement law has been interpreted as emphasising the efficiency of national measures from an economic standpoint.¹⁶⁴⁹ Despite the *Wouters* rule being fundamentally viewed as a transposition of free movement law into antitrust law,¹⁶⁵⁰ it appears that the Court is demonstrating increased deference towards national courts. The only cases applying a strict LRM standard are *API*¹⁶⁵¹ and *OTO*.¹⁶⁵² It might be that object restrictions along with broader objectives such as road safety, which do not directly benefit the consumers in the relevant market, are subjected to a harsher proportionality assessment by the Court. However, with insufficient case law to validate this hypothesis, it remains a plausible yet unconfirmed proposition at this stage.

In summary, the necessity requirement harbours the potential to uphold a double market failure test. The application of a LRM standard introduces an efficacy analysis of the measures in the sense of a double market failure assessment. Nevertheless, the Court appears cautious of potential conflicts between competition and national interests, often deferring the ultimate test to the national courts.

6.2.1.3.2 *Double Market Failure in the Definition of Non-Economic Activities*

Since non-economic activities are considered beyond the scope of EU antitrust law, there is no proportionality test assessing the scope of public policy intervention and, consequently, no double market failure analysis. As explained above, the finding of a non-economic activity implies the absence of a market in

¹⁶⁴⁶ *ibid.*

¹⁶⁴⁷ Case C-136/12 *Consiglio Nazionale dei Geologi* (n 660), para 56.

¹⁶⁴⁸ Joined Cases C-427/16 and C-428/16 *CHEZ Elektro Bulgaria* (n 42), para 58.

¹⁶⁴⁹ Chapter 3, section 3.1.3.2.

¹⁶⁵⁰ *Monti* (n 62) 1088.

¹⁶⁵¹ Joined Cases C-184, 187, 194, 195 & 208/13 *API and Others* (n 40), para 56.

¹⁶⁵² Case C-1/12 *Ordem dos Técnicos Oficiais de Contas* (n 660), para 100.

the sense of EU antitrust law.¹⁶⁵³ This observation is completely in line with a qualification approach, which rather than pursuing a balance of diverse objectives – as found in a justificatory exercise – prescribes static legal categorisation, establishing criteria for the inapplicability of the relevant legal provision.¹⁶⁵⁴

However, it is worth noting that public policy intervention through non-economic activities might inadvertently induce market failures in adjacent markets to the non-economic activity. The functional approach to economic activity¹⁶⁵⁵ implies that activities of an economic nature, which are connected to the exercise of the non-economic activity, but which can be separated from it, are still subject to EU antitrust law.¹⁶⁵⁶ Thus, the concept of non-economic activity must be applied with caution to prevent non-economic entities from restricting competition in adjacent markets when carrying out non-economic activity.

Surprisingly, the Court appears to adopt a broad interpretation of the concept of *separability* between non-economic activities and related economic activities. The judgment in *Compass-Datenbank*¹⁶⁵⁷ is contentious in this regard. The Court ruled that the determining factor when discerning whether an ancillary task should be considered part of the non-economic activity is the *usefulness* of that task to the exercise of public authority.¹⁶⁵⁸ This broad interpretation unwittingly triggers government failures in adjacent markets. Similarly, the ruling in *FENIN* showcased a lenient stance on the issue of double market failure. The Court held that the mere purchasing of goods (procurement) by an entity which does not carry out an economic activity falls outside the scope of the competition law provisions,¹⁶⁵⁹ a decision that has elicited criticism for potentially enabling

¹⁶⁵³ On the distinction between categorisation (qualification) and balancing (justification) see Chapter 1, section 1.2.2.

¹⁶⁵⁴ Opinion of AG Poiares Maduro in Case C-205/03 P *FENIN* (n 1545), para 27: ‘By contrast, that law will not apply if the exercise of the activity does not involve the pursuit of an objective of capitalisation in any way, with the result that there can be no market’.

¹⁶⁵⁵ e.g., Case C-113/07 P *SELEX Sistemi Integrati v Commission* (n 43), para 14.

¹⁶⁵⁶ e.g., Case C-1/12 *Ordem dos Técnicos Oficiais de Contas* (n 660), para 37.

¹⁶⁵⁷ Case C-138/11 *Compass-Datenbank GmbH v Republik Österreich* (n 1475).

¹⁶⁵⁸ *ibid.*, para 41: ‘[t]he collection of the data would be rendered largely useless in the absence of the maintenance of a database which stores the data for the purpose of consultation from the public’.

¹⁶⁵⁹ Case C-205/03 *FENIN v Commission* (n 490), para 26. In this sense the economic activity is ancillary to a non-economic activity, see Whish and Bailey (n 440) 91.

distortions of competition through buying power.¹⁶⁶⁰ In essence, an expansive interpretation of the separability criterion could unjustifiably insulate economic activity from antitrust scrutiny, potentially undermining competition within the internal market over time.

In conclusion, there is no double market failure test under the theory of non-economic activities. Moreover, the ECJ's predilection for a more lenient approach to separability carries the risk of Member States inducing government failures in adjacent markets.

6.2.1.4 Identifying Trade-Offs: *Stricto Sensu* Proportionality

In light of the preceding discussion, it is clear that the doctrine of non-economic activities does not incorporate a proportionality test. The situation with respect to the *Wouters* rule, however, may be different. Legal scholarship has interpreted the rule of reason as a balancing act. Nevertheless, the above analysis demonstrates that this interpretation is far from unequivocal. Considering that the cases are largely decided under the preliminary ruling procedure, any considerations of proportionality *stricto sensu* are typically deferred to the national courts. Furthermore, the absence of a balancing act is reinforced by the fact that in *Meca-Medina*, the only direct action in which the Court applied the *Wouters* rule, the ECJ did not examine the *stricto sensu* proportionality of the measure.

Therefore, if there exists any form of balancing in the sense of the framework defined in Chapter 3 under the *Wouters* rule, it lies solely within the national courts' purview. The necessity and suitability tests can be construed as factual assessments of the effects of national measures, deprived of any evaluative judgment¹⁶⁶¹ – in other words, 'formal proportionality' and not balancing.¹⁶⁶² The sole component conducive to evaluative judgments is *stricto sensu* proportionality. This renders the balancing between the competition and other objectives unfeasible under the rule of reason.

¹⁶⁶⁰ Wulf-Henning (n 755).

¹⁶⁶¹ This is based on Marzal's assessment of proportionality under free movement law, Marzal (n 548) 637. See Chapter 3, section 3.1.3.2.

¹⁶⁶² On the notion of 'formal proportionality' in this thesis, see Chapter 3, section 3.3.4.

6.2.2 The Existence of a Market Failure Test under Article 101(1)

Neither the *Wouters* rule nor the doctrine of non-economic activities incorporates a market failure test in the sense of the framework for this thesis. However, market failure theory can help to elucidate the *modus operandi* of these exceptions.

6.2.2.1 Market Failure and the Wouters Rule of Reason

Whilst academic literature has drawn connections between the *Wouters* rule and market failure,¹⁶⁶³ the former cannot be interpreted as a market failure test. Even if certain of its underlying tenets align with a narrow market failure theory, the test, as applied by the ECJ, is void of any proper balancing act between competition and other objectives. Five key points can be made.

First, a market failure analysis of the rationales acceptable under *Wouters* reveals that the classification of these measures as remedies to a market failure offers limited, if any, insight into the Court's case law,¹⁶⁶⁴ which goes well beyond an efficiency-based approach. Furthermore, externalities are ubiquitous in all markets.¹⁶⁶⁵ Consequently, without any established threshold, market failures become redundant, rendering the *Wouters* rule applicable in virtually every public policy intervention. Hence, an element of subjectivity appears to exist when discerning what is considered a 'true' failure and, conversely, 'acceptable' market performance.¹⁶⁶⁶ However, there is no notion of such a threshold in the case law.

Second, the analysis is not confined to the relevant market. Although the Court in *OTO* analysed the market conditions in order to find that the measure was disproportionate, in *API* the objective of road safety benefits society in general rather than exclusively the consumers of road haulage services. Consequently, the *Wouters* rule appears to inhabit the potential to shoulder a broad general market failure test. Whilst academic discourse has emphasised the direct consumer benefit as a part of this (partial) market failure test,¹⁶⁶⁷ the scope of the analysis under

¹⁶⁶³ See section 6.2.1.1.1.1 of the current chapter.

¹⁶⁶⁴ Although information asymmetries and externalities might, to some extent, help elucidate the rationale of intervention.

¹⁶⁶⁵ See, Chapter 3, section 3.2.1.

¹⁶⁶⁶ e.g., Pelkmans (n 418) 4: 'In practice, is it difficult to distinguish a market failure from minor distortions, 'let alone, to identify the precise boundaries of the market failure'. For Similar view see Friederiszick, Röller and Verouden (n 340) 637.

¹⁶⁶⁷ Janssen and Kloosterhuis (n 304) 336-337.

Wouters goes beyond the relevant market as there is no requirement of consumer benefit like the one contained in Article 101(3) TFEU.

Third, it has also been demonstrated that broader market failures are accommodated within the *Wouters* rule. Given the absence of any efficiency or consumer benefit criteria in Article 101(1), the Court appears more accommodating of these broader considerations. It is therefore argued that the *Wouters* rule is broader than the exemption under Article 101(3).

Fourth, it has been shown that the rule of reason doctrine does not encompass any market diagnostics test determining market conditions or the need for intervention. However, it includes a double market failure test via the necessity criterion. In *API*, the Court conducted a strict LRM test assessing the efficiency of regulatory intervention in relation to the perceived market failure (road safety). Similarly, in *OTO*, the Court invalidated national measures when less restrictive means were available. Nevertheless, this aspect of proportionality is often deferred to the national courts.

Finally, under the *Wouters* rule, there is no clear balancing between competition and broader efficiencies or external objectives. Naturally, this observation can be nuanced given most of the cases are preliminary rulings, leaving the *stricto sensu* balancing to national courts.

In conclusion, it is argued that there is no explicit balancing via *stricto sensu* proportionality under the *Wouters* rule. Instead, the assessment of that limb has largely been left to the national discretion. Nonetheless, *Wouters* has the potential to accommodate a broad market failure, surpassing both economic efficiency and the relevant market (general equilibrium analysis).

6.2.2.2 Market Failure and Non-Economic Activities

The application of market failure theory to explain the legal test of non-economic activities is two-folded.

First, both a broad and a narrow market failure standard can elucidate the rationale behind excluding non-economic activities from the scope of the antitrust provisions. It has been demonstrated that the public authority exception generally applies to activities that are non-excludable in line with public goods theory. Notwithstanding this, even though this has been a significant element in several AGs Opinions, the Court tends to favour an empirical approach, classifying as public authority those tasks typically performed by the State. When applying a

broad market failure standard, solidarity can be interpreted as a remedy to a distributional failure, applicable to redistributive activities shielded from the market. Hence, market failure theory may offer insight into *why* certain activities can be construed as non-economic in the sense of the case law of the Court.

Second, as non-economic activities correspond to a qualification approach, there is no proportionality test and, consequently, no market failure test. The definition of non-economic activities is a static exception applying when certain criteria are satisfied, independent of the necessity or proportionality of the intervention. The limited nature of the assessment can be attributed to the lack of EU competences in the sectors like public security and social welfare. Therefore, the proportionality of public policy intervention via non-economic activities lies entirely within the realm of national law.

In summary, non-economic activities exist outside of the market and market failure theory. Economic efficiency does not factor into the determination of non-economic activities. Rather, the Court has developed various criteria to determine whether or not an activity has truly been retracted from the competitive sphere.

6.3 Conclusions: Imbalance under Article 101(1)?

This chapter has described and analysed the case law pertaining to the disapplication of Article 101(1) TFEU within the market failure framework underpinning this thesis. In essence, the exceptions to Article 101(1) appear to be constructed as protective shields, safeguarding predominantly national public policy practices from the reach of the antitrust provisions, rather than serving as market failure assessments.¹⁶⁶⁸ Four points can be made.

First, notwithstanding its semblance of a qualification exercise in disapplying Article 101(1), the *Wouters* doctrine exemplifies a fully-fledged justification exercise. It assumes the character of a quintessential public policy exemption, expanding beyond the relevant market and encompassing object restrictions, in contrast to Article 101(3). This doctrine bears the hallmarks of a pragmatic exception, born out of necessity during the pre-modernisation era.¹⁶⁶⁹

¹⁶⁶⁸ The exception being Case C-519/04 P *Meca-Medina* (n 660).

¹⁶⁶⁹ Before Regulation 1/2003 the Commission held a monopoly on the application of Article 101(3) TFEU.

The preponderance of preliminary rulings in these cases lends credence to this conclusion. Nevertheless, in today's context, the case law under Article 101(1) may appear incongruous and antiquated within the modernised landscape of competition law. Contrary to Article 101(3), there is no explicit balancing act between competition and/or economic efficiency and broader efficiencies and/or external objectives under Article 101(1). Instead, the *Wouters* rule endorses a strictly formal balancing exercise between the means and the objectives, leaving any *stricto sensu* balancing to the discretion of the national courts. In this sense, *Wouters* can, if consistently applied, encompass only a double market failure test.

Second, the doctrine of non-economic activities exemplifies a qualification exercise wherein neither a proportionality assessment nor a market failure test factor into the evaluation. Nonetheless, market failure theory could potentially offer valuable insights into understanding the rationale behind the withdrawal of these activities from the market and the scope of Article 101(1).

Third, despite the potential obsolescence of the *Wouters* rule, the exceptions under Article 101(1) are far from redundant. Both *Wouters* and the theory of non-economic activities cast a wider net than the efficiency defence under Article 101(3). It has been demonstrated that under Article 101(1), both *Wouters* and the theory of non-economic activities cater to broader policy objectives beyond the relevant market, without necessitating any explicit assessment of economic efficiency. In this regard, a broader market failure standard is required to explain these rationales. Moreover, despite the lack of a balancing act, the rule of reason holds the potential to shoulder a broad market failure test. In essence, rather than subscribing to a consumer welfare or efficiency approach, these doctrines seem to be predicated on a more abstract notion of competition.

Fourth and finally, a comparative analysis uncovers fundamental divergences in the treatment of public policy intervention under Article 101(3) and under Article 101(1). The former operates under strict conditions and primarily revolves around efficiency and consumer benefit, whereas the latter adopts a broader approach, bounded solely by a double market failure test. In contrast to Article 101(3), under the rule of reason the entity is not required to provide any evidence of efficiencies, as long as the restriction is necessary to achieve a legitimate objective. Furthermore, given that most cases constitute preliminary rulings, the ECJ exhibits a deferential stance towards national courts. Consequently, whilst *Wouters* might appear incoherent within the post-modernisation framework, it is not rendered obsolete. These semi-public measures

call for a different assessment compared to that prescribed under Article 101(3). These two exception regimes operate under a fundamentally different logic. Article 101(3) reconciles restrictions with the competition law's status quo through a balancing exercise, effectively integrating the concepts of economic efficiency and consumer welfare. In contrast, the Article 101(1) exceptions shield public policy from the purview of competition law, extending beyond the confines of the relevant market, without requiring a balancing act between the restriction of competition, efficiency enhancements and consumer benefit. In this context, these exemption regimes underscore the complex interplay between competition theory and public policy factors in the application of the antitrust provisions and the nuanced role of market failure analysis within this legal framework.

PART IV

Market Failure – The State Aid Narrative

7. MARKET FAILURE IN STATE AID LAW: INTRODUCTION AND THEORY

7.1 Introduction

This part of the thesis, comprised of Chapters 7, 8 and 9, explores the role and value of market failure within the realm of EU State aid law. It is suggested that market failure assumes a more pronounced analytical role in State aid law due to its focus on State intervention as opposed to the free play of the market.¹⁶⁷⁰ State aid law has been described as a ‘privileged dialogue between the Commission, national government and favoured firms’¹⁶⁷¹ in which firms only play an indirect role.¹⁶⁷² This chapter demonstrates that, although not a general test within the meaning of welfare economics, Article 107(3) TFEU can be construed as a broad market failure test.

Like the antitrust regime, the State aid law has undergone a modernisation process. However, the shift towards a more economic approach is arguably distinct in State aid law from that in the antitrust regime.¹⁶⁷³ There are several reasons to explain this fact. State aid law operates within a horizontal relationship between the EU and its Member States, directly constraining an aspect of sovereignty – specifically, the allocation and use of public funds. State aid law is, therefore, more

¹⁶⁷⁰ See e.g., Communication from the Commission, ‘Guidelines on State aid for environmental protection and energy’ 2014-2020 (2014/C 200/01), para 9.

¹⁶⁷¹ Hussein Kassim and Bruce Lyons, ‘The New Political Economy of EU State Aid Policy.’ (2013) 13 *Journal of Industry, Competition & Trade* 1, 11.

¹⁶⁷² Cini (n 45) 1.

¹⁶⁷³ Sections 7.2 and 7.4 of the current chapter explore the nature of State aid modernisation.

politically sensitive than antitrust law, which primarily applies vertically to the actions of private firms. Since State aid necessitates public intervention, the provisions on compatibility address not only efficiency improvements but also explicitly acknowledge the consideration of external objectives.

Similar to other areas of EU competition law, State aid modernisation has prioritised the introduction of a refined economic approach to target ‘bad aid’, moving away from the previous formalistic approach. Another crucial aspect is the implementation of this refined economic approach through the development of common assessment principles that are streamlined into the various soft law regimes. However, these principles leave several questions unresolved, which this chapter explores.

This part of the thesis, namely Chapters 7, 8 and 9, shows that market failure theory holds a central role, both explicitly and implicitly, in the Commission’s assessment under the direct assessment and the various soft law regimes. The State aid regime is characterised by minimal legal requirements on one hand and a broad margin discretion afforded to the Commission in applying these rules on the other. Both these characteristics make it challenging to systematise a clear legal test. Nonetheless, it is argued that even when disregarding the Commission’s discretion and practice, EU Courts interpret the State aid rules in light of a broad market failure concept.

The remainder of this chapter includes four sections. First, it briefly explores the theoretical fundamentals of State aid law to discern how it differs from the antitrust regime. Second, the legal framework is described and analysed, particularly regarding the discretion of the Commission and the legal limitations thereof. Third, the introduction and development of economic principles in State aid modernisation are examined, representing a vital step in assessing the application of these principles under the direct assessment in the subsequent chapter. Finally, the last section offers some conclusions.

7.2 The Basic Theoretical Foundations of State Aid Control

This section shows that the State aid regime exhibits both significant differences and similarities when compared to the antitrust provisions. Four general observations can be made.

First, whilst State subsidies have been granted for centuries, dating back to the Roman Empire,¹⁶⁷⁴ State aid law, as such, is a uniquely European phenomenon without any similar counterpart in any other jurisdiction.¹⁶⁷⁵ It diverges from antitrust law and its global influences and, consequently, the development of State aid law was a lengthy and difficult process.¹⁶⁷⁶ However, its enforcement has significantly increased in the past 20 years.¹⁶⁷⁷

Second, State aid regulation is often described as ‘inherently political’,¹⁶⁷⁸ as it regulates government action rather than the conduct of private firms. As shown throughout this chapter, the State aid rules are flexible, and their application can readily be amended to accommodate different policy objectives. Nonetheless, this does not imply that the field is void of core principles and theological fundaments.¹⁶⁷⁹

Third, the theoretical foundations for State aid are, in many aspects, analogous to those of the antitrust provisions. State aid rules govern distortions of competition resulting from State subsidies to private or public firms that are in actual, or at least potential, competition with other firms.¹⁶⁸⁰ Based on the same presumption that free competition is the most optimal way to organise markets, State aid law also embodies competition law’s status quo.¹⁶⁸¹ Nevertheless, given its political character, it is unclear to what extent State aid control pursues the precise objectives of the EU antitrust regime, particularly regarding the focus on consumer welfare. Whilst State aid control in the EU is based on the objective to ensure that government intervention does not distort competition,¹⁶⁸² it has been posited that State aid policy represents a blend of internal market policies,

¹⁶⁷⁴ Juan Jorge Piernas López, *The Concept of State Aid Under EU Law: From Internal Market to Competition and Beyond* (Oxford University Press 2015) 21.

¹⁶⁷⁵ Bacon (n 671) 4.

¹⁶⁷⁶ Kassim and Lyons (n 1671) 3.

¹⁶⁷⁷ Philipp Werner and Vincent Verouden, *EU State Aid Control: Law and Economics* (Wolters Kluwer 2017) 7.

¹⁶⁷⁸ Kassim and Lyons (n 1671) 1.

¹⁶⁷⁹ See, in particular, section 7.3.2.2.2 of the current chapter.

¹⁶⁸⁰ Franz Jürgen Säcker and Frank Montag, *European State Aid Law: A Commentary* (Hart 2016) 7.

¹⁶⁸¹ On the nature of competition law’s status quo, see Chapter 3, 3.1.2.

¹⁶⁸² Eugene Stuart and Iana Roginska-Green, *Sixty Years of EU State Aid Law and Policy. Analysis and Assessment*. (Kluwer Law International 2018) 3.

competition interests and objectives of economic efficiency and fiscal discipline.¹⁶⁸³ A distinction between ultimate and intermediate goals is useful here.¹⁶⁸⁴ Although State aid may encompass intermediate goals that differ slightly from those of antitrust rules, its main objective, in line with the wording of Article 107(1) TFEU, is to avoid distortions of competition by government subsidies to private firms.¹⁶⁸⁵ However, as explored in this chapter, the role of secondary objectives in State aid law may render it more accommodating to market failure analysis and result in a distinct theory of harm. The most striking contrast between State aid law and antitrust law is that the former explicitly promotes equity/distributional objectives.¹⁶⁸⁶ This contrast is remarkable given that the State aid regime is seemingly founded on the same notion of social and consumer welfare as antitrust law.¹⁶⁸⁷ This chapter does not distinguish a separate notion of welfare for State aid – as there is no ground for such a distinction – but notes that the broader notion of welfare explored in Chapter 4 appears readily adopted in EU State aid law. In this sense, State aid law inherently embodies a conflict between efficiency and external objectives from the outset.

Fourth, it has also been suggested that these objectives have changed over time, primarily due to changing shifts in the Commission's policy priorities.¹⁶⁸⁸ Owing to the political nature of the field, it is guided by various soft law instruments, particularly in relation to the compatibility assessment of aid, where the Commission enjoys a large margin of discretion.¹⁶⁸⁹ Consequently, there is an inherent tension between soft and hard law in the identification and enforcement of hard legal principles within the field. Before analysing the different compatibility regimes, this chapter, therefore, identifies the hard legal principles

¹⁶⁸³ Bacon (n 671) 5.

¹⁶⁸⁴ The distinction comes from Parret, 'Shouldn't We Know What We Are Protecting?' (n 9) 399.

¹⁶⁸⁵ Article 107(1) TFEU provides that: 'Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever, which *distort or threatens to distort competition* by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market'. See also, e.g., Buelens and others (n 369) 6.

¹⁶⁸⁶ On the recognition of equity objectives in State aid law see e.g., Friederiszick, Röller and Verouden (n 340); Nitsche and Heidhues (n 457); Buelens and others (n 369).

¹⁶⁸⁷ The debate on the appropriate welfare standard largely mirrors discussions in antitrust scholarship. A social welfare standard reminiscent of antitrust law post-modernisation is proposed by Nitsche and Heidhues (n 457).

¹⁶⁸⁸ Piernas López (n 1674) 10.

¹⁶⁸⁹ See section 7.3.2.2 of the current chapter.

applicable.¹⁶⁹⁰ It is argued that, despite not always having been the case, as of today EU State aid policy is increasingly aligned with antitrust law, with a particular emphasis on economic analysis.

7.3 The Legal Framework of State Aid Control

This section examines the distortive nature and the notion of State aid for the purpose of our analysis. Unlike the Commission's discretion when assessing the compatibility of aid,¹⁶⁹¹ the notion of State aid within Article 107(1) TFEU is objective¹⁶⁹² without any discretion afforded to the Commission.¹⁶⁹³ The notion of State aid is predicated on four cumulative criteria.¹⁶⁹⁴

7.3.1 The Notion and Limitations of State Aid

This section outlines the four cumulative criteria that constitute the notion of State aid contained in Article 107(1) TFEU. Further, it explicates the limitations these criteria engender and highlights their implications on public policy intervention within the context of State aid law.

7.3.1.1 The Criterion of an Economic Advantage

First, the measure in question must be considered to confer an economic advantage upon its recipients. The corpus of case law pertaining to the criterion of economic advantage is extensive and highly complex. In essence, this criterion implies that the measure confers an economic benefit upon the recipient undertaking, which it

¹⁶⁹⁰ *ibid.*

¹⁶⁹¹ See section 7.3.2.2 of the current chapter.

¹⁶⁹² e.g., Case C-83/98 P *France v Ladbroke Racing and Commisison* EU:C:2000:248, para 25; Case C-487/06 P, *British Aggregates* EU:C:2008:757, para 111; Case C-486/15 P *Commission v France and Orange* EU:C:2016:912, para 87; Case T-79/21 *Ryanair* EU:T:2023:334, para 192. Moreover, it is clear from the case law that Article 107(1) does not distinguish between State measures based on their aims but defines them in respect to their effects (see, Opinion of AG Pitruzzella in Case C-362/19 P *Commission v Fútbol Club Barcelona* EU:C:2020:838, para 67).

¹⁶⁹³ Case T-67/94 *Ladbroke Racing v Commission* EU:T:1998:7, para 52.

¹⁶⁹⁴ e.g., Joined Cases C-331/20 P and C-343/20 P *Voltea SA v Commission* EU:C:2022:886, para 102.

would not have been able to secure under normal market conditions,¹⁶⁹⁵ ‘that is to say, in the absence of State intervention’.¹⁶⁹⁶

Similar to Articles 101(1) or 102 TFEU, Article 107(1) TFEU is only applicable to undertakings defined as entities carrying out economic activity.¹⁶⁹⁷ The relevant case law and exceptions were identified in the previous chapter. As with the antitrust provisions, the theories of public authority and solidarity serve as crucial limitations to the notion of state aid.¹⁶⁹⁸

According to the Commission’s Notice, an undertaking is considered to have received an economic advantage:

Whenever the financial situation of an undertaking is improved as a result of State intervention on terms differing from normal market conditions, an advantage is present. To assess this, the financial situation of the undertaking following the measure should be compared with its financial situation had the measure not been taken.¹⁶⁹⁹

This paragraph accentuates the role of the State when participating in a market, emphasising that such involvement must not negatively influence the competitive game. To assess the economic advantage, the Court employs a ‘market economy operator test’ (or ‘private operator principle’),¹⁷⁰⁰ first developed by the Commission in 1980.¹⁷⁰¹ The purpose of this test, or principle, is to ‘assess whether the State has granted an advantage to an undertaking by not acting like a market economy operator to a certain transaction’.¹⁷⁰²

¹⁶⁹⁵ Case C-39/94 *Syndicat français de L’express international (SFEI) et al v La Poste* EU:C:1996:285, para 60.

¹⁶⁹⁶ Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (C/2016/2946), para 66.

¹⁶⁹⁷ On the notion of undertaking, see Chapter 4, section 4.2.1.1.

¹⁶⁹⁸ See Chapter 6, section 6.1.3.

¹⁶⁹⁹ Commission Notice on the notion of State aid as referred to in Article 107(1) (n 1696), para 67.

¹⁷⁰⁰ E.g., Case C-142/87 *Belgium v Commission* (‘*Tubemeuse*’) EU:C:1990:125, para 29; Joined Cases C-331/20 P and C-343/20 P *Voltea SA v Commission* (n 1694), para 53; Case C-579/16 P *Commission v FIH Holding and FIH Erhversbank* EU:C:2018:159, paras 45-47.

¹⁷⁰¹ Viktor Kreuschitz and Peter Nehl, ‘The Notion of State Aid: Criterion of Advantage’ in Hofmann and Micheau (eds) (n 504) 84, 127.

¹⁷⁰² Commission Notice on the notion of State aid as referred to in Article 107(1) (n 1696), para 76.

By focusing on a comparison with ‘normal’ market conditions, the criterion of economic advantage demonstrates that State aid can only be granted in exceptional circumstances, as it disrupts the default mode of free markets. As such, State aid represents a rupture from the economic rules governing market interactions. As put by Bacon, what matters is whether the advantage is ‘unmarketlike’, meaning that the advantage would not have been accorded to the undertaking under the normal course of events in private markets.¹⁷⁰³

Finally, although this thesis does not specifically address the provision of services of general economic interest,¹⁷⁰⁴ it is important to note that numerous subsidy schemes rooted in equity considerations may fall outside the scope of Article 107(1). As established by the *Altmark* case law, these schemes can be regarded as compensatory payment for public service and do not offer an economic advantage.¹⁷⁰⁵ By fulfilling the conditions set forth in the *Altmark* case law, certain subsidy schemes may be exempted from being classified as State aid. This exemption ensures that these measures do not distort competition or infringe upon the principles of the EU internal market, whilst still allowing for the provision of essential public services based on equity considerations.

7.3.1.2 The Criterion State Origin

Contrary to the antitrust provisions, which govern agreements and conduct between and by undertakings, State aid involves the granting of financial assistance through State resources. This criterion highlights the unique nature of State aid in comparison to other aspects of competition law, as it directly addresses the allocation and use of public funds in providing support for undertakings. As held by the Court as early as 1970, ‘aid cannot be considered separately from the effects of its method of financing’.¹⁷⁰⁶ This criterion results from the text of Article 107(1) TFEU, according to which aid should be granted ‘by a Member State

¹⁷⁰³ Bacon (n 671) 29.

¹⁷⁰⁴ See delimitations in Chapter 1, section 1.2.6.

¹⁷⁰⁵ Case C-280/00 *Altmark Trans GmbH* EU:C:2003:415, paras 89-94. According to the Court four criteria must be met. First, there must be a clearly defined public service obligation. Second, the parameters on the basis on which compensation is calculated must be established in advance and they must be objective. Third, the compensation cannot exceed what is necessary. Fourth, the undertaking discharging the service must be either chosen according to a public procurement procedure or the level of compensation must be determined based on the cost of a typical and well-run undertaking (as efficient competitor comparison).

¹⁷⁰⁶ Case 47/69 *France v Commission* EU:C:1970:60, para 8.

through State resources'. According to the case law, aid can be granted through State resources both directly and indirectly.¹⁷⁰⁷

When the State directly grants aid through a branch of a public authority, this criterion is relatively straightforward to ascertain.¹⁷⁰⁸ In such cases, there is a clear connection between the public funds and the support provided to the firm, which makes the assessment of State involvement unambiguous. However, in other instances, determining whether State resources are involved can be more complex and nuanced.¹⁷⁰⁹ These cases may involve indirect forms of aid, such as tax breaks, preferential loans, or guarantees provided through intermediaries, where the link between the State and the assistance provided to the undertaking is less evident.

The key task of the Court of Justice has been to clarify what level of State control is required for resources to qualify as State resources.¹⁷¹⁰ The state resources criterion has been interpreted broadly to cover not only direct grants funded by public finances but also, *inter alia*, 'loan guarantees, direct investment in the capital of companies and benefits in kind'.¹⁷¹¹

The inherent limitation posed by the criterion of State origin is that State aid law specifically addresses situations where direct or indirect state intervention occurs. This limitation means that State aid law does not apply to situations where support is provided by private entities or market players without any involvement from public authorities.¹⁷¹²

¹⁷⁰⁷ Case 82/77 *Van Tiggele* (n 721), para 25.

¹⁷⁰⁸ Commission Notice on the notion of State aid as referred to in Article 107(1) (n 1696), para 39. See also, Vincent Verouden and Philipp Werner, 'Introduction - The Law and Economics of EU State Aid Control' in Werner and Verouden (n 1677) 1, 23.

¹⁷⁰⁹ See, e.g., Case T-607/17 *Voltea v Commission* EU:T:2020:180 for a case when State aid was granted through a private intermediary. This is also the case for public undertakings, see Commission Notice on the notion of State aid as referred to in Article 107(1) (n 1696), para 40.

¹⁷¹⁰ e.g., Antonios Bouchagiar, 'When Do Funds Become State Resources: The Notion of Aid in View of the Recent EEG and Achema Judgments' 2020(1) European State Aid Law Quarterly 19.

¹⁷¹¹ Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (C/2016/2946) (n 1696), para 51.

¹⁷¹² In such cases, Articles 101 or 102 TFEU may address potential distortions of competition.

7.3.1.3 The Criterion of Selectivity

Pursuant to Article 107(1) TFEU aid must favour ‘certain undertakings or the production of certain goods’. Whilst this criterion is distinct from the criterion of economic advantage,¹⁷¹³ it underscores that only selective measures which disrupt the balance between the recipient and its competitors are prohibited.¹⁷¹⁴ *A contrario* measures of general application, that do not specifically favour certain undertakings, such as general fiscal measures, fall outside the scope of Article 107(1).¹⁷¹⁵

Selectivity in the context of State aid can manifest in two forms: material and regional.¹⁷¹⁶ Material selectivity occurs when a measure, either *de jure* or *de facto*, applies solely to a certain group of undertakings or a particular sector of the economy.¹⁷¹⁷ Numerous instances of material selectivity occur within the area of taxation where the Court employs a reference framework to establish whether or not a tax measure can be considered selective.¹⁷¹⁸ The reference framework consists of assessing the measures against the normal tax system in place, identifying any deviations, and evaluating the justifications for such deviations. Regional selectivity, on the other hand, emerges under certain circumstances when measures only apply to a designated regional territory.¹⁷¹⁹ In certain situations, regional selectivity, usually through taxation,¹⁷²⁰ can give rise to concerns under State aid rules if it results in the preferential treatment of undertakings operating within a specific geographical area. This could lead to distortions of competition between regions and create imbalances within the EU internal market.

¹⁷¹³ e.g., Case C-15/14 P *Commission v MOL* EU:C:2015:362, para 59. Case C-831/21 P *Fachverband Spielhallen and LM v Commission* EU:C:2023:686, para 35; Case T-448/18 *Ryanair* EU:T:2021:626, para 156.

¹⁷¹⁴ Verouden and Werner (n 1708) 21.

¹⁷¹⁵ Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (C/2016/2946) (n 1696), para 118.

¹⁷¹⁶ *ibid.*, para 119.

¹⁷¹⁷ *ibid.*, para 120.

¹⁷¹⁸ e.g., Joined Cases C-72/91 and C-73/91 *Sloman Neptun* EU:C:1993:97, para 21. See also, Viktor Kreuschitz and Peter Nehl, ‘The Notion of State Aid: Criterion of Selectivity’ in Hofmann and Micheau (eds) (n 504) 133: ‘As a general rule, tax measure are compatible ‘when it is ‘justified by the nature of a general scheme of the system of which it is part’ or by the ‘logic of the system’.

¹⁷¹⁹ Commission Notice on the notion of State aid as referred to in Article 107(1) (n 1696), paras 143-144.

¹⁷²⁰ *ibid.*, paras 142-144.

Selectivity is a complex area, and the case law is vast beyond the scope of this research. The nuanced nature of selectivity and its various forms make it a challenging area for analysis. In essence, State aid law primarily targets public interventions that disrupt market equality through targeted subsidies, rather than general measures that apply indiscriminately to undertakings. One suggested rationale of the selectivity criterion is that the EU has no competence in general national taxation policy.¹⁷²¹ For the purposes of this analysis, it is sufficient to acknowledge that general measures indistinctly applicable to all undertakings are not caught by Article 107(1). This criterion effectively narrows the scope of State aid law as the remedy of market failure via general taxation policy is not prohibited under Article 107(1) unless it distorts competition in favour of one or a group of undertakings.

7.3.1.4 The Criteria of Distortion of Competition and Effect on Trade

Lastly, in order for a measure to fall under the purview of State aid law, it must simultaneously distort competition and affect trade within the EU. According to the Commission, any measure is considered to distort competition, ‘when it is liable to improve the competitive position of the recipient compared to other undertakings with which it competes’.¹⁷²² It is therefore not necessary to demonstrate an actual distortion of competition, as it is sufficient that the measure ‘is liable to’ cause such an effect.¹⁷²³ Likewise, an actual effect on trade does not need to be established,¹⁷²⁴ as it is deemed satisfactory to demonstrate that the measure ‘is liable to’ affect trade.¹⁷²⁵ Despite the Court’s rejection of a general *de*

¹⁷²¹ Verouden and Werner (n 1708) 22.

¹⁷²² Commission Notice on the notion of State aid as referred to in Article 107(1) (n 1696), para 187.

¹⁷²³ e.g., Case C-148/04 *Unicredito Italiano* EU:C:2005:774, para 55; Case C-667/13 *Banco Privado Português and Massa Insolvente do Banco Privado Português* EU:C:2015:151, para 46.

¹⁷²⁴ Commission Notice on the notion of State aid as referred to in Article 107(1), para 190.

¹⁷²⁵ Case C-518/13 *Eventech v The Parking Adjudicator* EU:C:2015:9, para 66; Joined Cases C-197/11 and C-203/11 *Libert and others* EU:C:2013:288, para 77; Case T-288/97 *Friulia Venezia Giulia* EU:T:2001:115, para 41.

minimis rule,¹⁷²⁶ the Commission has adopted regulations for both general and sectorial *de minimis* exemptions.¹⁷²⁷

It is noteworthy that the criterion of distortion of competition engenders a symbiotic relationship between the notion of aid and the compatibility of State aid. Whilst a formal assessment of these conditions is not required when determining the existence of State aid,¹⁷²⁸ a more thorough examination of the distortions may be necessary when balancing the positive effects of the aid with its negative effects for the purpose of declaring State aid compatible with the internal market.¹⁷²⁹ However, the Commission has a significant degree of discretion in its assessment of compatibility, in contrast to the objective nature of the notion of State aid. It is interesting to note that the Commission's Common Principles of Assessment for State Aid Compatibility (the 'CAP') place a great emphasis on the various types of distortions that can arise from State aid.¹⁷³⁰ The Commission identifies three principal distortions of competition created by State aid.¹⁷³¹ Firstly, State aid can negatively impact a firm's incentives to invest and compete by interfering 'with the allocation of rents through markets'. Secondly, State aid may distort competition in the product market by triggering various responses from competitors. Thirdly, it can affect competition in input markets and more specifically the location of investment. Thus, the Commission must assess 'the magnitude of the distortions of competition' as part of the compatibility assessment.¹⁷³²

¹⁷²⁶ Bacon (n 671) 89; Case 57/86 *Greece v Commission* EU:C:1988:284, paras 17-18; Case C-142/87 *Tubemeuse* (n 1700), para 43; Case C-310/99 *Italy v Commission* EU:C:2002:143, para 86; Case C-172/03 *Heiser* EU:C:2005:130, para 32; Joined Cases T-227/01 to T-229/01, T-265/01, T-266/01 and T-270/01 *Territorio Histórico de Álava v Commission* EU:T:2009:315, para 148.

¹⁷²⁷ Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid.

¹⁷²⁸ Kreuzschitz and Nehl, 'The Notion of State Aid: Criterion of Selectivity' (n 1718) 151: 'The Common trend within the EU Courts' case law is that no actual assessment of these criteria is required'.

¹⁷²⁹ This is further discussed in Chapter 8, section 8.2.1.4.

¹⁷³⁰ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), paras 44-56.

¹⁷³¹ *ibid.*, para 44.

¹⁷³² *ibid.*, para 51.

7.3.2 The Legal Framework of State Aid Compatibility

Generally, State aid may be exempted under either Article 107(2) or (3) TFEU, which provide for two different types of compatibility: *automatic* and *discretionary* compatibility.¹⁷³³ This section describes these different regimes of compatibility. Further, the extent of discretion of the Commission within the assessment under Article 107(3) is examined.

It is suggested that automatic compatibility under Article 107(2) entails leaving the market diagnostic and market failure assessment to be carried out on the national level of the involved Member State by taking a decentralised approach. Therefore, this Article results in an assessment entailing significant discretion, rather than a rigorous market failure test. However, this paragraph's relevance to the overall research is limited due to its narrow scope. In contrast, it is argued that Article 107(3) is far-reaching and centralises any market failure analysis within the purview of the Commission.

7.3.2.1 The Nonexistence of Balancing under Article 107(2)

7.3.2.1.1 *The Content of Article 107(2)*

Article 107(2) TFEU provides that:

2. The following shall be compatible with the internal market:

- (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
- (b) aid to make good the damage caused by natural disasters or exceptional occurrences;
- (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of

¹⁷³³ e.g., Case C-667/13 *Banco Privado Português* (n 1723), para 91. Also called *de jure* aid, see, Viktor Kreuschitz and Hanns Peter Nehl, 'De Jure Compatible State Aid under Article 107(2) TFEU' in Hofmann and Micheau (eds) (n 504) 234.

Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.

It is argued that Article 107(2) provides an exception to the ‘union-interest’ aspect of the EU state aid regime by granting significant discretion to the national authorities responsible for granting the aid in question. Within the wording of Article 107(2), these measures *shall* be declared compatible with the internal market, provided that the relevant criteria are met. Accordingly, the Commission is required to declare aid meeting the criteria compatible with the internal market, without having the authority to assess whether State aid is an appropriate measure in the particular circumstances.¹⁷³⁴ This does not imply that the responsibility lies entirely with the Member States, as the Commission still plays a role, albeit a limited one. Under Article 107(2), the Commission’s role is limited to verifying whether the conditions outlined in the provisions have been fulfilled, in contrast to the broad discretion under Article 107(3).¹⁷³⁵ This section now explores the categories of aid in Article 107(2).

7.3.2.1.1.1 Social Aids

The first category in Article 107(2)(a) pertains to so-called ‘social aid’. Whilst the terminology of ‘social character’ initially suggests that this category could be applied broadly, it is restricted in its scope. The requirement embedded in the text of Article 107(2)(a) that the aid must be directed towards ‘individual final consumers’¹⁷³⁶ severely limits its potential scope.

The requirement that the aid should have a social character circumscribes the application of Article 107(2)(a) to ‘certain categories of consumers whose situation justified social intervention’.¹⁷³⁷ As a result, the provision has been successfully used in cases such as granting aid that defers mortgage payments for

¹⁷³⁴ e.g., Säcker and Montag (n 1680) 519.

¹⁷³⁵ Kreuschitz and Nehl, ‘De Jure Compatible State Aid under Article 107(2) TFEU’ (n 1733) in Hofmann and Micheau (eds) (n 504) 234, 235.

¹⁷³⁶ e.g., Case T-445/05 *Associazione italiana del risparmio gestito v Commission* EU:T:2009:50. The individual character of the aid means that an aid that is aimed to all categories of investors cannot be considered within that provision.

¹⁷³⁷ Bacon (n 671) 96.

socially vulnerable consumers,¹⁷³⁸ or subsidising transport costs for categories of consumers residing in remote areas.¹⁷³⁹

The ultimate requirement set forth in Article 107(2)(a) dictates that the aid should be granted without discrimination related to the origin of the products. This condition was not met in the *P & O European Ferries (Vizcaya) v Commission* case,¹⁷⁴⁰ where the Court upheld the judgment of the General Court finding that the aid is discriminatory. According to the General Court, the key criterion for assessing whether such aid is discriminatory is that ‘it must be ascertained whether consumers benefit from the aid in question irrespective of the economic operator supplying the product or service capable of fulfilling the social objective relied on by the Member State concerned’.¹⁷⁴¹

In sum, Article 107(2)(a) provides a narrow exception, confined to specific consumer groups necessitating social intervention, and subject to the additional requirements that the aid be directed towards individual final consumers and granted without discrimination based on the origin of products.

7.3.2.1.1.2 Disaster Aids

The second category in Article 107(2)(b) concerns aid that seeks to remedy damages caused by natural disasters or other exceptional occurrences. The Court has ruled that, since this provision constitutes an exception, it must be interpreted restrictively.¹⁷⁴² The key criterion is that it only applies to ‘compensation for natural calamities or other extraordinary events’.¹⁷⁴³ Although the suitability of

¹⁷³⁸ e.g., Decision of the Commission 13 August 2009, *Homeowners mortgage support scheme*, OJ C 209, 2 and 24 November 2009, *Guarantee by government for housing loans* OJ C 25 2.

¹⁷³⁹ e.g., Commission Decision (C(2012) 2512 final) of 20 April 2012 (SA33966 Aide à caractère social au bénéfice des résidents des îles de la Guadeloupe). This category of social aid is today block-exempted by Article 51 (‘Social aid for transport for residents of remote regions’ of the Commission Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

¹⁷⁴⁰ Case C-442/03 P *P&O European Ferries (Vizcaya) v Commission* EU:C:2006:356.

¹⁷⁴¹ Case T-116/01 *P & O European Ferries (Vizcaya) v Commission* EU:T:2003:217, para 163.

¹⁷⁴² Case C-278/00 *Greece v Commission* EU:C:2004:239, para 81; Cases C-346 and 529/03 *Atzeni* EU:C:2006:130, para 79; and Case T-268/06 *Olympiaki Aeroporia Ypiresies* (‘Olympic Airways’) v *Commission* EU:T:2008:222, para 52.

¹⁷⁴³ Joined Cases C-71/09 P etc *Comitato ‘Venezia vuole vivere’ v Commission* EU:C:2010:771, para 175.

this category of aid is decided on the national level, there is extensive EU control of the severity of the element,¹⁷⁴⁴ the causal link¹⁷⁴⁵ and the absence of overcompensation.¹⁷⁴⁶

This category of aid has recently assumed renewed relevance as a remedy for addressing the economic challenges caused by the COVID-19 pandemic.¹⁷⁴⁷ However, it has been noted that it is more difficult to apply than Article 107(3)(b).¹⁷⁴⁸

7.3.2.1.1.3 Cold War Aids

The third and final category is so-called ‘Cold war aids’,¹⁷⁴⁹ intended to compensate for economic disadvantages which are caused by the division of Germany following WW2. However, this provision has become obsolete, and Article 107(2)(c) now features explicitly a clause allowing the Council to repeal the provisions upon a proposal from the Commission.

7.3.2.1.2 *The Nature of Article 107(2) TFEU*

It is worth noting that contrary to Article 107(3) explored below, Article 107(2) is primarily focused on aid aimed at remedying equity failures. Whilst disaster relief is not limited to equity measures, a key feature of that provision is to exempt aid that serves a redistributive function. Article 107(3), which falls under the discretion of the Commission, is more likely to be applicable in addressing traditional market failures, including exceptions such as regional aid.

¹⁷⁴⁴ e.g., Commission Decision (2010/473/EU) of 15 December 2009 on support measures implemented by Spain in the agricultural sector following the increase in fuel prices (notified under document C(2009) 9971), para 196. The Commission considers that in any case, the increase in fuel prices does not constitute an exceptional occurrence and therefore this aid cannot qualify for the exception provided for in Article 107(2)(b) of the TFEU as aid to make good the damage caused by an exceptional occurrence.

¹⁷⁴⁵ e.g., Cases C-346 and 529/03 *Atzeni* (n 1742), para 79; Case C-73/03 *Spain v Commission* EU:C:2004:711, para 37.

¹⁷⁴⁶ e.g., Bacon (n 671) 259.

¹⁷⁴⁷ Phedon Nicolaides, ‘Application of Article 107(2)(b) TFEU to Covid-19 Measures: State Aid to Make Good the Damage Caused by an Exceptional Occurrence’ (2020) 11(5) *Journal of European Competition Law & Practice* 238.

¹⁷⁴⁸ *ibid.*

¹⁷⁴⁹ e.g., Bacon (n 671) 94.

As explained above, the discretion of the Member States under Article 107(2) is not absolute but merely limited to the suitability of the aid measure. In *Philip Morris v Commission*, the Court affirmed the limited powers of the Commission under Article 107(2) by employing an *a contrario* argument in reference to Article 107(3).¹⁷⁵⁰ Thus, it can be inferred that the Commission retains the power to verify that the conditions necessary for the granting of aid under Article 107(2) are met.¹⁷⁵¹

Nevertheless, contrary to Article 107(3), Article 107(2) is only applicable to a limited series of situations. As stated above, as this provision constitutes an exception to the general prohibition enshrined in Article 107(1), it must be narrowly construed.¹⁷⁵² It is argued that the Court's interpretation of the criteria in Article 107(2) has been overly restrictive, resulting in a significant curtailment of its scope.

Most significantly, Article 107(2) lacks a market failure test since the proportionality assessment of measures falling thereunder is mainly conducted on a national level.¹⁷⁵³ The absence of an EU-level assessment beyond the strict fulfilment of the criteria of Article 107(2) implies that there is no balancing mechanism capable of shouldering a market failure test. Consequently, the focus of the following sections will be on Article 107(3).

7.3.2.2 The Pervasiveness of Balancing under 107(3)

This section describes the content and elucidates the role of the Commission in the assessment under Article 107(3) TFEU. This provision establishes so-called 'discretionary' exceptions to the prohibition of State aid within the sense of Article 107(1).¹⁷⁵⁴ As previously explained, unlike the assessment conducted under Article 107(2), the analysis under Article 107(3) centralises any market failure test at the Union level. Under this provision, the Commission wields broad discretion to find aid compatible without being bound to undertake such an analysis or to

¹⁷⁵⁰ Case 730/79 *Philip Morris Holland BV v Commission of the European Communities* EU:C:1980:209, para 17.

¹⁷⁵¹ Viktor Kreuschitz and Hanns Peter Nehl, 'General Theory on Compatibility of State Aid' in Hofmann and Micheau (eds) (n 504) 234–235; Leigh Hancher, Tom Ottervanger and Piet Jan Slot, *EU State Aids* (4th edn, Sweet & Maxwell 2012) 753.

¹⁷⁵² Case C-156/98 *Germany v Commission* EU:C:2000:467, para 49.

¹⁷⁵³ Therefore, it will not be further analysed in this chapter.

¹⁷⁵⁴ e.g., Bacon (n 671) 99.

assess grounds of compatibility *ex officio*.¹⁷⁵⁵ This discretion is manifested, in particular, through ‘complex economic and social assessments’.¹⁷⁵⁶ The ECJ has affirmed that the Commission holds exclusive competence to declare aid measures compatible under Article 107(3), subject to review by the EU Courts.¹⁷⁵⁷ Given the central role of the Commission within the assessment process, this provision can be placed within the *default mode* of EU competition law, as previously explained.

7.3.2.2.1 *The Content of Article 107(3)*

Article 107(3) TFEU covers a broad spectrum of aid measures, most of which are subject to specific sectorial regimes.¹⁷⁵⁸ However, in instances where aid measures fall outside the scope of sector-specific guidelines, the compatibility of those measures is assessed directly under Article 107(3).¹⁷⁵⁹ This provision includes both efficiency and equity (redistributive) justifications for State aid measures.¹⁷⁶⁰ This section provides a brief overview of the various aid categories covered by Article 107(3)

7.3.2.2.1.1 Regional Aid

The first category of aid contained in 107(3)(a) is regional aid.¹⁷⁶¹ A more detailed analysis of this particular aid regime is provided in Chapter 9.¹⁷⁶² Article 107(3)(a) stipulates that ‘aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation’, may be compatible with the internal market. Regional aid

¹⁷⁵⁵ *ibid.* This also result from the wording of Article 107(3) which provides that the Commission may consider such aid compatible with the internal market.

¹⁷⁵⁶ Case C-431/14 P *Greece v Commission* EU:C:2016:145, para 68; Case C-526/14 *Kotnik* (n 519), para 38, Case C-817/18 P *Vereniging tot Behoud van Natuurmonumenten in Nederland and Others v Vereniging Gelijkberechtiging Grondbezitters and Others* ECLI:EU:C:2020:637, para 99; Case C-470/20 *AS Veejaam* EU:C:2022:981, para 29.

¹⁷⁵⁷ Case C-526/14 *Kotnik* (n 519), para 37; Case C-284/12 *Deutsche Lufthansa* (n 701), para 28.

¹⁷⁵⁸ See Chapter 9 for an analysis of sectorial frameworks.

¹⁷⁵⁹ e.g., *Bacon* (n 671) 49.

¹⁷⁶⁰ See 2005 SAAP (n 20) and e.g., *Friederiszick, Röller and Verouden* (n 340).

¹⁷⁶¹ Although regional aid can also be declared compatible on the basis of Article 107(3)(c).

¹⁷⁶² See Chapter 9, section 9.2.

aims to foster economic development and to promote territorial cohesion within the sense of Articles 3 and 174 of the Treaty.¹⁷⁶³ From that perspective, regional aid has been described as an exception ‘in the interest of solidarity’,¹⁷⁶⁴ a claim that will be closely examined subsequently.¹⁷⁶⁵

7.3.2.2.1.2 Aid for an Important Project of Common European Interest & Financial Aid

Article 107(3)(b) provides that ‘aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State’ may be declared compatible with the internal market. This provision can be divided into two distinct categories of aid measures. First, aid contributing to important projects of common European interest (IPCEI) may under certain conditions specified in the IPCEI communication¹⁷⁶⁶ be declared compatible. Such aid measures appear to address an integrational failure in realising transnational projects, which stems from the costs associated with economic integration between Member States.

The second type of aid measure that may be declared compatible under Article 107(3)(b) is financial aid or, as stated in that article, aid ‘to remedy a serious disturbance in the economy of a Member State’.¹⁷⁶⁷

¹⁷⁶³ Article 3 TEU provides that the Union ‘shall promote economic, social and territorial cohesion, and solidarity among Member States’. According to Article 174 TFEU, ‘the Union shall develop and pursue actions leading to the strengthening of its economic social and territorial cohesion’. However, whilst the Treaties emphasise the objective of territorial cohesion, it does impose not impose an obligation on the Commission to apply regional aid rules in a more flexible way to favour the goals of economic and social cohesion over competition policy, see to this effect, Joined Cases T-254/00, T-270/00 and T-277/00 *Hotel Cipriani v Commission* EU:T:2008:537, para 299.

¹⁷⁶⁴ Säcker and Montag (n 1680) 281.

¹⁷⁶⁵ See Chapter 9, section 9.2.

¹⁷⁶⁶ Communication from the Commission, ‘Criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest’ (2014/C 188/02).

¹⁷⁶⁷ This provision holds direct relevance to the a potential broader macroeconomic failure standard, as explained in Chapter 9.

7.3.2.2.1.3 Aid for the Development of Economic Activities or Areas

Thirdly, Article 107(3)(c) represents the most frequently utilised provision within the paragraph. This provision constitutes, due to its broad wording, a sort of catch-all category. Under the third limb of Article 107(3), ‘aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest’ may be declared compatible with the internal market. A meticulous analysis of this provision is presented in Chapter 8.

Two notable observations can be derived from this provision. First, its extensive formulation suggests that it can encompass a wide spectrum of different aid measures, such as regional aid,¹⁷⁶⁸ agricultural aid,¹⁷⁶⁹ R&D&I aid,¹⁷⁷⁰ environmental aid,¹⁷⁷¹ and potentially any other ad hoc aid measure.¹⁷⁷² Consequently, most sectorial aid regimes are adopted based on Article 107(3)(c). An examination of some of these sectorial regimes is conducted subsequently in Chapter 9. Second, Article 107(3)(c) incorporates an explicit proportionality test, which serves as a counterbalance to its broad wording. As seen previously, this proportionality test plays a crucial role in ensuring that the aid granted is proportional to its intended objectives and does not exceed the necessary means to achieve them.

7.3.2.2.1.4 Cultural Aid

This exemption category was added in 1993 with the Maastricht Treaty.¹⁷⁷³ Previously, cultural aids were exempted under the catch-all category of Article 107(3)(c).¹⁷⁷⁴ However, the importance of this insertion has been questioned in

¹⁷⁶⁸ Communication from the Commission, ‘Guidelines on regional State aid’ (2021/C 153/01), paras 161-163.

¹⁷⁶⁹ Commission Notice, ‘European Union Guidelines for State aid in the agricultural and forestry sectors and in rural areas 2014 to 2020’ (2014/C 204/01), para 2.

¹⁷⁷⁰ Communication from the Commission, ‘Framework for State aid for research and development and innovation’ (2022/C 414/01), para 2.

¹⁷⁷¹ Communication from the Commission, ‘Guidelines on State aid for climate, environmental protection and energy 2022’ (C/2022/481), para 7.

¹⁷⁷² This is further explored in Chapter 8.

¹⁷⁷³ Official Journal of the European Communities No C-191/10 (29/07/1992).

¹⁷⁷⁴ Bacon (n 671) 109.

State aid scholarship.¹⁷⁷⁵ In addition, cultural and heritage conservation is today covered by articles of the GBER,¹⁷⁷⁶ making any direct assessment of diminished relevance. The cultural derogation is problematic as there is no definition of culture on an EU level. In light of the principle of subsidiarity, culture is, therefore, defined on a national level.¹⁷⁷⁷

In this context, the responsibility of identifying a cultural market failure is left to the discretion of national authorities. Nonetheless, the Commission using its discretionary powers can ensure that the aid adheres to the established criteria outlined in its common framework. This process enables the Commission to maintain a balance between respecting national autonomy and safeguarding the overall objectives of the internal market.

7.3.2.2.1.5 Sui Generis Exemption by the Council

The final segment of Article 107(3) stipulates that, based on a proposal from the Commission, the Council may create additional categories of aid beyond those specified in Article 107(3), eligible for exemption. This flexibility showcases the political nature of the State and its adaptability to address novel and unique circumstances. This provision has only been invoked on a limited number of occasions.¹⁷⁷⁸

Complementing this provision, Article 108(2) TFEU enables the Council to approve individual aid measures itself in ‘exceptional circumstances’. Rather than creating additional categories, the Council may independently exempt individual aid measures. This, again, illustrates the political character of the state aid regime. Not only does Article 107(3)(e) entail legislative flexibility but Article 108(2), in addition, creates a *sui generis* derogation from the State aid provisions in the hand of a political body. The term ‘exceptional circumstances’ within Article 108(2) lacks a precise definition. AG Cosmas has suggested that this term entails ‘something extraordinary and unforeseen or at least something not permanent or

¹⁷⁷⁵ *ibid.*

¹⁷⁷⁶ Articles 53-54 of Commission Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (n 1739).

¹⁷⁷⁷ Kreuschitz and Nehl, ‘De Jure Compatible State Aid under Article 107(2) TFEU’ (n 1733) 240, 301.

¹⁷⁷⁸ Bacon (n 671) 121.

continuous and of course something other than normal'.¹⁷⁷⁹ This means that 'a chronic unsatisfactory situation in one sector of economic activity [...] cannot *ipso facto* come within the concept [...]'.¹⁷⁸⁰ What is clear from the case law is that this provision must be interpreted strictly.¹⁷⁸¹

7.3.2.2.2 *Limitations to the Discretion of the Commission*

This subsection suggests that the discretion of the Commission under Article 107(3) TFEU can then be limited through two distinct approaches.

The first category of limitations is *internal limitations*, which refers to the process of 'auto-limitation' by the Commission itself. As held by the Court of Justice in long-standing case law:

[I]n adopting rules of conduct and announcing by publishing them that they will henceforth apply to the cases to which they relate, the Commission imposes a limit on the exercise of its aforementioned discretion and cannot depart from those rules without being found, where appropriate, to be in breach of general principles of law, such as equal treatment or the protection of legitimate expectations.¹⁷⁸²

It is however important to clarify that the soft law of the Commission must respect the requirements of Article 107(3). Accordingly, aid that is not necessary for the attainment of one of the objectives of that provision cannot be declared compatible with the internal market.¹⁷⁸³ This issue is closer further explored in Chapter 8.

The second category of limitations pertains to the *external limitations* imposed by EU law. According to the case law of the Court of Justice, there are certain requirements that the Commission must respect.

¹⁷⁷⁹ Opinion of AG Cosmas in Case C-122/94 *Commission v Council* EU:C:1995:395, para 83.

¹⁷⁸⁰ *ibid.*

¹⁷⁸¹ e.g., Case C-510/08 *Mattner* EU:C:2010:216, para 32; Case C-121/10 *Commission v Council* EU:C:2013:784, para 40.

¹⁷⁸² e.g., Case C-431/14 P *Greece v Commission* (n 1756), para 186; Case C-75/05 P and C 80/05 P *Germany and Others v Kronofrance* EU:C:2008:482, para 60; Case C-464/09 P *Holland Malt v Commission* EU:C:2010:733, para 46.

¹⁷⁸³ Case C-526/14 *Kotnik* (n 519), para 49; Case C 630/11 P to C 633/11 P *HGA and Others v Commission* EU:C:2013:387, para 104 and the case-law cited therein.

First, the aid must, generally, comply with general principles of EU law as held by the Court of Justice in *Nuova Agricast*.¹⁷⁸⁴ It follows that the Commission cannot declare any aid that infringes general principles such as equal treatment or the protection of legitimate expectations, compatible with the internal market.¹⁷⁸⁵

Second, stemming from the first requirement, two specific criteria can be identified: the aid must be necessary and proportionate.¹⁷⁸⁶ In *Philip Morris Holland v Commission*, the ECJ held that aid that does not respect the principle of necessity cannot be considered compatible with the internal market.¹⁷⁸⁷

Additional requirements emerge from the principles of necessity and proportionality. Firstly, operational aid is, in general, not compatible with the internal market.¹⁷⁸⁸ Second, aid that does not ‘induce the recipient undertakings to adopt conduct likely to assist attainment of one of the objectives referred to in Article 107(3)’ cannot be declared compatible.¹⁷⁸⁹ Thus, it is necessary that the aid measure provides an ‘incentive effect’.¹⁷⁹⁰

From the above presentation, it is evident that the Commission possesses a wide margin of discretion when declaring aid compatible under Article 107(3). However, there are general requirements that must be complied with.

7.3.2.3 The GBER as a Presumption of Market Failure

The ultimate ground for compatibility is also the absolute broadest one: the General Block Exemption Regulation.¹⁷⁹¹ Over time, the GBER has gradually

¹⁷⁸⁴ Case C-390/06 *Nuova Agricast* EU:C:2008:224, para 51; Case C-67/09 P *Nuova Agricast* (n 590), para 65; Case C-431/14 P *Greece v Commission* (n 1756), para 69; Case T-102/21 *Bastion Holding and Others v Commission* EU:T:2023:243, para 31.

¹⁷⁸⁵ Case C-464/09 P *Holland Malt v Commission* EU:C:2010:733 (n 1782), para 46; Case C-667/13 *Banco Privado Português and Massa Insolvente do Banco Privado Português* (n 1723), para 69.

¹⁷⁸⁶ Viktor Kreuschitz and Hanns Peter Nehl, ‘General Theory on Compatibility of State Aid’ in Hofmann and Micheau (eds) (n 504) 223, 225.

¹⁷⁸⁷ Case 730/79 *Philip Morris* (n 1750), para 17.

¹⁷⁸⁸ Case C-288/96 *Germany v Commission* (‘Jadekost’) EU:C:2000:537.

¹⁷⁸⁹ Case C 630/11 P to C 633/11 P *HGA and Others v Commission* (n 1783), para 104; Case T-778/17 *Autostrada Wielkopolska v Commission* EU:T:2019:756, para 180.

¹⁷⁹⁰ See section 7.4.2.2.2 of the current chapter.

¹⁷⁹¹ GBER (n 1739).

expanded¹⁷⁹² and today encompasses virtually all the sectors of State aid. Aid measures falling under the GBER are presumed to proportionately address a market failure within the framework described in the subsequent section.¹⁷⁹³ This means that aid that meets GBER requirements is exempt from the obligation of notification laid down in Article 108(3) TFEU.¹⁷⁹⁴

The broad application of the GBER shows that certain common market failures are left to Member States themselves for resolution. In this regard, the GBER signifies a crucial development in the division of responsibilities between the Commission and the authorities of the Member States.¹⁷⁹⁵

The presumption of market failure is grounded in the experience of the Commission. The Commission has established maximum aid amounts and intensities to ensure that the overall balance between the negative and positive effects is positive,¹⁷⁹⁶ thus avoiding any double market failures resulting from the intervention in the market.

7.4 Market Failure and State Aid Modernisation

This section explores the increasingly prominent role of economics and market failure in the compatibility assessment of state aid, as part of an intricate legal analysis. To analyse the practical application of the more economic approach in practice, it is imperative to establish a comprehensive understanding of its foundational principles. It is shown that the modernisation agenda emerged initially in the 2005 State Action Plan and was further elaborated in the 2012 State Aid Modernisation Communication. In light of these documents, a common set of

¹⁷⁹² On previous extension see e.g., Michael Berghofer, 'The General Block Exemption Regulation: A Giant on Feet of Clay' (2009) 3 *European State Aid Law Quarterly* 323.

¹⁷⁹³ See section 7.4.2 of the current chapter.

¹⁷⁹⁴ Commission Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (n 1739), recital 6.

¹⁷⁹⁵ Phedon Nicolaides, 'An Economic Assessment of the Usability of the New General Block Exemption Regulation for State Aid (Regulation 651/2014)' (2014) *European Competition Journal* 403.

¹⁷⁹⁶ e.g., Kristyna Deiberova and Harold Nyssens, 'The New General Block Exemption Regulation (GBER): What Changed' (2009) 8 *European State Aid Law Quarterly* 27. Although this was noted to the precedent GBER it can be argued that the same reasoning remains applicable to the latest version.

principles was adopted. The Commission has advocated a broad test based on market failure and a balancing exercise of positive and negative effects of State aid. It is posited that the highly broad nature of this test, which is applied on a case-by-case basis, offers limited certainty to Member States and firms.

In this respect, state aid modernisation appears to be guided by two conflicting leitmotifs. On one hand, the necessity to delineate enforcement priorities and provide a common framework for State aid assessment. On the other, the desire of the Commission to avoid constraining its discretion by adopting an excessively rigid and precise methodology. Consequently, whilst the more economic approach permits closer scrutiny of national aid measures, it leaves many questions unresolved.

To fully comprehend these principles, it is essential to understand the background upon which they rest. Prior to modernisation, the State aid regime faced criticism for its absence of a proper balancing exercise and the overly strict and formalistic application of the various soft law regimes.¹⁷⁹⁷ Both Member States and the EU acknowledged the necessity to rethink the balance between the different rationales of State intervention through State aid.¹⁷⁹⁸ Analogous to the antitrust provision, the modernisation process in State aid law implemented a more economic approach (called a ‘refined economic approach’).¹⁷⁹⁹ This modernisation process aimed to make the State aid regime more efficient by advocating ‘less and better targeted aid’.¹⁸⁰⁰

State aid was the last domain of EU competition law to undergo the modernisation process. As previously stated, State aid is a highly political legal field. The political nature of State aid control implied that much of the practical analysis lacked a firm grounding in economic principles.¹⁸⁰¹ Thus, the modernisation of State aid has been not only an ideological question from the view of competition theory but also a politically sensitive one.

Against that background, this section outlines the methodology of the Commission in assessing the compatibility of aid measures under Article 107(3)

¹⁷⁹⁷ Friederiszick, Röller and Verouden (n 340) 630.

¹⁷⁹⁸ *ibid.*, 625.

¹⁷⁹⁹ 2005 SAAP, para 18.

¹⁸⁰⁰ *ibid.*

¹⁸⁰¹ *ibid.*

TFEU. To understand the implications of the remodelling of the State aid regime, the first subsection describes the underlining principles of State aid modernisation. The second subsection examines the common assessment principles of the Commission. Finally, some conclusions are provided before examining the approach in practice under the following section.

7.4.1 Guiding Principles of State Aid Modernisation

In order to understand the function of the test developed by the Commission, this subsection focuses on the objectives of State aid modernisation. It is shown that these objectives have been primarily defined in two key instruments.

However, first, it is crucial to consider whether there is a difference between modernisation in State aid law and antitrust law. The guiding principles of State aid modernisation present both similarities and differences with the modernisation enterprise under the antitrust provisions. Similarly, it aims to bring an end to the formalistic approach in favour of an effect-based formula. In contrast, however, the State aid rules go well beyond economic efficiency and explicitly recognise several equity-based grounds for exemption,¹⁸⁰² rendering a more economic approach challenging to put into practice.¹⁸⁰³ This dual character of promoting both efficiency and equity presents complications and, therefore, needs to be reconciled with reliance on conventional economic principles and market failure. As previously observed, a conventional narrow concept of market failure excludes any equity improvement. Thus, only by adopting a broader market failure concept based on a trade-off function can both efficiency and equity be incorporated. In scholarship, a distinction between rationales based on market failure and those based on equity has been suggested.¹⁸⁰⁴ According to these scholars, a distinction must be made between efficiency, which is a neutral concept, and equity, which is not.¹⁸⁰⁵ In cases of conflict between these two welfare-enhancing concepts, economic analysis plays a part in identifying trade-offs.¹⁸⁰⁶ However, the Treaty

¹⁸⁰² This is the case for social or regional aid for example.

¹⁸⁰³ e.g., Friederiszick, Röller and Verouden (n 340) 625 who write that ‘the economic and legal principles underlying state aid control are by their very nature more challenging’.

¹⁸⁰⁴ Friederiszick, Röller and Verouden (n 340) 625 ff.

¹⁸⁰⁵ *ibid.*

¹⁸⁰⁶ *ibid.*

provides limited guidance on how to balance undistorted competition with broader efficiency or equity considerations of national policymakers.¹⁸⁰⁷

Shifting the focus to the modernisation instruments, the first document paving the way for reform within the field of State aid was the 2005 State aid action plan ('SAAP').¹⁸⁰⁸ In this consultation paper, the Commission established a balancing test,¹⁸⁰⁹ which has subsequently become the standard conceptual framework employed under Article 107(3).¹⁸¹⁰ Based on the Lisbon Strategy, the modernisation of the State aid regime is, according to the Commission, based on four key elements:

- 'less and better targeted state aid;
- a refined economic approach;
- more effective procedures, better enforcement, higher predictability and enhanced transparency;
- a shared responsibility between the Commission and Member States [...]' ¹⁸¹¹

The first two elements are closely intertwined. To ensure better targeting, State aid should mainly be granted to correct market failures,¹⁸¹² which also simultaneously serves as the cornerstone of the analytical framework provided by the refined economic approach ('REA'). As put by the Commission:

Making more use of a refined economic approach is a means to ensure a proper and more transparent evaluation of the distortions to competition and trade associated with state aid measures. This approach can also help investigate the reasons why the market by itself does not deliver the

¹⁸⁰⁷ Michael Blauburger, 'From Negative to Positive Integration. European State Aid Control through Soft and Hard Law' MPIfG Discussion Paper 08/4, Max Planck Institute for the Study of Societies 7.

¹⁸⁰⁸ 2005 SAAP (n 20).

¹⁸⁰⁹ Vincent Verouden, 'EU State Aid Control: The Quest for Effectiveness' (2015) *Eur. St. Aid. L.Q.* 459, 469.

¹⁸¹⁰ See section 7.4.2 of the current chapter.

¹⁸¹¹ 2005 SAAP (n 20), point 18.

¹⁸¹² Justus Haucap and Ulrich Schwalbe, 'Economic Principles of State Aid Control' (2011) Düsseldorf Institute for Competition Economics, Discussion Paper No 17, 17.

desired objective of common interest and in consequence evaluate the benefits of state aid measures in reaching these objectives.¹⁸¹³

One key feature within the analysis is:

[M]arket failures, such as externalities, imperfect information or coordination problems, which may be reasons why the markets do not achieve desired objectives of common interest, in particular if they are of an economic nature. In those cases, identifying the market failure at stake will help evaluate better whether state aid could be justified and acceptable, would represent the most appropriate solution, and how it should be implemented to achieve the desired objective without distorting competition and trade to an extent contrary to the common interest.¹⁸¹⁴

It is noticeable that the SAAP adopts a traditional microeconomic perspective on market failures, focused on allocative efficiency.¹⁸¹⁵ In the spirit of efficiency, the SAAP also incorporates considerations of double market failure/government failure. Government failure, being the flip side of market failure, must consequently be considered within State aid control.¹⁸¹⁶ Whilst market failure can ensure that there is a legitimate rationale for intervention, government failure can provide the tools to measure the efficacy of the intervention.

On this point, the Commission recognises that State aid is generally only the ‘second best’ option to achieve allocative efficiency.¹⁸¹⁷ Hence, any granting of aid must precede a thorough verification of whether less distortive measures could better remedy the targeted market failure.¹⁸¹⁸ In the absence of government failure, by ensuring that less distortive means are not available, economic

¹⁸¹³ 2005 SAAP (n 20), point 22.

¹⁸¹⁴ 2005 SAAP (n 20), point 23.

¹⁸¹⁵ *ibid.*

¹⁸¹⁶ e.g., David Spector, ‘State Aids: Economic Analysis and Practice in the European Union’ in Xavier Vives (ed), *Competition Policy in the EU: Fifty Years on from the Treaty of Rome* (OUP 2009) 176, 177.

¹⁸¹⁷ 2005 SAAP (n 20), 7.

¹⁸¹⁸ *ibid.*

inefficiency caused by a market failure might provide a legitimate ground for granting State aid under Article 107.¹⁸¹⁹

The primary objectives of State aid modernisation were further developed in 2012 through the ‘Communication on State Aid Modernisation’ (SAM).¹⁸²⁰ According to the Commission, modernisation is required to strengthen the control of the Commission and to shape state aid control into a tool for promoting the sound use of public resources and limiting distortions of competition.¹⁸²¹ The objectives of State aid modernisation are described as threefold:

- (i) ‘to foster sustainable, smart and inclusive growth in a competitive internal market’;
- (ii) ‘to focus Commission *ex ante* scrutiny on cases with the biggest impact on the internal market whilst strengthening the Member States cooperation on State aid enforcement’;
- (iii) ‘to streamline the rules and provide for faster decisions’.

Some of the key proposals of the SAM to achieve these objectives are:

- a) ‘Identification and definition of common principles applicable to the assessment of compatibility of all the aid measures carried out by the Commission [...]’.¹⁸²²
- b) ‘Revision and streamlining of State aid guidelines, to make them consistent with those common principles’.¹⁸²³
- c) ‘revision and possible extension of the [GBER]’ in order to focus enforcement on cases with the biggest impact on the internal market.¹⁸²⁴
- d) ‘a possible review of the de minimis Regulation’.¹⁸²⁵

¹⁸¹⁹ *ibid.*

¹⁸²⁰ Communication on State aid modernisation (n 20).

¹⁸²¹ *ibid.*, para 6.

¹⁸²² *ibid.*, point 18.

¹⁸²³ *ibid.*, point 18.

¹⁸²⁴ *ibid.*, point 19.

¹⁸²⁵ *ibid.*, point 19.

Both these soft law instruments are overly ambitious in reshaping the State aid regime by developing a common economic framework for the compatibility assessment. Yet, they offer little clarification on how these common principles are to be developed, with a view to the specificities of the field of State aid law. An issue that the subsequent subsection explores.

7.4.2 The Development of a Common ‘Economic Test’

This section shows that the common principles adopted by the Commission take the shape of an economic test based on the presence of a market failure. In essence, this test incorporates three criteria. First, the existence of a market failure in the broadest sense; second, an effective remedy to that failure; and third, a positive overall balance between the positive effects and negative effects on competition and trade.

As mentioned above, a key element of state aid modernisation is the identification and development of common principles of assessment of compatibility and their streamlining into the soft law instruments of the different State aid regimes. Since State aid is granted by the Member States it can be difficult to consider the area ‘as a truly ‘European’ policy’.¹⁸²⁶ In this context, the modernisation agenda represents a significant step towards formulating a clear European policy in the area. Whilst the SAAP formulated a balancing test without further specification, the Commission elaborated on its methodology in a 2009 Commission staff working document (the ‘CAP’).¹⁸²⁷ A balancing test would provide for a solid economic analysis of the State aid regime, as opposed to the rather rudimentary methodology previously applied.¹⁸²⁸

To facilitate the treatment of ‘good aid’¹⁸²⁹ and focus the control on the most distortive aid measures, the Commission has developed a balancing exercise which ‘requires a common framework to evaluate and compare the different soft

¹⁸²⁶ Leigh Hancher and Phedon Nicolaides, ‘Compatibility of Aid – General Introduction’ in Werner and Verouden (n 1677) 194.

¹⁸²⁷ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454).

¹⁸²⁸ Friederiszick, Röller and Verouden (n 340) 631, 658.

¹⁸²⁹ Communication on State aid modernisation (n 20), para 12.

law'. This has been incorporated into many subsequent guidelines.¹⁸³⁰ It is also applied by the Commission in practice when directly assessing aid under Article 107(3)(c) TFEU.¹⁸³¹ The balancing test of the Commission further refines the methodology of the 2005 SAAP and seems to draw elements from the so-called CRA report¹⁸³² and prominent views in scholarship.¹⁸³³

The methodology of the compatibility assessment revolves around a balancing exercise between the distortive effects on trade on competition and the positive effects, considering the aid's impact on 'the social welfare of the EU'.¹⁸³⁴ Although centred around a balancing exercise, the test does not follow a traditional scheme of proportionality. The actual test is based on three stages¹⁸³⁵ of assessment:

1. 'Is the aid measure aimed at a well-defined objective of common interest?
2. Is the aid well designed to deliver the objective of common interest i.e. does the proposed aid address the market failure or other objectives?
 - i. Is the aid an appropriate policy instrument to address the policy objective concerned?
 - ii. Is there an incentive effect, i.e. does the aid change the behaviour of the aid recipient?
 - iii. Is the aid measure proportionate to the problem tackled, i.e. could the same change in behaviour not be obtained with less aid?
3. Are the distortions of competition and effect on trade limited, so that the overall balance is positive?'¹⁸³⁶

¹⁸³⁰ See e.g., Hjältström (n 20) ft 40. However, as pointed out by Hancher and Nicolaides (n 1826) 203, 'State aid guidelines have become highly complex and spread over 39 separate guidelines and communications, many but not all of which have now been revised as part of the SAM exercise'.

¹⁸³¹ See Chapter 8.

¹⁸³² Nitsche and Heidhues (n 457) commissioned by the Commission.

¹⁸³³ e.g., Friederiszick, Röller and Verouden (n 340).

¹⁸³⁴ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 9.

¹⁸³⁵ Interestingly there is no additional specification regarding whether these criteria should be applied cumulatively or in a sequential way. See to this effect Friederiszick, Röller and Verouden (n 340) 649.

¹⁸³⁶ *ibid.*

According to the Commission, economic tools may be helpful when determining whether State aid is necessary and proportionate.¹⁸³⁷ The following subsection describes and analyses these steps in greater detail, demonstrating that the concept of market failure is central to the Commission's methodology.

7.4.2.1 A Well-Defined Objective of Common Interest or Market Failure?

The first step of the analysis consists of identifying a 'well-defined objective of common interest', although this is not explicitly required by the Treaties. The term 'objective of common interest' can be understood either as an efficiency contribution (remedying a market failure) or in terms of equity.¹⁸³⁸ Thus, the term appears to be remarkably broad in its scope.¹⁸³⁹ As put by the SAAP:

State aid may be declared compatible with the Treaty provided it fulfils clearly defined objectives of common interest and does not distort intra-community competition and trade to an extent contrary to the common interest. State aid measures can sometimes be effective tools for achieving objectives of common interest. They can correct market failures, thereby improving the functioning of markets and enhancing European competitiveness. They can also help promote e.g. social and regional cohesion, sustainable development and cultural diversity, irrespective of the correction of market failures.¹⁸⁴⁰

The CAP explicitly acknowledges that the rationales for providing State aid can be either based on efficiency or equity.¹⁸⁴¹ In the subsequent subsections, these rationales are examined individually, starting with efficiency rationales and then moving on to equity.

¹⁸³⁷ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3' (n 454), para 10.

¹⁸³⁸ *ibid.*, para 18.

¹⁸³⁹ See also Commission Decision (2013/126/EU) 'Ciudad de la Luz' (n 1839), para 103 where the Commission considers that 'a market failure 'exist if the market outcome does not lead to highest total social welfare'.

¹⁸⁴⁰ 2005 SAAP (n 20), para 10.

¹⁸⁴¹ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3' (n 454), paras 18-31.

The precise relationship between an ‘objective of common interests’ and the theory of market failure is unclear.¹⁸⁴² According to the Commission, all objectives of common interest can be understood as contributing to efficiency and/or equity.¹⁸⁴³ In this sense, market failure appears to be used both as a normative¹⁸⁴⁴ (the rationale of intervention) and an analytical tool (assessing the incapacity of the market to deliver the most optimal outcome).¹⁸⁴⁵

What is clear is that the use of efficiency as a ‘growth-enhancing objective’¹⁸⁴⁶ is directly linked to the concept of market failure. In its assessment of efficiency rationales, the CAP focuses on market failure:

In the absence of evidence to the contrary in a specific case, the Commission considers that markets deliver an efficient allocation of resources in the economy. However, there may be circumstances in which Member States can demonstrate that markets fail to deliver an efficient outcome for instance in terms of socially profitable investment not being undertaken, in terms of some activities being excessively provided or not provided at lowest cost.¹⁸⁴⁷

In this regard, the Commission reasserts the default mode and status quo of EU competition law. It is only when market forces alone cannot reach an efficient outcome without state aid that a market failure can be considered to exist.¹⁸⁴⁸ As seen previously,¹⁸⁴⁹ the default mode can, however, easily be set aside as market failure is ubiquitous. The Commission is aware of this problem. Any market

¹⁸⁴² This issue will be analysed in the subsequent section.

¹⁸⁴³ *ibid.*, para 12.

¹⁸⁴⁴ i.e., the mere act of improving efficiency or equity.

¹⁸⁴⁵ See Chapter 3 section 3.3. This issue is further discussed and expanded upon in the following chapter.

¹⁸⁴⁶ Nicole Robins, ‘The Implications of State Aid Modernisation’ 201(3) 12 Competition Law Journal 251, 252.

¹⁸⁴⁷ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 19.

¹⁸⁴⁸ *ibid.*

¹⁸⁴⁹ See Chapter 3, section 3.2.1.

failure remedied via State aid must therefore be significant.¹⁸⁵⁰ Moreover, claims of market failures must be substantiated by economic evidence beyond the objectives of lowering prices or increasing production.¹⁸⁵¹ Whilst the Commission recognises that market failure can take various shapes and forms, it asserts that most commonly these will be present in the shape of externalities, information asymmetries or coordination problems,¹⁸⁵² and sometimes public goods.¹⁸⁵³ Externalities, public goods and imperfect information have been covered previously in this thesis.¹⁸⁵⁴ Coordination problems, however, are not as well-known as the other sources of market failures. These market failures occur when:

[T]he costs of contracting, uncertainty about the collaborative outcome and network effects prevent the effective design or even the conclusion of contract agreements, thus leading to inefficiently low levels of coordination and output.¹⁸⁵⁵

Coordination failure appears closely interlinked to the concept of imperfect information as both these concepts suppose the absence of complete information in the sense of perfect competition.¹⁸⁵⁶ Yet, coordination problems do not create an asymmetry of information in favour of one of the parties to the agreement. Instead, the emphasis seems to be on the *common* uncertainty preventing efficient coordination in the sense of development and investment. For instance, the need for a given technology may require significant sunk costs, which prevents a contract that would lead to economic efficiency from being signed.¹⁸⁵⁷ A common area where coordination failures may occur is standardisation.¹⁸⁵⁸ As such, there

¹⁸⁵⁰ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 19.

¹⁸⁵¹ *ibid.*, para 20.

¹⁸⁵² *ibid.*, paras 21–25.

¹⁸⁵³ *ibid.*, para 22.

¹⁸⁵⁴ See Chapter 2, section 2.2.1.

¹⁸⁵⁵ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 21.

¹⁸⁵⁶ See Chapter 2, section 2.2.1.3 on incomplete information.

¹⁸⁵⁷ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 21.

¹⁸⁵⁸ Friederiszick, Röller and Verouden (n 340) 633; Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 21.

appears to be a fine line between a coordination problem and common business uncertainty. The difference lies in the creation of significant inefficiencies. However, as pointed out in scholarship, it is unclear what the role of State aid is in this context.¹⁸⁵⁹ Due to the presence of risk and uncertainty in most businesses, it is never sufficient that an economic activity/project may suffer from coordination issues or imperfect information.¹⁸⁶⁰ The Commission requires that the Member States demonstrate that these market failures affect the profitability to the point where the activity/project would not be undertaken and that this results in economic efficiency.¹⁸⁶¹

This conclusion holds for any market failure. Thus, market failure can never be presumed on the basis that a firm would not undertake a project without aid.¹⁸⁶² As put by the Commission:

Only where market forces alone, in the absence of aid, would not be able to reach an efficient outcome, can a market failure be considered to exist.¹⁸⁶³

This raises the question of how to prove a ‘significant market failure’. Whilst the quantification of positive and negative effects is part of the last step of the test, some preliminary quantification process is necessary in order to identify a significant market failure. As previously seen, the quantification of market failure has been considered by some economists as difficult, if not impossible.¹⁸⁶⁴ This fact was stressed by the CRA report which considered that ‘the results will almost always remain incomplete estimates’.¹⁸⁶⁵ To measure the precise quantity of a market failure one has to identify the difference between the social and the private returns, which depends on a variety of factors such as market structure, the patent

¹⁸⁵⁹ *ibid.*, 634.

¹⁸⁶⁰ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 23.

¹⁸⁶¹ *ibid.*, para 23. ‘This would be the case where the cost of the activity is high enough to wipe out the profit of the undertaking, but still lower than the overall benefit for society’.

¹⁸⁶² *ibid.*, para 20.

¹⁸⁶³ *ibid.*

¹⁸⁶⁴ See Chapter 3, section 3.2.1. See also, Friederiszick, Röller and Verouden (n 340) 637.

¹⁸⁶⁵ Nitsche and Heidhues (n 457) 106.

system, the importance of the innovation and the R&D production function.¹⁸⁶⁶ However, conceptually a balancing exercise requires estimates of the size of the costs and positive effects of State aid.¹⁸⁶⁷ From this perspective, it is possible to examine the *likelihood* and the *magnitude* of a market failure via not a quantitative but a qualitative assessment.¹⁸⁶⁸ However, the CRA report recommended that when possible the Member States should quantify the benefits and costs of the State aid.¹⁸⁶⁹ This approach consisting of quantifying estimates was followed by the Commission in the CAP:

There are many ways to identify market failures. They may in some cases be quantifiable. For instance, Member States may sometimes be able to provide econometric estimates of knowledge or environmental spill-overs. However, there is rarely enough information to conduct fully-fledged econometric studies in the context of particular cases. Market inefficiencies can also be identified through benchmarking or surveys which show that a given market is characterized by significant external effects or information problems [...].¹⁸⁷⁰

The Commission continued by providing some relevant criteria to identify market failures and to link them to specific objectives of common interest.¹⁸⁷¹ For example, R&D&I aid is unlikely to tackle a significant market failure and thus be accepted if there are similar ongoing projects without aid.¹⁸⁷²

7.4.2.1.2 *Equity Rationales and Distribution Failures*

In addition to efficiency considerations, equity objectives are also recognised as valid justifications for State aid under Article 107(3) TFEU.¹⁸⁷³ It has been suggested that a total welfare approach solely focusing on the neutral concept of

¹⁸⁶⁶ Friederiszick, Röller and Verouden (n 340) 637.

¹⁸⁶⁷ Nitsche and Heidhues (n 457) 106.

¹⁸⁶⁸ Friederiszick, Röller and Verouden (n 340) 637.

¹⁸⁶⁹ Nitsche and Heidhues (n 457) 106-107.

¹⁸⁷⁰ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 24.

¹⁸⁷¹ *ibid.*, para 25.

¹⁸⁷² *ibid.*, para 25.

¹⁸⁷³ Buelens and others (n 369) 29. See also Friederiszick, Röller and Verouden (n 340) 634; Nitsche and Heidhues (n 457) 6.

efficiency is not appropriate in the context of State aid.¹⁸⁷⁴ Therefore, the appropriate welfare standard differs from total efficiency.¹⁸⁷⁵ The Commission recognises that the market process itself ‘can produce or reinforce inequalities’, both social and regional ones.¹⁸⁷⁶ Whilst some objectives can contribute to both efficiency and equity enhancement, the Commission identifies a series of aid measures that are more capable to be justified for equity reasons:¹⁸⁷⁷

- i) Regional aid;
- ii) Aid for the provision of SGEI;
- iii) Social aid directed at certain categories of workers experiencing difficulties;
- iv) Aid for rescue and restructuring;
- v) Aid for cultural products or services.¹⁸⁷⁸

Regarding the burden of proof, the CAP is quite succinct with regard to equity objectives. Equity rationales may be substantiated by statistical data exhibiting social or regional disparities.¹⁸⁷⁹ The CRA report suggests that just as for market failures, Member States should be obligated to clearly define the equity failure and provide an explanation as to why and how the aid measure is the most effective means to achieve the equity objective.¹⁸⁸⁰

A fundamental problem when identifying equity rationales is that they are not based on a neutral economic concept verifiable by estimates. Rather than being based on an economic optimum, equity rationales depend on the citizens’ preferences.¹⁸⁸¹ As a result, it seems that identifying equity rationales must always involve significant discretion for the Member States. Even if the Commission recognises that equity objectives may differ from Member State to Member State,

¹⁸⁷⁴ Friederiszick, Röller and Verouden (n 340) 635.

¹⁸⁷⁵ Buelens and others (n 369) 9. A broader welfare criterion was also argued by the CRA report, Nitsche and Heidhues (n 457) 50.

¹⁸⁷⁶ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3’ (n 454), para 26.

¹⁸⁷⁷ *ibid.*, para 28.

¹⁸⁷⁸ *ibid.*

¹⁸⁷⁹ *ibid.*, para 29.

¹⁸⁸⁰ Nitsche and Heidhues (n 457) 3.

¹⁸⁸¹ Friederiszick, Röller and Verouden (n 340) 634.

it considers that it is often possible to identify ‘a broad common interest in the pursuit of such objectives’.¹⁸⁸² Nevertheless, the precise meaning of these broad common interests is unclear. Like efficiency rationales, equity rationales must further an objective of common interest. However, the Member States pursue individual and different distributional policies.¹⁸⁸³

Finally, the separation between efficiency and equity appears to require a trade-off mechanism when these two objectives are not aligned. Although several objectives of common interest address both efficiency and equity,¹⁸⁸⁴ there might be conflict.¹⁸⁸⁵ This is dealt with by the ultimate step in the analysis, explored below.

7.4.2.2 A Well-Designed Aid Measure

The second stage of the test involves assessing whether the aid measure addresses the problem it is intended to solve and corresponds to the issue of double market failure/government failure.¹⁸⁸⁶ This second test is an application of ‘formal proportionality’¹⁸⁸⁷ and is divided into three requirements: (i) appropriateness of the aid instrument; (ii) an incentive effect; and (iii) proportionality.

7.4.2.2.1 *The Appropriateness of the Aid Instrument*

The appropriateness requirement would appear to enable the Commission to verify the efficiency of the means of intervention (i.e., lack of government failure/double market failure). This aspect evaluates ‘whether the aid is properly designed to reach the well-defined objective of common interest’.¹⁸⁸⁸ The appropriateness limb

¹⁸⁸² Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 29.

¹⁸⁸³ An example of the diversity of national policies can be seen in the context of public health policies, which remain predominantly national, see Jeremy Richardson, ‘The Onward March of Europeanization: Tectonic Movement and Seismic Events’ in Jeremy Richardson (ed.), *Constructing a Policy-Making State? Policy Dynamics in the EU* (Oxford Academic 2013) 334, 337.

¹⁸⁸⁴ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 27.

¹⁸⁸⁵ Friederiszick, Röller and Verouden (n 340) 635.

¹⁸⁸⁶ *ibid.*, 650.

¹⁸⁸⁷ See, Chapter 3, sections 3.3.2 and 3.3.4.

¹⁸⁸⁸ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 13.

determines whether aid is an appropriate instrument or if other policy instruments should be preferred. State aid law is thus intrusive in the national discretion to design policy measures. Although the Commission emphasises that ‘State aid control does not super-impose a single way to intervene in the economy’,¹⁸⁸⁹ economic theory tends to favour certain means over others.¹⁸⁹⁰ In addition to the choice between State aid and other regulatory measures, different aid measures can be used to achieve different purposes (grants, loans etc.)¹⁸⁹¹

The appropriateness test appears to provide the Commission with significant discretion in approving different aid instruments. It, however, still demands a formal assessment of the aid measure. According to the Commission, this condition requires that Member States consider other policy tools amongst State aid and adopt an informed decision based on experiences, benchmarking or cost-benefit analysis.¹⁸⁹²

7.4.2.2.2 *The Incentive Effect*

One of the primary objectives of State aid modernisation has been to apply the ‘incentive effect’ test more rigorously to identify ‘good aid’.¹⁸⁹³ In accordance with the case law of the EU Courts, the Commission has the authority to declare incompatible any aid measure not inducing the aid beneficiaries to adopt conduct likely to realise one of the objectives of Article 107(3) TFEU.¹⁸⁹⁴ In this context, the consumer welfare standard plays a critical role since there can be no consumer benefit without an incentive effect.¹⁸⁹⁵

¹⁸⁸⁹ *ibid.*, para 30.

¹⁸⁹⁰ See Chapter 2, section 2.1 and the discussion on welfare theorem; Nitsche and Heidhues (n 457), 50 emphasised that State aid is typically not the optimal instrument for addressing redistributive concerns; Buelens and others (n 369), 13.

¹⁸⁹¹ Nitsche and Heidhues (n 457) 10.

¹⁸⁹² Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3, paras 30-31.

¹⁸⁹³ Hancher and Nicolaides (n 1826) 204.

¹⁸⁹⁴ Case 730/79 *Philip Morris* (n 1750), paras 16-17; Case T-126/99 *Graphischer Maschinenbau v Commission* EU:T:2002:116, para 34 ; Case T-551/10 *Fri-El Acerra v Commission* EU:T:2013:430, paras 81–93; and Case C 630/11 P to C 633/11 P *HGA and Others v Commission* (n 1783), para 104.

¹⁸⁹⁵ Friederiszick, Röller and Verouden (n 340) 650.

The requirement of an incentive effect in the CAP implies that the aid measure must induce firms to engage in an activity that contributes to the realisation of a public interest objective, which they would not carry out without the aid, or which would undertake in a limited or different manner.¹⁸⁹⁶ According to the Commission, the incentive effect is identified by a counterfactual scenario.¹⁸⁹⁷ The measurement is the level of activity with or without the aid measure.¹⁸⁹⁸

The task of demonstrating the incentive effect varies depending on whether efficiency or equity objectives are at play. For Member States to show an incentive effect regarding efficiency objectives, the CAP requires that the aid changes the behaviour of the recipient (or is likely to change that behaviour), or changes the level of its activities and thus correct the market failure and improve the market outcome.¹⁸⁹⁹ The absence of action without the aid is typically proven by internal documents of the aid beneficiary,¹⁹⁰⁰ as well as external data in the form of industrial benchmarks.¹⁹⁰¹ When pursuing equity objectives, the incentive effects are demonstrated by showing how the activity which is the target of the aid entails additional costs,¹⁹⁰² in terms of a ‘social or regional disadvantage’, which are compensated for by the aid.¹⁹⁰³

7.4.2.2.3 *Proportionality*

As stated above, the Commission does not have the power to exempt State aid which infringes general principles of EU law,¹⁹⁰⁴ including the principle of

¹⁸⁹⁶ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3, para 32.

¹⁸⁹⁷ *ibid.*, para 32.

¹⁸⁹⁸ Verouden and Werner (n 1708) 7, 38.

¹⁸⁹⁹ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 34.

¹⁹⁰⁰ *ibid.*, para 35. These include budgetary forecast, profitability calculations, business plans, risk assessments etc.

¹⁹⁰¹ *ibid.*, para 36.

¹⁹⁰² *ibid.*, para 37.

¹⁹⁰³ *ibid.*, para 38.

¹⁹⁰⁴ Case C-67/09 P *Nuova Agricast* (n 590), para 65.

proportionality.¹⁹⁰⁵ The previous steps in the analysis, namely the appropriateness and incentive effect, can be seen as part of a broader proportionality analysis. In this context, this third limb of the test takes the shape of a necessity requirement.

The general principle is that for the aid to be proportionate, there can be no overcompensation.¹⁹⁰⁶ Both the amount and the intensity of the aid must be strictly limited to the minimum necessary for the aided activity to be performed in order to avoid any windfall profit distorting competition.¹⁹⁰⁷ The strict limitation appears to enforce a LRM standard within the necessity assessment. Whilst it appears that evidence of an incentive effect might be used to demonstrate proportionality,¹⁹⁰⁸ these two tests are distinct from each other:

[...] whereas the incentive effect is essentially a question of whether or not behaviour is changed, the analysis of the proportionality of the aid requires a different degree of appreciation as it regards the extent to which the aid exceeds what is necessary to produce the change of behaviour.¹⁹⁰⁹

Numerous Guidelines of the Commission identify maximum intensities¹⁹¹⁰ and thus provide a presumption of proportionality for any aid falling within those amounts.¹⁹¹¹ It is only in the case where there are no such maximum intensities, or if the aid exceeds those numbers, that a detailed proportionality assessment must be made. In such instances, Member States are required to submit evidence allowing the Commission to evaluate the amount of aid necessary, including ‘extra operating benefits for the aid recipient’.¹⁹¹²

¹⁹⁰⁵ e.g., Case 730/79 *Philip Morris* (n 1750), para 17; Case T-187/99 *Agrana Zucker und Stärke v Commission* EU:T:2001:140, para 74.

¹⁹⁰⁶ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 42.

¹⁹⁰⁷ *ibid.*, para 39.

¹⁹⁰⁸ *ibid.*, para 40.

¹⁹⁰⁹ *ibid.*, para 40.

¹⁹¹⁰ Just as in the GBER (n 1739). Maximum aid intensities typically take the shape of a percentage of eligible costs.

¹⁹¹¹ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 43.

¹⁹¹² *ibid.*, para 42. These extra benefits are defined as ‘lower costs due to the use of a new production technology or additional revenues’.

7.4.2.3 *Stricto Sensu Balancing*

The overall balancing in part three of the test is essential to guarantee that aid measures, whilst targeting pre-identified market failures, do not create other types of market failures,¹⁹¹³ or at the very least, have a net positive effect. By focusing on distortions of competition, the methodology essentially balances the correction of external market failure with the competition law's status quo.¹⁹¹⁴ The underlying presumption that unfettered competition is the most optimal means of organising markets necessitates that any negative impact on competition and trade be offset by a net positive effect with respect to efficiency/equity.

To undertake the *stricto sensu* balancing, the Commission initially assesses the negative impact of the measure on competition and trade.¹⁹¹⁵ Subsequently, in a second stage, the Commission evaluates the positive effects of the measure to ensure that the balance is overall positive.

7.4.2.3.1 *The Theory of Harm in the CAP*

The first step in the analysis involves the assessment of the distortion of competition in a quantitative manner. Thus, the theory of harm in the CAP must be analysed. In contrast to the analysis under Article 101(3) TFEU, the Commission quantifies the harm to competition under Article 107(3). To this end, the Commission distinguishes three types of distortion of competition.¹⁹¹⁶ First, State aid may distort the incentive to invest and compete. By affecting the investment incentives of firms, State aid may undermine dynamic efficiency.¹⁹¹⁷ The negative impact on the incentive to invest and innovate is equally applicable to both the beneficiary of the aid and its competitors.¹⁹¹⁸ For instance, State aid could decrease incentives to gain a patent, although an assessment must be made on a case-by-case basis.¹⁹¹⁹ Second, State aid may distort competition in the

¹⁹¹³ Friederiszick, Röller and Verouden (n 340) 652.

¹⁹¹⁴ On competition law's status quo see Chapter 3, section 3.1.2.

¹⁹¹⁵ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), paras 44-56.

¹⁹¹⁶ *ibid.*, para 44. Although other types of distortions are also foreseeable, see e.g., Friederiszick, Röller and Verouden (n 340) and Nitsche and Heidhues (n 457).

¹⁹¹⁷ Friederiszick, Röller and Verouden (n 340) 653.

¹⁹¹⁸ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 46.

¹⁹¹⁹ Nitsche and Heidhues (n 457) 88.

product market, resulting in the so-called ‘crowding out’ of competitors who may react to the aid by reducing their sales and investment plans.¹⁹²⁰ Such distortions of competition may prove particularly severe in instances where the aid facilitates quality improvement and the recipient holds significant market power.¹⁹²¹ Third, State aid may distort competition in input markets, especially with respect to the location of investment. This scenario arises when the aid favours the use of a particular input, for example, a type of labour or an environmentally friendly intermediate product.¹⁹²² However, the most crucial distortion within input markets pertains to the choice of a specific location,¹⁹²³ whereby aid earmarked for investment in a specific region can produce negative spillover effects in regions where investment is withdrawn as a result of the aid measure.¹⁹²⁴ Such distortions may impair competition when the losing region possesses a comparative advantage concerning that specific production.¹⁹²⁵

In the assessment of the distortion of competition, the Commission pays particular attention to the effects on competitors and input suppliers,¹⁹²⁶ whilst also considering its impact on consumers, albeit in a secondary capacity.¹⁹²⁷ In terms of the market analysis, the Commission focuses on those markets where the effects of the aid measure are ‘most obvious/prominent’.¹⁹²⁸

Having defined and quantified the distortion of competition, the Commission proceeds to undertake the crucial balancing exercise.

7.4.2.3.2 *The Balancing of the Distortion with Positive Effects*

The ultimate step of the analysis involves a *stricto sensu* balancing act to determine whether the concerned Member State has sufficiently demonstrated that the

¹⁹²⁰ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 47.

¹⁹²¹ Nitsche and Heidhues (n 457) 86.

¹⁹²² Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 48.

¹⁹²³ *ibid.*, para 49.

¹⁹²⁴ *ibid.*

¹⁹²⁵ *ibid.*

¹⁹²⁶ *ibid.*, para 51.

¹⁹²⁷ *ibid.*, para 51.

¹⁹²⁸ *ibid.*, para 55. On market definition in State aid cases see Nitsche and Heidhues (n 457) 119 ff.

negative effects of the aid measure are outweighed by its positive effects. Whilst the balancing exercise is conducted on a case-by-case basis, the Commission has outlined some general principles,¹⁹²⁹ including the following.

First, the benefits arising from the aid measure must be directly linked to the change of behaviour of the aid beneficiary, which should enable the attainment of a common interest goal.¹⁹³⁰ It would appear that the term ‘common interest goal’ here refers to an objective of common interest under Article 107(3) TFEU.

Second, a distinction must be made between equity and efficiency objectives. The positive effects of efficiency objectives are described as ‘an increase or decrease in activity in an output market which is regarded as beneficial to the common interest’.¹⁹³¹ Examples include the reduction of emissions produced by environmental aid or the creation of new products by R&D aid.¹⁹³² Consumer benefits, on one hand, include lower prices, increased choice of products, better quality or innovation.¹⁹³³ Equity objectives on the other hand entail benefits understood as ‘equity-enhancing output’ or a ‘change in the way output is delivered’.¹⁹³⁴ Examples include the increase in employment for handicapped workers or higher salaries for workers in a specific region.¹⁹³⁵ In essence, the Commission requires a positive external impact, meaning that the aid can only be approved if it produces positive effects beyond the transfer of funds from the Member State to the aid beneficiary.¹⁹³⁶

Third, the Commission identifies a common interest at the EU level by balancing policy considerations.¹⁹³⁷ Whilst some public policy objectives may be more or less tangible, others may not be commensurable with negative impacts on competition and trade.¹⁹³⁸ As a consequence, the Commission has a broad margin

¹⁹²⁹ *ibid.*, para 57.

¹⁹³⁰ *ibid.*, para 59.

¹⁹³¹ *ibid.*, 50.

¹⁹³² *ibid.*

¹⁹³³ *ibid.*

¹⁹³⁴ *ibid.*

¹⁹³⁵ *ibid.*

¹⁹³⁶ *ibid.*, para 60.

¹⁹³⁷ *ibid.*, para 62.

¹⁹³⁸ *ibid.*

of discretion for establishing relative weightings.¹⁹³⁹ It has intimated that a social welfare standard for effects that are not commensurable with restrictions of competition may facilitate a more coherent evaluation.¹⁹⁴⁰ This involves, whenever possible, developing a unit of measurement for certain economic effects, positive and negative, of the aid and thus elevating the overall quality of the assessment.¹⁹⁴¹

The balancing test is challenging due to the inherent difficulties in quantifying positive and negative effects. The Commission recognises that, in many cases, the quantification of the effects of an aid measure will not be very precise.¹⁹⁴² To tackle this problem the Commission identifies ‘orders of magnitude of the effects involved’.¹⁹⁴³ When it is possible to quantify these effects, units such as money terms, number of jobs created, and turnover created, are relevant.¹⁹⁴⁴ Positive and negative effects on competitors are measured via sales numbers, profits or jobs.¹⁹⁴⁵ Quantification of effects for citizens, however, might be more problematic and here the Commission relies on ‘orders of magnitude’ to measure product choice, quality, or innovation.¹⁹⁴⁶ Another challenge is attaching a value to non-price factors of goods or services, which the Commission addresses through consumer surveys, expert opinions, marketing research,¹⁹⁴⁷ or EU or national policy documents,¹⁹⁴⁸ along with ‘its own judgment’.¹⁹⁴⁹ The quantification of equity involves a particularly large margin of appreciation for the Commission.¹⁹⁵⁰

¹⁹³⁹ *ibid.*

¹⁹⁴⁰ *ibid.*

¹⁹⁴¹ *ibid.*

¹⁹⁴² *ibid.*, para 63. In para 64 the Commission also states that it is usually simpler to quantify short-term quantity and price effects compared to long-term effects on incentives to invest or innovate. Consequently, a short-term improvement in total welfare does not automatically result in the approval of the measure.

¹⁹⁴³ *ibid.*

¹⁹⁴⁴ *ibid.*, para 65.

¹⁹⁴⁵ *ibid.*, para 66.

¹⁹⁴⁶ *ibid.*

¹⁹⁴⁷ *ibid.*, para 67.

¹⁹⁴⁸ *ibid.*

¹⁹⁴⁹ *ibid.*

¹⁹⁵⁰ *ibid.*, para 68.

Fourth and finally, the Commission provides non-binding indicators for situations where positive and negative effects are difficult to quantify or compare.¹⁹⁵¹ For example, certain aid measures are more likely to be prohibited, such as distortive aid that primarily benefits the aid beneficiary¹⁹⁵² or operating aid.¹⁹⁵³ Large aid measures with little benefit in relation to their costs are also likely to be prohibited.¹⁹⁵⁴ Additionally, aid that produces distortions over several Member States is unlikely to be accepted if its benefits are mainly located in one single Member State.¹⁹⁵⁵

On the contrary, a positive stance is more likely taken for certain measures. These include measures that are likely to produce positive effects whilst being less distortive.¹⁹⁵⁶ Significant positive effects across several Member States are an indicator that aid may be accepted.¹⁹⁵⁷ Aid supporting disadvantaged regions or socially vulnerable groups is likely to be accepted if it is limited to the net extra cost to compensate for disadvantages.¹⁹⁵⁸ Aid producing positive spill-over effects on other markets is also likely to be viewed positively.¹⁹⁵⁹

In practice, the balancing undertaken by the Commission appears to be constrained by the challenges inherent in quantifying market failures and efficiency enhancements. As a result, the Commission often resorts to a qualitative assessment. In particular, factors based on experience and orders of magnitude are useful when determining the net value of positive and negative effects respectively.

¹⁹⁵¹ *ibid.*, para 70.

¹⁹⁵² *ibid.*, para 71.

¹⁹⁵³ *ibid.*

¹⁹⁵⁴ *ibid.*

¹⁹⁵⁵ *ibid.*

¹⁹⁵⁶ *ibid.*, para 72.

¹⁹⁵⁷ *ibid.*

¹⁹⁵⁸ *ibid.*

¹⁹⁵⁹ *ibid.*

7.4.3 Balancing Objectivity with Flexibility

This section has analysed the common test defined in the CAP. Several observations can be made.

First, the broad and general nature of the common principles seems deliberate, recognising the difficulty of establishing a one-size-fits-all approach for the variety of State aid regimes. As previously mentioned, as these common principles have been gradually incorporated into revised versions of various State aid soft law Guidelines,¹⁹⁶⁰ Chapter 9 undertakes a detailed analysis of some of these sectorial regimes.

Second, the Commission appears to be balancing between a more economic approach, entailing certainty and neutrality, whilst maintaining a broad margin of discretion. The relationship between ‘objectives of common interest’ and ‘market failure’ is a prime example of this. The choice of the term ‘objective of common interest’ instead of ‘market failure’ is both logical and confusing. From a logical standpoint, the broad term provides the Commission with an extensive margin of discretion to accommodate diverse public policy objectives. The deliberate use of broad terminology enables the Commission to exercise its discretionary powers in assessing the compatibility of State aid. It is confusing since the added value of the term is uncertain given that the Commission suggests that objectives of common interest are equated to narrow market failures or equity failures.¹⁹⁶¹ In this respect, it is argued that ‘market failure’ is an equally broad term as ‘objective of common interest’. This confusion is further compounded by the CRA report’s singular focus on market failure, broadly formulated to include equity concerns next to efficiency.¹⁹⁶² As a result, it is unclear whether a market failure in itself is

¹⁹⁶⁰ For the set of Guidelines adopted subsequently to the CAP see, e.g., CEEAG 2014-2020 (n 1670), para 27; Communication from the Commission, ‘Guidelines on State aid to promote risk finance investments’ (2014/C 19/04), para 54; Communication from the Commission, ‘Guidelines on State aid to airports and airlines’ (2014/C 99/03), para 79; Communication from the Commission, ‘Framework for state aid research and development and innovation’ (n 433), para 36; Communication from the Commission, ‘Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty’ (2014/C 249/01), para 38; Communication from the Commission, ‘Guidelines for the examination of State aid to the fishery and aquaculture sector’ (2015/C 217/01), para 24.

¹⁹⁶¹ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 18.

¹⁹⁶² Nitsche and Heidhues (n 457) 106.

sufficient, or if it must be ‘linked’ to a specific goal of common interest.¹⁹⁶³ In essence, the issue at hand is whether an increase in efficiency in a given market is sufficient to satisfy the requirement that the aid aims to achieve an objective of common interest, whilst also demonstrating that the market is failing to produce it without the aid. This raises the question of whether market failure is merely a normative concept or whether it can be used as an analytical tool to assess the presence of market failure. It has been suggested that ‘it is assumed that objectives of common interest are normally related to remedying market failures’.¹⁹⁶⁴ On the contrary, other scholars,¹⁹⁶⁵ and the CAP, appear to stress that both elements are requirements for exemption under Article 107(3).¹⁹⁶⁶ However, the SAAP seems to suggest that the correction of a market failure is enough on its own merit to qualify as an objective of common interests.¹⁹⁶⁷ Moreover, the case law of the Court simply requires that the aid must be necessary in order to attain the objectives of Article 107(3),¹⁹⁶⁸ making it challenging to identify the precise parameters of efficiency or equity in individual cases.

Consequently, it is uncertain what value, if any,¹⁹⁶⁹ the novelty term ‘market failure’ offers to the analysis. The lack of consensus and clarity regarding the precise meaning of these key concepts leads to a lack of legal certainty in the field undermining the effectiveness of the State aid regime and creating a challenging environment for business, public authorities, and other stakeholders. This thesis aims to untangle this uncertainty through a comprehensive analysis of relevant case law and Commission decisions.

Third, the CAP emphasises closer scrutiny of the design of aid measures. This requirement reflects that the Commission is aware of the risk of double

¹⁹⁶³ As suggested in the Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 25.

¹⁹⁶⁴ Buelens and others (n 369) 3.

¹⁹⁶⁵ e.g., Patrick Thieffry, ‘State Aid Modernisation in Action: Regional Airports and Renewable Energies’ (2014) ERA Forum 15, 283, 287.

¹⁹⁶⁶ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 25.

¹⁹⁶⁷ 2005 SAAP (n 20), para 10.

¹⁹⁶⁸ e.g., Case C-526/14 *Kotnik* (n 519), para 49.

¹⁹⁶⁹ It remains uncertain whether the inclusion of the term ‘market failure’ has any practical implications, given that the notion of objective of common interest is broadly formulated to encompass both efficiency and equity rationales.

market failure resulting from poorly designed aid measures. Especially, by focusing on the incentive effect of the aid, the Commission can conduct a more detailed examination of the efficiency of State aid.

Fourth and finally the introduction of a refined-economic approach and a balancing exercise in the CAP leaves several important issues unresolved. One such issue pertains to the inherent difficulties in quantifying both the negative and positive effects of aid measures, which poses a challenge to the *mise-en-oeuvre* of the refined economic approach. Although qualitative parameters may help to counterbalance these difficulties, there remains significant uncertainty as to the practical implication of the balancing test. Whilst the flexible approach of the Commission may provide valuable insight into the overall impact of a particular aid measure, it is questionable in terms of consistency and predictability, thereby possibly undermining the objectives of State aid modernisation. Moreover, the Commission's reliance on qualitative assessments underscores the need for greater clarity and transparency in the decision-making process, particularly in cases where the net impact of an aid measure is difficult to quantify. Ultimately, the balancing exercise represents a crucial component of the State aid framework, one that seeks to balance the correction of market failures with the goals of preservation of unfettered competition in the EU. It is, therefore, imperative to conduct a comprehensive analysis to clarify and systematise the balancing exercise.

7.5 Conclusions

This chapter has established and described the foundational legal framework requisite for conducting a market failure analysis within the context of the State aid regime. In the course of this exploration, three key issues have been examined.

First and foremost, it has been underscored that the theoretical underpinnings of State aid law partially diverge from those of antitrust law, despite sharing largely parallel objectives. Whereas the origins of antitrust may be traced back to the United States, notably through the enactment of the Sherman Act¹⁹⁷⁰ – a jurisdiction that still lacks a State aid regime to this day – State aid law emerges as a distinctly European construct. This divergence suggests that State aid law

¹⁹⁷⁰ The Sherman Antitrust Act of 1890 (26 Stat. 209, 15 U.S.C. §§ 1–7).

represents a departure from the global influences that shape antitrust law. Two primary characteristics set State aid law apart: its evolutionary nature and its inherent political complexion.

Second, this chapter has explored the applicable legal framework governing State aid. It has been shown that Article 107(2) lacks a proportionality assessment, thereby rendering it incapable of embodying a market failure test. Conversely, Article 107(3) is expansive, granting the Commission a significant margin of discretion in evaluating the compatibility of aid measures. However, this discretion is not without its internal and external constraints. Nevertheless, even in the presence of these limitations, they only marginally circumscribe the wide-ranging discretion wielded by the Commission.

Third, this chapter has demonstrated that, akin to antitrust law, the State aid regime has undergone a modernisation process. However, it is posited that whilst the modernisation of State aid law shares considerable similarities with antitrust law, the shift towards a refined economic approach in State aid law has been met with more contention, particularly in light of the inherent political character and sensitivities of the regime. The key consequence of State aid modernisation has been precisely the adoption of a so-called ‘refined economic approach’, marked by the promulgation of a set of common principles of assessment. Through these principles, the Commission has embraced a broad balancing test grounded in market failure theory, extending significantly beyond the traditional boundaries of antitrust analysis. Nevertheless, these principles are deliberately broad and general, reflecting a balancing act by the Commission between the pursuit of a more predictable economic approach and the preservation of its wide margin of discretion. Specifically, the precise role of market failure as grounds for justification pursuant to Article 107(3) remains shrouded in ambiguity. Furthermore, these guiding principles leave numerous questions unanswered, matters to be more thoroughly explored in subsequent chapters. Among the unresolved issues lies the challenge of quantifying positive and negative effects for the purpose of balancing – a task that seems inherently complex to implement in practice. This thesis now transitions to the subsequent chapter, where the practical application of the Commission’s market failure test within the CAP is analysed.

8. MARKET FAILURE IN STATE AID LAW: THE DIRECT ASSESSMENT

This chapter explores the common approach used in practice to determine whether a market failure test is included in the assessment of the compatibility of aid. It is argued that the Commission employs a State aid-specific market failure test in the exercise of its discretion, which includes elements of a general market failure analysis but also has certain limitations. Conversely, the Court interprets Article 107(3) TFEU as implicitly encompassing a broad market failure concept with only a few qualifying legal criteria.

By direct assessment this research refers to aid measures that are not subject to sectorial soft law regimes and are therefore assessed directly under the catch-all provision of Article 107(3), making them subject to the ‘full-balancing test’ described above.¹⁹⁷¹

In the first section in this chapter, a detailed analysis is conducted to examine a series of Commission decisions where the existence of market failure analysis was a crucial factor. These specific decisions are of significant interest as they have been subject to appeals before the EU Courts. The analysis encompasses both the Commission decisions and the subsequent Court cases to provide a comprehensive understanding of how the market failure test has been applied in practice.

In the second section, the market failure framework developed in Chapter 3 is applied to these cases to determine how it has been incorporated into State aid law. It is demonstrated that State aid law consists essentially of two separate market failure tests. The first, which is discretionary, is employed by the Commission. This test applies to different degrees depending on the nature of the

¹⁹⁷¹ Hancher and Nicolaidis (n 1826) 197.

case. The second test, which is judicial, is vaguer and broader in nature and consists of the minimum requirements mandated by the case law.

8.1 Article 107(3)(c): Market Failure in Practice

This section shows that the approaches of the Commission and the EU Courts to the refined economic approach and market failure analysis have undergone significant evolution over time. Three distinct periods of evolution are identified and examined in detail.

8.1.1 A ‘True Market Failure’ as a Mandatory Requirement

This subsection demonstrates that, in the antecedent practice, following the modernisation process the Commission relied on the existence of a market failure as a core condition to declare aid as being compatible with the internal market. This methodology was largely confirmed by the General Court, which referred to the Commission’s large margin of discretion in making complex economic and social assessments.

In its Decision on *the introduction of digital television (DVB-T) in Berlin Brandenburg*,¹⁹⁷² the Commission applied a market failure test under Article 107(3)(c) TFEU in order to declare a German aid scheme incompatible. The Media Authority for Berlin and Brandenburg (a local government authority) launched an aid scheme aiming to promote the digitisation of broadcasting transmission, through which firms received financial assistance for the switchover from analogue to digital terrestrial television.¹⁹⁷³ Having found that the financial assistance constituted State aid in the meaning of Article 107(1),¹⁹⁷⁴ the Commission turned towards the compatibility assessment.

The German government contended that the aid scheme was justified as it was designed ‘to ensure pluralistic media diversity in an increasingly converging field, to safeguard infrastructure competition for digital modes of transmission, to

¹⁹⁷² Commission Decision (2006/513/EC) of 9 November 2005 on the State Aid which the Federal Republic of Germany has implemented for the introduction of digital terrestrial television (DVB-T) in Berlin-Brandenburg (notified under document number C(2005) 3903).

¹⁹⁷³ *ibid.*, paras 7-18.

¹⁹⁷⁴ *ibid.*, 49-84.

use frequencies efficiently and to develop new services and uses'.¹⁹⁷⁵ Furthermore, the existence of cohesion failures, or distribution failures, was investigated.¹⁹⁷⁶

The Commission initiated the compatibility assessment by acknowledging that the digital switchover 'has great advantages in terms of more efficient spectrum usage and increased transmission possibilities'.¹⁹⁷⁷ In this context, the Commission found that it leads to 'new and better quality services and to wider consumer choice'.¹⁹⁷⁸ It appears that the economic efficiencies created by the switch from analogue to digital transmission are beyond dispute. The Commission observed that the digital switchover could be delayed if the process was left to market forces without any state intervention,¹⁹⁷⁹ since it 'may be hindered by certain market failures'.¹⁹⁸⁰

It is important to provide a clear explanation of the CAP sequences as applied by the Commission. Whilst the possible creation of efficiencies is a legitimate objective of common interest, it is not sufficient in itself to establish that the market is plagued by a market failure. In order for the aid to be compatible, a market failure must be established providing evidence that the desired result cannot be achieved without the aid measure. Accordingly, rather than seeing market failure as the rationale for the aid, it is inserted into the analysis in the stage of the proportionality test.¹⁹⁸¹ In its decision, the Commission identifies five possible market failures: coordination problems; positive externalities; market power; lack of investment in infrastructure; and uncertainty.¹⁹⁸²

Furthermore, the Commission's approach suggests an implicit adoption of a threshold that screens out minor market distortions from the analysis. According to the Commission, the initial step of the formal assessment of the measure is to

¹⁹⁷⁵ *ibid.*, para 20.

¹⁹⁷⁶ *ibid.*, para 88.

¹⁹⁷⁷ *ibid.*, para 85.

¹⁹⁷⁸ *ibid.*

¹⁹⁷⁹ *ibid.*, para 87.

¹⁹⁸⁰ *ibid.*, para 88.

¹⁹⁸¹ *ibid.*, para 94.

¹⁹⁸² *ibid.*, paras 95-99.

determine whether these are ‘true market failures’.¹⁹⁸³ In the decision, the Commission identified at least two instances of ‘true market failures’.

First, the coordination problem is a market failure for the purpose of applying Article 107(3)(c).¹⁹⁸⁴ In particular, consumers might not switch to the digital platform before it comprises a large number of broadcasters,¹⁹⁸⁵ posing potential obstacles for the sector to coordinate on a timeframe.¹⁹⁸⁶ Broadcasters may opt to delay their own transitions until other broadcasters have already made the switch.¹⁹⁸⁷ However, the Commission rejected the notion that State aid represents an appropriate means to facilitate a simultaneous switchover and thus combat the coordination failures.¹⁹⁸⁸ Given that the broadcasters merely operate via licences and do not own the frequency spectrum, the use of State aid to reduce transmission costs cannot be accepted.¹⁹⁸⁹

Second, the switchover to digital broadcasting yields positive externalities¹⁹⁹⁰ as explained above. However, the Commission maintained that State aid is not necessary to achieve these benefits,¹⁹⁹¹ in particular as no reasoning or calculation was provided to demonstrate that the proposed aid amount constitutes the minimum necessary.¹⁹⁹²

The Commission’s decision leaves room for ambiguity as to whether market failure is a *rationale* (normative aspect) or a *test* (analytical aspect). To a certain extent, it appears to be both. The creation of efficiencies can justify the aid measure, yet a ‘true’ market failure must exist for the aid measure to be proportionate, thereby excluding minor market distortions that can be mitigated without the aid. The initial justification for the measure was based on the *prima*

¹⁹⁸³ *ibid.*, para 100 (emphasis added).

¹⁹⁸⁴ *ibid.*, para 102.

¹⁹⁸⁵ *ibid.*, para 101.

¹⁹⁸⁶ *ibid.*

¹⁹⁸⁷ *ibid.*

¹⁹⁸⁸ *ibid.*, para 102.

¹⁹⁸⁹ *ibid.*

¹⁹⁹⁰ *ibid.*, para 10.

¹⁹⁹¹ *ibid.*, para 107.

¹⁹⁹² *ibid.*, para 105.

facie identification of a market failure,¹⁹⁹³ which must subsequently be thoroughly examined to assess the presence of a ‘true market failure’ in order to meet the criteria of proportionality.

Germany appealed the case to the General Court, which subsequently upheld the Commission’s decision¹⁹⁹⁴ a ruling that was ultimately confirmed by the ECJ.¹⁹⁹⁵ During the appeal to the General Court, Germany argued that the Commission had abused its powers when assessing the compatibility of the aid and had violated general principles of law.¹⁹⁹⁶ Germany specifically contested the application of market failure as a criterion. It claimed that the concept of market failure appears for the first time in the SAAP, and that the Commission appeared to lack a clear understanding of how to apply it in State aid control.¹⁹⁹⁷

The General Court initially noted that, according to a long-standing case law, within the assessment under Article 107(3) the Commission has a large margin of discretion for complex social and economic assessments.¹⁹⁹⁸ Therefore, the jurisdictional review is limited to a manifest error and any misuse of power.¹⁹⁹⁹ Whilst soft law instruments are not binding *erga omnes* for Member States, they do bind the Commission, provided that they do not violate the norms of the Treaties.²⁰⁰⁰ The Communication on the transition from analogue to digital broadcasting from 2003,²⁰⁰¹ in addition to the SAAP, highlights two situations where public intervention is warranted: the existence of a general interest or market failure.²⁰⁰² The General Court approved the Commission’s use of the market failure criterion, in accordance with the provisions of the soft law, and

¹⁹⁹³ i.e., the creation of efficiencies would suggest the presence of a market failure.

¹⁹⁹⁴ Case T-21/06 *Germany v Commission* EU:T:2009:387.

¹⁹⁹⁵ Case C-544/09 P *Germany v Commission* EU:C:2011:584.

¹⁹⁹⁶ Case T-21/06 *Germany v Commission* (n 1994), para 24.

¹⁹⁹⁷ *ibid.*, para 27.

¹⁹⁹⁸ *ibid.*, para 50.

¹⁹⁹⁹ *ibid.*, para 50.

²⁰⁰⁰ *ibid.*, para 51-52.

²⁰⁰¹ Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, ‘on the transition from analogue to digital broadcasting (from digital ‘switchover’ to analogue ‘switch off’)’ COM (2003) 541 final.

²⁰⁰² *ibid.*, point 1.4.

ruled that the Commission had not abused its powers in conducting its assessment.²⁰⁰³

This approach was subsequently confirmed in another case concerning digitisation. In its decision in *Mediaset*, the Commission refused to grant an exemption of State aid implemented by Italy for subsidising the purchase of digital decoders by final consumers.²⁰⁰⁴ In Italy, national legislation had established a deadline by which all broadcast programs and multimedia services were required to switch to digital transmission technologies.²⁰⁰⁵ Italy argued that State aid was necessary to combat a market failure as, despite the legal deadline, most households were still reliant on the analogue transmission network.²⁰⁰⁶

Regarding the assessment under Article 107(3)(c), Italy put forward, *inter alia*, that a legal deadline is not in itself enough for the switchover if demand is under-stimulated.²⁰⁰⁷ Consumers will not be incentivised to purchase a digital decoder in a market where most consumers will use analogical terrestrial TV.²⁰⁰⁸

The Commission started by outlining its methodology as confirmed in the CAP.²⁰⁰⁹ First, the Commission identified an objective of common interest,²⁰¹⁰ which, as seen, can be understood either in terms of efficiency or equity benefits.²⁰¹¹ The switchover from analogue to digital transmission results in efficiency increases, leading in turn to ‘new and better quality services and to wider consumer choice’.²⁰¹² The efficiency enhancement resulting from the

²⁰⁰³ Case T-21/06 *Germany v Commission* (n 1994), paras 53-52.

²⁰⁰⁴ Commission Decision (2007/374/EC) Decision of 24 January 2007 on State aid C 52/2005 (ex NN88/2005, ex CP 101/2004) implemented by the Italian Republic for the subsidised purchase of digital decoders (notified under document number C(2006) 6634).

²⁰⁰⁵ Law No 66, converting into law, with amendments, Decree-Law No 5 of 23 January 2001.

²⁰⁰⁶ Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), para 23: ‘In June 2005, the overall digital TV penetration rate was 34.5% of households’.

²⁰⁰⁷ *ibid.*, para 51.

²⁰⁰⁸ *ibid.*

²⁰⁰⁹ *ibid.*, para 133.

²⁰¹⁰ *ibid.*, paras 134-139.

²⁰¹¹ See Chapter 8, section 7.4.2.1.

²⁰¹² Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), para 134.

correction of the perceived market failure is thus enough to consider that the measure is aimed at a well-defined objective of common interest.²⁰¹³

Moving on to the proportionality analysis, which pertains to the condition that the aid measure is well-designed. Consumer subsidies aimed at addressing market failures that impede the switchover are, in principle, considered to be well-designed.²⁰¹⁴ The primary issues in the case revolved around two questions: first, whether these perceived market failures are ‘true market failures that prevent the market from achieving economic efficiency’;²⁰¹⁵ and second, whether the aid is an appropriate instrument for addressing such market failures.²⁰¹⁶ Similar to the German aid case explored above, the coordination problems were considered to be *true* market failures.²⁰¹⁷ However, contrary to the Italian government, the Commission considered that the legal deadline was sufficient to ensure coordination of the switchover, thereby rendering the consumer subsidies inappropriate.²⁰¹⁸ Moreover, whilst consumer subsidies can increase the demand for digital transmission, it does not specifically address the coordination problems between market players.²⁰¹⁹

Finally, the Commission found that the measure was not proportionate *stricto sensu* as it ‘gives rise to unnecessary distortions of competition [...] in favour of the incumbent terrestrial television broadcasters’.²⁰²⁰ The exclusion of satellite operators from the beneficiary pool effectively concentrated the aid amongst a select group of incumbents operating in an already highly concentrated market.²⁰²¹ Given that the market could be characterised as a ‘strict oligopoly’, it was concluded that the aid measure would entail distortions with a considerable impact on competition.²⁰²²

²⁰¹³ *ibid.*, para 139.

²⁰¹⁴ *ibid.*, para 140.

²⁰¹⁵ *ibid.*, para 142.

²⁰¹⁶ *ibid.*

²⁰¹⁷ *ibid.*, para 143.

²⁰¹⁸ *ibid.*, para 144.

²⁰¹⁹ *ibid.*

²⁰²⁰ *ibid.*, paras 166-171.

²⁰²¹ *ibid.*, para 167.

²⁰²² *ibid.*, para 170.

Before the General Court, Mediaset argued, *inter alia*, that the Commission failed to adequately appreciate the existence of a market failure.²⁰²³ The firm presented three main arguments. First, it contended that the mandatory legal deadline was insufficient to remedy the coordination failure.²⁰²⁴ Second, it maintained that the Commission did not adequately acknowledge the presence of externalities as a form of market failure.²⁰²⁵ Lastly, Mediaset asserted that the measure did not distort competition, but rather promoted it.²⁰²⁶

In its judgment, the General Court agreed with the Commission on the unnecessary character of the aid and shed some light on the role of market failure as a rationale for State aid compatibility:

In order to be compatible with the common market for the purposes of [Article 107(3)(c) TFEU], aid must pursue an objective in the common interest and, must be necessary and proportionate for that purpose. The common interest objective purportedly pursued by the measure at issue *is to address a market failure* [...]. [I]n the present case, the mandatory nature of the date laid down for digitization is such as to resolve the problem of coordination among operators and, accordingly, the subsidy for the purchase of digital decoders was unnecessary.²⁰²⁷

In conclusion, the General Court upheld the Commission decision, and endorsed the Commission's methodology in the SAM according to which an 'objective of interest' is required under Article 107(3)(c) and that the remedying of a market failure is an objective of common interest in its own right. With regard to the externalities, the General Court found that the Commission acknowledged that digitisation brings about positive externalities. However, due to the selectivity of the aid measure, which excluded satellite platforms, these externalities were not being produced to the possible extent.²⁰²⁸

It can be concluded that during this first period, the Commission applied market failure as an instrumental requirement for declaring State aid compatible

²⁰²³ Case T-177/07 *Mediaset v Commission* EU:T:2010:233, para 119.

²⁰²⁴ *ibid.*, para 119.

²⁰²⁵ *ibid.*, para 121.

²⁰²⁶ *ibid.*, para 122.

²⁰²⁷ *ibid.*, para 125.

²⁰²⁸ *ibid.*, para 128.

with the internal market. Whilst the EU Courts did not provide any further guidance on the meaning of market failure, they acknowledged the Commission's broad margin of discretion in this regard.

8.1.2 Market Failure as a Non-Mandatory Requirement

This subsection shows that in subsequent cases, the Commission adopted a broader approach towards justifying State aid under Article 107(3)(c) based on market failure. The EU Courts, on their side, recognised that whilst market failure might be a factor in determining the compatibility of State aid, it is not a precondition for doing so.

In its decision in *Magic Mountain*, the Commission found that a public funding scheme for the construction and operation of climbing complexes throughout Germany constituted illegal state aid in the sense of Article 107(1).²⁰²⁹ The aid was granted to the German Alpine Association ('DAV') and its local sections, who were to operate the climbing centres.²⁰³⁰ The complaint was brought by a group of companies operating competing commercial climbing halls throughout Germany.²⁰³¹ Having concluded that the measure constituted illegal State aid, the analysis turned towards their compatibility under Article 107(3)(c).

The Commission started by recalling the CAP, however without any mention of 'market failure'.²⁰³² The first step of the assessment consisted in determining the existence of an objective of common interest. According to the Commission, the purpose of the measures was to promote sport and physical integrity.²⁰³³ In this sense, it aimed at 'supporting amateur sport for masses and to improve access to it'.²⁰³⁴ In terms of the rationale of justification, the Commission referred to Article 165 TFEU which makes the promotion of sports an objective of the EU, without mentioning market failure as a condition for granting the State aid. The second step of the assessment involves evaluating the necessity and

²⁰²⁹ Commission Decision (C(2012) 8761 final) on 5 December 2012 Climbing Centres of Deutscher Alpenverein (SA33952 (2012/NN)), para 63.

²⁰³⁰ *ibid.*, para 1.

²⁰³¹ *ibid.*, para 7.

²⁰³² *ibid.*, para 67.

²⁰³³ *ibid.*, para 69.

²⁰³⁴ *ibid.*, para 68.

design of the aid measure. In this step, the Commission invoked the existence of a market failure to demonstrate that the measure was both appropriate and necessary.²⁰³⁵ Specifically, the Commissions found that the measures addressed a market failure in that:

[T]he projects would not be realised in the absence of public funding and investments in the climbing halls may bring about positive externalities in particular when they allow complementary activities to develop and where it would be difficult for a private owner/operator of a climbing hall to appropriate the commercial benefits of such complementary activities.²⁰³⁶

Based on the preceding factors the Commission concluded that the measures were necessary.²⁰³⁷ Notwithstanding this, the Commission's elaboration on incentive effects, which constitute a critical aspect of the economic analysis, is brief. The demonstration of such incentive effects is based on the mere proposition that the projects would not have materialised in the absence of aid.²⁰³⁸ Ultimately, the aid was also found to be proportionate *stricto sensu* based on the fact that it is, *inter alia*, exclusively granted to associations without commercial interests.²⁰³⁹

The competitors of DAV lodged an appeal before the General Court, which was ultimately dismissed.²⁰⁴⁰ The applicants asserted two claims. According to the first claim, the decision was founded on an erroneous application of the criteria of Article 107(3)(c) due to the absence of a market failure and the unnecessary nature of the aid measure.²⁰⁴¹ In their second claim, the applicants contended that an objective of common interest, such as the promotion of sport, could only be accepted if a market failure had been established, which was not the case in the relevant market in this case.²⁰⁴²

²⁰³⁵ *ibid.*, para 70.

²⁰³⁶ *ibid.*

²⁰³⁷ *ibid.*, para 72.

²⁰³⁸ *ibid.*, para 73.

²⁰³⁹ *ibid.*, para 78.

²⁰⁴⁰ Case T-162/13 *Magic Mountain* EU:T:2016:341.

²⁰⁴¹ *ibid.*, para 43.

²⁰⁴² *ibid.*, para 75.

With respect to the first claim (incorrect application of Article 107(3)(c) criteria), the applicants claimed that the Commission is required to follow its approach set out in the CAP which has subsequently been incorporated into other Guidelines and applied in other decisions.²⁰⁴³ Although these Guidelines were inapplicable *in casu*, they ought to formulate general principles in the assessment.²⁰⁴⁴ However, the Commission, according to the applicants, did not conduct a sufficiently in-depth economic analysis, which contravened the CAP and the case law of the EU Courts.²⁰⁴⁵

The General Court began by recalling the large margin of discretion afforded to the Commission in making complex social and economic assessments,²⁰⁴⁶ thereby limiting the scope of judicial review to the identification of a manifest error of appreciation and the accuracy of the facts.²⁰⁴⁷ Regarding the Guidelines invoked by the applicants, the General Court held that the Commission cannot be bound by its Guidelines outside their specific field of application.²⁰⁴⁸ Furthermore, a non-confirmed staff working document cannot create general principles of assessment.²⁰⁴⁹ Since the CAP is not an officially adopted document intended to produce ‘external effects’,²⁰⁵⁰ the Commission is not bound to comply with it under the general principles of legitimate expectations or equality.²⁰⁵¹ Consequently, the CAP cannot be considered to constitute binding Guidelines.²⁰⁵²

Second, the General Court rejected the applicants’ contestation that the Commission was required to adopt a certain economic analysis in its decision-

²⁰⁴³ *ibid.*, para 44.

²⁰⁴⁴ *ibid.*

²⁰⁴⁵ *ibid.*, para 44.

²⁰⁴⁶ *ibid.*, para 50.

²⁰⁴⁷ *ibid.*, para 51.

²⁰⁴⁸ *ibid.*, para 58.

²⁰⁴⁹ *ibid.*, para 56. Moreover, it is established case law that the anterior practice of the Commission cannot affect the validity of the contested decision (para 59).

²⁰⁵⁰ *ibid.*, para 56 from French ‘effets externes’.

²⁰⁵¹ *ibid.*, para 56. See also, Case T-21/06 *Germany v Commission* (n 1994), para 51; Case C-397/03 P *Archer Daniels Midland and Archer Daniels Midlands Ingredients v Commission* EU:C:2006:32, para 91.

²⁰⁵² *ibid.*, para 57.

making process, noting the absence of any such legal requirement.²⁰⁵³ On the contrary, the Commission is required to conform to its former decisional practice in other cases.²⁰⁵⁴ Whilst the economic principles relied on by the Commission have not been invalidated by the case law, they do not constitute a legal requirement.²⁰⁵⁵

Third, the General Court found that, contrary to the claim of the applicants, the Commission, when analysing factors such as market failure, incentive effect and effects on competition, applied an underlying detailed economic analysis.²⁰⁵⁶

Moving on to the second claim, (the requirement of a market failure in order to find an objective of common interest) the applicants argued that rather than truly assessing the existence of a market failure, the Commission had presumed such a market failure based on the fact that DAV was in charge of a public interest task.²⁰⁵⁷ They further contended that no market failure existed in the relevant market and that, by extension, no objective of common interest could be established.²⁰⁵⁸

However, the General Court rejected this argument:²⁰⁵⁹

[...] contrary to what is claimed by the applicants, Article 107(3)(c) does not require the proof of a market failure in order to declare aid compatible with the internal market.²⁰⁶⁰

Evidence of a market failure can constitute a relevant factor when declaring State aid compatible with the internal market [... in so far as]

²⁰⁵³ *ibid.*, para 60.

²⁰⁵⁴ *ibid.*, para 59-60.

²⁰⁵⁵ *ibid.*, para 59-60.

²⁰⁵⁶ *ibid.*, para 61.

²⁰⁵⁷ *ibid.*, para 72.

²⁰⁵⁸ *ibid.*, para 73.

²⁰⁵⁹ *ibid.*, para 76.

²⁰⁶⁰ *ibid.*, para 77: ‘contrairement à ce que soutiennent les requérantes, l’article 107, paragraphe 3, sous c), TFUE n’exige pas la preuve d’une défaillance du marché afin de déclarer une aide compatible avec le marché intérieur.’

the existence of a market failure is capable of justifying State intervention.²⁰⁶¹

However, the General Court further held that ‘market failure is not an indispensable condition’, as it is also possible to declare aid compatible on the basis of an objective of common interest.²⁰⁶² In this case, it is clear that, in light of Article 165 which makes the promotion of sport an EU objective, the contested measures pursued an objective of common interest, namely the promotion of amateur sport and making it more accessible to the public.²⁰⁶³

Ultimately, the General Court confirmed that the Commission’s decision clearly demonstrated the existence of a market failure in that sports associations are not normally capable of financing investments in infrastructure using their own resources.²⁰⁶⁴ In this regard, the applicant had not submitted any evidence that DAV could construct the necessary infrastructure without public support.²⁰⁶⁵

Following *Magic Mountain*, it has been established that market failure can serve as valid grounds for declaring aid compatible under Article 107(3)(c), but this is not a legal requirement. In subsequent cases, the Commission has analysed aid measures according to the CAP. For instance, in *Søndagsavisen* the Commission applied the public goods theory to identify a market failure.²⁰⁶⁶ The case concerned a Danish subsidy scheme for media undertakings, in particular newspapers/publications, based on various factors such as editorial content.²⁰⁶⁷ Although the aid measure constituted State aid under Article 107(1), the Commission found that the objective of the aid was to promote the fundamental

²⁰⁶¹ *ibid.*, para 78: La preuve d’une défaillance du marché peut constituer un élément pertinent pour déclarer la compatibilité d’une aide d’État avec le marché intérieur (voir, en ce sens, arrêt du 6 octobre 2009, Allemagne/Commission, T-21/06, non publié, EU:T:2009:387, point 58). En effet, la présence d’une défaillance du marché est susceptible de justifier une intervention étatique.

²⁰⁶² *ibid.*, para 79.

²⁰⁶³ *ibid.*, para 79.

²⁰⁶⁴ *ibid.*, para 81.

²⁰⁶⁵ *ibid.*, para 83. Here, the Court also emphasised that the Berlin section’s decision to abandon its project following the initial rejection of public funding underscores the merits in the Commission’s findings.

²⁰⁶⁶ Decision of the Commission (C(2013) 7870 final) of 20 November 2013 on Production and innovation aid to written media (SA36366 (2013/N)).

²⁰⁶⁷ *ibid.*, para 10. The main subsidy scheme benefits publications which are printed news media and written internet-based media, provided they have a minimum of 50% editorial content.

values of freedom of expression and information enshrined in Article 11 of the Charter.²⁰⁶⁸ As in *Magic Mountain*, the market failure analysis was conducted within the context of the necessity test of the aid measure. With reference to the market failure analysis submitted by the Danish government, the Commission concluded that information and news content must be distinguished from ‘traditional consumable products or goods’.²⁰⁶⁹

Media content is non-rival and non-excludable in the sense that the same article or story may be consumed by an undefined number of readers at no added cost. As a consequence, it is difficult to hinder consumers from getting access to content even when the consumer does not pay for the media. Although the availability of media content has generally increased, the willingness among consumers to pay for the production of the content has thus decreased, also for high quality products. However, the production of high quality information content, such as news based on investigative journalism may incur high operating costs. This development and changes of market structures and conditions lead to an increased market failure in terms of reduced editorial content and potentially in the long term reduces quality.²⁰⁷⁰

The Commission noted that ‘incentives for a private media undertaking to produce high quality socio-political and independent content available to all citizens on equal terms are limited’.²⁰⁷¹ Thus, from a ‘public interest perspective’, the free market is incapable of delivering the desired output without State support.²⁰⁷² The General Court, upon reviewing the case, upheld the market failure analysis submitted by the Commission and rejected the applicant’s claim of a lack of reasoning and insufficient analysis of the necessary and appropriate nature of the aid measure.²⁰⁷³

^{2068 2068} *ibid.*, para 32: In particular, ‘[t]he objective of the scheme ‘is to ensure the dissemination of information and promotion of debate’ and will ensure ‘that media content of high quality is produced to Danish citizens [...] with a view to ensuring media pluralism and the viability of socio-political news to citizens’.

²⁰⁶⁹ *ibid.*, para 34.

²⁰⁷⁰ *ibid.*

²⁰⁷¹ *ibid.*, para 35.

²⁰⁷² *ibid.*

²⁰⁷³ Case T-167/14 *Søndagsavisen v Commission* EU:T:2016:603, para 38.

In conclusion, during the second period, an evolution in the Commission's approach from a rigid market failure to a broader analysis is noticeable. The shift is reflected in the assessment of broad efficiencies. The EU Courts provided some guidance on the meaning of market failure, by holding that whilst market failure is not a mandatory legal requirement, it might be a relevant factor for determining the compatibility of State aid.

8.1.3 Market Failure and Public Interest Objectives: The *Hinkley Point C* Case

The ultimate period is marked by the seminal *Hinkley Point C* case, which has been claimed to have significantly reshaped the landscape of State aid law.²⁰⁷⁴ The judgment is notable for rejecting the view that Article 107(3)(c) requires an objective of common interest. However, the relevance of market failure in assessing the compatibility of State aid was reaffirmed, reflecting the continued significance of the concept in State aid analysis. Moreover, the ECJ's ruling provided valuable insight into the nature of the balancing test under Article 107(3).

8.1.3.1 The Decision of the Commission

The Commission's decision in *Hinkley Point C* concerned a highly complex State aid measure granted by the United Kingdom in support of the construction and operation of a new nuclear power station.²⁰⁷⁵ The aid scheme consisted of various measures, including a contract for difference providing financial support²⁰⁷⁶ and a credit guarantee.²⁰⁷⁷ The aid measures were found to be illegal aid under Article

²⁰⁷⁴ e.g., Phedon Nicolaides, 'Shedding Light into the "Black Box" of State Aid: The Impact of Hinkley Point C on the Assessment of the Compatibility of State Aid' (2021) 20(1) *European State Aid Law Quarterly*, 4; Julian Nowag, 'Hinkley Point C – Is Semi-Permeable Membrane Protecting the Internal Market's Nucleus?' (2020 *European Law Blog*) available at: <<https://europeanlawblog.eu/2020/07/23/hinkley-point-c-is-semi-permeable-membrane-protecting-the-internal-markets-nucleus/>>; Corinne Rüchardt, 'Hinkley Point C: ECJ Confirms Commission's Approval of Aid to Nuclear Energy Plant' (2020 *Kluwer Competition Law Blog*) <available at: <<https://competitionlawblog.kluwercompetitionlaw.com/2020/09/28/hinkley-point-c-ecj-confirms-commissions-approval-of-aid-to-nuclear-energy-plant/>>.

²⁰⁷⁵ Commission Decision (EU) 2015/658) of 8 October 2014 which the United Kingdom is planning to implement for support to the Hinkley Point C nuclear power station (notified under document C(2014) 7142).

²⁰⁷⁶ *ibid.*, para 6.

²⁰⁷⁷ *ibid.*, para 48.

107(1) TFEU.²⁰⁷⁸ However, the compatibility of the aid scheme with Article 107(3)(c) remained highly contentious.

The UK argued that the aid scheme pursued an ‘objective of common interest’ in the sense of the Euratom Treaty,²⁰⁷⁹ by promoting nuclear energy,²⁰⁸⁰ which in turn contributes to decarbonisation.²⁰⁸¹ In order to justify the need for aid measures, the UK asserted that nuclear generation is susceptible to numerous market failures, which makes it impossible to achieve an efficient level of decarbonisation and security of supply without State intervention.²⁰⁸² In support of this argument, the UK cited evidence showing that there had been no investment in the sector over the previous 30 years, and that similar nuclear projects in other Member States had received State support.²⁰⁸³ As the Energy and Environmental Guidelines of 2014 did not apply to the nuclear sector the aid measures had to be assessed directly under Article 107(3)(c).

In its decision, the Commission found that the aid measures were aimed at promoting nuclear energy, which it considered to be an objective of common interest,²⁰⁸⁴ despite not being shared by all Member States.²⁰⁸⁵ Additionally, the aid measures were deemed to contribute to diversification and security of supply.²⁰⁸⁶

²⁰⁷⁸ *ibid.*, para 288.

²⁰⁷⁹ This section will only delve into the relationship between the TFEU and the Euratom Treaty as far as it is essential for the analysis. For a detailed examination see, Alicja Sikora, ‘Applicability of the EU State Aid and Environmental Rules in the Nuclear Sector’ (2020)4 European State Aid Law Quarterly 515. More generally on the relationship between the EU Treaties and the Euratom, see T Cusack, ‘A Tale of Two Treaties: An Assessment of the Euratom Treaty in Relation to the EC Treaty’ (2003) 40 Common Market Law Review 117.

²⁰⁸⁰ Commission Decision (EU) 2015/658 ‘Hinkley Point C’ (n 2075), para 273. The Euratom Treaty was concluded in 1957. All EU Member States are Members of Euratom. According to its preamble the signatory parties recognise ‘that nuclear energy represents an essential resource for the development and invigoration of industry and will permit the advancement of the cause of peace [...]’.

²⁰⁸¹ *ibid.*, para 271.

²⁰⁸² *ibid.*, para 273.

²⁰⁸³ *ibid.*, paras 273-274.

²⁰⁸⁴ *ibid.*, 374.

²⁰⁸⁵ Austria argued in the EU Courts that the promotion of nuclear energy does not qualify as an objective of common interest since it is not shared by all Member States.

²⁰⁸⁶ *ibid.*, 374.

Regarding the necessity of the intervention, the Commission found that the argument made by the UK that ‘a residual market failure exists in carbon emissions in the long run’ had merits, and ‘justifies some sort of government intervention to foster low carbon generation, which includes nuclear’.²⁰⁸⁷ However, it is worth noting that despite the Commission’s straightforward approach to nuclear energy, the issue of nuclear energy and its environmental externalities remains a contentious topic, far from clear-cut.²⁰⁸⁸ Furthermore, the Commission identified a potential market failure in that ‘the security of supply is not adequately priced in, and that private investment decisions in electricity may remain below the social optimum’.²⁰⁸⁹

Nevertheless, despite the presence of these market failures in the relevant market, they could not, according to the Commission, be invoked to justify investment in nuclear energy specifically. Instead, they could be used to justify investment in low carbon generation in general.²⁰⁹⁰ In other words, the deleterious effects of CO₂ emissions were recognised as a market failure.²⁰⁹¹ In such cases, State intervention is not only warranted but essential to mitigate the negative externalities. Yet, in the context of this particular case, a specific market failure within the investment of nuclear energy must be identified. To this effect, the Commission identified two market failures which it deemed to be ‘more relevant’.²⁰⁹²

First, nuclear energy investment ‘is subject to significant risk’ due to the large capital costs involved, long construction times, and the significant time required to recover the investment.²⁰⁹³ The lack of market-based financial instruments capable of effectively hedging against these risks represents a specific market failure affecting certain technologies, including nuclear energy.²⁰⁹⁴ In this

²⁰⁸⁷ *ibid.*, para 378.

²⁰⁸⁸ e.g., Leigh Hancher and Antonios Bouchagiar, ‘Hinkley Point C: Trimming the SAM, While Extending the Reach of Wider EU Law Infringements?’ 4 (2021) *European State Aid Law Quarterly* 529, 529.

²⁰⁸⁹ *ibid.*, para 379.

²⁰⁹⁰ *ibid.*, para 380.

²⁰⁹¹ For instance, State intervention on the carbon market through regulation or taxation.

²⁰⁹² *ibid.*, para 381.

²⁰⁹³ *ibid.*, para 382.

²⁰⁹⁴ *ibid.*

regard, without effective risk management mechanisms, investors may be deterred from investing in nuclear energy, even if it has significant societal benefits.

‘Second, there is the risk of (predominantly political) ‘hold-up’ once the investment is made’.²⁰⁹⁵ Due to the controversial nature of nuclear technology, successive governments may adopt differing views of its desirability, creating significant uncertainty for investors, who are in a weaker bargaining position.²⁰⁹⁶ In this context, the lack of policy stability and predictability increases the risk associated with nuclear energy investments, which could ultimately erode private sector appetite for capital deployment in this area. Whilst the Commission acknowledged that it remained uncertain as to whether this matter constitutes a genuine market failure, it recognised the potential relevance of the issue in substantiating the contention that investment in nuclear energy presents unique and challenging obstacles.²⁰⁹⁷

Ultimately, the Commission concluded that the aid measures were necessary and appropriate, as they effectively addressed a market failure specific to the nuclear energy investment,²⁰⁹⁸ and the aid measures were declared compatible with Article 107(3)(c).

8.1.3.2 The Judgment of the General Court

An application for annulment of the Commission decision was lodged before the General Court by Austria, supported by Luxembourg.²⁰⁹⁹ The applicant put forward a multitude of pleas, however this subsection focuses only on the claims that are relevant to our analysis.

Firstly, Austria presented several arguments to demonstrate that the promotion of nuclear energy does not constitute an objective of ‘common’ interest.²¹⁰⁰ The General Court began its analysis by reaffirming that:

[...] in order to be capable of being declared compatible with the internal market pursuant to Article 107(3)(c) TFEU, aid must be aimed at the

²⁰⁹⁵ *ibid.*, para 384.

²⁰⁹⁶ *ibid.*, para 384.3.

²⁰⁹⁷ *ibid.*

²⁰⁹⁸ *ibid.*, paras 392 and 406.

²⁰⁹⁹ Case T-356/15 *Austria v Commission* EU:T:2018:439.

²¹⁰⁰ *ibid.*, para 59.

development of an activity that constitutes a public interest objective and be appropriate, necessary and proportionate.²¹⁰¹

Upon examining the existence of a common interest objective, the General Court upheld the Commission's position that the provisions and objectives of the Euratom Treaty were relevant in this regard.²¹⁰² The 'provisions of the Euratom Treaty constitute special rules in relation to the [TFEU]' and derogate from the EU Treaties.²¹⁰³ Conversely, the EU Treaties cannot derogate from the provisions of the Euratom Treaty.²¹⁰⁴ Therefore, if the Euratom Treaty does not provide specific rules with respect to aid measures, Article 107(3) can be applied to such measures.²¹⁰⁵ Thus, as put forth by Hancher and Bouchagiar, '[t]he objectives of the Euratom Treaty would form part of the compatibility assessment under Article 107(3)(c)'.²¹⁰⁶

Moreover, it cannot be inferred from the mention of 'common interest' in Article 107(3) 'that the public interest objectives that may be pursued by the Member State are limited to those that are common to all or to the majority of the Member States'.²¹⁰⁷ This part of the argument is remarkable. Whilst the Commission has previously applied the concept of 'objective of common interest' broadly to objectives defined by the Member States,²¹⁰⁸ the inclusion of the contested objective of promoting nuclear energy appears to unavoidably broaden the scope of Article 107(3)(c).²¹⁰⁹

The General Court went on to clarify the meaning of 'common interest' under Article 107(3)(c):

²¹⁰¹ *ibid.*, para 48. See to that effect, Case T-177/07 *Mediaset* (n 2023), para 125.

²¹⁰² *ibid.*, para 78.

²¹⁰³ *ibid.*, para 73.

²¹⁰⁴ *ibid.*, para 72.

²¹⁰⁵ *ibid.*, para 73.

²¹⁰⁶ Hancher and Bouchagiar (n 2088) 531.

²¹⁰⁷ *ibid.*, para 87.

²¹⁰⁸ Nicolaidis, 'Shedding Light into the "Black Box" of State Aid: The Impact of Hinkley Point C on the Assessment of the Compatibility of State Aid' (n 2074) 8.

²¹⁰⁹ Opinion of AG Hogan in Case C-594/18 P *Austria v Commission* EU:C:2020:352, para 1: 'This case can be described as the legal side of a dispute between Member States that are in favour of nuclear power and those that are not'.

In referring to a ‘common’ interest in [...] *Mediaset v Commission* [which was the correction of a market failure] the Court was merely indicating that the interest had to be a public interest and not just a private interest of the beneficiary of the aid measure.²¹¹⁰

As regards the concept of common interest mentioned at the end of Article 107(3)(c) TFEU, it should be noted that it related to the balance to be struck between the advantages and disadvantages arising from an aid measure, and precludes measures which adversely affect trading conditions to an extent contrary to the common interest being authorised.²¹¹¹

According to the General Court, the term ‘common interest’ in Article 107(3)(c) must be distinguished from the term ‘objective of common interest’ used by the Commission (the latter being used as a rationale to declare aid compatible). In addition to the public interest character, the promotion of nuclear energy is strengthened by Article 194(2) TFEU, which provides that each Member State has the right to choose its preferred sources of energy.²¹¹²

It follows from the judgment of the General Court that a common interest objective thus need not be shared by all or the majority of Member States.²¹¹³ As suggested by Phedon, ‘[t]he interests of other Member States are safeguarded by the requirement that trade is not excessively distorted, not by coincidence of policy preferences’.²¹¹⁴ To sum up, the General Court ruled that the promotion of nuclear power, in the sense of the Euratom Treaty, constitutes an objective of common interest, without any reference to market failure or economic spill-over effects of such objectives on society.²¹¹⁵

Secondly, Austria claimed that the decision violated EU environmental law. On one hand, Austria argued that recognising the promotion of nuclear energy as an objective of common interest would infringe EU environmental rules such as the principles of protection of the environment, the precautionary principle, the

²¹¹⁰ *ibid.*, para 86.

²¹¹¹ *ibid.*, para 87.

²¹¹² *ibid.*, para 97.

²¹¹³ *ibid.*, para 87.

²¹¹⁴ *ibid.*, page 536.

²¹¹⁵ *ibid.*, para 128.

‘polluter pays’ principle and the principle of sustainability.²¹¹⁶ However, the General Court dismissed this claim, ruling that these principles cannot apply to the Euratom Treaty, which the other Treaties cannot derogate from.²¹¹⁷

On the other hand, Austria contended that within the balancing exercise, the Commission did not sufficiently weigh the negative effects of the aid measure on the environment,²¹¹⁸ in particular the costs of storing nuclear waste.²¹¹⁹ In other words, the applicant asserted that in balancing the positive and negative effects, the Commission failed to adequately consider these environmental costs, which create market failures due to their environmental externalities. To support this claim, Austria invoked the same general principles as in its previous claim.

The General Court dismissed this claim as well. It noted that since the UK did not specifically intend to give effect to the aforementioned environmental principles by adopting the aid measure, the Commission was not required to take those principles into account when establishing the balance required under Article 107(3)(c).²¹²⁰ Further, the Court ruled that:

[...], with regard to the disadvantages of the measures at issue, it must be noted that, in the context of the application of Article 107(3)(c) TFEU, the Commission must weigh up the advantages of the measures at issue and their negative impact *on the internal market*. Although protection of the environment must be integrated into the definition and implementation of EU policies, particularly those which have the aim of establishing the internal market, it does not constitute, per se, one of the components of that internal market, defined as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured. Consequently, when identifying the negative effects of the measures at issue, the Commission was not obliged to take into account the extent to which the measures at issue are detrimental to the implementation of that principle (see, to that effect, judgment of 3 December 2014, *Castelnou Energía v Commission*, T-57/11,

²¹¹⁶ *ibid.*, para 100.

²¹¹⁷ *ibid.*, para 112.

²¹¹⁸ Again, the reader is reminded that focus will be given to the aspects relevant to our analysis.

²¹¹⁹ *ibid.*, paras 401 – 574.

²¹²⁰ *ibid.*, para 515.

EU:T:2014:1021, paragraphs 189 to 191). That applies equally to the precautionary principle, the ‘polluter pays’ principle and the sustainability principle relied on by the Republic of Austria.²¹²¹

The General Court noted that, aside from these principles, Austria did not invoke any EU legislation in support of its claim.²¹²² It further stated that applying these principles to the compatibility analysis of aid granted for the construction or operation of a nuclear power plant would be inconsistent with the provisions of the Euratom Treaty.²¹²³ Based on these considerations, the General Court, therefore, rejected the claim of Austria.

Finally, Austria argued that the Commission could only declare the aid measure compatible if it had found that ‘the liberalised market for the generation and supply of electrical power was failing’.²¹²⁴ According to the applicant, the generation and supply of electricity can be secured by other means than nuclear technology, thus negating the presence of a market failure.²¹²⁵ As such, without a market failure, the intervention cannot be regarded as necessary.

However, the General Court simply reaffirmed its judgment in *Magic Mountain*, which established that Article 107(3)(c) does not require the presence of a market failure:

While the existence of a market failure may be a relevant factor for declaring State aid compatible with the internal market, the absence of market failure does not necessarily mean that the conditions laid down in Article 107(3)(c) TFEU are not satisfied (judgments of 9 June 2016, *Magic Mountain Kletterhallen and Others v Commission*, T-162/13, not published, EU:T:2016:341, paragraphs 78 and 79, and of 18 January 2017, *Andersen v Commission*, T-92/11 RENV, not published, EU:T:2017:14, paragraph 69).²¹²⁶

²¹²¹ *ibid.*, para 516.

²¹²² *ibid.*, para 517.

²¹²³ *ibid.* In particular the Court referred to Article 106a(3) of the Euratom Treaty, according to which the provisions of the TFEU ‘shall not derogate from the provisions of this Treaty’.

²¹²⁴ *ibid.*, para 148.

²¹²⁵ *ibid.*

²¹²⁶ *ibid.*, para 150.

Furthermore, the General Court clarified that State intervention may be necessary even in the absence of a proper market failure, particularly when market forces cannot by themselves ensure the achievement of a public interest objective ‘in sufficient time, even if, as such, that market cannot be considered to be failing’.²¹²⁷ In this regard, the Commission’s market failure assessment, based on the significant risks and lack of market-based instruments, was deemed sufficient to conclude the need for the State aid.²¹²⁸

8.1.3.3 The Judgment of the Grand Chamber

In May 2020, the Grand Chamber issued its landmark ruling in the *Hinkley Point C* case,²¹²⁹ which has been argued to potentially have significant implications on the compatibility assessment of State aid under Article 107(3)(c) TFEU.²¹³⁰ Whilst the Court largely upheld the case of the General Court, it provided crucial clarification on the nature of Article 107(3)(c).²¹³¹

First, upon examining the claim that the promotion of nuclear energy does not constitute an objective of common interest the Court provided new light on the conditions of Article 107(3)(c). Moreover, with regards to the interplay between the TFEU and the Euratom Treaty, the Court affirmed that whilst Euratom is a distinct and specialised sectorial Treaty, the more comprehensive TFEU may apply in the nuclear sector when Euratom does not contain specific rules on a given issue.²¹³²

With respect to the existence of an objective of common interest, the ECJ followed the Opinion of AG Hogan by adopting a textual approach to Article 107(3)(c).²¹³³ According to the Court, Article 107(3)(c) only contains two conditions: (i) the aid ‘must be intended to facilitate the development of certain

²¹²⁷ *ibid.*, para 151.

²¹²⁸ *ibid.*, para 155.

²¹²⁹ Case C-594/18 P *Austria v Commission (Hinkley Point C)* EU:C:2020:742.

²¹³⁰ Nicolaides, ‘Shedding Light into the “Black Box” of State Aid: The Impact of Hinkley Point C on the Assessment of the Compatibility of State Aid’ (n 2074).

²¹³¹ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), paras 79-128.

²¹³² *ibid.*, para 32. See also Opinion of AG Hogan in Case C-594/18 P *Austria v Commission* (n 2109), para 38: ‘[...] the provisions of the Euratom Treaty have to be considered as *leges speciales* in respect to the provisions of the TFEU which does not preclude the application of the TFEU if the Euratom Treaty does not have any special or specific rules in that area’.

²¹³³ Opinion of AG Hogan in Case C-594/18 P *Austria v Commission* (n 2109), para 57.

economic activities or certain of economic areas’; and (ii) ‘it must not adversely affect trading conditions to an extent contrary to the common interest’.²¹³⁴ Unlike Article 107(3)(b), the compatibility of aid is not ‘dependent on its pursuing an objective of common interest’.²¹³⁵ The fact that the CAP requires ‘a well-defined objective of common interest’ is immaterial in this regard.²¹³⁶ The reference to an objective of common interest in the Guidelines is also of no consequence since they do not apply to the current case.²¹³⁷ The Court further noted that even if the CAP were a binding framework from which the Commission cannot depart without violating general principles of law:

The Commission cannot in any event, by those instruments, improperly reduce the scope of Article 107(3)(c) TFEU by providing that provision to be applied in a manner that is incompatible with [those two conditions].²¹³⁸

Subsequently, the Court proceeded to assess whether the aid measure fulfils the criterion of contributing to the development of economic activity as outlined in Article 107(3)(c). Ultimately, the Court determined that the aid measures indeed satisfy this condition.²¹³⁹

Second, the Court also clarified the role of EU environmental legislation within the analysis under Article 107(3)(c). Just as before the General Court, this claim contains several pleas arguing, on one hand, that State aid cannot be declared compatible if it infringes EU environmental law and, on the other, that the environmental externalities produced by the aid must be accounted for under the balancing test (the second condition of Article 107(3)(c) as defined above by the Court). In relation to the plea of a general requirement that aid must comply with EU environmental principles, the ECJ held that the General Court erred in law

²¹³⁴ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 19. This has been confirmed in Joined Cases C-649/20 P, C-658/20 P and C-662/20 P *Spain and Others v Commission* EU:C:2023:60, para 104: ‘in any event, it is in the light of Article 107(3)(c) TFEU – and not of the previous practice or other decisions of the Commission – that it must be assessed whether or not aid satisfies the conditions laid down by that provision for its application’.

²¹³⁵ *ibid.*, para 20. See *Opinion of AG Hogan in Case C-594/18 P Austria v Commission* (n 2109), for a literal interpretation.

²¹³⁶ *ibid.*, para 24.

²¹³⁷ *ibid.*, para 22.

²¹³⁸ *ibid.*, para 24.

²¹³⁹ *ibid.*, paras 59-69.

when declaring that these principles do not apply to the Euratom Treaty.²¹⁴⁰ The Court invoked both Article 37 of the Charter²¹⁴¹ and the integration clause outlined in Article 11 TFEU,²¹⁴² thereby concluding that ‘the requirement to preserve and improve the environment [...] as well as [...]those principles] are applicable in the nuclear energy sector’.²¹⁴³ The Court also cited its case law in *Nuova Agricast*,²¹⁴⁴ wherein it held that State aid cannot contravene other rules or general principles of EU law.²¹⁴⁵

Nevertheless, environmental effects do not have a role to play in the proportionality assessment. The Court ruled that:

[...] the requirement to preserve and improve the environment, expressed inter alia in Article 37 of the Charter and in Articles 11 and 193(1) TFEU, and the rules on EU law on the environment are applicable in the nuclear sector. It follows that when the Commission checks whether State aid for an economic activity falling within that sector meets the first conditions laid down in Article 107(3)(3)(c) TFEU [...] it must [...] check that that activity does not infringe rules of the environment. If it finds an infringement of those rules, it is obliged to declare the aid incompatible with the internal market without any other form of examination.

However, with regard to the second condition that the aid must not adversely affect trading conditions to an extent contrary to the common interest, the Court emphasised that the balancing between positive and negative effects is made in the context of the internal market.²¹⁴⁶ The Court expounded that:

²¹⁴⁰ *ibid.*, para 46.

²¹⁴¹ According to which, ‘a high level of environmental protection and the improvement of the quality of the environment must be integrated into the policies of the Union and ensured in accordance with the principle of sustainable development’.

²¹⁴² *ibid.*, para 42. Article 11 TFEU provides that environmental protection must be integrated into the definition and implementation of the Union’s policies and activities.

²¹⁴³ *ibid.*

²¹⁴⁴ Case C-67/09 P *Nuova Agricast* (n 590).

²¹⁴⁵ *ibid.*, para 44.

²¹⁴⁶ *ibid.*, para 101. See also confirming the judgement in *Hinkley Point C*, Case C-284/21 P *Commission v Braesch and Others* EU:C:2023:58, para 24: ‘it is apparent from the overall system and teleology of State aid control that the Commission is entrusted with that control solely as a

Article 26(2) TFEU states that that market ‘shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties’. Therefore, examination of the second condition laid down in Article 107(3)(c) TFEU entails the Commission taking into account the negative effects of the State aid on competition and trade between Member States, but does not require any negative effects other than those to be taken into account.²¹⁴⁷

Third and lastly, the Grand Chamber had to adjudicate on the claim that market failure constitutes a condition under Article 107(3)(c). Despite the Court’s previous clarification that Article 107(3)(c) only encompasses the two aforementioned conditions, it confirmed the case law of the General Court, stating that:

[...] even though the Commission may consider it necessary in the context of Article 107(3)(c) TFEU to examine whether the planned aid enables a market failure to be remedied when determining whether that aid is compatible with the internal market, the existence of such a failure nevertheless does not constitute a condition for declaring aid to be compatible with the internal market under that provision.²¹⁴⁸

Thus, the ECJ confirmed that although ‘the existence of a market failure may be a relevant factor’ within the compatibility assessment, the absence of market failure does not imply that the conditions of Article 107(3)(c) are not met.²¹⁴⁹ The judgment indicates that whilst a market failure may constitute evidence that the requirements of Article 107(3)(c) are met, it is not a requirement.

In summary, the *Hinkley Point C* ruling shed further light on the conditions of Article 107(3)(c). The ECJ clarified that the aid must contribute to promoting the development of certain economic activities, or areas, and not harming competition or trading conditions contrary to the common interest. Notably, the provision does not mandate any additional criteria. The Court additionally

competition authority and that, accordingly, in the exercise of that power, that institution is not entitled to impose on Member States policies that are not linked to competition’.

²¹⁴⁷ *ibid.*, para 101.

²¹⁴⁸ *ibid.*, para 66.

²¹⁴⁹ *ibid.*, para 67.

affirmed that EU environmental legislation is applicable to the nuclear energy sector and that whilst the presence of a market failure may provide evidence of the compatibility of aid, it is not a mandatory requirement.

8.1.4 From a Permissive to a Dogmatic Approach

It has been shown that the application of the legal assessment of the market failure test in the CAP has evolved over time. Initially, the analysis of the Commission placed market failure at the centre of the assessment and deemed the presence of an efficiency-enhancement²¹⁵⁰ sufficient to satisfy the requirement of an objective of common interest. Additionally, the Commission required the presence of a ‘true’ market failure order for the aid to meet the requirements of necessity and appropriateness. Accordingly, market failure is present in both a normative (rationale) and analytical (test) form. The EU Courts, in their turn, adopted a permissive approach to the Commission’s reshaping of the compatibility assessment.²¹⁵¹

During the second period of State aid modernisation, both the EU Courts and the Commission adopted a broader approach to the objectives of Article 107(3)(c), going beyond the scope of a conventional market failure. Cases such as *Magic Mountain* and *Søndagsavisen* illustrate this shift, as the rationale for the aid was not limited to a conventional market failure, but rather aimed at achieving broader public policy objectives such as the promotion of sport and physical integrity, or the protection of freedom of expression. Market failure was viewed as an analytical test to determine whether the aid was appropriate and necessary, rather than being the rationale for the aid. This approach was also reflected in the General Court’s ruling in *Hinkley Point C*, which recognised that ‘the boundaries of public policy can stretch beyond the mere remedying of market failure’.²¹⁵²

²¹⁵⁰ e.g., via the creation of positive externalities.

²¹⁵¹ The General Court’s permissive approach to the Commission’s soft law is evident in Case T-177/07 *Mediaset* (n 2023), para 125, where the GC endorsed the Commission’s market failure test by ruling that Article 107(3)(c) TFEU requires an objective of common interest, which can be understood either as remedying a market failure or a distributional objective.

²¹⁵² Phedon Nicolaides, ‘The Compatibility of State Aid with the Internal Market’ (2018) 4 *European State Aid Law Quarterly* 534,534. This stance has also been adopted by the General Court subsequently to *Hinkley Point C*, see Case T-718/20 *Wizz Air Hungary v Commission* EU:T:2022:276, para 35: ‘by imposing that condition [that the measure must aim to prevent social hardship or address market failure’], the Guidelines [the 2014 Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty] did unduly not reduce the

Whilst market failure may be an essential requirement, it is not an indispensable criterion, and aid can also be justified on a (broader) basis, namely an objective of common interest, as noted by the General Court.²¹⁵³

The third period is the current era, which began with the judgment of the Grand Chamber in *Hinkley Point C*²¹⁵⁴ and can be qualified as dogmatic. By adopting a literal interpretation of Article 107(3)(c), the ECJ appears to have shifted the focus of that provision towards the ‘the development of economic activities’ rather than broader public policy concerns. However, the ECJ’s ruling raises six important points that require consideration.

First, the Grand Chamber clarified that Article 107(3)(c) contains only two conditions: a contribution to economic development and a balancing test limited to the effects on the internal market.

Second, nevertheless, it remains unclear whether these criteria truly change the assessment of compatibility under Article 107(3)(c). The criterion of facilitating the development of economic activities or certain areas is ambiguous and could be interpreted even more broadly than an objective of common interest. The concept of ‘development of economic activities’ appears broader than the remedy of market failures, as it can potentially encompass any efficiency gains that contribute to the growth of economic activities (i.e., making the cake bigger). In this regard, it could potentially cover minor distortions that do not necessarily meet the requirement of a ‘true’ market failure. Moreover, it is not necessarily limited to the promotion of economic efficiency alone but may also encompass broader objectives. Some have suggested that this case broadened the scope of Article 107(3) to ‘cover any policy objective’.

Third, it has been suggested that this case widened the scope of Article 107(3)(c) ‘since the development of an economic activity can cover any policy

scope of that provision [...] within the meaning of the judgment [in *Hinkley Point C*]. Further, it is apparent from paragraphs 66 and 67 on that judgement that the fact that the proposed aid enables a market failure to be addressed may constitute a relevant factor in assessing the compatibility of that aid under Article 107(3)(c) TFEU’.

²¹⁵³ Case T-162/13 *Magic Mountain* (n 2040), para 79. Implicitly the GC adopted a similar position, holding that the measure must further a public interest, see Case T-356/15 *Austria v Commission* (n 2099), para 86.

²¹⁵⁴ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129).

objective’.²¹⁵⁵ The Court affirmed that market failure analysis under the proportionality assessment remains a valid and flexible approach, which falls within the discretion of the Commission. Moreover, as previously discussed, the normative role of market failure may still be relevant under the broad concept of ‘development of economic activities’. Thus, there are indications that despite the Court ruling, market failure remains a crucial element in the compatibility assessment.

Fourth, it is worth noting that the *stricto sensu* balancing test under Article 107(3)(c) is considerably narrower in scope than a CAB analysis in the sense of welfare economics. The evaluation of negative effects is limited to their impact on competition and trade (i.e., the restriction of competition). Therefore, the *stricto sensu* test under Article 107(3)(c) functions in a similar way to the one under Article 101(3), which is a ‘bounded balancing test’, limited to the assessment of the benefits solely in relation to the effects of competition and trade. Contrary to a general balancing exercise, broader negative effects which cannot be quantified in terms of a restriction of competition are excluded from the analysis. However, there is a difference between the balancing under Article 107(3)(c) and Article 101(3) in that the former merely requires a net positive effect and does not safeguard competition and trade as such.

Fifth, the timing of the judgment coincided with the expiration of the Commission Guidelines²¹⁵⁶ and, as such, it has the potential to shape a new era of State aid enforcement. Nonetheless, as discussed below, despite the ECJ’s intervention in *Hinkley Point C*, the compatibility test of the Guidelines has not undergone substantial changes.²¹⁵⁷

Sixth and lastly, the requirement that aid must not violate other provisions of the Treaty is an extension of the case law in *Nuova Agricast*, where the Court held that aid must not infringe general principles of EU law.²¹⁵⁸ This finding seems logical since Article 107(3) is not construed as a *lex specialis*, unlike Article

²¹⁵⁵ Nicolaides, ‘Shedding Light into the “Black Box” of State Aid: The Impact of Hinkley Point C on the Assessment of the Compatibility of State Aid’ (n 2074) 8.

²¹⁵⁶ Hancher and Bouchagiar (n 2088) 535.

²¹⁵⁷ For an analysis of the latest CEEAG and RAG, see Chapter 9.

²¹⁵⁸ Case C-390/06 *Nuova Agricast* EU:C:2008:224, para 51; Case C-67/09 P *Nuova Agricast and Cofra v Commission* EU:C:2010:607 (n 590), para 65; Case C-431/14 P *Greece v Commission* (n 1756), para 69. On the limitations of that requirement see, Hancher and Bouchagiar (n 2088), 541.

106(2).²¹⁵⁹ Therefore, Article 107(3)(c), in contrast to Article 106(2), is not an ‘autonomous provision’.²¹⁶⁰

8.2 Article 107(3)(c): A Market Failure Analysis

This section applies the criteria outlined in Chapter 3²¹⁶¹ to the material described above to determine whether a market failure test can be identified within Article 107(3)(c) TFEU. The test comprises four components:

- i) Identifying the rationale of intervention;
- ii) Identifying any market failure test/ ‘market diagnostics’;
- iii) Identifying double market failure test;
- iv) Identifying potential trade-offs/balancing between competition; economic and external objectives.²¹⁶²

This test will help ascertain the existence and the extent of market failure analysis under Article 107(3)(c). Beyond applying the criteria, this section analyses the relevance of market failure, as a legal test, under Article 107(3)(c).²¹⁶³ It is argued that the test employed by the Commission can be characterised as a State aid-specific discretionary market failure test. Although not a legal requirement, this test is tolerated by the EU Courts. A closer examination of the legal review of Commission decisions by the EU Courts reveals that, in its broadest interpretation, Article 107(3)(c) can be deemed to include a market failure test.

²¹⁵⁹ On the nature of Article 106(2) TFEU as both a *lex specialis* and *lex generalis*, see e.g., Chan-Mo Chung, ‘The Relationship Between State Regulation and EC Competition Law: Two Proposals for a Coherent Approach’ (1995) 16 European Competition Law Review 87.

²¹⁶⁰ On the autonomous nature of Article 106(2) TFEU see e.g., Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (n 558) 216.

²¹⁶¹ See, Chapter 3, section 3.3.

²¹⁶² *ibid.*

²¹⁶³ Which replies to the main research question, which is: *What role and value, if any, does market failure hold within legal analysis of public policy intervention on markets in EU competition law?*

8.2.1 Applying the Criteria to Article 107(3)(c)

This section applies the four limbs of the market failure framework outlined in Chapter 3 to Article 107(3)(c) TFEU, taking the shape of a proportionality analysis. The first step of the test involves examining the rationale of the State aid measures, which determines the type of market failure considerations, if any, that apply under Article 107(3)(c). The second limb assesses the existence of a legal test – so-called ‘market diagnostics’ – for assessing the presence and extent of market failure, which is typically assessed through a suitability test. This step is an extension of the first, as the rationale determines the basis for derogation, whilst market diagnostics is used to ascertain the existence of market failure *in casu* and any threshold that may apply. This is traditionally accomplished through a suitability test. The third limb, the double market failure analysis, involves assessing the efficiency of the measures themselves. This part enables a more in-depth examination of the efficiency/external objectives that are permitted under Article 107(1)(c), as well as the level of judicial scrutiny over the measure. Finally, the analysis of the *stricto sensu* proportionality and trade-offs brings clarity to the balancing of narrow and broad market failure considerations and the status quo of competition law. This last step is necessary to determine the legal value of market failure in the State aid law of the EU.

8.2.1.1 The Rationale of Public Policy Intervention

The initial step of analysis is to assess market failure as a rationale for public intervention, both in terms of efficiency rationales and broader external objectives (the ground for justification). As outlined in Chapter 2, market failure can be understood either from a broad or a narrow perspective.²¹⁶⁴ The former approach includes ‘economic’ objectives,²¹⁶⁵ or ‘efficiency rationales’,²¹⁶⁶ whilst the latter standard may incorporate macroeconomic considerations²¹⁶⁷ that extend beyond mere static efficiency and may involve external or equity objectives that require a trade-off scenario.²¹⁶⁸ It is evident from the soft law, the Commission’s practice

²¹⁶⁴ See, Chapter 2 sections 2.2.1 and 2.2.2.

²¹⁶⁵ e.g., Ogus (n 18) 29-46.

²¹⁶⁶ e.g., Friederiszick, Röller and Verouden (n 340) 632.

²¹⁶⁷ e.g., Marciano and Medema (n 46) 4. See also Chapter 2, section 2.2.2.1.

²¹⁶⁸ e.g., Friederiszick, Röller and Verouden (n 340) 15.

and EU antitrust scholarship that both broad and narrow standards are relevant under Article 107(3)(c) TFEU.

8.2.1.1.1 *Efficiency and Narrow Market Failure Rationales*

The majority of the cases examined in the preceding analysis appear to fit into a conventional understanding of market failure, as efficiency rationales are present both in the case law and the Commission practice. The use of efficiency rationales as a remedy to a market failure is also stressed in both the SAM and the CAP.²¹⁶⁹ In particular, the CAP emphasises the role of externalities, public goods, imperfect information and coordination problems as significant factors contributing to market failure.²¹⁷⁰

In the first line of cases concerning digitisation and broadband, whilst external objectives were potentially present,²¹⁷¹ the Commission primarily emphasised efficiency rationales. In its decision on *the introduction of digital television (DVB-T) in Berlin Brandenburg*,²¹⁷² the Commission found that the aid contributed to a ‘more efficient spectrum usage and increased transmission possibilities’²¹⁷³ resulting in ‘new and better-quality services’ and ‘wider consumer choice’.²¹⁷⁴ Such efficiencies are enough in themselves to consider that the aid pursues an objective of common interest.²¹⁷⁵ In this perspective, market failure acts as a rationale (normative aspect) for declaring State aid compatible with the internal market. By promoting efficiencies in the market, State aid is remedying a presumed market failure. Equally, in *Mediaset*, the Commission identified an objective of common interest in the shape of efficiency increases resulting in new and better services and wider consumer choice.²¹⁷⁶

²¹⁶⁹ Communication on State aid modernisation (n 20), para 12; Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 12.

²¹⁷⁰ See Chapter 7, section 7.4.2.2.1.

²¹⁷¹ e.g., Commission Decision (2006/513/EC) ‘Berlin-Brandenburg’ (n 1972), paras 7.18. Germany emphasised e.g., ‘pluralistic media diversity’.

²¹⁷² *ibid.*

²¹⁷³ *ibid.*, para 85.

²¹⁷⁴ *ibid.*

²¹⁷⁵ Communication on State aid modernisation (n 20), para 12; Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 12.

²¹⁷⁶ Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), paras 134-139.

However, in the second line of cases, the relationship between the rationales of State aid and market failure is less clear-cut. In *Magic Mountain*, although the applicant put forward the positive externalities created by the construction of climbing halls, the Commission referred to the ‘social and educational function’ of sport under Article 165 TFEU.²¹⁷⁷ From an economic perspective, climbing activities can be seen as ‘merit goods’ producing broader positive externalities for society²¹⁷⁸ in the shape of e.g., improved public health. The benefits of sports activities extend beyond the individual participant to the broader community, including reduced public healthcare spending resulting from a healthier population.²¹⁷⁹ Yet, there appears to be a lack of explicit reasoning in the Commission’s assessment.

The same line of reasoning is applied in *Søndagsavisen*.²¹⁸⁰ Whilst the Commission did not dispute the evidence put forward by the Danish government related to the presence of a market failure, the objective of the aid measure was not considered to be efficiency/equity improvement. Instead, the measure could be justified on the basis that it ensured ‘the dissemination of information and promotion of debate’ resulting in ‘high quality’ media content.²¹⁸¹ Therefore, the second line of cases switches the focus of market failure from a normative tool to an analytical framework.

Finally, in *Hinkley Point C*, the UK submitted several arguments to support the existence of a market failure, such as the need to internalise negative externalities resulting from carbon emissions, referred to as ‘decarbonisation’, and the presence of residual market failures in the nuclear sector leading to uncertainty and lack of investments.²¹⁸² However, the Commission followed the methodology

²¹⁷⁷ Case T-162/13 *Magic Mountain* (n 2040).

²¹⁷⁸ Chapter 2, section 2.2.1.4. See also, Commission Decision (2013/126/EU) ‘Ciudad de la Luz’ (n 1839), para 103. ‘A ‘market failure’ is said to exist if the market outcome does not lead to the highest total social welfare. A[n] inefficient market outcome may arise in the case of so-called public or merit goods. Such goods generate positive external effects where the social benefits exceed the private benefits’.

²¹⁷⁹ Public health is an essential factor of economic growth see e.g., <<https://www.bma.org.uk/what-we-do/population-health/addressing-social-determinants-that-influence-health/valuing-health-why-prioritising-population-health-is-essential-to-prosperity>>.

²¹⁸⁰ Decision of the Commission (C(2013) 7870 final) ‘Production and innovation aid to written media’ (n 2066).

²¹⁸¹ *ibid.*, para 32.

²¹⁸² Case C-594/18 *P Austria v Commission (Hinkley Point C)* (n 2129), para 203.

of *Magic Mountain* and *Søndagsavisen*, considering the promotion of nuclear energy to constitute an objective of common interest on its own merit.²¹⁸³ As discussed earlier, the ECJ ruled that an objective of common interest is not a relevant criterion under Article 107(3) TFEU. Instead, what counts is whether the aid measure is ‘intended to facilitate the development of certain economic activities or of certain economic areas’.²¹⁸⁴ The aid scheme in this case aimed to develop ‘an activity within the meaning of Article 107(3)(c) [...] intended to replace ageing nuclear energy generating capacity that was scheduled for closure’.²¹⁸⁵ The relationship between the development of economic activity and market failure is unclear, as the former appears to be able to encompass any efficiency improvement. As seen previously, some scholars argue that the development of economic activities is sufficiently broad to capture any market failure rationales.²¹⁸⁶ As a result, any added value created by the remedy of a market failure can also be seen as contributing to the development of an economic activity. However, it is uncertain whether this conclusion also applies to broader market failure standards, and thereby can justify all forms of State aid.

8.2.1.1.2 *Macroeconomic Stability, Equity and Distribution Failures*

In its soft law, the Commission recognises that state aid can be justified on either efficiency grounds *or* equity considerations.²¹⁸⁷ This position is reinforced by Article 107(2) TFEU and the GBER.²¹⁸⁸ The appropriate welfare standard, therefore, differs from total efficiency²¹⁸⁹ and is defined by the Commission as

²¹⁸³ *ibid.*, para 374.

²¹⁸⁴ *ibid.*, para 19.

²¹⁸⁵ *ibid.*, para 61.

²¹⁸⁶ Nicolaides, ‘Shedding Light into the “Black Box” of State Aid: The Impact of Hinkley Point C on the Assessment of the Compatibility of State Aid’ (n 2074) 10.

²¹⁸⁷ Commission, Staff Working Document, ‘Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3’ (n 454), para 18. See also e.g., Friederiszick, Röller and Verouden (n 340); Nitsche and Heidhues (n 457).

²¹⁸⁸ e.g., aid for disadvantaged workers.

²¹⁸⁹ Buelens and others (n 369) 9.

‘total social welfare’.²¹⁹⁰ The meaning of this standard is, however, shrouded in a veil of uncertainty, thereby impeding its practical application.

The first line of cases above reveals a strong inclination towards efficiency-based rationales, particularly when both efficiency and external objectives are present.²¹⁹¹ Whilst efficiency rationales might lend themselves better for quantification, the reasons underlying this preference remain unclear. Conversely, the second line of cases demonstrates a shift in focus by the Commission towards the social aspects of the goals, rather than their efficiency contributions. In *Magic Mountain* and *Søndagsavisen*, the Commission placed greater emphasis on the social objectives of the measures when identifying their legitimate rationale.²¹⁹² A similar approach was taken in *Hinkley Point C*.²¹⁹³ The notion that Article 107(3)(c) includes equity objectives is further bolstered by the provision’s application to the evaluation of regional aid measures.²¹⁹⁴

An important question is whether the inclusion of external goals under Article 107(3)(c) would be affected by the Court’s literal interpretation in *Hinkley Point C*. It is suggested that nothing indicates that the ruling significantly alters the outcome with respect to external objectives. The criterion of ‘development of an economic activity’ appears to be sufficiently expansive to encompass any State aid granted to a firm or sector, based on external objectives.

However, despite the existence of cases that promote redistribution or macroeconomic objectives, these grounds have not been prominently featured in the direct assessment of State aid since the modernisation process, at least not in cases appealed before the EU Courts. Nonetheless, such cases do exist, as evidenced by a recent approval of a Swedish aid scheme under Article 107(3)(c)

²¹⁹⁰ Commission Decision (2013/126/EU) ‘Ciudad de la Luz’, para 103 where the Commission consider that ‘a market failure ‘exist if the market outcome does not lead to highest total social welfare’.

²¹⁹¹ Although other objectives were invoked such as the promotion of culture, cultural diversity and media plurality see, Commission Decision (2006/513/EC) ‘Berlin-Brandenburg’ (n 1972), para 45; Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), para 172.

²¹⁹² Case T-162/13 *Magic Mountain* (n 2040), para 79; Decision of the Commission (C(2013) ‘Production and innovation aid to written media’ (n 2066), para 32.

²¹⁹³ Commission Decision (EU) 2015/658) ‘Hinkley Point C’ (n 2075), para 374. Rather than identifying economic efficiencies the Commission merely conceded that the promotion of nuclear energy is an objective of common interest.

²¹⁹⁴ See Chapter 9, section 9.2

aimed at assisting disadvantaged workers in entering the labour market,²¹⁹⁵ albeit after first being assessed under the Employment Aid Communication.²¹⁹⁶

One possible explanation for the dearth of equity cases can be attributed in part to the significant amount of soft law regimes in the area,²¹⁹⁷ together with the overarching GBER,²¹⁹⁸ which is examined subsequently. Furthermore, many equity-based aid measures are carried out by firms under a public service obligation and are as a consequence governed by the *Altmark* case law²¹⁹⁹ or the SGEI regime,²²⁰⁰ both of which are excluded from this research. Similarly, stability failures are generally dealt with under different sectorial regimes.²²⁰¹

8.2.1.2 Identifying a Market Diagnostic Test: Is the Market Failing?

This step involves determining the existence of a legal test for market failure, through a double assessment: first the examination of the existence of a market failure, and second, the assessment of the significance of that market failure (establishing a threshold to counteract the ubiquity of market failure).²²⁰² This test has been referred to as ‘market diagnostics’ or ‘prima facie proportionality’.²²⁰³ It is crucial to recollect that whilst the limb of market diagnostics verifies the appropriateness and necessity of the intervention itself, the double market failure limb relates to the proportionality of the measure itself:

i) Is the market failing?

²¹⁹⁵ Commission Decision (C(2022) 3102 final) of 15 May 2022 on State Aid SA100209 (2022/N) (Sweden Entry Jobs).

²¹⁹⁶ Communication from the Commission, ‘Criteria for the analysis of the compatibility of State aid for the employment of disadvantaged and disabled workers subject to individual notification’ (2009/C 188/02).

²¹⁹⁷ e.g., the RAG analysed in Chapter 9, section 9.2

²¹⁹⁸ Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid (n 1727).

²¹⁹⁹ Case C-280/00 *Altmark Trans GmbH* (n 1705). See Chapter 7, section 7.3.1.1.

²²⁰⁰ Commission Decision (2012/21/EU) of 20 December 2011 on the application of Article 106(2) of the Treaty on the functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs (n 567).

²²⁰¹ This issue is further discussed in Chapter 9.

²²⁰² See Chapter 3, section 3.3.2.

²²⁰³ *ibid.*

ii) Is the market failure significant?

A critical review of the Commission's market failure test reveals a deviation from the traditional proportionality test.²²⁰⁴ Moreover, the role of market failure in the CAP is ambiguous.²²⁰⁵ Market failure has evolved from both a normative (rationale) and an analytical tool (justification/proportionality), to exclusively fulfilling the latter function.²²⁰⁶ The application of market failure as a diagnostic tool is evidenced in the Commission's practice and affirmed by the Court of Justice in *Hinkley Point C*.²²⁰⁷

As explained in Chapter 3, this research posits that the market diagnostic tool should form part of a *prima facie* suitability test of the measure.²²⁰⁸ Whereas this part of the suitability test deals with the appropriateness of intervention, the second part assesses the appropriateness of the specific aid measure (double market failure).²²⁰⁹

Figure 8.1

Appropriateness in the Commission's Methodology	
<i>Appropriateness of intervention</i>	<i>Appropriateness of the measure</i>
Is the market failing?	Is the aid measure remedying the market failure?

The legal assessment under Article 107(3)(c) enshrines a market diagnostics test, extending beyond the indirect threshold establishment facilitated by the GBER²²¹⁰

²²⁰⁴ On the traditional view of proportionality, see Chapter 3, section 3.1.3.1.

²²⁰⁵ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 12. The concept of market failure emerges in the second stage of the analysis; however, the Commission highlights that remedying a market failure is also considered an objective of common interest.

²²⁰⁶ This approach has been met with the acceptance of the Court in Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 66.

²²⁰⁷ *ibid.*, para 66.

²²⁰⁸ It is referred to as 'prima facie suitability' since the test of incentives also pertains to a certain extent to the suitability of the measure (i.e., the suitability of the measure to remedy the pre-identified market failure).

²²⁰⁹ See, figure 8.1.

²²¹⁰ GBER (n 1739).

and the De Minimis Regulation.²²¹¹ However, the nature of this market diagnostic test has evolved over time.

In the first line of cases, market failure not only serves as a rationale but also as a proper market diagnostic tool. In its decision on *the introduction of digital television (DVB-T) in Berlin Brandenburg*,²²¹² the Commission noted that the switchover from analogue to digital transmission could be delayed if left completely to market forces without any intervention from the State,²²¹³ due to market failures hindering the realisation of this efficiency improvement.²²¹⁴ In addition, the Commission appears to establish a threshold by requiring ‘true market failures’.²²¹⁵ It is within this logic that market failure is employed to assess that the result cannot be achieved by market forces alone. This threshold was reaffirmed by the Commission in *Mediaset*, where it examined whether the coordination failures at issue were ‘true market failures that prevent the market from achieving economic efficiency’.²²¹⁶

The use of market failure as a diagnostic tool to assess the need for intervention is also evident in the second line of cases. In *Magic Mountain*, the Commission found a market failure was present since the project of constructing climbing halls would not have been realised without public funding, due to the limited commercial interest in offering such educational and complementary activities.²²¹⁷ In this sense, market failure is established by demonstrating that without the aid, the sought-after efficiency or equity objective would not be achieved. Although the General Court upheld the use of market failure as a diagnostic tool, it held that ‘Article 107(3)(c) does not require the proof of a market failure’.²²¹⁸ However, the General Court continued, it may be a relevant factor as

²²¹¹ Commission Regulation (EU) No 1407/2013 on the application of Articles 107 and 108 TFEU to de minimis aid (OJ L 352/1) (n 1727).

²²¹² Commission Decision (2006/513/EC) ‘Berlin-Brandenburg’ (n 1972).

²²¹³ *ibid.*, para 87.

²²¹⁴ *ibid.*, para 88.

²²¹⁵ *ibid.*, para 100 (emphasis added).

²²¹⁶ Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), para 142.

²²¹⁷ Commission Decision (C(2012) 8761 final) ‘Deutscher Alpenverein’ (n 2029), para 70.

²²¹⁸ *ibid.*, para 77: ‘contrairement à ce que soutiennent les requérantes, l’article 107, paragraphe 3, sous c), TFUE n’exige pas la preuve d’une défaillance du marché afin de déclarer une aide compatible avec le marché intérieur.’

evidence of market failure is sufficient to justify State intervention.²²¹⁹ The Commission again utilised market failure as a suitability requirement in *Søndagsavisen*, and the General Court upheld the decision.²²²⁰ Public funding to promote the freedoms of expression and information might be necessary since there is a market failure in that ‘incentives for a private media undertaking to produce high quality socio-political and independent content available to all citizens on equal terms are limited’.²²²¹ The public goods character of news and information entails that the market itself is unable to deliver the desired output without State intervention.²²²²

In *Hinkley Point C*, market failure as a broad diagnostic tool was confirmed by the Court of Justice. The Commission, in its decision, adopted a meticulous market diagnostic test. Despite the UK’s suggestion that a residual market failure existed in carbon emissions and lack of security of supply, the Commission found that neither of these market failures could justify investment in nuclear energy specifically.²²²³ The existence of a broadly defined market failure in the energy market, i.e., negative externalities generated by carbon-intense activities, was considered insufficient to conclude that the market for nuclear energy was failing. To pass the market diagnostic test, a market failure specific to the investment of nuclear energy must be established. Ultimately, the Commission identified such nuclear-specific market failures in ‘significant risk’ and uncertainty.²²²⁴ However, the qualification of these broad concepts as market failures is problematic since the Commission did not explain the extent to which these concepts lead to an increase in efficiency or equity in the market.

It would appear that the market failure test applied by the Commission was loosened by the Court as it held that it was sufficient that the Commission had shown that the desired level of investment in nuclear energy could not be delivered

²²¹⁹ *ibid.*, para 78: ‘La preuve d’une défaillance du marché peut constituer un élément pertinent pour déclarer la compatibilité d’une aide d’État avec le marché intérieur (voir, en ce sens, arrêt du 6 octobre 2009, Allemagne/Commission, T-21/06, non publié, EU:T:2009:387, point 58). En effet, la présence d’une défaillance du marché est susceptible de justifier une intervention étatique’.

²²²⁰ Case T-167/14 *Søndagsavisen v Commission* (n 2073).

²²²¹ *ibid.*, para 35.

²²²² *ibid.*

²²²³ *ibid.*, para 380.

²²²⁴ Commission Decision (EU) 2015/658 ‘Hinkley Point C’ (n 2075), para 385.

‘in sufficient time’, without requiring a failure as such.²²²⁵ Rather than it being necessary to demonstrate that the market is failing, it suffices to establish that market forces alone cannot act within the desired timeframe. However, it is clear from the case law of the Court that this part of the analysis falls within the discretion of the Commission. As shown in the judgment of the Grand Chamber, where it reaffirmed the General Court’s ruling in *Magic Mountain*: whilst the Commission might consider it necessary to investigate the existence of a market failure when determining the compatibility of aid, such a failure does not constitute a condition under Article 107(3)(c).²²²⁶

In light of the above, it can be concluded that both the practice of the Commission and the case law of the EU Courts have reaffirmed the relevance of market failure as a diagnostic tool for evaluating the suitability of intervention through State aid under Article 107(3)(c).

8.2.1.3 Identifying Double Market Failure: Efficacy versus Efficiency

This step involves the application of ‘double market failure proportionality’, which entails the application of the principle of proportionality *internally* to the aid measure at stake in the form of a double market failure test. As previously explained,²²²⁷ the concept of double market failure refers to a ‘full-scale diagnostic tool frequently employed by policy analysts to determine the exact scope and nature of [public policy] intervention’.²²²⁸ The double market failure concept includes an analysis of the intervention itself to ensure that it does not create a ‘nonmarket failure’, also referred to as a ‘government failure’.²²²⁹

Whilst the market diagnostic test discussed earlier takes the shape of an appropriateness test, the more in-depth proportionality analysis of the measure’s appropriateness and necessity could be construed as a double market failure test, which evaluates the efficacy and/or efficiency of the intervention. This subsection,

²²²⁵ Case T-356/15 *Austria v Commission* (n 2099), para 156.

²²²⁶ *ibid.*, para 66.

²²²⁷ See Chapter 3, section 3.2.1 and 3.2.2.

²²²⁸ Zerbe Jr and Mccurdy (n 97) 558.

²²²⁹ See Chapter 3, section 3.2.2.

therefore, focuses on the two final branches of the Commission’s proportionality test, namely the incentive effect criterion and the least amount of aid criterion.²²³⁰

In State aid law, as opposed to antitrust law, there is a stronger separation between the efficacy and efficiency of the aid measure. In this regard, the double market failure test focuses on the efficacy of the measure in achieving its objectives, with relatively minor attention given to the potential creation of inefficiencies, as evaluated through the least amount of aid criterion.²²³¹ This is because the efficiency of the measure is only assessed in relation to other possible means of intervention. Instead, the efficiency of the measure appears to be more rigorously assessed under the *stricto sensu* limb, where both positive and negative effects are to be quantified, whenever possible.²²³²

Figure 8.2

Efficiency and Efficacy in the Commission’s Methodology	
<i>Appropriateness & Necessity of the Aid Measure</i>	<i>Stricto Sensu Balancing (as defined by the Commission)</i>
Is the aid measure effectively remedying the market failure? Are there any other means that might also remedy the measure whilst creating less inefficiencies?	Does the aid measure result in more efficiencies/equity than inefficiencies?

The double market failure test employed in State aid law appears to align more closely with the formal proportionality analysis, as detailed in Chapter 3 of this thesis.

As previously noted, the second part of the CAP assesses the design of the aid measure through a proportionality test based on (i) the appropriateness of the measure: (ii) its incentive effects; and (iii) the least amount of aid criterion

²²³⁰ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 9.

²²³¹ See, Figure 8.2.

²²³² *ibid.*, para 58.

(although simply referred to as ‘proportionality’ in the CAP).²²³³ This part of the test falls within the discretion of the Commission as it requires complex economic and social assessment.²²³⁴ Nonetheless, proportionality is a general principle of EU law which cannot be disregarded.²²³⁵ Therefore, the proportionality test is mandatory.²²³⁶

In the first line of cases, the Commission found that the aid measures were not appropriate to remedy the identified market failures and would, as a consequence, result in government failures. In the Decision on *the introduction of digital television (DVB-T) in Berlin Brandenburg*,²²³⁷ the aid measure was not considered appropriate as it did not truly reduce any costs for the broadcasters, who had their hands tied anyways by the timeframe of their operating licences on their respective frequencies.²²³⁸ Furthermore, the German government failed to put forward any evidence that the aid complied with the least amount of aid criterion.²²³⁹ On appeal, the General Court recalled the broad margin of discretion of the Commission in carrying out the assessment.²²⁴⁰ Ultimately, it upheld the decision and underlined, in particular, that the switch from analogue to digital transmission had been accomplished in other German Länder without State aid.²²⁴¹ Accordingly, the aid measure was deemed unnecessary to achieve the desired incentive effects.

In the *Mediaset* decision, the Commission found that consumer subsidies are, in principle, appropriate means to remedy the market failures impeding the switchover from analogue to digital frequencies.²²⁴² However, it ultimately found that the legal deadline alone was sufficient to combat the market failure, rendering

²²³³ *ibid.*, para 9. By ‘least amount of aid-criterion’ it is referred to the third part of the test, namely to analyse whether the change in behaviour could be obtained with less aid’.

²²³⁴ See Chapter 7, section 7.3.2.2.2 on the discretion of the Commission.

²²³⁵ *ibid.*

²²³⁶ *ibid.*

²²³⁷ Commission Decision (2006/513/EC) ‘Berlin-Brandenburg’ (n 1972).

²²³⁸ *ibid.*, para 102.

²²³⁹ *ibid.*, para 105.

²²⁴⁰ Case T-21/06 *Germany v Commission* (n 1994), para 50.

²²⁴¹ *ibid.*, paras 64-65.

²²⁴² Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), para 140.

the aid measure unnecessary.²²⁴³ Furthermore, the Commission concluded that the aid measure was disproportionate as it was designed in a way that created ‘unnecessary distortions of competition’.²²⁴⁴ This assertion is noteworthy since it appears that the Commission deviated from its own methodology. Under the formal proportionality analysis, the assessment should be limited to the efficacy of the aid measure, without any balancing between positive and negative effects. Hence, it is unclear whether this necessity assessment is part of the *stricto sensu* balancing or a general necessity requirement. Nonetheless, the analysis was ultimately upheld by the General Court.²²⁴⁵

The second line of cases places a greater emphasis on the incentive effect of aid, as a fundamental part of the REA.²²⁴⁶ In *Magic Mountain*, the Commission considered that the mere fact that the project would not have been realised without the aid, due to the lack of commercial interest, was sufficient to demonstrate that the aid was appropriate, necessary and produced the required incentives.²²⁴⁷ This part of the decision seems to fuse the appropriateness criterion for the intervention (i.e., the existence of a market failure) with the effectiveness of the measure (i.e., its incentive effect), such that the fulfilment of the first criterion is deemed to satisfy the second. With regard to the least amount of aid criterion, the Commission took the position that the competent administrative authorities, through detailed knowledge of the funding needs, ensured that the amount was proportionate.²²⁴⁸ Additionally, the non-commercial nature of the activities and the non-profit status of the recipient appeared to be enough to conclude that the amount was proportionate, as any surplus could only be reinvested in educational or sports activities.²²⁴⁹ This last point is remarkable because it suggests that,

²²⁴³ *ibid.*, para 144.

²²⁴⁴ *ibid.*, paras 166-168. Specifically the explicit exclusion of satellite operators from the aid measure resulted in unnecessary restrictions.

²²⁴⁵ *ibid.*, para 125.

²²⁴⁶ See Chapter 7, section 7.4.1. This is seen as a key principle of modernisation.

²²⁴⁷ Commission Decision (C(2012) 8761 final) ‘Deutscher Alpenverein’ (n 2029), para 72. The Commission also provided an example of a project for constructing a climbing hall in Berlin which was ultimately abandoned due to the refusal of the local authorities to co-finance the project.

²²⁴⁸ *ibid.*, para 74.

²²⁴⁹ *ibid.*, paras 78-79.

contrary to the Court's longstanding case law in *Höfner*,²²⁵⁰ in State aid law, the legal form of the undertaking is relevant to the compatibility assessment.

Once again, the General Court recalled the large margin of discretion afforded to the Commission.²²⁵¹ As seen above, one of the main arguments raised by the applicants was that the Commission did not follow its approach set out in the CAP. However, the General Court rejected this plea based on the non-binding character of the CAP.²²⁵² In particular, the applicants contended that the Commission had not considered other less restrictive measures, as required by the CAP.²²⁵³ Nevertheless, the General Court ruled that such an analysis is not required by Article 107(3)(c).²²⁵⁴ In addition, the Commission had rightfully pointed out that alternative measures, such as fiscal instruments, are complementary but non-alternative instruments to attain the objective of promoting sport for the masses.²²⁵⁵ As for the least amount of aid criterion, the General Court held that the Commission is not obliged to calculate an exact amount and to ensure that that amount is the strict minimum necessary when the aid measure is of sectorial application.²²⁵⁶ Instead, it suffices that the Commission based its decision on concrete elements relating, *inter alia*, to the nature of the aid measure or the relevant market.²²⁵⁷

Thirdly, the risk of double market failure was a critical element in the *Hinkley Point C* case.²²⁵⁸ The Commission considered that a credit guarantee as such was neither sufficient nor appropriate for tackling 'long term capital market failures' related to e.g., the complexity of construction and the lifecycle of the project.²²⁵⁹ However, since the credit guarantee was backed up by a contract for difference, investors were allowed to commit equity to the project.²²⁶⁰ The

²²⁵⁰ Case C-41/90 *Höfner* (n 35).

²²⁵¹ Case T-162/13 *Magic Mountain* (n 2040), para 50.

²²⁵² *ibid.*, para 48.

²²⁵³ *ibid.*, para 90.

²²⁵⁴ *ibid.*

²²⁵⁵ *ibid.*, para 91.

²²⁵⁶ *ibid.*, para 94.

²²⁵⁷ *ibid.*

²²⁵⁸ See section 8.2.1.3 of the current chapter.

²²⁵⁹ Commission Decision (EU) 2015/658 'Hinkley Point C' (n 2075), paras 393-406.

²²⁶⁰ *ibid.*, para 396.

combination of these instruments, together with their specific characteristics, led the Commission to the conclusion that the aid scheme was adequate and offered an ‘adequate incentive effect’.²²⁶¹ Due to the complexity of the measures the Commission undertook an in-depth assessment to ensure that there was no risk of overcompensation, though it did not assess whether the same objective could have been achieved with less aid.²²⁶² Ultimately both the General Court²²⁶³ and the Grand Chamber²²⁶⁴ upheld the analysis of the Commission.

The double market failure test under Article 107(3)(c) is two-fold. First, the efficacy of the measure is assessed in terms of its appropriateness and adequate incentives. In this regard, the Commission generally²²⁶⁵ verifies that the measure is capable of achieving the objective invoked. Second, there is, albeit to a lesser extent, also an assessment of the efficiency of the measure. The least amount of aid criterion, which addresses the question of government failure in the shape of overspending public funds, falls directly under the necessity requirement. However, the General Court ruled in *Magic Mountain* that the Commission is under no obligation to consider less restrictive measures other than State aid.²²⁶⁶ Therefore, there is no strict LRM standard imposed on the Commission in EU state aid law.

The above analysis suggests that EU State aid law *can* comprise a very strict double market failure test, although its application does not appear to be a mandatory requirement. The scope of this part of the test ultimately rests within the discretion of the Commission. At a minimum, it must be demonstrated that the objective of the aid would not have been achieved without the aid measure. Moreover, the EU Courts exercise only minimal review under a manifest error standard.²²⁶⁷ Unlike the efficiency-based test in Article 101(3) TFEU, it appears that Article 107(3)(c) does not require evidence that the measure enhances efficiency or equity beyond a safeguard against overcompensation.

²²⁶¹ *ibid.*, para 406.

²²⁶² *ibid.*, paras 407-489.

²²⁶³ Case T-356/15 *Austria v Commission* (n 2099), paras 222-226 and 383-400.

²²⁶⁴ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), paras 119-122.

²²⁶⁵ This was not the case in Case T-162/13 *Magic Mountain* (n 2040), where the analysis was much shorter.

²²⁶⁶ Case T-162/13 *Magic Mountain* (n 2040), para 90.

²²⁶⁷ See Chapter 7, section 7.3.2.2.2.

8.2.1.4 Identifying Trade-Offs: *Stricto Sensu* Proportionality

The final component of the test is employed to assess potential trade-offs between competition, narrow efficiencies and broader efficiencies/external objectives.²²⁶⁸ Such an assessment is of crucial importance in discerning the conciliation between competition law's status quo and the theory of market failure, which is referred to, in this thesis, as substantial proportionality.²²⁶⁹

As illustrated in the case study above, the extent of *stricto sensu* balancing under Article 107(3)(c) TFEU remains a complex topic subject to disagreement. It is suggested that the *stricto sensu* test is noticeably narrower in the indirect assessment than the general CBA suggested in State aid legal scholarship.²²⁷⁰

Moreover, this analysis demonstrates the symbiotic relationship between the notion of State aid and the compatibility assessment.²²⁷¹ The CAP appears more restricted than a traditional CBA of all efficiencies and inefficiencies created by the aid measure, as the purpose of the last step is to balance 'the distortions of competition and effect on trade' with the positive effects generated by the aid measure.²²⁷² According to the Commission, the crucial question is whether 'the distortions of competition and effect on trade [are] limited, so that the overall balance is positive?'²²⁷³

This subsection suggests that, unlike the antitrust regime, State aid law lacks a general efficiency-based balancing act. The final step in the Commission's market failure test resembles the 'no elimination of competition' criterion in Article 101(3) rather than a true *stricto sensu* balancing between positive and negative effects. Consequently, the CAP focuses on the distortions of competition and trade caused by the aid measure.²²⁷⁴ In this sense, it can be described as a one-sided balancing test. Despite emphasising the quantification of positive effects, the CAP's practical implementation seems limited to abstract positive effects,

²²⁶⁸ See Chapter 3, section 3.3.4.

²²⁶⁹ *ibid.*

²²⁷⁰ e.g., Friederiszick, Röller and Verouden (n 340) 652 who argued that this step is grounded in efficiency and an overall positive balance between efficiencies and inefficiencies.

²²⁷¹ See Chapter 7, section 7.3.1.4.

²²⁷² Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 9.

²²⁷³ *ibid.*

²²⁷⁴ *ibid.*, paras 44-56.

followed by the mere identification of a market or an equity failure. Furthermore, in contrast to the antitrust regime, under State aid balancing, a net positive balance suffices.²²⁷⁵

The first line of cases and the Commission's decision in *Mediaset*²²⁷⁶ evinces a confusion between necessity on one hand and *stricto sensu* balancing on the other. As seen above, the Commission found that the measure at issue engendered 'unnecessary distortions of competition', since it excluded satellite operators from the aid scheme, without any apparent justification.²²⁷⁷ Based on this finding, the Commission concluded that the measure was 'neither necessary nor proportional'.²²⁷⁸ This analysis cannot be understood as a strict balancing between positive and negative effects. Instead, it is the formal proportionality or the design of the measure that is assessed. The measure was found to go beyond what is necessary to achieve the intended objective.

In the second line of cases, the Commission appears to have adopted a more literal approach to its soft law documents and the letter of Article 107(3)(c). The Treaty itself does mandate a full balancing of the measure. As stated by Article 107(3)(c), what may be considered compatible with the internal market is:

(c) aid to facilitate the development of certain economic activities or of certain economic areas, *where such aid does not adversely affect trading conditions to an extent contrary to the common interest*.²²⁷⁹

In *Magic Mountain*, the Commission assessed both the impact on trade and trading conditions as well as the effects on competition arising from the measure.²²⁸⁰ Yet, this test appears to be more akin to a safety check in the sense of a 'no elimination of competition' test rather than a balancing exercise. After evaluating the effects of the measure on trade, the Commission concluded that its effects were 'limited' and 'that trading conditions are not adversely affected to an extent contrary to the common interest'.²²⁸¹ This seems to be far from the quantitative and qualitative

²²⁷⁵ See Chapter 5, section 5.3.1.4.

²²⁷⁶ Commission Decision (2007/374/EC) 'purchase of digital decoders' (n 2004).

²²⁷⁷ *ibid.*, para 167.

²²⁷⁸ *ibid.*, para 170.

²²⁷⁹ (emphasis added).

²²⁸⁰ Commission Decision (C(2012) 8761 final) 'Deutscher Alpenverein' (n 2029), paras 74-95.

²²⁸¹ *ibid.*, para 83.

balancing approach taken by the CAP, which requires that ‘the Member State has demonstrated that the positive effects of the aid, if any, outweigh its negative effects’.²²⁸² Similarly, the Commission found that the impact of the measure on competition was ‘limited’ and therefore not contrary to the common interest in the sense of Article 107(3)(c). It appears that Article 107(3)(c) establishes a threshold for competitive restrictions rather than providing a balancing tool in the form of a CBA or *stricto sensu* analysis.

Before the General Court, the applicants argued that the Commission had failed to conduct a proper balancing between the positive and negative effects,²²⁸³ and had merely conducted a general assessment, without any specific evidence of the positive and negative effects of the aid measure.²²⁸⁴ However, the General Court found that the Commission had ‘implicitly’ conducted a balancing test²²⁸⁵ since the negative effects were limited, and that was sufficient for the Commission to consider that the aid measure was not contrary to the common interest.²²⁸⁶ This, according to the General Court, would be enough to consider that the positive effects outweigh the negative effects.²²⁸⁷ Furthermore, since the case involved a sectorial aid scheme, the Commission was able to base its decision on the general characteristics of the market or the aid scheme without the need for a more detailed analysis as would be required for individual aid measures.²²⁸⁸ Thus, it seems that limited effects on trade and competition are enough to presume that the overall balance is positive. The same reasoning was adopted by the Commission in *Søndagsavisen*.²²⁸⁹

In the third line of cases, the Court of Justice confirmed the literal approach of Article 107(3)(c), thereby settling any doubts about the general nature of the balancing test in that article. Although the Commission claimed to conduct a

²²⁸² Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 57.

²²⁸³ Case T-162/13 *Magic Mountain* (n 2040), para 97.

²²⁸⁴ *ibid.*, paras 98–99.

²²⁸⁵ *ibid.*, para 110.

²²⁸⁶ *ibid.*

²²⁸⁷ *ibid.*

²²⁸⁸ *ibid.*, para 112.

²²⁸⁹ Decision of the Commission (C(2013) 7870 final) ‘Production and innovation aid to written media’ (n 2066).

‘through balancing’,²²⁹⁰ the decision solely focuses on the negative effects on trade and competition.²²⁹¹ The quantification process and balancing test of the CAP are conspicuous by their absence. However, the Commission did thoroughly assess the negative effects of the measure in order to conclude that they are ‘limited’.²²⁹² Hence, the quantification adopted merely considers the negative effects in order to establish the presumption that limited effects are outweighed by the positive effects of the aid.

Before the General Court, Austria claimed, *inter alia*, that the Commission had committed a manifest error in concluding that the positive effects outweighed the negative ones.²²⁹³ Nonetheless, the General Court rejected this claim, finding that the Commission could, on the basis of the elements examined, conclude that the measure was overall positive.²²⁹⁴

However, as noted above, the main contribution of the case to the balancing test is the General Court’s confirmation, ultimately upheld by the Grand Chamber, of its limited nature.²²⁹⁵ The balancing exercise is not of a general nature but is limited to the balance between the positive effects of the measure and its negative effect ‘*on competition and trade between Member States*’.²²⁹⁶

In conclusion, the balancing test under Article 107(3)(c) is limited. First, its sole function is to balance the positive effects of the measure, namely efficiencies or equity rationales that contribute to the development of economic activities, against the negative effects on trade and competition. In this sense, the balance is between competition law’s status quo and other narrow or broader efficiencies. As noted in scholarship, this implies that Article 107(3)(c) does not require aid to not have negative effects on other policy objectives and that, as a result, State aid does not need to ‘be capable of addressing multiple policy objectives’.²²⁹⁷

²²⁹⁰ *ibid.*, para 548.

²²⁹¹ *ibid.*, paras 495–549.

²²⁹² *ibid.*, para 547.

²²⁹³ Case T-356/15 *Austria v Commission* (n 2099), para 402.

²²⁹⁴ *ibid.*, para 530.

²²⁹⁵ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 101.

²²⁹⁶ *ibid.*

²²⁹⁷ Nicolaides, ‘The Compatibility of State Aid with the Internal Market’ (n 2152) 535.

Second, the balancing test does not appear to embody a general equilibrium test in the sense of Pareto or Kaldor-Hicks efficiency.²²⁹⁸ Instead, limited negative effects provide a presumption that the balance is overall positive. As there is no explicit *de minimis* rule in State aid, but merely a requirement that the aid should be ‘liable to’ distort competition and affect trade,²²⁹⁹ the proportionality analysis pursuant to Article 107(3)(c) is centred around the identification of negative effects on trade and competition. Only when these effects are not limited can the overall balance be deemed contrary to the common interest. This quasi-balancing, which primarily assesses negative effects, could be seen as some sort of administrative or judicial economy. It can be deduced from the above that the need to properly quantify and balance the positive effects with the distortions of competition and trade only arises when the negative effects are significant. Nonetheless, it remains ambiguous whether this limited test presupposes an implicit quantification of benefits in the first step. It has been suggested that whereas steps 1 and 2 involve identifying the positive effects of the measure, this final step solely assesses the negative effects of the aid to ensure that the overall balance is positive.²³⁰⁰ Yet, in the absence of any explicit balancing exercise, even such an approach appears to be limited in its practical application.

8.2.2 The Existence of a Market Failure Test in Article 107(3)(c)

Article 107(3)(c) TFEU, as applied by the Commission, encompasses a broad market failure test, both implicitly and explicitly. The legal requirements stemming from the case law can also be clarified by pivoting towards market failure as a theoretical cornerstone. However, this observation must be nuanced. Whilst market failure forms the analytical and sometimes normative nucleus of the assessment, the test cannot be construed as a general market failure test in line with the framework set out in Chapter 3.

Article 107(3)(c) embodies a broad State aid-specific market failure test. The ensuing subsection first delineates the elements of market failure theory that are present in the analysis under Article 107(3)(c). The second subsection analyses the obstacles to finding that the analysis includes a general market failure test.

²²⁹⁸ On the notion of an equilibrium see, Chapter 2, section 2.1.

²²⁹⁹ See Chapter 7, section 7.3.1.4.

²³⁰⁰ See Friederiszick, Röller and Verouden (n 340) 650 who suggest that steps 1 and 2 of the test focus on assessing the benefits whilst step 3 is concerned with delineating the negative effects.

Lastly, a conclusion is drawn highlighting that the analysis under Article 107(3)(c) encompasses two State aid-specific market failure tests: one discretionary and one that is strictly governed by legal requirements.

8.2.2.1 The Incorporation of a Market Failure Test in the Legal Assessment

Market failure theory reveals itself in three distinct facets in the analysis.

First and foremost, in the assessment of the negative and positive effects, there are no constraints that confine the market failure test to the relevant market. In this regard, it can be asserted that State aid law incorporates a test that more closely aligns with a general equilibrium analysis.²³⁰¹ Upon analysis of the assessment of the positive effects of aid, it becomes apparent that cases falling under Article 107(3)(c) have taken into consideration externalities that extend well beyond the relevant market. These externalities encapsulate broader public interest objectives,²³⁰² such as the promotion of amateur sports for the masses,²³⁰³ media diversity²³⁰⁴ or the promotion of nuclear energy.²³⁰⁵ These effects are distinct from narrow efficiency gains within the relevant market. This is a significant finding as it shows that State aid law transcends the market-governed nature of the antitrust regime.

Second, the objectives of compatibility of State aid under Article 107(3)(c) can be mirrored in market failure theory. Despite the judgment of the ECJ in *Hinkley Point C*, it is argued that the role of market failure remains largely unaffected. As noted previously, ‘the development of certain economic activities or of certain economic areas’ is sufficiently broad to include any instance of market failure,²³⁰⁶ nonetheless, further clarification from the Court may be necessary.

²³⁰¹ Contrary to the market-governed approach adopted in antitrust law. See, Chapter 5, section 5.3.1.4.

²³⁰² Decision of the Commission (C(2013) 7870 final) ‘Production and innovation aid to written media’ (n 2066), para 35, where the Commission referred to public interest objectives.

²³⁰³ Case T-162/13 *Magic Mountain* (n 2040).

²³⁰⁴ Case T-167/14 *Søndagsavisen v Commission* (n 2073).

²³⁰⁵ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129).

²³⁰⁶ See section 8.1.4 of the current chapter.

Both narrow and broader efficiencies are recognised under Article 107(3)(c). Despite the European Commission's separation of efficiency from equity consideration, it is possible to understand the State aid regime from a broad market failure standard. As stated by Heidhues and Nitsche in the CRA report, the 'social welfare standard' is broad enough to encompass both efficiency and equity objectives.²³⁰⁷

However, in the direct assessment of aid measures, equity-based rationales appear to be less prominent. Several plausible explanations for the absence of Court cases where equity standards have been invoked have been presented. A number of these measures fail to meet the criteria for State aid as they fall under the *Altmark* doctrine.²³⁰⁸ Moreover, only a limited number of cases culminate in litigation before the Courts.²³⁰⁹ Finally, there exists a substantial body of soft law dealing with the most common cases of State aid based on equity objectives.²³¹⁰ Lastly, a considerable number of these aid measures can be exempted under the GBER.²³¹¹

Third, the Commission adopts a market diagnostics test that evaluates both the existence of a market failure and the remedy by public policy intervention. This approach utilises market failure both as a normative and as an analytical tool under Article 107(3)(c). When assessing the appropriateness of the public policy intervention, the Commission determines the existence of a market failure. This was evident in its decision on *the introduction of digital television (DVB-T) in Berlin Brandenburg*,²³¹² and in *Mediaset*,²³¹³ where the Commission required the presence of 'true markets failures'. Although the adjective 'true' was later dropped, the requirement of a market failure was further affirmed in *Magic Mountain* and *Hinkley Point C*. Moreover, in both *Hinkley Point C* and *Mediaset*, the Commission conducted a thorough and detailed analysis of the incentive effect

²³⁰⁷ Nitsche and Heidhues (n 457) 50.

²³⁰⁸ See Chapter 7, section 7.3.1.1.

²³⁰⁹ In 2022, 68 cases were brought before the General Court. See, Judicial statistics for 2022, available at: <<https://curia.europa.eu/jcms/upload/docs/application/pdf/2023-03/cp230042en.pdf>>.

²³¹⁰ See Chapter 9. These include e.g., the 2022 Guidelines on regional State aid (n 1768); The Guidelines on State aid for the employment of disadvantaged and disabled workers (n 2196).

²³¹¹ See Chapter 7, section 7.3.2.3.

²³¹² Commission Decision (2006/513/EC) 'Berlin-Brandenburg' (n 1972).

²³¹³ Commission Decision (2007/374/EC) 'purchase of digital decoders' (n 2004),

of the measures ensuring that the market was unable to deliver an effective remedy without the aid.²³¹⁴

The focus on incentive effects ensures the effectiveness of the aid measure and the absence of government failure. In this sense, the modernisation of State aid law draws from antitrust law, by applying a counterfactual test to determine whether the project could proceed without the State aid.²³¹⁵ Thus, it is essential to provide evidence that the objective cannot be attained without the aid and that the aid produces sufficient incentive effects. Additionally, the necessity criterion requires the absence of overcompensation, thereby upholding a measure of efficiency in the intervention.

Fourth, the balancing process in the CAP takes the shape of a general equilibrium analysis.²³¹⁶ Both positive and adverse effects should be evaluated in qualitative terms, and where feasible in quantitative ones.²³¹⁷ The broad scope of the balancing process was limited by the Court of Justice in *Hinkley Point C*, where it held that the aid measure is balanced strictly against its effect on trade and competition in the internal market.²³¹⁸ Despite this limitation, the analysis still includes broad scope, going beyond the market-governed approach of antitrust law, since the evaluation extends beyond the boundaries of the relevant market. In such a general balancing exercise, there is a clear trade-off scenario between the efficiency or equity created by the measure and the harm caused to competition.

In sum, the assessment under Article 107(3)(c) adopts, a priori, the shape of a general equilibrium analysis predicated on the identification of a market failure. However, this observation must be nuanced as there are certain limitations hindering the existence of a general market failure test under Article 107(3)(c). The analysis now turns towards this specific issue.

²³¹⁴ Commission Decision (EU) 2015/658) ‘Hinkley Point C’ (n 2075), paras 375-413; Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), paras 140-168.

²³¹⁵ Case T-162/13 *Magic Mountain* (n 2040), para 87; Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 56.

²³¹⁶ See Chapter 7, section 7.4.2.3.2. As shown in practice, however, this test is much narrower and more abstract.

²³¹⁷ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), 58.

²³¹⁸ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 101.

8.2.2.2 The Limitations in Embedding a Fully-Fledged Market Failure Test

Several impediments, both of practical and legal nature, make the incorporation of a fully-fledged market failure test in Article 107(3)(c) TFEU impossible. The practical obstacles relate to the discretion of the Commission and the evolving nature of State aid law. The legal challenges appear to pertain to the narrow nature of the proportionality test in State aid law as opposed to a more general proportionality analysis.²³¹⁹

Firstly, the ubiquity of market failure previously explored²³²⁰ implies that the mere existence of a market failure is a broad and, as such, intangible finding. Externalities are ubiquitous, indicating that without a threshold, market failure is not a test but a constant condition of every market.²³²¹ In accordance with this perspective, the Commission stipulates within the CAP that ‘any market failure needs to be significant for State aid to improve efficiency’.²³²² Consequently, an assessment of the ‘presence and magnitude of market failures’ becomes a requisite.²³²³ This approach is discernible in earlier cases, where the Commission required the existence of ‘true markets failures’.²³²⁴ By contrast, in *Magic Mountain* the use of market failure as a diagnostic tool appears to be more akin to a ‘term’ than a bona fide legal and economic ‘concept’ or, even to a lesser extent, a legal ‘test’. Rather, the mere fact that a project would not have been realised without aid is sufficient to consider that the market is failing.²³²⁵ This approach was corroborated by the General Court in *Hinkley Point C*:

While the existence of a market failure may be a relevant factor for declaring State aid compatible with the internal market, the absence of market failure does not necessarily mean that the conditions laid down in Article 107(3)(c) TFEU are not satisfied [...]. For example, State

²³¹⁹ On the nature of the proportionality principle, see Chapter 3, section 3.1.3.

²³²⁰ See Chapter 3, section 3.2.1.

²³²¹ *ibid.*

²³²² Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 19.

²³²³ *ibid.*

²³²⁴ Commission Decision (2006/513/EC) ‘Berlin-Brandenburg’ (n 1972); Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004). See section 8.1.1 of the current chapter.

²³²⁵ Commission Decision (2006/513/EC) ‘Berlin-Brandenburg’ (n 1972), para 74.

intervention may be considered to be necessary for the purpose of that provision where market forces are not capable by themselves of ensuring that the public interest objective of the Member State is achieved in sufficient time, even if, as such, the market cannot be considered to be failing.²³²⁶

The judgment was ultimately upheld by the Court.²³²⁷ Accordingly, less than a lack of a threshold, market failure is not a *sine qua non* condition. This suggests that even minor market distortions might be remediable via State aid without necessitating the identification of a ‘true market failure’.

Secondly, and more critically, the balancing exercise appears both nebulous and superficial. As seen in the previous chapter, in theory the balancing test takes the shape of a general equilibrium test balancing the efficiency/equity gains against the market failure engendered in terms of market power/competition, or any related, concurrent market failure. Yet, the absence of an encompassing of either the qualitative or quantitative parameters of the positive effects of the aid obfuscates the test. The lack of an explicit *de minimis* rule is arguably the source of this limited nature of the balancing exercise.²³²⁸ As a consequence, there is no in-depth assessment of distortions of competition under Article 107(1).²³²⁹ It is, therefore, argued that the balancing test under Article 107(3) takes the shape of an assessment of distortive effects where limited effects on trade and competition are suffice to presume a positive overall balance.

Finally, the lion’s share of these requirements seems to fall within the discretion of the Commission. As put by the Court in *Hinkley Point C*, Article 107(3)(c) comprises only two conditions: the aid ‘must be intended to facilitate the development of certain economic activities or of certain economic areas’ and ‘it must not adversely affect trading conditions to an extent contrary to common interest’.²³³⁰ The Court does not advocate a market failure test but simply tolerates it. As consistently held by the EU Courts, the Commission ‘may consider it necessary’, but it is not a requirement.

²³²⁶ Case T-356/15 *Austria v Commission* (n 2099), para 151.

²³²⁷ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129).

²³²⁸ See Chapter 7, section 7.3.1.4.

²³²⁹ *ibid.*

²³³⁰ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 19.

As previously underscored, the State aid regime has significantly evolved over time. Hence, it can be inferred that the Commission's policies in State aid are highly volatile, demonstrating sensitivity to political tendencies in the Member States. This tendency is currently evidenced by the criticised²³³¹ loosening of the State aid rules following the Russian invasion of Ukraine, which led to the adoption of a Temporary Crisis and Transition Framework.²³³² Therefore, it must be reiterated that the State aid system exhibits notable flexibility and remains, undeniably, a highly political field.

8.2.2.3 Case Law Requirements – an Even Broader Market Failure Test

Despite the apparent flexibility of the State aid regime and its sensitivity to political conjecture, it is argued that a broad concept of market failure is embedded within the legal requirements stemming from the Court's case law, in addition to the State aid-specific market failure test applied by the Commission.

First, the clarification of the Court in *Hinkley Point C* should not be interpreted as a limitation of State aid law. Rather, it should be seen as an affirmation that Article 107(3)(c) is not confined to specific public policy objectives. The Court explicitly noted that, '[t]he Commission cannot in any event, by those instruments, improperly reduce the scope of Article 107(3)(c) TFEU'.²³³³ This clarification arguably changed little in relation to the Commission's broadly construed approach in the CAP. As explained in Chapter 2, economic efficiency is not a goal in itself, but a means to achieve a certain predefined welfare standard.²³³⁴ The Court, thereby, reaffirms the broad social welfare standard adopted in State aid law. Consequently, it follows that any market failure, along with numerous distributional failures, is in principle remediable under Article

²³³¹ This despite resistance from several Member States. See e.g., 'Euractiv, "Eleven EU Countries Urge 'Great Caution' in Loosening State Aid Rules" 15 February 2023, available at: <<https://www.euractiv.com/section/economy-jobs/news/eleven-eu-countries-urge-great-caution-in-loosening-state-aid-rules>>'.

²³³² 'European Commission Press Release P/1563, "State Aid: Commission Adopts Temporary Crisis and Transition Framework to Further Support Transition towards Net-Zero Economy" 9 March 2023, available at: <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_1563>'; 'White & Case, "The European Commission Loosens State Aid Rules to Foster Energy Transition and Prevent the Flight of Green Technologies from Europe" 27 March 2023, Available at <insight-alert/european-commission-loosens-state-aid-rules-foster-energy-transition-and>'.

²³³³ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 24.

²³³⁴ See Chapter 2, section 2.1.

107(3)(c). Even though the boundaries of ‘the development of certain economic activities or of certain economic areas’ are ambiguous, the boundaries are comparably obscure in the Commission’s approach.

Secondly, as aforementioned, State aid must respect the general principle of proportionality, which implies that it must be necessary and proportionate.²³³⁵ It must also be established that the aid measure generates an incentive effect.²³³⁶ From the entirety of the cases examined, it is evident that this necessitates demonstrating that the market alone cannot achieve the desired objective. This leads us back to the broadest conceivable definition of market failure: the failure to yield an optimal result for society. This requirement is capable of functioning as a minimum filter, capturing certain minor market disturbances that, whilst falling under the category of facilitating ‘the development of certain economic activities or of certain economic areas’, do not warrant State intervention.

Thirdly, although the balancing process in Article 107(3)(c) is limited to the effects of the aid measure on competition and trade, thereby excluding consideration of any other market failures engendered by the intervention, it ensures a balancing process between the market failure induced in terms of competition and the sought-after enhancement of efficiency/equity. In this regard, the analysis incorporates a ‘loose’ market failure test. Evidently, in the absence of any general *stricto sensu* balancing, it remains possible that an aid measure generates a net inefficiency from a welfare-economic perspective. Therefore, Article 107(3)(c) cannot be construed as implying a welfare-economic efficiency enhancement in the sense of Pareto or Kaldor-Hicks efficiency.

8.3 Conclusions – Physis or Nomos?

This chapter has critically examined the practical application and judicial review of the balancing exercise set out in the Commission’s refined economic approach. It has demonstrated that the Commission’s methodology can be construed as a market failure test, albeit applied to varying degrees on a case-by-case basis. Furthermore, the legal review of this discretion by the Court takes the shape of a broad-spectrum market failure test.

²³³⁵ See Chapter 7, section 7.3.2.2.2.

²³³⁶ *ibid.*

Reflecting the evolutive nature of State aid policy, the application of market failure as a legal test has transformed over time. In the earlier cases following the initiation of State aid modernisation, the spotlight was predominantly cast on the identification of ‘true market failures’.²³³⁷ These cases evince a preference for relying on efficiency grounds over external objectives, whenever feasible, thus indicating a lean towards a narrow, conventional market failure analysis. Whereas the methodology of the Commission seems to apply market failure as a normative rationale (justification), it is primarily employed as an analytical tool (proportionality). The EU Courts, reciprocally, have upheld the market failure analysis of the Commission.²³³⁸

In subsequent developments, the Commission appears have reduced the emphasis on market failure as a normative rationale. Instead, market failure is applied as an analytical tool ensuring that the objective sought cannot be achieved without the aid measure.²³³⁹ Whilst upholding the analysis of the Commission, the EU Courts adopted a more reluctant approach towards turning market failure into a legal principle, holding that Article 107(3)(c) does not require the demonstration of a market failure, albeit it can constitute a relevant factor.²³⁴⁰

Ultimately, the adoption of market failure as a compulsory normative requirement was categorically decisively and unequivocally rejected by the ECJ in *Hinkley Point C*.²³⁴¹ The ECJ ruled that Article 107(3)(c) merely requires that State aid facilitates ‘the development of certain economic activities or of certain economic areas’.²³⁴² It is suggested that following the modernisation process, the Commission has exhibited a willingness to incorporate a fully-fledged analytical framework based on the principles of market failure. However, this ostensibly robust framework has proven too rigid for the direct assessment and was, consequently, disapproved by the Court. Yet, this judicial stance should not be construed as an absolute rebuke of market failure analysis. Instead, it can be argued that the Court’s judgment in *Hinkley Point C* may only introduce minimal

²³³⁷ See section 8.1.1 of the current chapter.

²³³⁸ *ibid.*

²³³⁹ See section 8.1.2 of the current chapter.

²³⁴⁰ *ibid.*

²³⁴¹ See section 8.1.3.3 of the current chapter.

²³⁴² Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 19.

substantive changes, expanding the objectives of Article 107(3)(c) rather than restricting them.²³⁴³

In essence, it is argued that market failure manifests itself in two aspects in the direct assessment of State aid. Firstly, the Commission, through the exercise of its discretion, has formulated and applied a State aid-specific market failure test. This test includes a double market failure standard: beyond the mere existence of a market failure, aid must be necessary to create incentive effects, thereby ensuring that conspicuous government failures are not tolerated.²³⁴⁴ This test has been largely upheld by the EU Courts, underscoring its legitimacy and appropriateness within State aid analysis.²³⁴⁵

Secondly, the minimum requirements set forth by the Court under Article 107(3)(c) demonstrate that the very core of that provision embodies a broad market failure test.²³⁴⁶ This broader test requires the aid to achieve a result which would not be possible or likely by the free play of the market without State intervention.²³⁴⁷ Finally, in contrast with the antitrust regime, the positive effects engendered by State aid are not confined to the relevant market but assessed within the parameters of a general equilibrium.

In summary, notwithstanding the relevance of market failure in the context of both the practical assessment and judicial review under Article 107(3)(c), the absence of a comprehensive *stricto sensu* analysis precludes the interpretation of that provision as a general market failure test. Instead, the test applied by the Commission is construed as a State aid-specific market failure test.²³⁴⁸ Conversely, the EU Courts exercise their judicial review through the application of an extremely broad market failure test, revolving around an assessment of necessity.²³⁴⁹

²³⁴³ See section 8.1.4 of the current chapter.

²³⁴⁴ See section 8.2.2.1.

²³⁴⁵ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 67.

²³⁴⁶ See section 8.2.2.3 of the current chapter.

²³⁴⁷ As explored in Chapter 9, this broadly formulated legal test has been incorporated into the new sets of Guidelines from 2022 onward.

²³⁴⁸ See section 8.2.2.1 of the current chapter.

²³⁴⁹ See section 8.2.2.3 of the current chapter.

9. MARKET FAILURE IN SECTORIAL AID REGIMES: CONCORDANCE OR CONTRADICTION?

This chapter explores the streamlining of the market failure test, as defined in the CAP, within sector-specific soft law regimes. The objective is twofold: firstly, to discern whether these regimes conform or diverge from the overarching framework by implementing a distinct market failure analysis, and secondly, to assess the implications of divergencies or conformities. The analysis of this chapter is anchored primarily in the Guidelines established by the Commission, supplemented as needed by relevant case law.

Given the multitude of aid regimes, the focus is placed on two major regimes of EU State aid law: the Regional Aid Guidelines (RAG)²³⁵⁰ and the Guidelines on State Aid for Environmental Protection and Energy (CEEAG).²³⁵¹ Although narrower in scope than the direct assessment, these regimes claim significant ground in State aid law. Notably, the CEEAG and the RAG regimes encapsulate rationales that transcend the conventional paradigm of efficiency. Moreover, Both the CEEAG and the RAG underwent extensive revisions in 2022, providing up-to-date perspectives.²³⁵² However, it is important to note that instances may arise where measures which cannot be granted exemptions under a specific set of Guidelines might still be exempted under the direct assessment. In

²³⁵⁰ 2022 Guidelines on regional State aid (n 1768).

²³⁵¹ 2022 CEEAG (n 1771).

²³⁵² Other relevant guidelines such as the Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (n 1960) or the Guidelines on aid for training (n 483), remains within the 2014 framework, largely incorporating the framework set out in the CAP.

such a scenario, the aid measure is subject to the more general test explored in the previous chapter.

This chapter argues that, although these regimes may ostensibly deploy a market failure test analogous to that enshrined in the CAP, they manifest discernible divergencies. These deviations are not solely from the test applied within the direct assessment but, in some instances, even challenge the traditional paradigms of competition law analysis. In this sense, these regimes transpire sector-specific market failure tests, distinct from the general assessment in the CAP. This feature underscores the claim that, within the realm of EU State aid law, market failure is not conceptualised as a stringent methodology or a normative standard, but rather as a flexible analytical tool.

However, before delving into the specifics, a general clarification of the nature of State aid soft law is warranted. State aid guidelines have grown increasingly complex, encompassing over 40 separate guidelines and Communications.²³⁵³ Thus, streamlining the rules constitutes a key objective of State aid modernisation. According to Phedon and Hancher, the majority of State aid guidelines require the fulfilment of seven cumulative criteria for compatibility:²³⁵⁴

- i) contribution to a well-designed objective of common interest in accordance with Article 107(3) TFEU;
- ii) necessity for State intervention, indicating that the market alone cannot achieve the desired material improvement without State aid;
- iii) appropriateness of the measure;
- iv) incentive effect;
- v) fulfilment of the least amount of aid criterion;
- vi) overall positive balance of measure, whilst avoiding undue negative effects of competition and trade between Member States;
- vii) transparency of the aid, ensuring accessibility to the relevant acts.

Apart from a particular emphasis on transparency, these criteria essentially mirror those defined in the CAP. Further, this chapter explores the potential

²³⁵³ Hancher and Nicolaidis (n 1826) 193, 203.

²³⁵⁴ *ibid.*, 203.

reinterpretation of the first criterion in the revised guidelines in the wake of the ECJ's ruling in *Hinkley Point C*.²³⁵⁵

Whilst the selected aid regimes are capable of reflecting the entire Musgravian triangle (efficiency-stability-equity),²³⁵⁶ it is crucial to note that EU State aid law encompasses a specific regime on financial crisis aid that explicitly acknowledges financial stability as a key justification for State aid in the banking sector.²³⁵⁷ The regime delineates a novel restructuring blueprint, primarily through the implementation of a burden-sharing mechanism, 'with the objective of preventing systemic risk and ensuring the stability of the financial system'.²³⁵⁸ This framework epitomises the macroeconomic dimension of market failure, anchored on the tenet of stability.²³⁵⁹ Nevertheless, this chapter refrains from delving further into the examination of the financial crisis framework. This restraint is primarily due to one reason: it operates as a temporary framework, purported to deviate from the fundamental rules of State aid law during times of crisis. In this context, it resonates more closely with the COVID-19 Crisis Communication as opposed to the general State aid framework.²³⁶⁰ Although these regimes present illuminating examples of the flexible and evolutionary nature of State aid law, it would be misguided to derive conclusions about the general State aid framework based solely on their provisions.

This chapter is structured into three sections. The initial section explores the CEEAG, beginning with an analysis of its methodology and content, and thereafter analysing these Guidelines within the market failure framework defined in Chapter 3. The subsequent section examines the RAG, adopting the same analytical structure. The final section of the chapter offers conclusions and furnishes a comparative analysis of the CEEAG, RAG and CAP respectively.

²³⁵⁵ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 19.

²³⁵⁶ See Chapter 2, section 2.2.2.

²³⁵⁷ Communication from the Commission, 'State aid rules to support measures in favour of banks in the context of the financial crisis' (Banking Communication) (2013/C 216/01), para 2.

²³⁵⁸ Case C-526/14 *Kotnik* (n 519), para 88.

²³⁵⁹ See Chapter 2, section 2.2.2.1.

²³⁶⁰ Communication from the Commission, 'Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak' (2020/C 91 I/01).

9.1 State Aid, Market Failure and the Promotion of Environmental Sustainability

State aid is an important instrument for the Green Deal and for achieving the Union's environmental objectives.²³⁶¹ As articulated in the comprehensively revised 2022 CEEAG,²³⁶² '[c]ompetition policy and State aid rules in particular, has an important role to play in enabling and supporting the Union in fulfilling its Green Deal policy objectives'.²³⁶³ This domain is highly intricate as it intersects with various other Union policies and competences,²³⁶⁴ in particular instruments of secondary law.²³⁶⁵

This subsection demonstrates that, notwithstanding the absence of a general market failure test, the CEEAG contains a narrow sustainability-specific market failure framework. The concept of market failure remains integral to the analysis of environmental aid, given its aim to rectify negative environmental externalities and incentivise sustainable practices, underpinning economic efficiency and welfare. Within the context of environmental protection and energy, externalities are frequently presented as the key source of market failure,²³⁶⁶ potentially casting environmental aid in a more efficiency-oriented light in comparison to the assessment within the CAP.

The 2022 CEEAG has undergone substantial expansion in comparison to the previous Guidelines. Within its framework, the CEEAG enumerates a series of covered aid measures addressing various environmental and energy considerations:

²³⁶¹ Communication From the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, 'the European Green Deal' COM (2019) 640 final, section 2.2.2.

²³⁶² 2022 CEEAG (n 1771).

²³⁶³ *ibid.*, para 4.

²³⁶⁴ Kai Struckmann and Sapi Geza, 'Energy and Environmental Aid' in Werner and Verouden (n 1677) 663, 663.

²³⁶⁵ See e.g., Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community (n 427); Directive (EU) 2018/2001 of the European Parliament and the Council of 11 December 2018 on the promotion of the use of energy from renewable resources.

²³⁶⁶ e.g., Struckmann and Geza (n 2364), 666.

- Aid for combatting greenhouse gas emissions including through support for renewable energy and energy efficiency;²³⁶⁷
- Aid for the improvement of the energy and environmental performance of buildings;²³⁶⁸
- Aid for clean mobility;²³⁶⁹
- Aid for resource efficiency and for supporting the transition towards a circular economy;²³⁷⁰
- Aid for the prevention or the reduction of pollution other than from greenhouse gases;²³⁷¹
- Aid for the remediation of environmental damage, the rehabilitation of natural habitats and ecosystems, the protection or restoration of biodiversity and the implementation of nature-based solutions for climate change adaptation and mitigation;²³⁷²
- Aid in the form of reductions in taxes or parafiscal levies;²³⁷³
- Aid for the security of electricity supply;²³⁷⁴
- Aid for energy infrastructure;²³⁷⁵
- Aid for district heating and cooling;²³⁷⁶
- Aid in the form of reductions from electricity levies for energy-intensive users;²³⁷⁷
- Aid for the closure of power plants using coal, peat or oil shale and of mining operations relating to coal, peat or oil shale extraction;²³⁷⁸

²³⁶⁷ 2022 CEEAG (n 1771), paras 77-134.

²³⁶⁸ *ibid.*, paras 135-157.

²³⁶⁹ *ibid.*, paras 158-216.

²³⁷⁰ *ibid.*, paras 217-252.

²³⁷¹ *ibid.*, paras 253-275.

²³⁷² *ibid.*, paras 276-291.

²³⁷³ *ibid.*, paras 292-324.

²³⁷⁴ *ibid.*, paras 325-370.

²³⁷⁵ *ibid.*, paras 371-382.

²³⁷⁶ *ibid.*, paras 383-398.

²³⁷⁷ *ibid.*, paras 399-419.

²³⁷⁸ *ibid.*, paras 420-447.

- Aid for studies or consultancy services on matters relating to climate, environmental protection and energy;²³⁷⁹

Notably, the initial category seemingly encapsulates a broad spectrum of decarbonisation measures, positioning itself as the most comprehensive category enumerated.²³⁸⁰

This section aims to assess the general principles of this complex field to determine to what extent the CEEAG adheres to or deviate from the test laid down in the CAP. The ensuing analysis is divided into two distinct subsections. The initial subsection examines and interprets the criteria within the compatibility assessment under the CEEAG. This exploration reveals that, whilst these criteria are principally grounded on a test analogous to the CAP, they exhibit considerable divergencies in both methodological and substantive terms. The latter subsection delves into the anatomy of the potential market failure test in CEEAG, comparing it with the assessment adopted in the direct assessment under Article 107(3)(c). Of critical importance is the argument that the CEEAG cannot be considered to reflect a market failure test within the framework established in Chapter 3, primarily due to the incorporation of a unique sustainability-laden welfare standard. Instead, this regime is primarily focused on correcting sustainability failures specifically and exhibits a high degree of adaptability vis-à-vis the overarching framework. Nevertheless, the analysis of the CEEAG regime unveils significant insights into the interpretation and application of market failure within the realm of State aid soft law, primarily functioning as an analytical tool rather than a normative rationale.

9.1.1 The Compatibility Assessment under the CEEAG

Following the judgment of the Grand Chamber in *Hinkley Point C*,²³⁸¹ the latest revision of the CEEAG incorporates certain textual alterations. Significantly, it dispenses with the requirement of a ‘well-defined objective of common interest’ as mandated by both the CAP and the 2014–2020 Guidelines.²³⁸² Whilst the

²³⁷⁹ *ibid.*, paras 448-454.

²³⁸⁰ This observation remains applicable when examining recent cases from the Commission.

²³⁸¹ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129). For an analysis of that judgment see, Chapter 8, section 8.1.3.3.

²³⁸² 2014 CEEAG (n 1670), para 27.

preceding version of the guidelines adhered to the sequencing of the CAP, the 2022 CEEAG presents a notably restructured test. However, upon closer examination, it may be contended that, in practice, such revisions do not substantially deviate from the previous approach. This argument is supported by the fact that the criterion of contribution to ‘the development of economic activities’ is interpreted analogously to the notion of an ‘objective of common interest’.²³⁸³

The CEEAG sets forth a somewhat fragmented methodology that encapsulates the two explicit textual conditions of Article 107(3). This comprises a positive condition, requiring that the aid should ‘facilitate the development of economic activities’, and a negative condition which stipulates that aid should not ‘unduly affect trading conditions to an extent that is contrary to the common interest’. Substantially, the test is essentially based on the CAP criteria – market failure, appropriateness, incentive effect, proportionality, and an overall positive balance²³⁸⁴ – which is then divided into separate sub-conditions of these principal criteria. These criteria and sub-conditions are examined below.

9.1.1.1 A Contribution to the Development of Economic Activity

The primary criterion of Article 107(3)(c) requires that the aid must ‘facilitate the development of certain economic activities’.²³⁸⁵ To satisfy this requirement, the CEEAG enumerates three sub-conditions.²³⁸⁶ These are: (i) the identification of the economic activity which is being facilitated, together with its positive effects on society; (ii) the incentive effect of the aid measure; and (iii) the absence of breach of any provisions of EU law.

First, the aid must identify the activity being facilitated, along with its ‘positive effects for the society at large and, where applicable, its relevance for specific policies of the Union’.²³⁸⁷ It is noteworthy that although sustainability is a core concept of the CEEAG, it seems that not all measures covered by them have

²³⁸³ Compare *ibid.*, paras 30-32 and 2022 CEEAG (n 1771), paras 23-25.

²³⁸⁴ See Chapter 7, section 7.4.2. These criteria essentially assess the design of the measure (appropriateness, incentive effect and proportionality) and that the distortions on competition and trade are limited to ensure a positive balance.

²³⁸⁵ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 19.

²³⁸⁶ 2022 CEEAG (n 1771), para 22.1.

²³⁸⁷ *ibid.*, para 22.a.

to advance sustainable development. The development of economic activity in itself appears to adopt a total welfare approach without placing additional weight on the sustainable nature of such development. Therefore, although most measures are required to further sustainable development, sometimes a net zero effect is deemed sufficient. This is illustrated in the CEEAG, which states that any aid measure falling within the aforementioned categories could potentially fall under the CEEAG as long as it mitigates negative environmental externalities *or* supports the ‘creation of new economic activities and services’, thereby promoting the ‘green economy’.²³⁸⁸ Nevertheless, it remains unclear how the mere creation of new economic activities contributes to the advancement of the ‘green economy’. Thus, the CEEAG contains two types of welfare creation through the development of economic activity: the enhancement of sustainability; and the creation of economic activity as such.

As for the latter category, based on the provided list the only aid measures that do not seem to require furthering sustainability to be deemed appropriate and necessary²³⁸⁹ are certain energy aids, such as ‘aid for the security of electric supply’.²³⁹⁰ Moreover, the CEEAG is clear that any such aid that aggravates market failures and poses a risk to incentive investments in the most polluting energy sources, such as coal, diesel, or oil, is unlikely to produce positive effects offsetting its negative effects.²³⁹¹ Regarding sustainability-enhancing measures, the CEEAG merely states that aid preventing or reducing the adverse effects of economic activities on the climate or the environment develops those activities by making them more sustainable.²³⁹²

To satisfy this first sub-condition, Member States must provide evidence demonstrating ‘*if* and *how*’ the aid will contribute to achieving the Union’s objectives of its climate, environmental and energy policies, and the anticipated benefits derived from the aid measure by showing its impact on ‘environmental protection, including climate change mitigation, or the efficient functioning of the internal energy market’.²³⁹³ This requirement aligns clearly with a traditional

²³⁸⁸ *ibid.*

²³⁸⁹ This assertion is further expanded upon in the subsequent subsections.

²³⁹⁰ 2022 CEEAG (n 1771), paras 325-351.

²³⁹¹ *ibid.*, para 368.

²³⁹² *ibid.*, para 34.

²³⁹³ *ibid.*, para 25 (emphasis added).

market failure approach centred on efficiency. In scholarship, redressing market failures also emerges as the key rationale for State aid in the environmental and energy sector.²³⁹⁴ Such environmental policies enhance efficiency either by combatting negative externalities or by generating positive externalities (merit goods).²³⁹⁵ The same interpretation holds regarding the previous set of Guidelines.²³⁹⁶ Therefore, the inclusion of the notion of ‘development of an economic activity’ as opposed to the previous requirement of an ‘objective of common interest’ seems to engender minimal substantive change within the framework of the CEEAG.

Second, the aid must induce an incentive effect within the meaning of the CAP.²³⁹⁷ This requirement does not receive a distinct interpretation specific to the context of environmental and energy aid.²³⁹⁸ The incentive effect must demonstrate that the beneficiary is likely to alter its behaviour by engaging in either an additional economic activity *or* a more environmentally friendly one, which it would not have carried out without the aid.²³⁹⁹ Similarly to the requirement in the CAP, this condition is proven by the application of a counterfactual test.²⁴⁰⁰

Finally, the granting of State aid is contingent upon its compliance with the relevant provisions of EU law. This sub-condition directly follows from the aforementioned *Hinkley Point C* case. However, it should be noted that this requirement is not restricted to environmental legislation. As noted by the Commission, it can apply in a variety of other circumstances.²⁴⁰¹

²³⁹⁴ Struckmann and Geza (n 2364) 666.

²³⁹⁵ On the notion of externalities see Chapter 2, section 2.2.1.1.

²³⁹⁶ 2014 CEEAG (n 1670), para 30: ‘The general objective of environmental aid is to increase the level of environmental protection compared to the level that would be achieved in the absence of the aid’.

²³⁹⁷ 2022 CEEAG (n 1771), paras 26-32.

²³⁹⁸ Other than specific guidance with regards to the various forms on environmental aid. For instance, in the case of aid for the improvement of energy and environmental performance of buildings, the ‘Commission considers that, in principle, aid to project with a payback period of less than 5 years does not have an incentive effect’ (*ibid.*, para 142).

²³⁹⁹ 2022 CEEAG (n 1771), para 26.

²⁴⁰⁰ *ibid.*, para 28.

²⁴⁰¹ *ibid.*, para 33.

9.1.1.2 Not Affecting Trading Conditions to an Extent Contrary to the Common Interest

The second textual condition of Article 107(3)(c) is that the provision of aid must not adversely affect trading conditions to an extent contrary to the common interest.²⁴⁰² In further defining this condition, the CEEAG delineates six sub-conditions that must be met.

9.1.1.2.1 *Presence of a Market Failure*

The first sub-condition requires that there must be a compelling need for State intervention.²⁴⁰³ To minimise potential distortion of competition and trade, the aid must be designed to remedy a market failure in the broadest sense. In accordance with the CAP, the aid must ‘bring about a material development that the market alone cannot deliver, for example by remedying market failures in relation to the projects or activities for which it is awarded’.²⁴⁰⁴ The primary rationale for correcting such market failures seems to be rooted in a conventional efficiency-based understanding of the concept. Whilst the Commission recognises that competitive markets generally lead to efficient outcomes ‘in terms of development of economic activities’, intervention through State aid may be necessary if ‘the market on its own fails to deliver an efficient outcome’.²⁴⁰⁵ The Member States are, therefore, required to demonstrate the existence of a market failure, either in terms of inadequately provided environmental protection or an inefficient energy market.²⁴⁰⁶ The CEEAG enumerates the main market failures which may obstruct efficient outcomes in terms of climate, environmental protection and energy.

Predominantly, negative externalities stand as the primary category of market failures. These typically emerge ‘when pollution is not adequately priced’.²⁴⁰⁷ In such a scenario, the costs of pollution faced by the relevant firms do not correspond to the costs borne by society at large. State aid may catalyse the

²⁴⁰² Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 19.

²⁴⁰³ 2022 CEEAG (n 1771), para 34.

²⁴⁰⁴ *ibid.*

²⁴⁰⁵ *ibid.*

²⁴⁰⁶ *ibid.*

²⁴⁰⁷ *ibid.*, para 34 (a).

necessary incentives to reduce pollution.²⁴⁰⁸ For example, State aid channelled towards the promotion of green energy has the potential to mitigate negative externalities in the digital sector, wherein energy consumption accounts for a substantial portion of the total Co2 emissions.²⁴⁰⁹

The second category of market failures delineated in the CEEAG pertains to positive externalities. These relate not to the mitigation of negative externalities, but rather to the creation of merit goods that confer benefits upon benefits consumers and society as a whole.²⁴¹⁰ Certain instances of eco-innovation or innovative renewable technologies may benefit market participants beyond the investor, thereby lessening the incentives to invest.²⁴¹¹ Examples encompass investment in wastewater treatment or waste-to-energy technologies. State aid may here counteract the impetus to invest in socially desirable goods.

Thirdly, information asymmetries may also engender sub-optimal outcomes from the standpoint of climate, environmental protection or energy efficiency.²⁴¹² However, as noted within the context of the earlier discussed *Hinkley Point C* case, it may be challenging to draw a precise line between information asymmetries and the common business uncertainty, as well as the usual risks borne by every firm.²⁴¹³ In this regard, the CEEAG seems to adopt a rather broad notion of asymmetric information, ostensibly tailored to address the potential lack of investment in greener technologies. To explain, '[t]his could, for instance, occur where external financial investors have a lack of information about the likely returns and risks of a project'.²⁴¹⁴ This quote illustrates the challenge of distinguishing between true market failures in the sense of information asymmetries and regular uncertainty in the outcome of specific business decisions. However, the Commission is aware of the challenge in parsing apart these phenomena:

²⁴⁰⁸ *ibid.*

²⁴⁰⁹ See on energy usage in the digital sector, e.g., <<https://www.polytechnique-insights.com/en/braincamps/planet/how-to-reduce-carbon-emissions-of-the-digital-sector/internet-of-things-50-billion-greenhouse-gas-producers>>.

²⁴¹⁰ On externalities see, Chapter 2 section 2.2.1.1.

²⁴¹¹ 2022 CEEAG (n 1771), para 34(b).

²⁴¹² *ibid.*, para 34(c).

²⁴¹³ For an analysis under Article 107(3)(c), see Chapter 8 section 8.1.3.

²⁴¹⁴ 2022 CEEAG (n 1771), para 34(c).

Although risk or uncertainty do not in themselves lead to the presence of a market failure, the problem of asymmetric information is linked to the degree of such risk and uncertainty. Both tend to be higher for environmental investments with a typically longer amortisation period, reinforcing a focus on a short-term horizon that could be aggravated by financing conditions for such investments in particular for SMEs.²⁴¹⁵

Thus, contrary to a traditional market failure approach, the CEEAG adopts a pragmatic definition capable of counteracting the lack of financial investments in the climate protection and energy sectors. It would appear that State aid as an instrument to create financial incentives not only levels the playing field in terms of information asymmetries, but also has the capacity to hedge part of the uncertainty involved in certain financial decisions.²⁴¹⁶ This broader construal of asymmetric information diverges somewhat from the customary economic objections to such asymmetry, which traditionally result in ‘adverse selection’ and inefficiencies.²⁴¹⁷

Fourth and finally, in line with the CAP, coordination failures are recognised as a common source of market failure within the sector. These failures are inextricably tied to the lack of common interests or incentives, also known as ‘split incentives’.²⁴¹⁸ Coordination failures may prevent the realisation of an efficient project due to uncertainty about the outcome, network effects, costs, etc.²⁴¹⁹ As seen previously, the precise nature of these market failures is ambiguous and they appear problematic to define.²⁴²⁰ Coordination failures manifest a close intertwining with the concept of imperfect competition, albeit diverging in nature – rather than inducing an asymmetry of information favouring one party, they generate a collective uncertainty that obstructs efficient coordination.²⁴²¹ Examples encompass uncertainty pertaining to an uninterrupted supply of energy

²⁴¹⁵ *ibid.*

²⁴¹⁶ However, this might increase the risk of reckless behavior, so-called moral hazard.

²⁴¹⁷ See Chapter 2, section 2.2.1.2.

²⁴¹⁸ 2022 CEEAG (n 1771), para 34(f).

²⁴¹⁹ *ibid.*

²⁴²⁰ *ibid.*, para 34(d): ‘[c]oordination failures may be further exacerbated by information problems, in particular those related to asymmetric information’. See also, for an analysis, Chapter 7, section 7.4.2.1.1.

²⁴²¹ *ibid.*

or the imperative to reach a critical mass before a project is commercially attractive to invest in.²⁴²²

Nonetheless, the mere existence of a market failure, whilst necessary, is not in and of itself sufficient to warrant the necessity of the aid measure.²⁴²³ The residual nature of the market failure must be substantiated, implying that it must be proven that the claimed market failure remains unremedied by other policies and instruments.²⁴²⁴ Thus, Member States are obliged to identify any existing policies and measures aimed at the identified market failure and demonstrate how State aid reinforces these policies and/or measures.²⁴²⁵ This requirement is further specified in relation to specific aid measures. For instance, with regard to decarbonisation measures, it must be shown how these measures affect ‘the Union’s ETS and related policies’, underscoring the inadequacies of the latter in fully internalising the costs of greenhouse emissions.²⁴²⁶ Another illustrative example pertains to mobility aid for the deployment of recharging or refuelling infrastructure, where the Member States must demonstrate the improbability of the market to, on its own, develop comparable infrastructure within the short term.²⁴²⁷

However, it has been acknowledged by the Commission that providing the existence of a residual market failure through a detailed assessment of existing measures can present challenges. Therefore, in the context of decarbonisation aid measures, if the need for aid is demonstrated, the CEEAG adopts the presumption that a residual market failure persists and can be effectively mitigated through the provision of decarbonisation aid unless evidence to the contrary comes to the fore.²⁴²⁸

9.1.1.2.2 *Appropriateness of the aid Measure*

Secondly, the aid must be appropriate. Similar to its application within the CAP, the appropriateness test assesses the efficacy of the intervention through a double

²⁴²² *ibid.*

²⁴²³ *ibid.*, para 35.

²⁴²⁴ *ibid.*, para 36.

²⁴²⁵ *ibid.*

²⁴²⁶ *ibid.*, para 89.

²⁴²⁷ *ibid.*, para 194.

²⁴²⁸ *ibid.*, para 91.

market failure standard, focusing on the design of the measure.²⁴²⁹ Under this condition, it must be verified that the aid measure is suitable to achieve the intended objective, whilst simultaneously requiring the absence of less distortive instruments that could achieve the same result.²⁴³⁰ In contrast to the CAP, the CEEAG explicitly imposes a LRM standard,²⁴³¹ which is subject to a twofold examination.

On one hand, the appropriateness of the aid measure is evaluated in comparison to alternative policy instruments.²⁴³² The fulfilment of such a stringent necessity criterion could prove to be a challenging task. To illustrate, employing State aid to redress information asymmetries may seem to appear less intuitive than other potential regulatory mechanisms.²⁴³³ Furthermore, the array of alternative instruments that could be employed is vast. In this regard, the Commission provides an illustrative, albeit non-exhaustive, list of alternative means to achieve environmental and energy objectives:

[...] such as market-based instruments or demand side measures involving regulation, compliance with the energy efficiency first principle, public procurement or standardisation, as well as an increase in funding of public infrastructure and general fiscal measures.²⁴³⁴

Moreover, various ‘soft instruments’ may be deployed.²⁴³⁵ A primary concern mandating substantiating the requirement of a strict LRM standard emanates from the potential for cross-policies to cancel out each other.²⁴³⁶ Consequently, the necessity arises to assess the impact of the aid measure on existing measures

²⁴²⁹ See, Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), paras 30-31.

²⁴³⁰ 2022 CEEAG (n 1771), para 39.

²⁴³¹ e.g., *ibid.*, para 43, ‘The Member States should, however, ensure that the aid is awarded in the form that is likely to generate the least distortion of trade and competition’.

²⁴³² *ibid.*, paras 40-42.

²⁴³³ e.g., by command-and-control regulation mandating the disclosure of certain information to the other party of an agreement.

²⁴³⁴ *ibid.*, para 49.

²⁴³⁵ *ibid.*, para 40, such as non-mandatory ecolabels or the dissemination of environmentally friendly technologies.

²⁴³⁶ *ibid.*, para 43.

targeting the same market failure.²⁴³⁷ Notably, the ‘polluter pays’ principle should be enforced when possible to tackle negative externalities generated by inappropriately priced pollution.²⁴³⁸ When assessing the appropriateness of aid measures in relation to alternative policy instruments, the Commission may take into account various factors. In its decision on a Finnish aid scheme comprising various capacity measures, granted to ensure the security of electric supply, the Commission’s assessment revealed that despite various market reforms targeting the same market failure, a residual risk of electricity supply inadequacy persisted, attributable to the intrinsic market structures.²⁴³⁹

On the other hand, the appropriateness of the aid measure must undergo assessment in relation to other possible aid instruments.²⁴⁴⁰ Member States are obligated to ensure that the selected aid measure is the least distortive one.²⁴⁴¹ In demonstrating the appropriateness of the aid measure in mitigating the market failure, Member States are obliged to substantiate their claim through the presentation of evidence that other potential aid measures – such as tax credits versus tax reductions, repayable advances as opposed to direct grants, or aid measures founded on financial instruments rather than equity instruments – are less fitting.²⁴⁴² For example, in the case of decarbonisation aid, the Commission requires that aid covering operational costs, rather than investment, may only be granted where Member States can provide evidence substantiating that such aid results in more environmentally friendly operating decisions.²⁴⁴³

9.1.1.2.3 *Proportionality of the Aid Measure*

The third sub-condition relates to the proportionality of the aid measure. The principle of proportionality requires that the aid must be limited to the amount of the requisite quantum (the least amount of aid criterion). The conceptualisation of proportionality within the CEEAG remains consistent with the meaning ascribed

²⁴³⁷ *ibid.*

²⁴³⁸ *ibid.*, para 42.

²⁴³⁹ Commission Decision (C(2022) 7306 final) of 11 October 2022 (Finnish strategic reserve), para 163.

²⁴⁴⁰ 2022 CEEAG (n 1771), paras 43-46.

²⁴⁴¹ *ibid.*, para 43.

²⁴⁴² *ibid.*, para 44.

²⁴⁴³ *ibid.*, para 121.

to it within the CAP, whereby the amount of aid is limited to what is strictly necessary.²⁴⁴⁴ As a general principle, the Commission considers that aid which corresponds to the net extra cost, referred to as the ‘funding gap’, is limited to the minimum amount necessary to realise the aided project or activity.²⁴⁴⁵ Determining the funding gap entails the establishment of a counterfactual scenario, discerning the difference between the revenues and costs of the aided project and those of a probable alternative project likely to transpire in the absence of State aid (the counterfactual).²⁴⁴⁶ However, in instances where a competitive bidding process is deployed, an exhaustive assessment of the net extra cost is considered unnecessary since such a procedure is regarded to provide ‘a reliable estimate of the minimum aid required by potential beneficiaries’.²⁴⁴⁷

To evaluate the net extra cost via a counterfactual analysis, Member States are required to quantify both the counterfactual and factual scenarios.²⁴⁴⁸ This quantification must encapsulate ‘all main costs and revenues, the estimated weighted average cost of capital of the beneficiaries to discount future cash flows, as well as the net present value for the factual and counterfactual scenarios, over the lifetime of the project’.²⁴⁴⁹ Leveraging this quantitative data, the Commission verifies the plausibility of the counterfactual, whilst the Member State bears the responsibility of providing explanation and justification for the assumptions and the methodology used in the quantification process.²⁴⁵⁰ Typically, the funding gap is defined as ‘the difference between the [net present value] for the factual scenario and the counterfactual scenario’.²⁴⁵¹ For instance, in a recent decision concerning a German aid scheme for the installation of rooftop solar photovoltaic (PV) panels, the Commission found the aid measure to be necessary based on the ‘significantly negative’ funding gaps observed in the reference projects.²⁴⁵²

²⁴⁴⁴ *ibid.*, para 47.

²⁴⁴⁵ *ibid.*, para 48.

²⁴⁴⁶ *ibid.*

²⁴⁴⁷ *ibid.*, para 49.

²⁴⁴⁸ *ibid.*, para 51.

²⁴⁴⁹ *ibid.*

²⁴⁵⁰ *ibid.*

²⁴⁵¹ *ibid.*

²⁴⁵² Commission Decision (C(2022) 6946 final) of 27 September 2022 (Easter Package 2022 Early Bird Measures & Additional round of solar PV tenders in 2022), para 120. See also Commission

Nevertheless, it merits mention that alternative calculation methods are permissible, particularly when the counterfactual consists of a business-as-usual scenario devoid of an alternative project.²⁴⁵³ Furthermore, the Commission also proposes alternative approaches to quantification in circumstances where the identification of the project's costs and benefits prove challenging.²⁴⁵⁴

9.1.1.2.4 *Transparency Requirement*

Fourthly, the Guidelines establish a specific transparency requirement. This condition serves to address any potential negative effects by guaranteeing full access to relevant information for competitors. As a result, the details of the aid measure must be disseminated either through the Commission's transparency award module website or an equivalent national platform.²⁴⁵⁵

9.1.1.2.5 *Avoidance of Undue Negative Effects on Competition and Trade*

The fifth sub-condition mandates that the granting of aid must demonstrate an 'avoidance of undue effects [...] on competition and trade'. Differentiating this sub-condition from the principal criterion outlined in Article 107(3)(c) – according to which the aid measure should not 'affect trading conditions to an extent contrary to the common interest'²⁴⁵⁶ – appears challenging. The inclusion of the term 'undue' seemingly suggests that certain restrictions are not permissible without necessitating a progression to the subsequent balancing phase. In essence, this criterion remains conspicuously open-ended, allowing for a significant degree of discretionary.

Moreover, the extent to which this sub-condition imposes any additional assessment beyond the compliance with the other criteria, which collectively serve to minimise any restrictions, remains ambiguous. A plausible interpretation

Decision (C(2022) 9980 Final) of 21 December 2022 (Offshore Wind Energy Act Amendments), para 105': 'Given the existence of a significantly negative funding gap for the reference projects of an average offshore wind installation, the Commission considers that the notified measure is necessary to support the targeted economic activities in a manner that increases environmental protection'.

²⁴⁵³ 2022 CEEAG (n 1771), para 53.

²⁴⁵⁴ *ibid.*, para 53.

²⁴⁵⁵ *ibid.*, para 58.

²⁴⁵⁶ *ibid.*, para 8.

suggests that whilst the prior sub-conditions strive to minimise the restriction imposed by the potential aid measure, this specific requirement directly probes the presence of any undue negative effects stemming from the aid measure, persistent despite compliance with the previous sub-conditions. Nonetheless, this subsection argues that this condition goes beyond a mere evaluation of the restrictions of competition and trade (its efficiency). Rather, it functions as a component of a more comprehensive appropriateness-necessity test, aimed at assessing the broader efficacy of the proposed aid measure.

The CEEAG appears to emphasise the identification of restrictions of competition, thereby reinforcing the symbiotic relationship between Article 107(1) and 107(3) described earlier.²⁴⁵⁷ In order to ensure the avoidance of undue negative effects on competition and trade, the Commission undertakes ‘an assessment of the distortive effect of the aid in question on trading conditions’.²⁴⁵⁸ Owing to its inherent nature, whereby it reinforces the position of the aid beneficiaries, State aid may instigate distortions of competition and exert an influence on trade between Member States, albeit being necessary, appropriate, and proportionate.²⁴⁵⁹ Naturally, schemes of a broader scope are less prone to producing distorting effects when compared to targeted or limited aid schemes.²⁴⁶⁰ Within the context of environmental and energy aid, there are two primary types of distortions, which relate to product markets and location effects respectively.²⁴⁶¹

With respect to product markets, the aid may have a long-term discouraging effect on efficiency, innovation and the adoption of ‘cleaner technologies’.²⁴⁶² For instance, aid granted to a project that provides transitory benefits but obstructs the adoption of cleaner technologies in the long term could engender such distortive effects.²⁴⁶³ Additionally, it may strengthen or sustain substantial market power on the part of the aid recipient within the product market.²⁴⁶⁴ Whilst the question of

²⁴⁵⁷ See, Chapter 7 section 7.3.1.4 and Chapter 8, section 8.2.1.4.

²⁴⁵⁸ 2022 CEEAG (n 1771), para 63. On the restrictive effect on State aid generally, see the analysis of the CAP Chapter 7, section 7.4.2.3.

²⁴⁵⁹ 2022 CEEAG (n 1771), para 64.

²⁴⁶⁰ *ibid.*, para 66.

²⁴⁶¹ *ibid.*, para 68.

²⁴⁶² *ibid.*, para 67.

²⁴⁶³ *ibid.*

²⁴⁶⁴ *ibid.*, para 69.

whether an aid measure ‘unduly’ restricts competition and cannot be justified appears to be a matter resolved on a case-by-case basis, the Commission provides some guidance:

[...] certain aid measures have negative effects on competition and trade that are unlikely to be offset. In particular, certain aid measures may aggravate market failures, creating inefficiencies to the detriment of consumers and social welfare. For instance, measures that incentivise new investments in energy or industrial production based on the most polluting fossil fuels, such as coal, diesel, lignite, oil, peat and oil shale, increase the negative environmental externalities in the market. They will not be considered to have any positive environmental effects, given the incompatibility of these fuels with the Union’s climate targets.²⁴⁶⁵

Similarly, measures that incentivise new investments in energy or industrial production based on natural gas may reduce greenhouse gas emissions and other pollutants in the short term but aggravate negative environmental externalities in the longer term, compared to alternative investments [...].²⁴⁶⁶

In regard to the aspect of location choice, it is crucial to note that State aid has the potential to trigger the relocation of activity without yielding substantial improvements in environmental protection. Aid aimed at attracting greener investments from other regions or preserving environmentally-friendly practices within a specific area might merely ‘displace activities or investments from one region into another without any net environmental impact’.²⁴⁶⁷ However, these effects tied to location displacement would appear to be assessed under the appropriateness and necessity test. Essentially, an inadequately targeted measure is patently inappropriate as it falls short of attaining the sought objective.

Under the assessment of decarbonisation measures, the CEEAG explicitly states that:

To deliver positive environmental effects in relation to decarbonisation, the aid must not merely replace or displace the emissions from one sector

²⁴⁶⁵ *ibid.*, para 128.

²⁴⁶⁶ *ibid.*, para 129.

²⁴⁶⁷ *ibid.*, para 68.

to another and must deliver overall greenhouse gas emissions reductions.²⁴⁶⁸

Accordingly, the same reasoning that applies to the displacement of the location of activity also applies to the displacement of emissions from one sector to another. The underlying concern is that decarbonisation aid may distort competition by replacing investments into cleaner alternatives already available on the market, and thus hamper the broader development of markets and the use of cleaner solutions, thereby stimulating or prolonging the consumption of fossil-based fuels and energy.²⁴⁶⁹ However, the Commission has clarified that measures exclusively targeted at renewable energy sources cannot be considered to stimulate or prolong the consumption of fossil-based fuels and energy.²⁴⁷⁰

Overall, the precise assessment of distortive effects and their magnitude in the compatibility assessment remains within the discretion of the Commission. Nevertheless, in numerous instances a detailed assessment is not required as certain presumptions are established in the CEEAG. One such presumption is that aid promoting environmentally-friendly alternatives and technologies at the expense of more polluting alternatives is, in principle, not considered to produce ‘undue distortion of competition, since it addresses market failures that make the aid necessary’.²⁴⁷¹ Consequently, the Commission focuses solely on the distortive effects produced on competitors ‘that likewise operate on an environmentally-friendly basis, even without the aid’.²⁴⁷² This feature is remarkable as it demonstrates that, within the realm of climate, environmental protection and energy, the Commission adopts a distinct welfare standard compared to the social welfare standard generally advocated in EU State aid law.²⁴⁷³ Whilst it remains possible that the positive effects that these measures produce for society may outweigh the restrictions on competition, such an assessment typically unfolds at a subsequent stage during the balancing process. By excluding any negative effects that may arise for competitors operating with more polluting raw materials,

²⁴⁶⁸ *ibid.*, para 116.

²⁴⁶⁹ *ibid.*, para 127.

²⁴⁷⁰ Commission Decision (C(2022) 5831) final of 8 August 2022 (SA100704, RRF - Support scheme for the promotion of biomethane), para 188.

²⁴⁷¹ 2022 CEEAG (n 1771), para 65.

²⁴⁷² *ibid.*

²⁴⁷³ See Chapter 7, section 7.4.2. and Commission Decision ‘Ciudad de la Luz’ (n 1839), para 103.

technologies, energy sources, etc., the CEEAG effectively introduces a clear value preference into the market failure analysis.²⁴⁷⁴

In summary, the assessment of restrictions of competition and trade constitutes merely one facet of the analysis. It becomes increasingly evident that the evaluation of any ‘undue restrictions on competition’ essentially serves as an integral component of a broader appropriateness and necessity examination, aimed at gauging the efficacy of the aid measure. Another noteworthy exemplification of the nature of this assessment emerges in the requirement for Member States to, in the case of decarbonisation measures, ‘demonstrate that reasonable measures will be taken to ensure that projects aid will actually be developed’.²⁴⁷⁵ Achieving this might involve setting a clear deadline,²⁴⁷⁶ studies of feasibility, monitoring project developments, etc.²⁴⁷⁷ Consequently, the sub-conditions delineated by the Commission seem to converge. A plausible interpretation of this confluence could be the Commission’s endeavour to harmonise its market failure assessment, as outlined in the CAP, with the textual requirements formulated in the *Hinkley Point C* case. The Court has unequivocally articulated that Article 107(3)(c) encompasses merely two criteria: (i) a contribution to the development of economic activity; and (ii) an absence of adverse effects on trading conditions to an extent contrary to the common interest.²⁴⁷⁸ Nonetheless, the Commission demonstrates a certain reticence in fully relinquishing the methodological framework established by the CAP. Whilst it may be tenable to posit that these two sets of analysis are not inherently antithetical, the attempt to assimilate the CAP’s market failure analysis within the requirements established by the Court has engendered a methodology marked by both fragmentation and substantial redundancy.

²⁴⁷⁴ This aspect is further analysed below in section 9.1.2.

²⁴⁷⁵ 2022 CEEAG (n 1771), para 120.

²⁴⁷⁶ For instance in Commission Decision (C(2023) 988 final) of 15 February 2023 (SA103648) - Denmark State aid measure to support the industrialization and upscaling of the production of PtX), para 134, to prevent non-realisation, the Danish authorities set a maximum project deadline of four years, with the potential for a one year extension if duly justified.

²⁴⁷⁷ 2022 CEEAG (n 1771), para 120.

²⁴⁷⁸ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 19.

In a parallel manner to the examination in the CAP, the final step of the compatibility analysis requires that the identified negative effects on competition and trade be balanced with the positive effects of the aid on the supported economic activities. These positive effects include ‘its contribution to environmental protection and objectives of energy policy’, sustainable transition and the targets laid out for 2030.²⁴⁷⁹

The preceding chapter demonstrated the lack of a balancing approach in the direct assessment under Article 107(3), which stands in contrast with the evaluation within the CAP.²⁴⁸⁰ It was argued that, in practice, the balancing phase of the test, rather than balancing any positive effects against the adverse effects on competition and trade, largely comprises an overarching assessment ensuring that the restrictions on competition and trade remain limited. Given the expansive and resource-intensive nature of the CAP’s balancing apparatus, such a limited approach to balancing might arguably be deemed judicious. Nonetheless, it is imperative that the balance between these approaches is carefully calibrated to safeguard an overall net positive impact. This section argues that, whilst the CEEAG seldom requires a fully-fledged balancing test, its methodological approach deviates markedly from the test embodied in the CAP.

In line with the CAP, the CEEAG, in theory, appears to provide for a similar balancing exercise.²⁴⁸¹ In this regard, the Commission considers an aid measure to be compatible with the internal market ‘only where the positive effects outweigh the negative effects’.²⁴⁸² However, as for the previous sub-condition, it remains unclear to what extent this final condition truly constitutes an independent assessment, or if compliance with the preceding criteria suffices to deduce that the positive effects outweigh the negative ones. Lending credence to this interpretation, the CEEAG states that aid measures which are disproportionate and do not address a well-identified market failure engender negative effects that, in most cases, overshadow any positive effects of the measure.²⁴⁸³

²⁴⁷⁹ 2022 CEEAG (n 1771), para 71.

²⁴⁸⁰ See Chapter 8, sections 8.2.1.4 and 8.2.2.

²⁴⁸¹ 2022 CEEAG (n 1771), para 71.

²⁴⁸² *ibid.*, para 73.

²⁴⁸³ *ibid.*

As explained above, executing a comprehensive balancing exercise is practically intricate; hence, the Commission generally refrains from engaging in a full-scale balancing act. Further, within the ambit of the CEEAG, there seems to be a discernible reticence to fully embrace a proper balancing exercise.²⁴⁸⁴ This is exemplified by an overarching preference for wide-ranging quasi-orders of magnitude and assumptions. In this regard, the CEEAG states that a critical element of the balancing process is compliance with the ‘do no significant harm’ principle encapsulated in Article 3 of the Taxonomy Regulation, which establishes a framework for determining whether an economic activity is environmentally sustainable for the purpose of sustainable investment.²⁴⁸⁵ This regulation exemplifies the complex interplay between regulation and State aid in the sphere of environmental sustainability.

In accordance with the ‘do no significant harm principle’, for an economic activity to be qualified as environmentally sustainable it must, *inter alia*, not cause significant harm to the environmental objectives stipulated in the Taxonomy Regulation.²⁴⁸⁶ This regulation enumerates six environmental objectives: climate change mitigation; climate change adaption; the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity ecosystems.²⁴⁸⁷

In addition to this principle, other vital factors in the assessment of the CEEAG are negative externalities, particularly where these adversely impact competition and trade to an extent contrary to the common interest.²⁴⁸⁸ Another specific parameter that enters into the economic assessment is the Commission’s generally favourable stance on measures aimed at facilitating ‘the participation of SMEs’ and ‘renewable energy communities’.²⁴⁸⁹

²⁴⁸⁴ This feature aligns the CEEAG with the primary law and the antitrust approach. See Chapter 5, section 5.3.1.4 and Chapter 8, section 8.2.1.4.

²⁴⁸⁵ Article 1 of Article 1 of European Parliament and Council Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 [2020] OJ L198/13.

²⁴⁸⁶ *ibid.*, Article 3.

²⁴⁸⁷ *ibid.*, Article 9.

²⁴⁸⁸ 2022 CEEAG (n 1771), para 72.

²⁴⁸⁹ *ibid.*, para 75.

In many, if not most instances, a proper balancing is unnecessary as the CEEAG has established various assumptions. Aid measures directly or indirectly supporting fossil fuels, or investment in natural gas, are unlikely to produce positive environmental effects, rendering a positive balancing unlikely.²⁴⁹⁰ In the case of decarbonisation aid, a powerful presumption is established. The Commission considers that:

Provided that all other compatibility conditions are met, the Commission will typically find that the balance for decarbonisation measures is positive in light of their contribution to climate change mitigation [...] as long as there are no obvious indications of non-compliance with the ‘do no significant harm principle’.

Indeed, it is only when there is harm to the environmental objectives of the Taxonomy Regulation that a balancing exercise becomes necessary. In this context, the Taxonomy Regulation constitutes the starting point for the balancing test in the CEEAG. For instance, in its decision on State aid to support the industrialisation and upscaling of production of ‘PtX’,²⁴⁹¹ the Commission determined that the Danish aid scheme at stake was compatible with the internal market.²⁴⁹² To arrive at this conclusion, the Commission identified the positive effects of the aid scheme and found that, in line with the CEEAG, ‘so long as there are no obvious indications of non-compliance with the ‘do no significant harm’ principle and so long as all other compatible conditions are met’ the distortions are outweighed by the positive effects of decarbonisation.²⁴⁹³

In summary, despite the inherent requirement for a balancing exercise embedded within the overarching criterion – the aid must not adversely affect trade conditions to an extent contrary to the common interest – there appears to be a

²⁴⁹⁰ *ibid.*, para 74.

²⁴⁹¹ Commission Decision (C(2023) 988 final) ‘Denmark State aid measure to support the industrialization and upscaling of the production of PtX’ (n 2476), para 4: ‘Power-to-X (“PtX”) products include hydrogen produced through electrolysis, and more complex derivatives of this hydrogen such as ammonia, methanol and kerosene produced through additional processes beyond electrolysis. PtX products made using renewable electricity are also known as renewable fuels of non-biological origin (“RENBOs”) in the EU regulatory framework’. See also, e.g., Commission Decision (C(2022) 5548 final) of 2 August 2022 (SA63177 - Germany Federal support for efficient heat networks), para 133.

²⁴⁹² *ibid.*, para 144.

²⁴⁹³ *ibid.*, para 143.

reluctance towards undertaking quantification and balancing in a substantive manner. In this context, the test under the CEEAG seems to operate analogously to the primary law framework as well as the assessment in antitrust law.²⁴⁹⁴ However, the Commission goes a step further in its clarification by elucidating certain presumptions and elements that carry particularly significant weight in the analysis. In this sense, the CEEAG appears to attempt to construct loosely defined orders of magnitude as a strategy to avert fully-fledged balancing unless strictly necessary. Compliance with the ‘do no harm principle’ emerges as a particularly salient factor within the analysis, underpinning the interplay between the soft law regimes in State aid law and secondary regulation.

9.1.1.3 Conclusions: A Test Presenting Divergencies

The methodology of the CEEAG, compared to the CAP, appears markedly more fragmented. Yet, it fundamentally encapsulates an identical assessment. This assessment, however, has been further refined and subdivided into additional subcategories, departing from the conventional sequence. These subcategories, at times, lack coherence and appear to fuse. A plausible explanation for this fragmented approach might lie in the Commission’s ambition to retain the three-step process of the CAP, whilst simultaneously abiding by the Court’s judgment in *Hinkley Point C*. In that judgment, Article 107(3)(c) TFEU was found to contain merely two criteria: the aid must contribute to the development of economic activity (or region); and it must not unduly affect trading conditions to an extent contrary to the common interest.

Under the first broad criterion, namely to facilitate the development of economic activity, the Commission essentially verifies that there is a broad contribution to such development and that the aid is producing incentive effects. In this regard, the proportionality analysis is inherently present from the outset, marking a deviation from the sequence outlined in the CAP.²⁴⁹⁵ Clarifying this primary criterion is indispensable, given the persistent ambiguity.²⁴⁹⁶ Does replacing the requirement of an ‘objective of common interest’ with a contribution

²⁴⁹⁴ (n 2484).

²⁴⁹⁵ Which starts by identifying an objective of common interest understood as market failure or equity. See Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), paras 9 and 12.

²⁴⁹⁶ See Chapter 8 section 8.2.1.1.1.

to ‘facilitate the development of an economic activity’ engender any practical implications? The preceding chapter posited that this revised condition can be interpreted as being broader in scope than its predecessor.²⁴⁹⁷ The CEEAG’s lack of guidance, offering only a cursory explanation regarding this criterion, further fortifies such an interpretation. This section has established that the criterion of a contribution to the development of economic activity intrinsically embraces a total welfare standard, accommodating broad developments. This, *prima facie*, seems to extend beyond the mere attainment of an objective of common interest.

Under the second criterion, a fully-fledged proportionality assessment is set into motion, which includes an assessment of market failure. The CEEAG requires a residual market failure, either in terms of sustainability or energy inefficiency. Whilst there is no express requirement to categorically define a market failure, aid can be granted only if it engenders a material development that the market alone cannot deliver.²⁴⁹⁸ This implies that, although there is no obligation to delineate the specific nature of the market failure in question, the CEEAG requires the existence of a market in general terms. In this respect, the broad nature of the first criterion (the development of economic activity) is circumscribed by the obligation to manifest a market failure in a broad sense – i.e., that the market is failing to achieve the material development without the aid. Consequently, it may be posited that this criterion retains significant parallels with the CAP.²⁴⁹⁹

Furthermore, still within the second primary criterion, the CEEAG sets forth sub-requirements concerning transparency and the ‘avoidance of undue negative effects of the aid on competition and trade’. Although the CAP similarly incorporates an assessment of the restrictions of competition ensuring that these are limited,²⁵⁰⁰ the test within the CEEAG appears to be distinct, extending its scope beyond a mere assessment of such restrictions. However, the contribution of this sub-condition remains ambiguous since it seems capable of being subsumed

²⁴⁹⁷ *ibid.*; Nicolaides, ‘Shedding Light into the “Black Box” of State Aid: The Impact of Hinkley Point C on the Assessment of the Compatibility of State Aid’ (n 2074), 10.

²⁴⁹⁸ 2022 CEEAG (n 1771), para 34: ‘The proposed State aid measure must be targeted towards a situation where it can bring about a material development that the market alone cannot deliver, for example by remedying market failures in relation to the projects or activities for which the aid is awarded’.

²⁴⁹⁹ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 18: ‘Whether a measure contributes to an objective of common interest can be understood either in terms of its contribution to efficiency or in terms of equity’.

²⁵⁰⁰ *ibid.*, paras 44-56.

by the appropriateness-necessity test on one side, and the balancing test on the other.

Finally, whilst the assessment conducted under the CEEAG and the CAP largely mirror one another, they exhibit critical divergences. Paramount among these, the CEEAG appears to redefine the welfare standard applicable to the environmental protection and energy sector by integrating value judgments that transcend a mere total or social welfare standard. Additionally, it provides further guidance on the balancing exercise, setting forth both presumptions and guiding principles.

On this note, this section now explores whether the test applied under the CEEAG leads to differing conclusions concerning market failure analysis when compared to the direct assessment under Article 107(3)(c).

9.1.2 A Market Failure Analysis of the CEEAG

In line with the examination under Article 101(3) TFEU and the direct assessment in Article 107(3)(c) TFEU, this section explores whether the CEEAG entails a different conclusion concerning the assessment of market failure in accordance with the test defined in Chapter 3.²⁵⁰¹ The following first four subsections are constructed around the constituent elements of that test, specifically:

- i) Identifying the rationale of intervention;
- ii) Identifying any market failure test/ ‘market diagnostics’;
- iii) Identifying double market failure test;
- iv) Identifying potential trade-offs/balancing between competition; economic and external objectives.²⁵⁰²

The concluding subsection argues that, formally, the CEEAG embodies a market failure test akin to that of the CAP. However, in substance, there are significant divergences. Despite its ostensible adoption of a total welfare approach to aid measures furthering energy efficiency, the predominant measures it encapsulates are characterised as decarbonisation measures. For these measures, the focus is placed on a sustainability-laden welfare standard. This not only marks a deviation from the CAP but also stands at variance with general competition theory.

²⁵⁰¹ See, Chapter 3 Section 3.3

²⁵⁰² *ibid.*

Consequently, the regime cannot accurately be characterised as incorporating a market failure test within the meaning of the framework outlined in Chapter 3. Instead, it constitutes a sustainability-specific market failure test.

9.1.2.1 The Rationale of Intervention in the CEEAG

As demonstrated earlier, State aid finds its justification in the dual foundation of efficiency and equity.²⁵⁰³ Similar to the primary law regime, the compatibility analysis of the CEEAG expands well beyond considerations of the relevant market and narrow efficiencies.²⁵⁰⁴ The CEEAG explicitly asserts that any measures falling within its scope must produce ‘positive effects for society at large’,²⁵⁰⁵ thereby requiring Member States to demonstrate the measure’s ‘material contribution to environmental protection, including climate change mitigation, or the efficient functioning of the internal energy market’.²⁵⁰⁶

Nonetheless, discerning the precise rationale for State aid under the CEEAG, especially when compared to the general compatibility regime, presents challenges. The CEEAG merely requires that ‘the aid facilitates the development of economic activity’,²⁵⁰⁷ but the precise meaning of this criterion remains nebulous. As previously explained, the Commission maintains that encompassed within the notion of ‘development of economic activity’ are measures that both promote more sustainable economic activities and those that ‘support the creation of new economic activities and services’, provided they do not yield disproportionate environmental damage.²⁵⁰⁸ Accordingly, whilst most measures under CEEAG must further sustainable development, in certain cases a net-zero effect suffices, especially concerning energy aid without any apparent sustainability benefits.²⁵⁰⁹ From this perspective, the CEEAG aligns with a

²⁵⁰³ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 18.

²⁵⁰⁴ See, Chapter 8, section 8.2.2.1.

²⁵⁰⁵ 2022 CEEAG (n 1771). Whilst this phrase is not mentioned in the text it is incorporated into the heading to section 3.1.1.

²⁵⁰⁶ *ibid.*, para 25.

²⁵⁰⁷ *ibid.*, para 22.

²⁵⁰⁸ *ibid.*, paras 24 and 26.

²⁵⁰⁹ Examples of this include State aid measures aimed at ensuring the security of electricity supply.

conventional market failure standard based on efficiency.²⁵¹⁰ However, although both these categories may be construed as furthering narrower and broader economic efficiencies, the matter is more complex.

It was discovered in the preceding analysis that the CEEAG established a distinct welfare standard for ‘aid for environmental purposes’, diverging from the Commission’s traditional social welfare standard when assessing the impact of such aid measures on competition and trade. Instead, it solely examines ‘the distortive effects in competitors that likewise operate on an environmentally-friendly basis, even without the aid’.²⁵¹¹ Consequently, the CEEAG marks a clear departure from a total welfare approach anchored in the maximisation of efficiency (even in its broadest sense), transitioning towards a sustainability-oriented welfare standard. Such a sustainability-laden analysis stands in stark contrast to the social/total welfare approach taken by the CAP,²⁵¹² which states the following:

To balance positive and negative effects, it is necessary to first evaluate and measure [the positive and negative effects of the aid measure] in qualitative terms as well as, where possible, in quantitative terms, and make an overall assessment of their impact on producers and consumers in each of the markets concerned. To that extent, using a social welfare standard facilitates an analytical description of the common interest, by disentangling effects of a different nature on different actors.²⁵¹³

Whilst it is anticipated and logical that specific guidelines might diverge from the general State aid rules, the CEEAG formulation of a sustainability-laden welfare standard may well have ramifications beyond its field of application. Such an approach seemingly deviates directly from the status quo of competition law,

²⁵¹⁰ This thesis has previously explained at length the efficiency of environmentally sustainable regulation in addressing market failures. See Chapter 2, section 2.2.1.1 on externalities, and Chapter 7, section 7.4.2.1.1.

²⁵¹¹ 2022 CEEAG (n 1771), para 65.

²⁵¹² e.g., Phedon Nicolaides and Ioana Eleonora Rusu, ‘The ‘Binary’ Nature of the Economics of State Aid’ (2010) 37(1) *Legal Issues of Economic Integration* 25, 30.

²⁵¹³ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 58.

which is vigorously upheld within the antitrust framework,²⁵¹⁴ and even reaffirmed in the CEEAG itself:

It is generally accepted that competitive markets tend to bring about efficient results in terms of prices, output and use of resources. However, State intervention may be necessary to facilitate the development of certain economic activities that would not develop at all or would not develop at the same pace or under the same conditions in the absence of aid. The intervention thereby contributes to smart, sustainable and inclusive growth.²⁵¹⁵

Despite reaffirming the argument that markets are generally efficient, the move away from a total welfare standard may arguably be more profound, suggesting that the urgency of the climate crisis challenges the established notion of efficiency.²⁵¹⁶ Furthermore, the CEEAG employs multiple welfare standards concurrently. Whilst environmental aid emphasises environmental objectives, the mere development of additional economic activity is sufficient for some measures. This hybrid approach underscores an exceptionally flexible and discretionary application of the State aid rules by the Commission.

In conclusion, whilst the Commission undeniably retains a significant degree of discretion in declaring State aid to be compatible under the auspices of the CEEAG, the rationales for State aid are more limited than under the direct assessment. Although a narrow efficiency standard remains relevant in certain cases, primarily by promoting additional economic activity and thereby fostering competition, the Guidelines markedly depart from the conventional market failure analysis. This deviation is manifest in the CEEAG's adoption of a welfare standard imbued with sustainability considerations, consequently attenuating the relevance of a traditional and narrow market failure analysis based on efficiency. The shift signifies that the rationales of the CEEAG diverge from the traditional objectives of maximising narrow or broad efficiency and/or equity in the sense of welfare economic grounded in Pareto or Kaldor-Hicks efficiency. Nevertheless, within this narrower welfare standard, the analysis remains centred on broader efficiency improvements in the shape of environmental protection and climate change

²⁵¹⁴ See, Chapter 5, sections 5.3.1.4 and 5.4.

²⁵¹⁵ 2022 CEEAG (n 1771), para 9.

²⁵¹⁶ For a similar conclusion regarding the Draft Guidelines on Horizontal Co-operation Agreements (n 49) see Chapter 5, section 5.3.1.1.3.

mitigation. This objective is often achieved through promoting measures that reduce the negative externalities engendered by inadequately priced pollution, a byproduct of production or consumption activities, and by subsidising more environmentally benign alternatives. Furthermore, the still important role played by efficiency enhancements is reinforced by the CEEAG linking the development of economic activities with the existence of market failures in terms of insufficient environmental protection or inefficiencies within the energy market, which will be addressed in the subsequent section.

9.1.2.2 Market Diagnostics in the CEEAG

As explained in the preceding chapters, this stage of a potential market failure test entails a legal assessment of two key aspects: first, the determination of the existence of a market failure; and second, the assessment of the significance of that market failure (establishing a threshold to counteract the ubiquity of market failure).²⁵¹⁷ This test has been referred to as ‘market diagnostics’ or ‘prima facie proportionality’.²⁵¹⁸ It is important to recall that whilst the limb of market diagnostics verifies the appropriateness and necessity of the intervention itself, the double market failure limb pertains to the proportionality of the specific aid measure.

First, it is explored whether the CEEAG deviates from the common framework when regarding the possible legal assessment of the existence of a market failure warranting intervention through the granting of State aid. The precise role of market failure in the CEEAG, along with its assessment, appears to align with what has been previously established in relation to the CAP. Accordingly, the market failure test is integrated into the analytical side of the test rather than its underlying rationale. In other words, once it has been established that an aid measure contributes to the development of economic activity by enhancing efficiency, either from the standpoint of the sustainability-laden oriented welfare standard discussed above or a total welfare standard, the existence of a market failure is assessed within the proportionality analysis of the aid measure. Whilst efficiency serves as a legitimate rationale, the enhancement of efficiency through State aid is permissible only if it is demonstrated that the market itself is failing to maximise efficiency. In this sense, the CEEAG adopts a broad

²⁵¹⁷ See Chapter 3 section 3.2.1.

²⁵¹⁸ See Chapter 3, section 3.3.2.

definition of market failure, akin to the position adopted by EU courts under the direct assessment.²⁵¹⁹

The proposed State aid measure must be targeted towards a situation where it can bring about a material development that the market alone cannot deliver, for example by remedying market failures in relation to the projects or activities for which the aid is awarded.²⁵²⁰

The Commission identifies the three primary market failures frequently culminating in either an inadequate level of environmental protection, and by extension inefficiency or an inefficient internal energy market: externalities; information asymmetries and coordination failures.²⁵²¹

However, the CEEAG goes further than the CAP in the requirement to identify a ‘residual market failure’.²⁵²² The mere existence of a market failure is deemed insufficient. It is incumbent to additionally demonstrate how the existing regulatory instruments and policies, aimed at the same market failure, fail to remedy the inefficiencies induced by that failure.²⁵²³ Moreover, evidence must be provided that the proposed aid measure does not counteract and undermine those policies or regulatory mechanisms.²⁵²⁴ This requirement engenders more incisive and effective market diagnostics than that employed under the direct assessment.

Yet it could be argued, conversely, that State aid, when targeted at a failure already mitigated by existing policies, may lack the necessary incentive effect to shift the behaviour of firms in contrast to a counterfactual scenario without the aid. As a corollary, its compatibility could not be categorically asserted. Thus, it remains uncertain whether the additional requirement in terms of establishing a residual market failure truly departs from the traditional test propounded in the CAP. According to this conventional test, an aid measure may be found

²⁵¹⁹ See e.g., Case T-356/15 *Austria v Commission* (n 2099), para 151.

²⁵²⁰ 2022 CEEAG (n 1771), para 34. It follows that the Member States are required to demonstrate the existence of a market failure that prevents the market for achieving either ‘a sufficient level of energy production or an efficient energy market’.

²⁵²¹ *ibid.*

²⁵²² *ibid.*, para 36.

²⁵²³ *ibid.*, para 35.

²⁵²⁴ *ibid.*, para 36.

inappropriate should it fail to produce an adequate incentive effect, or if the market failure is already adequately remedied by alternative measures.²⁵²⁵

Second, regarding the identification of the significance of the market failure, the CEEAG does not impose any additional threshold. In this respect, akin to the direct assessment, a threshold is indirectly ensured through the application of the GBER and the *de minimis* regulation.²⁵²⁶ In this context, there exists no additional mechanism filtering out minor market distortions from the scope of the CEEAG.

In conclusion, the CEEAG establishes a robust market diagnostic tool, supplemented with further guidance in relation to specific aid measures. It appears to go further than the common principles of assessment under Article 107(3)(c), wherein the existence of a residual market failure is not a direct requirement.

9.1.2.3 Double Market Failure in the CEEAG

This stage involves the application of the proportionality principle (appropriateness and necessity) internally to aid the measure at stake, a concept identified in this thesis as ‘double market failure proportionality’.²⁵²⁷ The preceding chapter established that the double market failure test under the direct assessment prioritises the efficacy of the measure – the achievement of the objective – attributing only minor importance to the efficiency of the aid measure – increased welfare. It was further contended that the necessity and appropriateness assessments generally reside within the discretion of the Commission, which rarely imposes a strict LRM standard.²⁵²⁸ These considerations are paramount when analysing the nature of the test under the CEEAG.

Under the CEEAG, multiple criteria directly and indirectly address aspects linked to a double market failure test of an aid measure. First, the measure must provide an incentive effect, a test which falls under the appropriateness limb of the proportionality test. To be deemed appropriate for achieving the desired objective (facilitate the development of economic activities) – whether in terms of environmental protection or the enhancement of efficiencies in the internal energy

²⁵²⁵ See Chapter 8, section 8.2.1.2.

²⁵²⁶ *ibid.*

²⁵²⁷ For a further explanation see Chapter 3, section 3.3.3.

²⁵²⁸ Moreover, such a LRM standard is not required by the EU Courts.

market – it must effectively alter the behaviour of the beneficiary.²⁵²⁹ As explained above, this part of the test does not deviate from the CAP and correlates with the effectiveness of the aid measure in rectifying the market failure.

Second, the CEEAG imposes a furthermore detailed assessment of the aid measure's proportionality, distinguishing between its appropriateness in relation to alternative policy instruments and its appropriateness amongst different aid instruments.²⁵³⁰ An appropriateness test of the use of State aid is an intrinsic part of the assessment in the CAP.²⁵³¹ However, as anticipated, the CEEAG details this in greater depth. What appears to extend beyond the CAP is the examination of the appropriateness amongst different aid instruments, wherein the Commission requires that the Member State 'demonstrate why other potentially less distortive forms of aid are less appropriate'.²⁵³² Through this requirement, the CEEAG imposes a resource-intensive LRM standard, obliging Member States to contemplate all other less restrictive alternatives. This limb operates akin to a strict double market failure test, evaluating the efficiency and efficacy of the measure.

Third, the aid measure must be 'proportionate', signifying that it must adhere to the least amount of aid criterion. This criterion does not appear to receive a different interpretation than it does under the direct assessment.

Fourth, the measure must meet the requirement of 'avoidance of undue negative effects on competition and trade'. As explained, due to the symbiotic relationship between Article 107(1) and Article 107(3), this criterion entails 'an assessment of the distortive effect of the aid in question on trading conditions'.²⁵³³ The exact meaning of this limb of the test is challenging to discern, and it has been argued that it inserts itself into a broader necessity-appropriateness assessment, hence embodying elements of both efficiency and efficacy.²⁵³⁴ In terms of a double market failure test, this seems to encapsulate significant components of efficiency: Notwithstanding the appropriateness of the measure, it must not unnecessarily

²⁵²⁹ 2022 CEEAG (n 1771), para 26.

²⁵³⁰ *ibid.*, paras 43-46.

²⁵³¹ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), paras 30-31.

²⁵³² 2022 CEEAG (n 1771), para 44.

²⁵³³ *ibid.*, para 64.

²⁵³⁴ See section 9.1.1.2.5 of the present chapter.

restrict competition and trade. Nevertheless, the precise interpretation of ‘undue restrictions’ remains ambiguous.

A salient issue is the ambiguity surrounding this limb’s capacity to effectively assess the efficiency of aid measures. The CEEAG poses several challenges in this context. Firstly, the Guidelines establish fundamental presumptions and principles for evaluating the efficiency of the measure.²⁵³⁵ Specifically, aid promoting environmentally friendly alternatives is presumed to not produce undue distortions of competition since they address a market failure.²⁵³⁶ As a consequence, no proper evaluation of any potential inefficiencies created by the measure on competition and trade is performed.

Secondly, however, the paramount issue lies not in the establishment of presumptions but in the sustainability-laden welfare standard adopted by the CEEAG. This step is a departure from a conventional efficiency assessment, gravitating instead towards an examination of the measure’s effectiveness in enhancing the environment whilst exerting the minimal possible restrictions on competitors, who also operate on a sustainable basis. Although this test could potentially be perceived as an efficiency assessment – if one considers efficiency as a form of ‘green efficiency’ – it unequivocally diverges from the conventional understanding of double market failure. It follows that even though the CEEAG undertakes an efficiency analysis, it does so within a limited scope.

In conclusion, the CEEAG embeds a strong mechanism for assessing the efficacy of aid measures, akin to the CAP. However, when efficiency is brought under scrutiny – for aid measures promoting environmental sustainability – the CEEAG departs from a conventional welfare economic approach. Moreover, the presumptions within the Guidelines seem to significantly reduce the relevance of market failure theory, at least if predicated on a general equilibrium analysis. Compounding this complexity is the Commission’s discretion, coupled with an absence of a precise definition of ‘undue restrictions’. It remains unclear whether these permissions are based on a well-articulated concept of efficiency, especially given that this step of the test appears to necessitate a comparative assessment of the restriction and benefits – an exercise deferred to a later stage of the analysis (the balancing criterion). Instead, under this sub-condition, the crucial consideration appears to be the aid measure’s suitability and necessity in realising

²⁵³⁵ 2022 CEEAG (n 1771), para 65.

²⁵³⁶ *ibid.*

the project, predominantly from an environmental sustainability standpoint rather than a welfare standard based on efficiency. In contrast, the evaluation of efficacy remains stringent, underscored by the tests of appropriateness and necessity.

9.1.2.4 Balancing and Trade-Offs in the CEEAG

The ultimate step of the assessment comprises a balancing process, measuring the positive and the negative effects of the aid measure on competition and trade.²⁵³⁷ Resembling the approach of the CAP, the balancing exercise in the CEEAG seems to be limited, as it refrains from undertaking an in-depth balancing exercise within the meaning of the market failure framework defined in Chapter 3.²⁵³⁸ Nonetheless, the CEEAG manifests notable distinct characteristics that differentiate its balancing mechanism from that of the CAP.

Firstly, as previously stated, the CEEAG departs from a traditional social welfare approach. Consequently, the balancing exercise does not strictly constitute a trade-off between restrictions on competition and trade and broader efficiencies in terms of sustainability. Instead, only the anticompetitive effects (inefficiencies) engendered towards competitors operating on an equally sustainable footing are considered.²⁵³⁹ This attribute is remarkable as it underscores that this specific aid regime bestows less importance on preserving the status quo of competition law, and instead accords priority to remedying sustainability failures.

Secondly, reflecting the approach employed under the direct assessment in 107(3)(c) TFEU, there seems to be a reluctance to embark on a resource-intense balancing exercise. Within this setting, certain quasi-orders of magnitude and presumptions are established. Most notably, compliance with the ‘do no significant harm’ principle and the preceding criteria of the assessment is, in principle, sufficient to establish a positive balancing exercise.²⁵⁴⁰ Additional factors, such as negative externalities²⁵⁴¹ and the promotion of SMEs,²⁵⁴² are also attributed additional weight. In this respect, a full-scale balancing act is

²⁵³⁷ *ibid.*, paras 71-76.

²⁵³⁸ See Chapter 8, section 8.2.1.4 and Chapter 3, section 3.3.

²⁵³⁹ 2022 CEEAG (n 1771), para 65.

²⁵⁴⁰ *ibid.*, para 134.

²⁵⁴¹ *ibid.*, para 72.

²⁵⁴² *ibid.*, para 75.

pragmatically side-stepped, being undertaken only when the ‘do no significant harm’ principle is breached.

Third, although the CEEAG provides for a detailed balancing in some instances, the succinct approach of identifying limited restrictions on competition, as observed in the direct assessment under Article 107(3)(c), is also observable within the CEEAG. Consequently, limited effects on competition and trade, coupled with respect of the ‘do no significant harm’ principle, generally suffice to infer that the measure generates a net positive impact.²⁵⁴³

In conclusion, the balancing exercise within the CEEAG appears to parallel the one in the CAP. However, it adopts a more pragmatic stance by establishing presumptions and principles able to anticipate outcomes without the necessity of engaging in a *stricto sensu* balancing act. In this regard, the balancing act makes further strides in ensuring a positive outcome and circumscribing the discretion of the Commission. Nonetheless, in instances where a fully-fledged balancing exercise is necessitated, the CEEAG offers minimal additional guidance.²⁵⁴⁴

9.1.2.5 Conclusions: A Sustainability Failure Approach

Analogous to the CAP, the CEEAG underscores the significance of the concept of market failure. The key rationale for this aid regime is the creation of broad efficiencies by the mitigation of sustainability failures. However, the market failure test in the CEEAG is distinct from the one in the CAP in several regards.

Firstly, the CEEAG primarily focuses on the creation of broader efficiencies by rectifying or mitigating market failures associated with sustainability (sustainability failures). For this purpose, it established a distinct sustainability-laden welfare standard. Whilst this notion was already present in the 2014–2020 Guidelines,²⁵⁴⁵ its adoption reflects a significant shift from the paradigms of traditional competition analysis. This departure from the status quo of competition law underscores the imperative of a pragmatic approach to effectively addressing the urgent challenges posed by the climate crisis. This shift bears two significant

²⁵⁴³ See Commission decisions discussed under section 9.1.1.2.6 of the current chapter.

²⁵⁴⁴ Essentially, the guidance is limited to the establishment of critical elements in the analysis, specifically, the internalisation of externalities and measures facilitating SME participation, as previously described in section 9.1.1.2.6.

²⁵⁴⁵ 2014 CEEAG (n 1670), para 90.

implications for the relevance of market failure analysis within the assessment of the CEEAG.

On one hand, it corroborates the previously posited assertion that, within the context of State aid law, market failure predominantly operates as an analytical framework rather than a normative tool.²⁵⁴⁶ Thus, market failure stands more as a method (analytical framework) than a normative standard. In its pragmatic pursuit of the Union's sustainability goals, the Commission has sidestepped the traditionally preferred social welfare standard, endorsing instead a sustainability-driven analysis. This not only exhibits the Commission's considerable flexibility in exercising its discretion but also reveals the flexibility of the market failure methodology adopted by the Commission. Within this framework, a balancing exercise and a double market failure test are incorporated, transcending the pursuit of mere economic efficiency.

On the other hand, it implies that the CEEAG lacks a market failure test in the sense of the framework outlined in Chapter 3.²⁵⁴⁷ Absent is an assessment that balances sustainability with either narrow efficiencies or broader ones, as would be typical in a market failure/general equilibrium analysis. Rather, the analysis could best be described as a partial sustainability equilibrium analysis, zeroing in on maximising environmental benefits without unduly restricting competition, but solely vis-à-vis equally sustainable competitors. This remarkable feature raises numerous questions about the prospective development of competition law, even outside the realm of State aid law.²⁵⁴⁸ Embracing a sustainability-laden welfare standard suggests that the CEEAG is not merely a tool to tackle market failures at large, but sustainability failures specifically.

Secondly, the CEEAG retains a social welfare standard for aid promoting an efficient energy market. Thus, within the same market failure framework, two distinct sets of welfare standards, and by extension, theories of harm, are concurrently applied. This prompts the pivotal question: what transpires when these concepts conflict? What happens when a measure simultaneously promotes sustainability and an efficient energy market, whilst inducing significant

²⁵⁴⁶ See, Chapter 8 section 8.3.

²⁵⁴⁷ See, Chapter 3 section 3.3.

²⁵⁴⁸ Especially concerning the challenge of reconciling the promotion of collective benefits with the criteria of Article 101(3) TFEU, as elaborated upon in Chapter 5 section 5.2.2.2.3.

restriction of competition? Regrettably, the CEEAG does not provide any further clarification in this regard.

In conclusion, the CEEAG largely reflects the analytical trajectory of the CAP. The precise assessment of distortive effects and their magnitude remains a prerogative of the Commission. Not surprisingly, in numerous aspects, the CEEAG imposes a more stringent double market failure test, necessitating additional scrutiny of national aid measures. It also advances a more pragmatic approach, establishing presumptions and balancing principles, thus instilling greater certainty at the expense of the Commission's discretion. Whilst the full balancing under the CAP has not been maintained in practice, favouring a more superficial analysis,²⁵⁴⁹ the CEEAG emerges as more pragmatic, and thereby employable, primarily due to its reliance on presumptions and balancing principles. Nonetheless, it is evident that owing to its distinct welfare standard, the CEEAG cannot be considered to reflect a market failure test in the sense of the framework of this thesis. Rather, it outlines a test specifically crafted for addressing sustainability failures. However, this section has unveiled important insights regarding the application, and notably the flexibility of said application, of market failure as an analytical tool in the Commission's soft law.

9.2 Regional Aid in the Interplay of Equity and Cohesion

This section explores the notion and regime of regional aid. In essence, RAG essentially adopts the methodology of the CAP. However, the regional aid regime, primarily through its commitment to mitigate regional imbalances and the promotion of 'territorial cohesion',²⁵⁵⁰ embraces a broad spectrum of objectives that extends beyond efficiency. These objectives are posited to transcend traditional market failure theory, extending to encompass matters of equity, stability and cohesion. Therefore, the RAG reflects a broad market failure standard.

Article 107(3)(a) TFEU explicitly allows for aid to be granted to certain regions 'where the standard of living is abnormally low or where there is serious

²⁵⁴⁹ See Chapter 8 section 8.2.1.4.

²⁵⁵⁰ 2022 Guidelines on regional State aid (n 1768), para 3.

underemployment [...] in view of their structural, economic and social situation'. However, it should be noted that regional aid which fails to satisfy the conditions of this provision – i.e., that does not fall under the RAG – may still fall under the broader derogation in Article 107(3)(c).²⁵⁵¹ Regional aid is closely interlinked with the broader cohesion policy of the EU.²⁵⁵² In fact, Article 3 TEU makes the promotion of 'economic, social and territorial cohesion' a goal of the EU. In this context, regional aid emerges as a vital source of State aid within the EU, constituting the largest sectorial aid regime underpinned by equity objectives and cohesion policy.

This section is divided into two subsections. The initial subsection describes and analyses the notion of cohesion, aiming to contextualise it within the dichotomy of efficiency and equity as well as the framework of market failure. It is suggested that cohesion, specifically territorial cohesion, is a concept that remains open-ended and devoid of a concise definition. Subsequently, the second subsection examines the Regional Aid Guidelines (RAG) with the objective of evaluating whether the assessment therein posits a distinct market failure test, in contrast to the CAP and the approach under the direct assessment. Whilst the regional aid regime extensively incorporates the principles of the CAP, there are notable discrepancies. Even though the RAG seems more inclined to balance efficiency and external objectives, these discrepancies lead to the regional aid regime lacking a proper analytical market failure test, such as the one proposed in the CAP framework.

9.2.1 The Elusive Notion of Cohesion

Before examining the regional aid regime, it is necessary to explore the concept of 'cohesion' to understand its implications in the context of market failure. The term 'cohesion' has been subject to various interpretations and is frequently

²⁵⁵¹ e.g., Hans W Friederiszick and Massimo Merola, 'Regional Aid' in Werner and Verouden (n 1677) 317, 320.

²⁵⁵² However, the General Court in Joined Cases T-254/00, T-270/00 and T-277/00 *Hotel Cipriani v Commission* (n 1763), para 299 ruled that this does not mean that 'provisions concerning national regional aid must be interpreted in a flexible manner in the light of the objectives of economic and social cohesion [...]'. Indeed, the protection of competition and the promotion of economic and social cohesion 'constitutes two distinct and autonomous Community policies'.

designated as ‘economic’, ‘social’ or more recently ‘territorial’ cohesion.²⁵⁵³ The RAG refers specifically to ‘territorial cohesion’.²⁵⁵⁴ Nevertheless, other guidelines, such as those for rescuing and restructuring aid for non-financial undertakings in difficulty, refer to a broad notion of ‘economic and social cohesion’.²⁵⁵⁵

Territorial cohesion, specifically, has been characterised as an ‘elusive and imagined notion’ highlighting the intangible and abstract nature of its interpretation.²⁵⁵⁶ Article 174 TFEU defines the Union’s cohesion policy:

In order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion.

In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions.

Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or geographic handicaps such as the northernmost regions with very low population density and island, cross-border and mountain regions.

Furthermore, the preamble of the Treaty is explicit in its intent to:

strengthen the unity and to ensure their harmonious development by reducing differences existing between the various regions and the backwardness of the less favoured groups.

²⁵⁵³ Teresa Sà Marques and others, ‘Re-Thinking Territorial Cohesion in European Planning Context’ *International Journal of Urban and Regional Research* 547, 547. Article 174 TFEU refers to ‘economic, social and territorial cohesion’.

²⁵⁵⁴ 2022 Guidelines on regional State aid (n 1768), paras 3, 4, 42, 50, 60, 75, 77, 78, 110, 135.

²⁵⁵⁵ Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (n 1960), para 36.

²⁵⁵⁶ e.g., Rob Atkinson and Carolina Pachhi, ‘In Search of Territorial Cohesion: An Elusive and Imagined Notion’ 2020(8)4 *Social Inclusion* 265.

Within the EU, cohesion is quantified by reference to macroeconomic indicators such as GDP, GDP per capita, employment rates, and life expectancy.²⁵⁵⁷ For the purpose of identifying disadvantaged regions, the Member States must establish regional aid maps.²⁵⁵⁸ Cohesion as a concept appears to manifest both on micro-economic and macro-economic levels and pertains to the harmonisation of disparities between regions and societal groups, in other words, an ‘equilibration of disparities’.²⁵⁵⁹ It is, therefore, implied from the Treaty that economic, territorial and social cohesion aims at reducing disparities in economic development between regions, and inequities among population groups in terms of access to resources, services and opportunities.

However, as indicated above, although the notion of ‘territorial’ cohesion is instrumental for the regional State aid regime, it has been the subject of considerable debate. Owing to its novelty, the definition of territorial cohesion remains elusive.²⁵⁶⁰ The term has been deemed ‘underdeveloped’, contributing to a lack of consensus on its meaning and interpretation,²⁵⁶¹ forming both a ‘theoretical concept and a political/normative programme’.²⁵⁶² This makes it difficult, if not impossible, to identify a clear legal meaning of a ‘dynamic narrative that changes through time’,²⁵⁶³ that has left researchers at a quandary. Medeiros proposed the most elaborate definition of the concept:

The process of promoting a more cohesive and balanced territory, by (i) supporting the reduction of socioeconomic territorial imbalances; (ii) promoting environmental sustainability; (iii) reinforcing and improving

²⁵⁵⁷ Eight report on economic, social and territorial cohesion, ‘Cohesion in Europe towards 2050’, available at: <https://ec.europa.eu/regional_policy/information-sources/cohesion-report_en>.

²⁵⁵⁸ The current Regional Aid maps for each Member States are valid for the period 2022 to 2027. This is discussed more in detail in the subsequent subsection.

²⁵⁵⁹ Ona Grazina and Viktor Kozlovskij, ‘EU Member State Disparity in Social Economic Cohesion Progress’ 2016 15(2) *Torun Business Review* 12.

²⁵⁶⁰ On the debate of its meaning see e.g., Eduardo Medeiros, ‘Territorial Cohesion: An EU Concept’ (2016)14(1) *European Journal of Spatial Development*; Mikko Weckroth and Sami Moiso, ‘Territorial Cohesion of What and Why? The Challenge of Spatial Justice for EU’s Cohesion Policy’ (2020) 8(4) *Social Inclusion* 183.

²⁵⁶¹ *Sà Marques and others* (n 2553) 547.

²⁵⁶² *Atkinson and Pachhi* (n 2556) 273.

²⁵⁶³ Panagiotis Artelaris and George Mavrommatis, ‘Territorial Cohesion as a Policy Narrative: From Economic Competitiveness to “Smart” Growth and Beyond’ (2020) 8(4) *Social Inclusion* 208, 208.

the territorial cooperation/governance process; and (iv) reinforcing and establishing a more polycentric urban system.²⁵⁶⁴

The concept of territorial cohesion is, thus, incredibly broad and can encompass a wide range of objectives. It implies that cohesion is related to both macroeconomic stability and equity through resource distribution as well as the remedy of traditional market failures such as environmental pollution. Therefore, on a case-by-case basis, it can cover either type 1 (aimed at enhancing efficiency narrowly or macroeconomically construed) or type 2 interventions (aimed at promoting equity).

Determining whether an aid measure promotes territorial cohesion or another related objective, such as employment or research and development, is an ambiguous matter. The Commission explicitly asserts that '[t]he objective of regional development and territorial cohesion distinguishes regional aid from other forms of aid', such as aid pertaining to training, employment, or R&D.²⁵⁶⁵ In the Green Paper on Territorial Cohesion the concept is vaguely referred to as being:

[...] about ensuring the harmonious development of [all the regions of the EU] and about making sure that their citizens are able to make the most of inherent features of these territories. As such, it is a means of transforming diversity into an asset that contributes to sustainable development of the entire EU.²⁵⁶⁶

The 2022 version of the RAG replaced the requirement to fulfil an objective of common interest with the stipulation that aid must contribute to 'regional development and cohesion', without further clarification.²⁵⁶⁷ Yet, the methodology remains untouched, and the aid measures covered by the RAG remain the same.²⁵⁶⁸ Thus, it seems that a cohesion objective in State aid policy is not necessarily defined in relation to a theoretical construct, but rather to the aim of the measures

²⁵⁶⁴ Medeiros (n 2560) 8.

²⁵⁶⁵ 2022 Guidelines on regional State aid (n 1768), para 4.

²⁵⁶⁶ Communication from the Commission to the Council, the European Parliament, the Committee of the Regions and the European Economic and Social Committee, 'Green paper on territorial cohesion: turning territorial diversity into strength' COM (2008) 616 final), p 3.

²⁵⁶⁷ 2022 Guidelines on regional State aid (n 1768), para 39.

²⁵⁶⁸ See, 2014 Guidelines on regional State aid (n 504), paras 31, 40 and 43.

providing State aid.²⁵⁶⁹ Moreover, territorial cohesion holds relevance solely within the context of disadvantaged regions, as designated in the regional aid maps.²⁵⁷⁰ According to the Commission, two kinds of aid ‘measures’ (as opposed to their objectives) may contribute to the development of disadvantaged regions: investment aid and operating aid.²⁵⁷¹

It becomes apparent that ‘cohesion’, and particularly ‘territorial cohesion’, are open-ended notions. Their nebulous meaning aligns with the flexible nature of State aid law as previously described. Therefore, to fully grasp the nature of public policy intervention in the field, it is necessary to turn towards the RAG in order to determine how these concepts are operationalised in the context of State aid.

9.2.2 Regional Aid Guidelines

The ensuing subsections initially undertake an examination of the methodology and compatibility assessment as defined in the RAG. Subsequently, an analysis is conducted to determine whether the assessment in the RAG deviates from the general assessment explored in the preceding chapter, specifically from the standpoint of the concept of market failure analysis.

9.2.2.1 The Methodology and Assessment of the RAG

The following subsections initially undertake an examination of the methodology and compatibility assessment as defined in the RAG. Subsequently, an analysis is conducted to determine whether the assessment in the RAG deviates from the general assessment explored in the preceding chapter, specifically from the standpoint of the concept of market failure analysis.

9.2.2.1.1 *A Contribution to Regional Development and Cohesion*

The core requirement for regional aid is that it must contribute to ‘regional development and cohesion’.²⁵⁷²

²⁵⁶⁹ This issue is analysed in detail in the subsequent section.

²⁵⁷⁰ 2022 Guidelines on regional State aid (n 1768), 150.

²⁵⁷¹ *ibid.*, para 6.

²⁵⁷² *ibid.*, para 39.

The primary objective of regional aid is the economic development of the EU's disadvantaged areas. By promoting and facilitating the sustainable development of assisted areas, the aid contributes to the EU's territorial cohesion policy, which aims to improve economic and social cohesion by reducing disparities in the level of development between areas.²⁵⁷³

As previously stated, the RAG does not provide a positive definition of 'regional development and cohesion'. Instead, it expressly enumerates the measures deemed to satisfy this criterion. Within this framework, three types of measures are recognised for their potential to contribute to such development and cohesion: 'investment aid schemes'; 'individual investment aid'; and certain 'operating aid schemes'.

Regarding the first category – 'investment aid schemes' – a set of criteria must be met for these schemes to be deemed contributory to regional development and territorial cohesion.²⁵⁷⁴ Foremost among these is the requirement that the aid scheme must form part of a regional development strategy with clearly defined objectives.²⁵⁷⁵ It is imperative, hence, to demonstrate that the scheme aligns with, and contributes to, the development strategy of the relevant area.²⁵⁷⁶ Moreover, additional requirements include co-financing through own resources and compliance with EU environmental legislation.²⁵⁷⁷

The second category – 'notifiable individual investment aid'²⁵⁷⁸ – may bolster regional development and promote territorial cohesion through a multitude of factors.²⁵⁷⁹ These encompass: the numbers of direct and indirect jobs created by the investment; an unwavering commitment by the beneficiary to undertake extensive training activities for its workforce; external economies of scale or other benefits resulting from clustering effects; knowledge spill-overs; cooperation with local research and knowledge dissemination organisations; and the duration of the

²⁵⁷³ *ibid.*, para 42.

²⁵⁷⁴ *ibid.*, paras 43-49.

²⁵⁷⁵ *ibid.*, para 43.

²⁵⁷⁶ *ibid.*, para 44.

²⁵⁷⁷ *ibid.*, paras 47-48.

²⁵⁷⁸ *ibid.*, paras 50-53.

²⁵⁷⁹ *ibid.*, para 50.

investment. Notably, for any ‘ad hoc aid’, Member States are required to demonstrate that the aid is consistent with, and contributes to, the development strategy of the relevant area.

The third and final category encapsulates ‘operating aid schemes’. Such schemes are deemed to promote regional development ‘only if the challenges that those areas face are clearly identified in advance’.²⁵⁸⁰ The fundamental justification for granting operating aid emanates from the possibility that the difficulties of maintaining or attracting economic investment in an area may be so severe that investment alone is insufficient to ensure regional development.²⁵⁸¹ Member States are thus required to demonstrate both the existence and scale of the challenges faced by SMEs and the specific necessity of operating aid.²⁵⁸²

Drawing from the preceding analysis, it becomes clear that there is an absence of a positive definitive definition of ‘territorial cohesion’ and ‘regional development’ within the framework of the RAG. Instead, the Guidelines offer a tripartite list of measures that could be justified on the grounds of regional development and territorial cohesion. A significant factor that emerges is the requirement that any investment aid must be part of, and consistent with, the regional development strategy. The assortment of relevant indicators designated to demonstrate that individual aid promotes regional development reveals considerations that extend beyond both narrowly and broadly construed efficiencies. The factors of employment and job creation appear to better fit within an approach favouring both macroeconomic stability and equity (by mitigating disparities and promoting overall economic growth). In this vein, it has been suggested that within the realm of regional aid, efficiency and equity are in conflict.²⁵⁸³ Whilst an investment decision may generate positive externalities, it has been suggested that:

[...] in most instances where economic activity is moved from one location to another, there is a price to be paid for a regionally more equal

²⁵⁸⁰ *ibid.*, para 54.

²⁵⁸¹ *ibid.*

²⁵⁸² *ibid.*, para 55.

²⁵⁸³ Friederiszick and Merola (n 2551) 337.

distribution of economic activity in the form of a reduced overall efficiency of the economy.²⁵⁸⁴

However, over a long-term horizon, economic growth in these regions may yield benefits to the EU as a whole.²⁵⁸⁵ It becomes compellingly clear, nonetheless, that the rationale underpinning regional aid transcends beyond narrowly and broadly construed efficiencies that are assessable instantaneously. In this context, regional development emerges as an autonomous objective, decoupled from conventional efficiency considerations, and is perceived as an impetus for long-term economic growth. The CAP does not explicitly refer to an increase in regional GDP as a goal. Moreover, it appears to categorise the reduction of regional disparities within the sphere of equity.²⁵⁸⁶ However, it is argued that the determination of whether regional aid promotes equity or economic stability must be assessed on a case-by-case basis, with attention paid to the unique parameters of each case.

9.2.2.1.2 *The Link Between the Guidelines and the Regional Aid Maps*

In order to fully understand the objectives of regional aid, an examination of the objectives and function of the regional aid maps becomes necessary. The methodology of the assessment for regional aid differs from that of other aid regimes. According to the CAP, the designation of regional aid maps constitutes a prerequisite for the granting of regional State aid.²⁵⁸⁷ Moreover, only regional aid granted in compliance with the establishment and subsequent notification of these regional aid maps can be exempted under the GBER.²⁵⁸⁸

The primary function of the regional aid maps is to demarcate the areas that satisfy the conditions set out in Articles 107(3)(a) and 107(3)(c) and are required to be notified to the Commission.²⁵⁸⁹ In addition to this, the aid maps must also define precise aid intensities that are applicable to the various regions delineated

²⁵⁸⁴ *ibid.*

²⁵⁸⁵ *ibid.*

²⁵⁸⁶ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 26.

²⁵⁸⁷ 2022 Guidelines on regional State aid (n 1768), para 150.

²⁵⁸⁸ Article 15(1) of the GBER (n 1739).

²⁵⁸⁹ 2022 Guidelines on regional State aid (n 1768), para 180.

on the map in accordance with the CAP.²⁵⁹⁰ Two distinct types of areas are designated based on the Treaty provision under which they fall.

Areas under Article 107(3)(a), referred to as ‘a’ areas, are regions ‘where the standard of living is abnormally low or where there is serious unemployment’.²⁵⁹¹ This has been interpreted by the ECJ as an indication that only regions ‘where the economic situation is extremely unfavourable in relation to the [Union] as a whole’ are eligible.²⁵⁹² The Commission identifies two types of areas that may be designated as ‘a’ areas. These are regions whose GDP per capita, measured in purchasing power, is equal to or below 75% of the EU-27 average,²⁵⁹³ and the outermost regions.²⁵⁹⁴

Areas under Article 107(3)(c), known as ‘c’ areas, are not confined to the economic conditions contained in Article 107(3)(a).²⁵⁹⁵ This provision grants the Commission the discretion to declare compatible aid intended to boost economic development in regions which are disadvantaged in comparison to the national average.²⁵⁹⁶ According to the Commission, these areas are either former ‘a’ areas or sparsely populated areas.²⁵⁹⁷ Non-predefined ‘c’ areas²⁵⁹⁸ are designated on the basis of GDP, population and unemployment rate numbers.²⁵⁹⁹

The thresholds for aid intensity are intricate and complex. Generally, in ‘a’ areas, the aid intensity is capped at 30–50%, contingent on the region’s GDP per

²⁵⁹⁰ *ibid.*, 151.

²⁵⁹¹ Text of Article 107(3)(a) TFEU.

²⁵⁹² Case 248/84 *Germany v Commission* EU:C:1987:437, para 19; Case C-169/95 *Spain v Commission* EU:C:1997:10, para 15; Case C-310/99 *Italy v Commission* (n 1726), para 77; Case C-113/00 *Spain v Commission* EU:C:2002:507, para 65.

²⁵⁹³ 2022 Guidelines on regional State aid (n 1768), para 159(1).

²⁵⁹⁴ *ibid.*, para 159(2).

²⁵⁹⁵ *ibid.*, para 161. These can be further categorised as either ‘pre-defined’ or ‘non-predefined’ ‘c’ areas.

²⁵⁹⁶ Case 248/84 *Germany v Commission* (n 2592), 19.

²⁵⁹⁷ 2022 Guidelines on regional State aid (n 1768), para 166.

²⁵⁹⁸ In order to determine the possible coverage from non-predefined ‘c’ areas, the Commission sets a maximum coverage ceiling of ‘a’ and ‘c’ areas, from which the ‘a’ areas and predefined ‘c’ areas are subtracted. The remaining population ceiling serves as a basis to determine the coverage of the non-predefined ‘c’ areas. See, *ibid.*, paras 156, 160 174, and 175.

²⁵⁹⁹ *ibid.*, 175.

capita.²⁶⁰⁰ In contrast, ‘c’ areas have their aid intensity thresholds set between 10–20% based on either GDP per capita or population factors.²⁶⁰¹

A multitude of aid measures, granted to the so-designated ‘assisted areas’ and compliant with the intensity thresholds, are exempted by the GBER from the notification regime.²⁶⁰² Consequently, they are presumed compatible with the State aid framework.²⁶⁰³ Regarding investment aid, the majority of regional aid schemes are covered by the GBER, with noted exceptions being sectors related to steel, coal, shipbuilding, synthetic fibres, transports as well as infrastructure, energy generation, distribution and infrastructure.²⁶⁰⁴

Furthermore, the GBER does not apply to aid schemes that are targeted at a limited number of specific sectors of economic activity, i.e., sectorial aid schemes.²⁶⁰⁵ Operating aid, on the other hand, is granted an exemption under the provision that it offsets either additional transportation costs of goods intended for further processing in the outermost and sparsely populated regions or additional operational costs incurred in carrying out economic activity in these outermost regions.²⁶⁰⁶ Thus, whilst investment aid enjoys a broader exemption, the exemption accorded to operational aid remains considerably limited.

In essence, a substantial number of aid measures are presumed to satisfy the conditions of Article 107(3)(a) and 107(3)(c). These aid measures are excluded from the market failure assessment, although they undergo an ex-ante assessment during the establishment of the regional aid maps. Additionally, the use of concepts such as GDP and population density as qualifiers serve to demonstrate the notion that the objectives underpinning regional aid transcend mere efficiency considerations.

²⁶⁰⁰ *ibid.*, para 179.

²⁶⁰¹ *ibid.*, para 182.

²⁶⁰² Articles 13–16 of the GBER (n 1739).

²⁶⁰³ On the nature of the GBER, see Chapter 7, section 7.3.2.3.

²⁶⁰⁴ Article 13(a) of the GBER (n 1739).

²⁶⁰⁵ *ibid.*, Article 13(b). More exceptions exist in Article 13.

²⁶⁰⁶ *ibid.*, Article 15(2).

In line with the CAP, the regional aid measure must alter the behaviour of the recipient undertaking in a way so that the undertaking performs ‘additional activity contributing to the development of an area’, which would otherwise not have been undertaken or only undertaken in a limited or different manner.²⁶⁰⁷ The RAG further stipulates that aid must serve to offset ‘the normal business risk of an economic activity’.²⁶⁰⁸ It also provides specific guidance for each of the categories of aid measures described above.²⁶⁰⁹

In the context of investment aid, the incentive effect can be substantiated in two distinct ways. Firstly, an incentive effect can be established if the aid catalyses the decision to invest in the designated area, considering that, without the aid, the investment would not have been sufficiently profitable.²⁶¹⁰ Secondly, such an effect may also be recognised when evidence is presented, demonstrating that the aid effectively stimulates the location of planned investment in the relevant area rather than an alternative location.²⁶¹¹ This recognition is predicated upon the notion that the aid offsets the net disadvantages and costs associated with investing in the relevant area.²⁶¹²

However, it is imperative to note that the RAG introduces a presumption. This presumption maintains that if regional aid in ‘a’ areas is granted through cohesion policy funds or the European Agricultural Fund for Rural Development, in ‘a’ areas, to investments deemed necessary to achieve standards fixed by EU law, the aid is considered to have an incentive effect if the absence of aid would lead to the closure of an existing establishment in that area.²⁶¹³

For operating aid schemes, the demonstration of incentive effects is accomplished by demonstrating that, in the absence of the aid, it is likely that the

²⁶⁰⁷ 2022 Guidelines on regional State aid (n 1768), para 58.

²⁶⁰⁸ *ibid.*

²⁶⁰⁹ *ibid.*, paras 62-74.

²⁶¹⁰ *ibid.*, para 59(1).

²⁶¹¹ *ibid.*, para 59(2).

²⁶¹² *ibid.*, para 59(2).

²⁶¹³ *ibid.*, para 61.

economic activity in the relevant area ‘would be significantly reduced due to the problems that the aid aims to tackle’.²⁶¹⁴

In sum, the requirement of the incentive effect does not significantly deviate from the one contained in the CAP. In this vein, the RAG establishes a similar assessment of the efficacy of the aid measure by employing a counterfactual.

9.2.2.1.4 *Need for State Intervention*

The RAG explicitly stipulates that State aid should be granted only in circumstances where such aid can instigate a material improvement, an improvement otherwise unattainable through market mechanisms.²⁶¹⁵ The RAG is structured coherently with the CAP, manifesting a clear dichotomy between efficiency and equity:

State aid measures can, under certain conditions, correct market failures and thereby contribute to the efficient functioning of markets and boost competitiveness. Where markets do not provide efficient outcomes but such outcomes are deemed unsatisfactory in terms of equity or cohesion, State aid may be used to obtain a more desirable, equitable market outcome.²⁶¹⁶

Nonetheless, the RAG harbours a powerful presumption: aid awarded for the development of areas in the relevant regional aid map rectifies a market failure.²⁶¹⁷ Specifically, this failure pertains to an insufficient level of ‘economic development of the region and territorial cohesion’ that can only be rectified by State intervention.²⁶¹⁸

In summary, the RAG does indeed mandate the existence of a market failure, either in terms of efficiency or in terms of equity (including cohesion). However, any aid granted in compliance with the Guidelines is automatically presumed to satisfy this condition. This aspect signifies a relatively diminished level of scrutiny compared to the evaluation conducted under the primary law

²⁶¹⁴ *ibid.*, para 73.

²⁶¹⁵ *ibid.*, para 75.

²⁶¹⁶ *ibid.*, para 76.

²⁶¹⁷ *ibid.*, para 77.

²⁶¹⁸ *ibid.*, para 77.

assessment. Yet, it is crucial to note that the regional aid maps must be predetermined and sanctioned by the Commission. This requires an ex-ante assessment to determine the need for such aid. Thus, whilst the scrutiny may appear less intensive in the latter stages of the assessment, an evaluation is conducted in the initial phase to ensure not only that the aid promotes territorial cohesion but also an optimal allocation of public resources.

9.2.2.1.5 *Appropriateness*

The appropriateness test as outlined in the RAG involves an assessment of both alternative policy instruments and other potential aid measures.²⁶¹⁹

With respect to investment aid, several alternative measures may prove more suitable than State aid. These alternatives could encompass infrastructural development, education and training initiatives, or measures aimed at improving the business environment.²⁶²⁰ Therefore, the Member States are obliged to effectuate an impact assessment, demonstrating the advantages of State aid in comparison to other policy options.²⁶²¹ Regarding operating aid, the Member States may calculate the aid amount ex-ante, thus incentivising firms to limit expenditures and cultivate a more cost-effective business model over time.²⁶²² In a similar vein, any individual aid measure must be substantiated by evidence demonstrating how such individual aid is more appropriate in contributing to regional development, compared to an aid scheme.²⁶²³ Of paramount importance is the Member States' obligation to ensure that the aid form chosen exerts the least impact on competition and trade.²⁶²⁴ In this regard, Member States are required to demonstrate why other potentially less distortive forms of aid are not appropriate.²⁶²⁵ For instance, if aid is conferred in the form of a direct grant, the Member States must substantiate that other forms of aid, such as repayable

²⁶¹⁹ *ibid.*, paras 78-86.

²⁶²⁰ *ibid.*, para 79.

²⁶²¹ *ibid.*, paras 80-82.

²⁶²² *ibid.*, para 84.

²⁶²³ *ibid.*, para 83.

²⁶²⁴ *ibid.*, para 85.

²⁶²⁵ *ibid.*

advances or low-interest loans, cannot equally effectively achieve the objective.²⁶²⁶

In conclusion, the RAG is relatively concise on the appropriateness test, thereby leaving substantial discretion to the Commission in the compatibility assessment of regional aid. Interestingly, the appropriateness test in the RAG, akin to its counterpart in the CEEAG, transcends the traditional parameters that would typically define the appropriateness limb of proportionality.²⁶²⁷ Instead of merely assessing the suitability of a measure in achieving a specific objective, it incorporates a LRM standard. This standard ensures that the measure adopted does not exceed what is necessary when compared to all possible alternative measures. Thus, it extends beyond conventional suitability assessment, embedding a more holistic, comparative analysis that maximises efficiency whilst minimising market distortions.

9.2.2.1.6 *Proportionality*

The RAG establishes specific rules to ensure that the provision of regional aid is limited to the strict minimum necessary for stimulating additional investment or activity in the targeted area.²⁶²⁸ A notable characteristic of these rules is the Commission's application of maximum aid intensities for investment aid.²⁶²⁹ These maximum intensities provide a dual benefit: predictability as a safe harbour for SMEs; and a respective cap on the possible amount of aid.²⁶³⁰ Apart from providing additional guidance, the proportionality requirement embodied in the RAG does not deviate from the corresponding requirement in the CAP, which also imposes a least amount of aid criterion.

9.2.2.1.7 *Avoidance of Undue Effects on Competition and Trade*

This final step of the assessment defined in the RAG mirrors the balancing condition contained in the CAP, requiring an assessment of the distortions of competition and negative impact on trade to ensure that these adverse effects do not outweigh the positive effects of the aid to an extent contrary to the common

²⁶²⁶ *ibid.*

²⁶²⁷ On the general nature of proportionality see, Chapter 3, section 3.1.3.1.

²⁶²⁸ 2022 Guidelines on regional State aid (n 1768), para 87.

²⁶²⁹ *ibid.*, para 88.

²⁶³⁰ *ibid.*, paras 88, 93-94.

interest.²⁶³¹ As seen above, the main criticism directed towards the test under the direct assessment is the lack of an adequate balancing exercise, which subsequently diminished the relevance of a market failure assessment under Article 107(3)(c).

Despite that fact, the Commission refers to this criterion as a balancing exercise within the framework of the RAG, analogous to the CAP.²⁶³² Accordingly, within this step of the test, it is essential to identify both the benefits and the adverse effects of the aid measure.²⁶³³ Whilst its contribution to regional development is established by the previous steps of the test, the measure might also produce additional positive effects, both in terms of efficiency and equity. The RAG, therefore, provides that positive effects extending beyond regional development and cohesion may be considered in the balancing exercise.²⁶³⁴ For instance, investment aid could, in addition to fostering job opportunities and promoting cohesion, also catalyse a transition towards environmentally sustainable activities.²⁶³⁵ Just as under the CEEAG, the Commission accords particular attention to the ‘do no significant harm’ principle when assessing such benefits.²⁶³⁶

In the evaluation of negative effects, two primary forms of distortions are relevant, both potentially leading to allocative inefficiency and/or ‘distributional concerns’, in parallel with the CEEAG: product market distortions and location effects.²⁶³⁷ Concerning product market distortions, the most manifest negative effect of State aid is its potential to promote inefficient outcomes by undermining rewards for the most efficient firms whilst diminishing the impetus for improvement generally borne by less efficient firms.²⁶³⁸ Additional adverse effects might include the creation or maintenance of overcapacity, reduction of competitors’ investments, creation of entry barriers, reduction of incentives to

²⁶³¹ *ibid.*, para 104.

²⁶³² *ibid.*, para 105.

²⁶³³ *ibid.*

²⁶³⁴ *ibid.*

²⁶³⁵ *ibid.*

²⁶³⁶ *ibid.*

²⁶³⁷ *ibid.*, para 106.

²⁶³⁸ *ibid.*, para 107.

innovate or even market exit instigation for competitors.²⁶³⁹ Moreover, it could increase or maintain substantial market power.²⁶⁴⁰

In terms of the effects of the location of economic activity, the implications are clear: investment attracted to a particular area signifies a lost opportunity for another region.²⁶⁴¹ Furthermore, the negative effects can be amplified by negative externalities adversely affecting competition and trade.²⁶⁴²

The RAG provides important guidance by identifying three scenarios where the adverse effects of regional investment aid are regarded as ‘manifestly outweigh any positive effects’, indicative of an unlikely positive balancing scenario.²⁶⁴³ The first situation arises when the aid induces overcapacity ‘in a market in absolute decline’.²⁶⁴⁴ The main rationale for this category is that such overcapacity may create negative effects well beyond that market by spreading to other areas.²⁶⁴⁵ The second scenario pertains to so-called ‘counter-cohesion effects’,²⁶⁴⁶ which occur when investment is diverted into the targeted region at the detriment of another region with higher or equivalent aid intensity.²⁶⁴⁷ Such effects are considered to run counter to the very rationale of regional aid.²⁶⁴⁸ The final scenario emerges when relocation results in a significant loss of jobs within existing locations in the EEA, where there is a causal link between the relocation and the aid.²⁶⁴⁹

For both investment aid schemes and individual aid, there are no presumptions of limited negative effects, similar to that in the CEEAG. In the case of investment aid schemes, the Member States must demonstrate that all negative effects are reduced to the minimum,²⁶⁵⁰ whereas individual investment aid must

²⁶³⁹ *ibid.*, para 107.

²⁶⁴⁰ *ibid.*, para 108.

²⁶⁴¹ *ibid.*, para 109.

²⁶⁴² *ibid.*, para 105.

²⁶⁴³ *ibid.*, para 112.

²⁶⁴⁴ *ibid.*, paras 112-115.

²⁶⁴⁵ *ibid.*, para 113.

²⁶⁴⁶ *ibid.*, para 116-117.

²⁶⁴⁷ *ibid.*, para 117.

²⁶⁴⁸ *ibid.*

²⁶⁴⁹ *ibid.*, para 118.

²⁶⁵⁰ *ibid.*, para 120.

be accompanied by evidence permitting the Commission to appraise potential distortions.²⁶⁵¹

Conversely, operating aid schemes are generally assumed to yield positive effects capable of compensating for the negative effects on competition and trade, provided the aid is necessary and proportional to achieve the contribution to regional development and territorial cohesion.²⁶⁵²

Prima facie, the balancing process embedded within the RAG appears more rigorous than in the CAP, and considerably more so than in the CEEAG. This observation gains further traction upon examination of recent Commission decisions concerning investment schemes rendered under the auspices of previous Guidelines. Here, the Commission is seen to engage in detailed assessments of both positive and negative effects.²⁶⁵³ In this vein, the Commission appears to exhibit a degree of reticence in pre-emptively establishing presumptions of compatibility in the context of regional aid. This aspect is noteworthy considering that the RAG serves as the principal soft law regime implementing equity objectives, as opposed to focusing primarily on efficiency considerations.

9.2.2.1.8 *Transparency Requirement*

Lastly, akin to the provisions found in the CEEAG, the RAG imposes a transparency requirement.²⁶⁵⁴ This stipulation mandates the Member States to disclose relevant information pertaining to the aid measure using either the Commission's transparency award module or a national or regional equivalent.²⁶⁵⁵

9.2.2.1.9 *Conclusions*

The methodological structure of the market failure test, as articulated in the RAG, presents only minor deviations from its counterpart in the CAP. The primary variation pertains to the substitution of the 'objective of common interest'

²⁶⁵¹ *ibid.*, paras 124-125.

²⁶⁵² *ibid.*, para 135.

²⁶⁵³ e.g., Commission Decision (C(2020) 4362 final) of 2 February 2020 (SA54226 - Hungary Regional Investment aid to Toray Industries Kft), paras 118- 151; Commission Decision (C(2022) 23 final) of 1 July 2022 (SA59516 - Hungary LIP - regional investment aid to Volta Energy Solutions Kft), paras 136-153; Commission Decision (C(2019) 5594 final) of 31 July 2019 (SA49461 – Portugal Regional investment aid to Navigator Tissue Cacia, SA), paras 116-152.

²⁶⁵⁴ 2022 Guidelines on regional State aid (n 1768), paras 136-141.

²⁶⁵⁵ *ibid.*, para 136.

requirement with a contribution towards ‘regional development and territorial cohesion’.²⁶⁵⁶ Yet, as advocated in the previous chapter, this new feature might not substantially alter the compatibility assessment of State aid.²⁶⁵⁷ This interpretation is supported by the similar meaning accorded to the notion of ‘objective of common interest’ in the 2014–2020 RAG, suggesting that this alteration might predominantly be of a semantic nature.²⁶⁵⁸ Notwithstanding adopting a similar methodology to the CAP, in substance the RAG’s market failure test departs from the CAP, an issue further analysed in the ensuing section.

It is noteworthy that, on paper, the RAG establishes a clear separation between efficiency and equity by requiring a market failure or equity failure (or cohesion concern).²⁶⁵⁹ Moreover, the Guidelines do not provide a positive definition of a ‘contribution to regional development and territorial cohesion’. Instead, they indirectly delineate this notion by stating that three types of measures are capable of fulfilling those objectives: investment aid schemes; individual investment aid; and operational aid.

In the overall balancing process, the guidance predominantly focuses on assessing the distortive effects on the product market and location, mirroring the approach of the CAP. Naturally, the RAG provides more detailed guidelines concerning the precise evaluation of investment aid and operational aid schemes. However, in contrast to the CEEAG, the RAG does not operate with similar presumptions and orders of magnitude. Therefore, in principle, regional aid is subjected to the full balancing test as outlined in the CAP. Currently, due to the delays in formulating and accepting the regional aid maps, there are no cases that rely solely on the 2022 RAG. Yet, the decisional practice of the Commission suggests that there is no notable difference in terms of focus compared with the 2014 Guidelines.²⁶⁶⁰ By establishing that the overall distortions are limited, it can be concluded that the regional aid yields a positive balance.²⁶⁶¹

²⁶⁵⁶ *ibid.*, para 3.

²⁶⁵⁷ See Chapter 8, section 8.2.1.1.1.

²⁶⁵⁸ 2014 Guidelines on regional State aid (n 504), paras 30–46.

²⁶⁵⁹ 2022 Guidelines on regional State aid (n 1768), para 39(2).

²⁶⁶⁰ With the exception of the removal of the requirement of an objective of common interest, the sequence of the assessment remains largely unchanged.

²⁶⁶¹ See referring to both the 2014 Guidelines and the 2022 RAG, Commission Decision (C(2022) 4329 final) of 28 June 2022 (SA61045 – Portugal Reduced rate of excise duty on certain alcoholic

The subsequent section now pivots to the issue of determining whether the RAG encapsulates a market failure test that differs from the one contained in the CAP.

9.2.2.2 A Market Failure Analysis of the RAG

Analogous to the analysis under Article 101(3) TFEU and the direct assessment in Article 107(3)(c) TFEU, this section explores whether the RAG proposes a distinct perspective regarding the market failure test outlined in Chapter 3.²⁶⁶² The succeeding four subsections are structured around the integral elements of that test, specifically:

- i) Identifying the rationale of intervention;
- ii) Identifying any market failure test/ ‘market diagnostics’;
- iii) Identifying double market failure test;
- iv) Identifying potential trade-offs/balancing between competition; economic and external objectives.²⁶⁶³

Overall, it is shown that the RAG essentially incorporates a broad concept of market failure, including not only efficiency considerations but also stability and equity failures. However, the RAG lacks a comprehensive market diagnostic test, as the occurrence of market failure is presumed. Therefore, the test can be most accurately described as a partial market failure test, which hinges on a double market test assessing the efficiency and efficacy of the measure to achieve its objectives.

9.2.2.2.1 *The Rationale of Intervention in the RAG*

The regional aid regime is intrinsically linked to the promotion of equity.²⁶⁶⁴ The broad and somewhat ambiguous concept of ‘territorial cohesion’ has been

products produced in the Autonomous Region of the Azores, from 112021 to 31122027), para 49. For a case under the 2014-2020 guidelines, see e.g., Commission Decision (C(2022)1690 final) of 22 March 2022 (SA63328 - Hungary LIP – regional investment aid to SK On Hungary Kft), para 160.

²⁶⁶² See Chapter 3, section 3.3.3.

²⁶⁶³ *ibid.*

²⁶⁶⁴ See section 9.2.2.1.1 of the current chapter.

demonstrated to span the full range of rationales, incorporating efficiency, equity and stability considerations simultaneously.

Regarding efficiency, the economic rationales of regional aid can be seen in terms of agglomeration effects, economic growth or ‘local market failures’.²⁶⁶⁵ The RAG framework itself defines ‘external economies of scale’ resulting from clustering effects as an efficiency justification capable of propelling regional development.²⁶⁶⁶ Moreover, the Guidelines underscore the generation of ‘additional economic activity’ when examining the incentive effect, thereby adopting a ‘making the cake bigger’ approach to social welfare enhancement through the use of regional State aid.²⁶⁶⁷ However, this aspect of welfare maximisation is less pronounced in the RAG than the CEEAG, attesting to the fact that regional aid is primarily perceived to advance objectives beyond narrow efficiency.

In terms of stability considerations, both GDP and employment play pivotal roles in regional aid. These objectives align well with a broad market failure standard based on stability. As noted, regional aid maps, which operate based on GDP per capita, must be established and notified in order to grant regional aid.²⁶⁶⁸ Additionally, employment levels are critical in designating non-predefined ‘c’ areas.²⁶⁶⁹ Moreover, macroeconomic standards become evident when evaluating notifiable individual investments, with the number of jobs created being a crucial factor in demonstrating a contribution to regional development.²⁶⁷⁰

Finally, with respect to equity, the RAG highlights the distributive aspects of regional aid, fitting into a broader market failure approach. The emphasis on distributional issues is linked to the expansive notion of territorial cohesion, which is arguably challenging to distinguish from the concept of social cohesion.²⁶⁷¹ This aligns with Article 3 TEU, which requires the Union to work for ‘a highly competitive social market economy aiming at full employment and social progress’. Accordingly, the RAG explicitly refers to the need for an ‘equitable

²⁶⁶⁵ Friederiszick and Merola (n 2551) 330 ff.

²⁶⁶⁶ 2022 Guidelines on regional State aid (n 1768), para 40(d).

²⁶⁶⁷ *ibid.*, paras 26(d), para 60.

²⁶⁶⁸ *ibid.*, paras 159 and 175.

²⁶⁶⁹ *ibid.*, para 175.

²⁶⁷⁰ *ibid.*, para 50.

²⁶⁷¹ See section 9.2.1 of the current chapter.

market outcome²⁶⁷² and focuses on reducing disparities by promoting aid in the most remote and disfavoured regions. By investing in regions with lower GDP per capita, State aid policy inevitably leads to transfers of resources. The intertwining of equity concerns with macroeconomic objectives is evident in this context.²⁶⁷³ For this reason, the RAG only minimally restricts relocation, stipulating that if the aid measure ‘is likely to result in a substantial loss of jobs, in existing locations within the EEA’, it is unlikely that these negative effects can be offset.²⁶⁷⁴

As noted above, regional development, in the EU context, is considered a goal in itself, fostering a variety of benefits such as economic growth and the reduction of inequalities. Instead of defining this objective positively, the delineation of territorial cohesion appears to be empirically based. In general, regional development can be fostered by investment or operational aid. By deconstructing the requirement of the RAG, it becomes clear that regional aid encapsulates the full spectrum of rationales in the sense of the Musgravian triangle: efficiency, equity, and stability.

9.2.2.2.2 *Market Diagnostics in the RAG*

The nature of the market diagnostic test has been described above.²⁶⁷⁵ Succinctly put, this step of a potential market failure test involves a legal assessment of, firstly, the existence of a market failure and, secondly, the significance of that market failure – the establishment of a threshold aimed at counteracting the ubiquity of market failure.²⁶⁷⁶

In line with the CAP, the RAG provides that the necessity for State intervention must be substantiated by either a market failure or an imperative to ensure a more equitable market outcome.²⁶⁷⁷ In this vein, the RAG apparently reaffirms the separation between efficiency and equity championed by the

²⁶⁷² 2022 Guidelines on regional State aid (n 1768), para 76.

²⁶⁷³ Regarding the possible intersection of macroeconomic and efficiency concerns within the context of market failure, see Chapter 2 section 2.2.2.1.

²⁶⁷⁴ 2022 Guidelines on regional State aid (n 1768), para 118.

²⁶⁷⁵ See section 9.1.2.2 of the current chapter.

²⁶⁷⁶ On the ubiquity of market failure see Chapter 3, section 3.2.1.

²⁶⁷⁷ 2022 Guidelines on regional State aid (n 1768), para 76.

CAP.²⁶⁷⁸ The contention here is that the objectives of the RAG can alternatively be comprehended from a broad market failure rationale that encompasses the trifecta of efficiency, stability and equity. This interpretation becomes increasingly compelling when considering the requirement of the RAG. In the broadest sense:

State aid should be targeted to situations where aid can bring about a material improvement that the market cannot deliver.²⁶⁷⁹

First, however, in contrast to both the CEEAG and the CAP, the RAG does not offer any additional guidance relating to the identification of market failure in individual cases. Instead, the RAG posits a robust presumption that any aid allocated for the areas encompassed in the regional aid maps is considered necessary and that the market, left to its own devices, cannot bring about outcomes that result in a sufficient level of economic development of the region and territorial cohesion.²⁶⁸⁰

It follows that the RAG does not include an assessment of the existence of a market failure but rather presumes market failure in any market in an assisted region. Nonetheless, as noted, the regional aid maps are demarcated based on criteria such as GDP per capita, unemployment and scarcity of population.²⁶⁸¹ In this respect, a heightened rate of unemployment could potentially be interpreted as a market failure remediable under a broad market failure standard. Yet, given the absence of an assessment, the RAG cannot be considered to incorporate a proper market diagnostic test.

Second, with regard to identifying a market failure threshold capable of deflecting the ubiquity problem, the RAG positions itself within the overarching State aid logic. The application of the *de minimis* regulation excludes minor market distortions from the scope of the RAG. The GBER additionally provides a presumption of market failure for numerous measures adopted in compliance with the criteria for designating the regional aid maps. Although these are still deemed remediable market failures, the GBER aids in ensuring that only the most serious market failures are captured under the RAG.

²⁶⁷⁸ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 18.

²⁶⁷⁹ 2022 Guidelines on regional State aid (n 1768), para 75.

²⁶⁸⁰ *ibid.*, para 77.

²⁶⁸¹ *ibid.*, paras 157-177.

In conclusion, due to the strong presumption of market failure ingrained in the RAG, there is an absence of a proper market diagnostic tool for the assessment of regional aid. Instead, based on the criteria of the designation of ‘a’ and ‘c’ areas, the presence of market failure is presumed.

9.2.2.2.3 *Double Market Failure Test in the RAG*

This step of the assessment involves the application of the principle of proportionality (appropriateness and necessity) internally to aid the measure at stake, a concept referred to as ‘double market failure proportionality’.²⁶⁸² The central question here is whether the RAG encompass an assessment of the efficiency and efficacy of the aid measure distinct from that within the CAP. In relation to the CEEAG, it was established that a strong emphasis on both the efficiency and efficacy of the measure is evident, constituting a strict double market failure test.²⁶⁸³

In contrast, given the broad objectives of the RAG, it appears plausible that the principal concern does not lie in the overall generation of efficiency. Instead, the focus of the double market failure test should be constrained to the efficacy of the measure to contribute to regional development and territorial cohesion, which in turn can be considered under either efficiency, equity or stability considerations. However, such a conclusion would be erroneous.

In line with the other sectorial aid regimes, the RAG imposes a stringent LRM standard. Firstly, Member States must demonstrate that the selected aid measure presents benefits in comparison to policy options outside of State aid.²⁶⁸⁴ For instance, in regional development, it might be considered more appropriate and efficient to develop transport infrastructure rather than providing financial support to undertakings transporting goods to and from a remote area.

Despite an emphasis on objectives beyond mere efficiency, efficiency considerations are nevertheless present in the appropriateness test, particularly in relation to demonstrating the suitability of the aid measure compared to other possible aid instruments. Here, the RAG requires that Member States demonstrate that the form in which the aid is awarded is ‘likely to have the lowest impact in

²⁶⁸² For a further explanation see Chapter 3, section 3.3.3.

²⁶⁸³ See section 9.1.2.3 of the current chapter.

²⁶⁸⁴ 2022 Guidelines on regional State aid (n 1768), paras 80-84.

distorting trade and competition’.²⁶⁸⁵ Regarding operating aid, appropriateness must also be proven. To do so, Member States may calculate the aid amount *ex-ante* in order to incentivise undertakings to limit costs and develop a more efficient business over time.²⁶⁸⁶

In terms of necessity, the RAG, akin to the CAP, incorporates a ‘least amount of aid’ criterion.²⁶⁸⁷ Concerning the most prevalent type of regional aid, namely investment aid, the RAG transcends the traditional approach by establishing maximum aid intensities that must be applied when formulating the regional aid maps.²⁶⁸⁸ However, for notifiable aid schemes targeting SMEs, aid amounts below these intensities are considered proportionate without further scrutiny.²⁶⁸⁹ For all other aid, the intensities constitute a cap when calculating the minimum aid required which, according to the RAG, is considered to be the net extra costs of investing in the area compared to a counterfactual scenario in the absence of the aid.²⁶⁹⁰ The ‘net extra cost’ approach fundamentally ensures that the least amount of aid criterion is respected. In sum, whilst further refinement of the least amount of aid criterion is accomplished through the establishment of maximum aid intensities, the core tenet of the test remains consistent with that under the CAP.

Lastly, the necessity and appropriateness of the aid measure are additionally assessed under the ‘avoidance of undue effects on competition and trade’ limb. Consistent with the CAP and the CEEAG framework, the RAG provides guidelines to evaluate the distortive effects on the product market and location effects.²⁶⁹¹ This test appears to endow the Commission with significant discretion in considering the efficiency of the measure in terms of its overall contribution to competition and trade.

The stringency of the double market failure test varies depending on the nature of the measure under scrutiny. For investment aid, both in the form of aid schemes and individual aid, there are no assumptions of limited negative effects

²⁶⁸⁵ *ibid.*, para 85.

²⁶⁸⁶ *ibid.*, para 84.

²⁶⁸⁷ *ibid.*, para 87-103.

²⁶⁸⁸ *ibid.*, para 88.

²⁶⁸⁹ *ibid.*, para 93.

²⁶⁹⁰ *ibid.*, para 94-95.

²⁶⁹¹ *ibid.*, paras 106-110.

contingent on compliance with the previous criteria of the test. Rather, the burden of proof to demonstrate that the negatives of the aid are limited to the minimum necessary falls on the Member States.²⁶⁹² However, such a presumption of compatibility exists for operational aid schemes.²⁶⁹³

In conclusion, the double market failure test in the RAG is markedly rigorous compared to the CAP, imposing a strict LRM standard without providing presumption or safe harbours. Furthermore, the test reveals strong efficiency considerations, in addition to its focus on the efficacy of the measure. In this regard, it appears more efficiency-oriented than the test under the direct assessment.

9.2.2.2.4 *Balancing and Trade-Offs in the RAG*

In its wording, the balancing phase of the test in the RAG does not diverge from that of the CAP, which rather than constituting substantive balancing forms part of the formal proportionality test. However, in practice, the Commission seems more amenable to assessing the balance between the positive and negative effects of regional aid.

The RAG explicitly prescribes a balancing exercise.²⁶⁹⁴ In terms of positive effects, the Commission is not restricted to solely considering the positive effects associated with regional development, but may also take into account other relevant factors such as an increase in economic activity and sustainability aspects.²⁶⁹⁵ Similar to the general State aid regime, effects appear to be assessed well beyond the relevant market. Thus, the balancing test incorporates elements of a general equilibrium test. The negative effects, as discussed in the previous subsection, are primarily product market distortions and location effects.

The RAG establishes certain assumptions which can be interpreted as broadly formulated orders of magnitude. It enumerates three scenarios where the negative effects are likely to eclipse any positive effects of the aid measure.²⁶⁹⁶ These are: aid leading to overcapacity in a market in absolute decline; counter-

²⁶⁹² *ibid.*, paras 120, 124-125.

²⁶⁹³ *ibid.*, para 135.

²⁶⁹⁴ *ibid.*, para 105.

²⁶⁹⁵ *ibid.*, para 105.

²⁶⁹⁶ *ibid.*, paras 111-118

cohesion effects; and relocation resulting in a substantial loss of jobs in existing locations in the EEA. This list exemplifies the nature of the regional aid regime, which, whilst including efficiency concerns, transcends the confines of traditional competition law analysis.

The initial category of manifest restrictions, namely the creation of overcapacity in declining markets, can be construed as an efficiency safeguard. By artificially preserving inefficient markets and generating overcapacities, the aid measure engenders serious allocative inefficiencies threatening the efficiency of the internal market.²⁶⁹⁷ The second category identifies a scenario where either there is an overall decline in cohesion or, at the very least, no net benefit from the aid measure.²⁶⁹⁸ By relocating investment from an area with a higher aid intensity, there is a net loss of potential cohesion. By relocating investment from an area with the same aid intensity, there is a net zero effect in terms of cohesion; however, inefficiencies may also be engendered by the costs of the relocation. It appears that this restriction is concerned with the overall efficiency of the aid measure. The final category outlines a scenario where there is a net loss in terms of jobs, which is understood as both an equity issue and a macroeconomically inefficient situation.²⁶⁹⁹

However, as seen above, the RAG encompasses one seemingly rebuttable presumption of positive balance when it comes to operating aid schemes that comply with the previous criteria.²⁷⁰⁰ Yet, despite containing a thorough balancing exercise on paper, the extent to which such balancing occurs in practice is a different issue. As demonstrated above, contrary to its practice under the direct assessment, it appears that the Commission is more receptive to conducting a comprehensive balancing of the effects of regional aid measures. This observation is noteworthy given that it is the primary regime which implements equity objectives as opposed to mere efficiency concerns. A plausible interpretation of the prevalence of balancing within the RAG could be the inherent difficulty in pre-establishing a positive balance between efficiency and equity without undertaking a fully-fledged balancing test – one that invariably demands value judgments.

²⁶⁹⁷ *ibid.*, para 113: in this case 'there is a risk that production or investment in other areas of the EEA may be negatively affected'.

²⁶⁹⁸ *ibid.*, para 118.

²⁶⁹⁹ *ibid.*

²⁷⁰⁰ *ibid.*, para 135.

Consistent with the principles of State aid modernisation²⁷⁰¹ and the case law of the EU Courts,²⁷⁰² the RAG incorporates a broad market failure test. This requires that regional aid can only be granted when it results in a significant improvement that the market itself cannot deliver. Given its wide-ranging rationales, the regional aid regime can be construed as epitomising the broadest possible market failure standard, encompassing efficiency, stability and equity objectives. Notably, the RAG diverges from the CAP in the following aspects.

First, by explicitly and concurrently emphasising equity and efficiency considerations, there seems to be no definitive distinction between these concepts within the assessment. Whilst the RAG separates these two modes of intervention on paper,²⁷⁰³ it becomes clear that the broad and amorphous notion of territorial cohesion can promote both objectives. Furthermore, the RAG explicitly states that positive effects beyond regional development are also considered in the balancing process. This aspect warrants emphasis. As underscored by the Court in its ruling in *Hinkley Point C*, negative effects beyond those negatively affecting competition and trade between Member States are excluded from the analysis.²⁷⁰⁴ However, as demonstrated by the RAG, the assessment of positive effects may be much broader; although negative externalities beyond those affecting competition and trade remain excluded. Consequently, the balancing exercise in Article 107(3) TFEU is structured to ascribe considerably greater emphasis to the benefits, relative to any adverse effects stemming from the aid measure.

Second, the analytical side of market failure is attenuated in the regional aid regime. As such, there is no proper market diagnostic test. Instead, aid granted in accordance with the pre-established regional aid maps is presumed to remedy a market failure in broad terms. In this sense, rather than a market failure test, what emerges is an inherent presumption of market failure.

Third, in a somewhat paradoxical stance, the RAG, whilst predominantly anchored in equity considerations, articulates a strict double market failure test

²⁷⁰¹ See Chapter 7, section 7.4.1.

²⁷⁰² See Chapter 8, section 8.2.2.3.

²⁷⁰³ 2022 Guidelines on regional State aid (n 1768), para 39(2).

²⁷⁰⁴ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 101.

grounded in both efficiency and equity. This would appear to reflect a carefully executed balance between the promotion of regional development and the maintenance of unfettered competition and the functioning of the internal market. Moreover, the RAG includes certain manifest restrictions which entail the presumption of negative equilibrium. The latter two manifest restrictions – namely, an overall decline in cohesion and relocation resulting in a significant loss of jobs in other areas – incorporate broader considerations. However, the first restriction – stemming from overcapacity – indicates that there are certain limitations imposed by the protection of competition law’s status quo in that certain hardcore restrictions cannot be tolerated.

In conclusion, although the RAG largely echoes the principles formulated in the CAP, significant disparities can be observed. However, the overarching leitmotif of modernisation remains intact, emphasising closer analytical scrutiny of national aid measures. The broad application of the market failure construct in the analysis exemplifies the flexibility of this concept. Crucially, the RAG sidesteps a proper market diagnosis, foregoing the need to identify a market failure in favour of a market failure presumption. Consequently, although the RAG manifests various components of a market failure test, it cannot be deemed as incorporating a market failure test in the sense of Chapter 3 of this thesis.

9.3 Conclusions: Concordance *and* Contradiction

This has delved into the application and nuances of market failure within EU State aid law through the lens of two distinct aid regimes – the CEEAG and the RAG.

Firstly, with respect to the CEEAG, the analysis is fundamentally rooted in the CAP’s market failure test. The test primarily addresses market failures such as externalities, information asymmetries, and coordination failures. However, the foundational rationale of the CEEAG is notably more confined than the CAP. Rather than pursuing a total welfare approach, the CEEAG arguably champions a perspective centred on a sustainability-driven welfare function. Moreover, the test encapsulated in the CEEAG applies the CAP’s framework to a specific scenario, aiming to redress sustainability failures via the strategic deployment of State aid. From this analytical perspective, it can be concluded that due to its partial and sustainability-laden approach, the CEEAG cannot be perceived as incorporating a market failure test within the sense of the framework defined in Chapter 3.

Notwithstanding this, the exploration of the CEEAG has revealed important insight into the role of market failure theory within the larger ecosystem of the State aid regime. The adoption of a market failure analysis highlights notable flexibility and evolution, serving both as an instrument to uphold (or at the very least sustain) the status quo of competition law and as a lever to deviate from it when deemed necessary. This illustrates the CEEAG's transcendence beyond the conventional boundaries of competition law analysis, emphatically moving past the sacrosanct maxim of efficiency.

Additionally, this examination has corroborated that market failure is essentially employed as an analytical tool, rather than a normative rationale. By shifting its preferred welfare function, the CEEAG demonstrates that rather than defining an optimal equilibrium of efficiency and/or equity, the construct of market failure in State aid law is primarily applied to assess the necessity and appropriateness of the public policy intervention, irrespective of the precise objective of that intervention.

In conclusion, the CEEAG, whilst bearing semblance to the established framework in the CAP, carves out a distinct path, endorsing not a general market failure test, but a partial sustainability-laden test that measures the appropriateness and necessity – i.e., market diagnostics and double market failure – of State aid in redressing sustainability failures. Notable divergences emerge when comparing the CEEAG's modus operandi with the CAP's approach. In particular, the CEEAG transcends the CAP's boundaries by introducing additional requirements for the double market failure test. There are important variances when compared to the approach adopted in the CAP. In this respect, the CEEAG goes beyond the CAP by stipulating additional prerequisites for the double market failure test. Finally, in parallel with the CAP, there is a conspicuous void in terms of a thorough balancing mechanism. Nevertheless, the CEEAG adopts a more pragmatic stance, crafting presumptions and principles that proffer feasible alternatives to a resource-intensive balancing exercise.

Second, concerning RAG, it stands in stark contrast to the CEEAG, gravitating more towards a traditional social welfare approach reminiscent of the CAP. The RAG stands as the primary aid regime where the dual considerations of efficiency and equity intermingle and potentially collide. This collision manifests through the nebulous concept of 'territorial cohesion', a term that remains elusive and open-ended. Rather than providing an explicit definition of territorial cohesion, the RAG regime delineates three categories of aid measures that might

promote regional development and territorial cohesion: investment aid schemes; individual investment aid; and operating aid schemes.

From a market failure perspective, the RAG articulates a rather broad approach, fundamentally construing market failure as the market's inability to achieve its objectives without State intervention. This is congruent with its broad spectrum of rationales that address efficiency, equity and stability dimensions simultaneously. Furthermore, by concurrently promoting equity and efficiency, the RAG deviates from the conventional dichotomy that typically separates these concepts.²⁷⁰⁵

However, the absence of a market diagnostic tool within the RAG signifies that it does not incorporate a market failure test in line with the framework of this thesis. Instead, any aid granted in accordance with the pre-established regional aid maps is presumed to remedy a market failure in broad terms. In this sense, the RAG integrates a partial market failure test, centred on assessing the appropriateness and necessity of the measure to redress a presumed market failure; in other words, an analytical double market failure test. Interestingly, in a manner analogous to the CAP, the RAG adopts a broad balancing approach, devoid of presumptions and armed with a rather limited set of guiding principles. Within this framework, the Commission appears more inclined towards conducting a fully-fledged balancing exercise. The precise reason behind this inclination remains unclear, yet a plausible contributing factor may be the inherent difficulty in pre-establishing assumptions of positive or negative balance between efficiency and equity without undertaking a comprehensive balancing test – one that invariably entails value judgments. As seen in Chapter 2, the only feasible method to incorporate equity into the market failure analysis necessitates acknowledging trade-offs.²⁷⁰⁶ Due to the complexity involved in quantifying equity concerns, a full-scale balancing exercise appears necessary in most instances.

A salient characteristic of the RAG is its establishment of a rigorous double market failure test underpinned by both efficiency and equity considerations. This feature further underscores the Commission's flexible approach towards the concept of market failure. Even under the presumption of an existing market failure, a strict double market failure test is invariably employed to ascertain that

²⁷⁰⁵ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 18.

²⁷⁰⁶ See Chapter 2, section 2.2.2.3.

the aid measure is both effective and efficient in remedying the market failure, without going further than necessary. In this respect, the RAG carefully strikes a balance between safeguarding competition and unimpeded trade and promoting regional development. To encapsulate, although the RAG largely incorporates the principles enshrined in the CAP, its principal divergence emanates from its reliance on a presumption of market failure, rather than a test verifying its existence. Additionally, the RAG departs from the CAP by ostensibly blurring the traditional dichotomy between efficiency and equity.

This chapter, through its examination of two prominent yet distinct aid regimes, reaffirms the claim that market failure in EU State aid law serves primarily as an analytical tool. It forms a structural matrix to evaluate national aid measures. Embedded within these aid regimes are diverse rationales, spanning from efficiency to equity. However, the analytical matrix remains unaltered, invariably probing identical queries: To what extent does the measure remedy a market failure; and to what extent is it doing so effectively and/or efficiently? The varied approaches with regard to the balancing test underscores a flexible approach, oscillating between protecting the status quo of competition and promoting broader efficiencies. In this regard, the unique characteristics of the State aid regime seem to result in exceptions to traditionally endorsed paradigms within competition law analysis.

PART V

A Contemporary Competition Law Paradox

10. CONCLUSIONS: PRESENTING THE PARADOX

The purpose of this chapter is threefold. Initially, it presents the main insights revealed by this thesis. Subsequently, it provides an answer to the main research question delineated in Chapter 1 and frames an inherent market failure paradox in EU competition law. Finally, it sets the scene for future developments and discussions in scholarship.

The thesis fundamentally addresses the prevailing ambiguity in embedding public policy objectives within the realm of competition law,²⁷⁰⁷ even as issues like sustainability and income inequality gain heightened attention.²⁷⁰⁸ Resolving this issue is primordial to design a clear and coherent enforcement policy of the competition law provisions. The theory of market failure has emerged as a potential connector to facilitate this integration. In this context, this thesis has told the tale of a juridification of the concept of market failure. To fulfil its aim to clarify the role of market failure theory in EU competition law in relation to public policy measures, the research question defined in Chapter 1 was formulated as:

What role and value, if any, does market failure hold within the legal analysis of public policy intervention on markets in EU competition law?

In order to answer the research question, Chapters 2 and 3 deconstructed the meaning of market failure for the purpose of formulating a methodological and theoretical framework. Chapter 2 highlighted the theoretical ambiguity inherent in the meaning of market failure, a notion the understanding of which has evolved over time.²⁷⁰⁹ When expanded to its broadest sense, market failure is ‘conceived

²⁷⁰⁷ See Chapter 1, section 1.2.1.

²⁷⁰⁸ See Chapter 1, section 1.1.

²⁷⁰⁹ See Chapter 2, section 2.2.

of as the failure of the market to bring about results that are in the best interests of society as a whole'. This examination argued that the issue of market failure raises two sets of inquiries: the nature of market failure (the *why* question) and the function of market failure (the *how* question).²⁷¹⁰

Rather than subscribing to a monolithic definition, the theory of market failure embraces both a conventional meaning and alternative, broader interpretations.²⁷¹¹ Within the context of this thesis, a broader market failure concept has been defined as extending beyond a purely efficiency-based paradigm to encompass so-called external objectives.²⁷¹² This perspective reconciles potential conflicts between efficiency considerations and external objectives through a welfare-balancing mechanism. Such an approach deviates from the mathematical formula proclaimed within neoclassical theory, thereby requiring a value-laden analysis.²⁷¹³ The broader standards presented in this thesis resonate with the framework encapsulated in the so-called Musgravian triangle, which transcends mere allocation failures (pertaining to efficiencies) by including stability and distributional failures.²⁷¹⁴ This approach fosters a more comprehensive understanding of the multifaceted dimensions of market failure.

The analysis presented in Chapter 3 consequently led to the development of a framework that has been systematically applied throughout this research, employed to examine the role and value of market failure in antitrust law and the State aid regime. By dismantling the different theories and examining the nature and function of market failure, a workable framework was constructed, that enables a more nuanced analysis of market failure in EU competition law. Essentially this framework assessed:²⁷¹⁵

- Market failure as a rationale for public policy intervention;
- Market failure as a legal test through 'market diagnostics';
- Double market failure as a legal test under the principle of necessity;

²⁷¹⁰ *ibid.*

²⁷¹¹ See Chapter 2, section 2.3.

²⁷¹² See Chapter 1, section 1.2.4.

²⁷¹³ See Chapter 2, section 2.3.

²⁷¹⁴ See Chapter 2, section 2.2.2.

²⁷¹⁵ See Chapter 3, section 3.3.

- Potential trade-offs balancing between narrow and broader efficiencies as well as external objectives.

By applying that framework, this chapter draws the conclusions of the research. It is structured around three core segments. The following two sections address the *how* (function) and *why* (nature) questions of market failure in the context of antitrust and State aid law, respectively. The subsequent section critically assesses the role and value of market failure across these legal fields, introducing the thesis of a ‘market failure paradox’. Concluding this thesis, the final section projects toward the future, identifying three key areas that legal scholarship should prioritise in order to develop a more nuanced and effective understanding of public policy interventions in EU competition law.

10.1 Expansive Market Failure in EU Antitrust Law

This subsection first explains the argument that market failure in antitrust is expansive (the *why* question). Second, it equips the reader with the main insights into the functioning of market failure in EU antitrust law (the *how* question).

10.1.1 *Why* Market Failure: The Antitrust Rationale

Recently, market failure theory has worked its way into antitrust law, underscoring its emerging significance within Commission policy instruments, particularly as an avenue to broaden the scope of current antitrust analysis. As this evolution unfolds, market failure increasingly presents itself as a quasi-legal construct spanning multiple sectors of competition law. Overall, it is suggested that market failure holds *expansive* potential in EU antitrust law.

First, this research posits that even if a market failure test is not generally applied in EU antitrust law, a market failure analysis has the potential to broaden the scope of public policy intervention within the realm of antitrust. By identifying instances where markets are unable to achieve optimal outcomes, a market failure analysis can serve as a catalyst for expanding the boundaries of EU antitrust law beyond the status quo of maintaining competition.²⁷¹⁶ This can be attributed to the intrinsic general equilibrium perspective that market failure theory espouses. This is not only the case of embracing a broad standard of market failure, implying a

²⁷¹⁶ On the concept of the status quo of competition law, see Chapter 3, section 3.1.2.

trade-off between efficiencies and broader objectives, but also by introducing a narrow market failure standard tethered to efficiency considerations alone. Even under the latter, in line with the efficiency paradigm of welfare economics, such an approach would represent a significant departure from orthodox antitrust analysis that confines itself to the promotion of short to medium-term efficiencies in the relevant market.

Second, market failure theory potentially offers proponents of a broad antitrust analysis a bridge – one that melds the promotion of public policy objectives with a more economic approach. Chapter 4 highlighted the extensive scholarly debates surrounding the appropriate welfare standard and the scope of Article 101(3), with diverging views held by various parties.²⁷¹⁷ A common feature of proponents of public policy integration within antitrust, such as those advocating for sustainability or addressing income inequalities in antitrust law, is the aspiration to expand the traditional, reductional conception of antitrust confined to narrow efficiency and consumer welfare.²⁷¹⁸ Rather than merely promoting the extension of antitrust beyond efficiencies, this thesis suggests that many of the critiques implicitly argue for a shift toward general equilibrium analysis, as opposed to the current partial analysis.²⁷¹⁹

Third, this thesis suggests that the problem is less about the confinement of Article 101(3) to efficiencies and more about the partial nature of the equilibrium analysis. As such, by fostering a better understanding of the inclusion of broader efficiencies, such as sustainability or innovation, within the balancing exercise, a market failure analysis can overcome the flawed distinction between economic and non-economic objectives. The results of this thesis indicate that there are valid *legal* reasons for expanding the range of efficiencies considered in EU antitrust law. However, whilst the nature of efficiencies is broad enough to capture public policy objectives, the scope of the analysis remains a problem generally limiting the analysis to short and medium-term efficiencies in the relevant market. The following section presents the findings that support this conclusion.

Finally, the proposal of the new Draft Guidelines on Horizontal Cooperation Agreements suggests an imminent shift in discourse, even at an institutional

²⁷¹⁷ See Chapter 4, section 4.3.2.

²⁷¹⁸ *ibid.* Even though there is no foundation in the Treaties to support such a reduction.

²⁷¹⁹ At least regarding the inclusion of non-equity standards like environmental protection or innovation.

level.²⁷²⁰ Herein, market failure theory emerges as a central pillar of the Commission's environmental strategy. These Guidelines underscored the imperative to recalibrate our perception of efficiency gains, moving beyond the confines of individual consumer benefits in the relevant market. As shown below, establishing consumer benefit in the relevant market presents unique challenges. The requirement to integrate an expanded approach within the limits of a conventional analysis creates inconsistencies and exposes the framework to potential critique.

10.1.2 *How Market Failure: The Antitrust Modus Operandi*

This thesis demonstrates that EU antitrust law lacks a general market failure test for assessing the outcome of public policy intervention in the market.²⁷²¹ Yet, an analysis predicated on market failure theory in the context of Article 101(1) and 101(3) TFEU provides valuable insights into both the function and nature of that provision.

The test currently applied under Article 101(3) can be viewed as a *partial competition law-oriented market failure test*.²⁷²² It is competition law-oriented because it contains a stark preference for the status quo of competition law²⁷²³ by primarily emphasising narrow efficiencies, although it does, in exceptional circumstances, incorporate broader efficiencies and potentially even external objectives. This 'partial' test, however, is considerably narrower in scope than a market failure test rooted in welfare economics. This limitation stems from antitrust law's market-governed view and the requirement of actual benefits accruing to the consumers in the relevant market. Consequently, this circumscribes the nature and extent of the balancing exercise in Article 101(3). In essence, a market failure analysis indicates that this provision operates within a partial equilibrium framework, displaying a marked preference for pro-competitive

²⁷²⁰ See Chapter 5, section 5.2.2.2.3. Besides this institutional acknowledgement, the shift in scholarly discourse has been described and analysed in Chapter 4, section 4.3.2.

²⁷²¹ See Chapter 5, section 5.3.2.1 and Chapter 6, section 6.2.2.

²⁷²² On the partial nature and competition-law orientation of that test, see Chapter 5 sections 5.2.3, 5.3.1.1.1 and 5.3.2.1.

²⁷²³ i.e., the thesis that competition law has a set of imbedded presumptions and preferences implying that it is the most optimal way to organise transactions in society. See Chapter 3 section 3.1.2.

efficiencies, whilst exhibiting a reluctance to conduct a CBA in accordance with the principles of Kaldor-Hicks efficiency.

The focus now shifts to an in-depth exposition of the insights provided by the market failure analysis of Article 101(3).²⁷²⁴ A distinction is drawn between the normative function of market failure, guiding *when* intervention is warranted, and its analytical function, determining *how* such failure ought to be remedied.²⁷²⁵ Four observations can be made.

First, market failure, within the sphere of antitrust analysis, holds a certain *normative value*. Article 101(3) does not explicitly limit the positive effects considered within the balancing exercise to narrow efficiencies. *Verba legis*, this article merely states that the benefits that may be considered are those that contribute ‘to improving the production or distribution of goods or to promoting technical or economic progress while allowing consumers a fair share of the resulting benefit’. The Commission’s current approach, however, defines the purpose of that Article as balancing the restriction of competition with ‘pro-competitive’ benefits²⁷²⁶ – primarily the individual advantages enjoyed by the consumers in the relevant market. Whilst the scope for encompassing broader objectives, such as sustainability, within such an analysis seems limited,²⁷²⁷ the Commission itself does not consider the limited approach an absolute rule to which it strictly adheres. In fact, the Commission appears to recognise a potentially broader welfare balancing exercise within Article 101(3) by stating that ‘the question of a contribution to economic progress within the meaning of [Article 101(3)] can only arise in those exceptional cases where the free play of competition is unable to produce the best result economically speaking’.²⁷²⁸ Finally, Chapter 5 has shown how these findings have been corroborated by the adoption of the Commission Draft Guidelines which emphasise the importance of

²⁷²⁴ See Chapter 5, section 5.3.

²⁷²⁵ This approach has been consistently applied throughout this thesis. For a discussion see Chapter 3, sections 3.2.1 and 3.2.2.

²⁷²⁶ Guidelines on the application of Article 81(3) (n 364), para 33.

²⁷²⁷ See Chapter 5, sections 5.2.2.2.1 and 5.2.2.2.2.

²⁷²⁸ Commission Decision (76/172/EEC) ‘Bayer/Gist-Brocades’ (n 977), para III(1) (emphasis added).

collective benefits beyond those specific to competition and consumers in the relevant market.²⁷²⁹

A similar conclusion can be drawn from the case law. Although the EU Courts refer to ‘efficiencies’ in their judgments, that does not necessarily mean that they embrace a narrow definition of benefits. Instead, as long as the benefits are of an ‘objective’ nature,²⁷³⁰ they can be broad or narrow. This approach is in line with the market failure test described in Chapter 3. Internalising negative externalities, such as those attributable to pollution, can be deemed economically efficient when taking into account broader efficiencies that extend beyond competition-specific considerations.²⁷³¹ Economic efficiency is generated by the adjustment of the economic equation through the conversion of indirect costs, such as those related to pollution, into tangible benefits for society and, by extension, the involved market actors. Such an approach is not necessarily at odds with the Guidelines on Article 101(3), which explicitly acknowledge that Article 101(3) covers both ‘cost’ and ‘qualitative efficiencies’.²⁷³² Notably, it is within this latter category that broader efficiencies beyond lower prices and higher output in the relevant market could be included. Understanding the role of broader efficiencies through the lens of market failure paves the way for broader benefits such as ‘cleaner production or distribution technologies, less pollution’, etc. to be considered within the analysis.²⁷³³

The ostensible link between ‘benefits’ under Article 101(3) and efficiencies is ambiguous. The outcome of external objectives, therefore, remains shrouded in uncertainty. Notwithstanding a tendency to prioritise narrow efficiencies, even in the presence of broader ones,²⁷³⁴ the established case law, which grants the Commission the discretion to consider public interest objectives and ‘objectives of a different nature’, appears to remain valid.²⁷³⁵ Accordingly, it seems that the absence of external objectives in the decisional practice of the Commission

²⁷²⁹ Draft Guidelines on Horizontal Co-operation Agreements (n 49), paras 601-608.

²⁷³⁰ Case C-56/64 *Consten and Grundig* (n 946), para 13.

²⁷³¹ See Chapter 2, section 2.2.1.1.

²⁷³² Guidelines on the application of Article 81(3) (n 364), para 59.

²⁷³³ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 578.

²⁷³⁴ Case T-17/93 *Matra Hachette v Commission* (n 972), paras 106-111.

²⁷³⁵ Case 26/76 *Metro I* (n 350), para 21. See also, Joined Cases T-528/93 etc. *Métropole* (n 983), para 118.

primarily arises as a result of its current enforcement priorities, rather than being a manifestation of the constraints of the legal framework.

In this context, ‘efficiencies’ and ‘benefits’ might often be synonymous in their implications. Based on the findings of this research, it is argued that the categorisation of ‘economic’ and ‘non-economic’ objectives is redundant. Such a classification is not only superfluous but engenders a false dichotomy, erroneously implying that non-economic objectives carry disproportionate weight beyond the scope of the welfare balancing exercise. A more compelling, welfare economics-informed balancing approach would involve incorporating broader efficiencies into the analysis, rather than viewing them as ‘non-economic objectives’ antithetical to narrow competition law efficiencies.²⁷³⁶

Nevertheless, it is important to note that despite the inclusion of broader efficiencies²⁷³⁷ and even external objectives,²⁷³⁸ antitrust law might not be equipped to undertake a general welfare analysis.²⁷³⁹ Moreover, a tangible bias endures, favouring linking broader efficiencies with narrow efficiency gains, wherever feasible. This inclination is exemplified by the treatment of innovation in the *GSK* case, where the Court did not disassociate technological progress from the subsequent increase in profits.²⁷⁴⁰ On this issue, the EU Courts have shown significant restraint, displaying a marked reluctance to undertake a Kaldor-Hicks balancing of broader efficiencies against restrictions of competition. This point leads us to the subsequent observation.

Second, in terms of the *analytical value* of market failure,²⁷⁴¹ a market failure analysis of Article 101(3) has exposed the theoretical and legal shortcomings of antitrust analysis. One critical limitation of antitrust analysis is its market-governed approach, which may create inconsistencies in evaluating collective benefits. Under Article 101(3), the test employed can best be described as a partial market failure analysis that balances narrow efficiencies with broader ones, and potentially even external objectives, in the relevant market. It is

²⁷³⁶ To convey these distinctions, this thesis employs the terminology of ‘narrow efficiencies’, ‘broader efficiencies’ and ‘external objectives’. See Chapter 1, Section 1.2.4 for further elaboration.

²⁷³⁷ See Chapter 5, section 5.3.1.1.1.

²⁷³⁸ See Chapter 5, section 5.3.1.1.3.

²⁷³⁹ As is explained below in relation to the analytical aspects of market failure.

²⁷⁴⁰ Case C-501/06 P *GSK* (n 78), para 120.

²⁷⁴¹ (n 2725).

suggested that the confinement of the test to the relevant market engenders a certain degree of logical inconsistency with respect to the evaluation of collective benefits. A proper market failure analysis can only be accommodated within Article 101(3) with the inclusion of so-called ‘out-of-market efficiencies’ through the cross-aggregation of benefits between markets. These out-of-market efficiencies are not only recognised in the Commission’s decisional practice, but also find support in the case law of the Court.²⁷⁴²

Is there potential to broaden the scope of the current analysis? This thesis has emphasised the acknowledgement of ‘collective benefits’ in the recently proposed Commission Draft Guidelines as an important development of EU antitrust law. These collective benefits ‘occur irrespective of the consumers’ individual appreciation of the product.’²⁷⁴³

However, even as Chapter 5 demonstrated how cross-aggregation, in principle, is feasible and with a growing recognition of broader efficiencies in antitrust analysis, the ‘fair share criterion’ remains a roadblock to a more wide-ranging analysis. This criterion upholds the notion that EU antitrust law is not premised on a general social welfare standard but is geared towards safeguarding consumers in the relevant market. This condition can be regarded as the bedrock of the consumer welfare standard. Thus, the analysis of out-of-market efficiencies can prove challenging, as a net positive effect must be demonstrated specifically with regard to the consumer in the relevant market.²⁷⁴⁴ Yet, the consumer pass-on criterion cannot be construed as a distributive function; a mere overall net positive effect may satisfy its requirement without any consideration of the equitable distribution of benefits. This thesis contends that it is not the benefit criterion but the fair share criterion that presents the greatest challenges to incorporating broader efficiencies such as sustainability into EU antitrust analysis. In traditional antitrust analysis, price increases must be counterbalanced by other associated benefits enjoyed directly or indirectly by the consumers in the relevant market – and not merely by society at large.

However, what about collective benefits, such as more environmentally friendly production methods or better living conditions for workers, created by broader efficiencies? The Commission is aware of the inherent challenge in

²⁷⁴² See Chapter 5, section 5.2.3.

²⁷⁴³ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 601.

²⁷⁴⁴ Case C-238/05 *Asnef-Equifax* (n 1144), para 70.

incorporating these collective benefits within the framework of Article 101(3), especially considering the fair share criterion. To account for these benefits, the Commission Draft Guidelines incorporate what this thesis designates as a ‘capacity-overlap criterion’, which seeks to consider both the consumers in the relevant market and the same consumers in their capacity as ‘consumer citizens’.²⁷⁴⁵ This criterion adopts an expansive approach by acknowledging that consumers may have dual roles in the marketplace and society at large and thus seeks to ensure that benefits are net positive for both capacities. However, reconciling the recognition of collective benefits with a market-governed approach poses challenges. The Commission requires that collective benefits be quantified to determine the portion of those benefits attributed to the consumer within the relevant market. Yet, this approach becomes problematic when the benefits are qualitative and cannot be easily quantified using traditional cost and benefit analysis methods.

The capacity overlap criterion, as applied by the Commission, requires a threshold whereby the population enjoying the collective benefits must be deemed ‘substantially the same’ as the consumer in the relevant market.²⁷⁴⁶ However, the precise meaning of ‘substantially the same’ in the context of quantification remains unclear. The inherent nature of collective benefits suggests they should benefit everyone, including the consumers within the relevant market. This position even to a certain degree appears to be supported by the Commission itself.²⁷⁴⁷ As such, it is difficult to envisage a situation in which there would not be capacity overlap to some degree. Thus, apart from the ‘substantially the same’ condition, the Commission also requires that the agreement covers a significant market share to avoid free-riding by non-consumer citizens and produce substantial benefits (by for instance reduced pollution). Overall, it is suggested that the quantification methods associated with the capacity overlap criterion are intangible and nebulous.

²⁷⁴⁵ See Chapter 5, section 5.2.2.2.3.

²⁷⁴⁶ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 604. This requirement is derived from an *a contrario* argument with the case law of the Court holding that benefits exclusively accrued to consumers on one side of the market cannot serve as justification for restrictions produced on another side. See, to this effect, Case C-382/12 P *MasterCard and Others v Commission* (n 593), para 242.

²⁷⁴⁷ *ibid.* In the Draft Guidelines the Commission took an overly broad example between car drivers purchasing fuel for their cars and citizens benefiting from reduced pollution resulting from a fuel composition enhancement.

However, amidst this intricacy one fact remains clear: it is not permissible to cross-subsidise between population groups. This restriction becomes particularly challenging for economic sustainability policies aimed at business conduct that reinforces environmental inequalities. When environmental injustices arise, it is often specific population groups that are hardest hit. To illustrate, consider a hypothetical scenario involving Firm A which employs an environmentally harmful production method that causes pollution and subsequent famine in part of the territory distinct from the relevant market due to offshoring. The benefits resulting from improving the condition for that population cannot be considered under the capacity-overlap criterion because there is no overlap between consumers and beneficiaries.

Finally, another fundamental challenge arises in the process of quantifying the net positive effects of any efficiencies. In order to quantify the positive effects of the agreement, one needs to measure the competitive harm inflicted by the agreement (i.e., the negative effects). However, antitrust analysis does not typically extend beyond a *de minimis* assessment when quantifying competitive harm, and there is no clear guidance on this matter. This difficulty is compounded when price is not a determining factor in the analysis. Overall, it would seem that the Commission has made every effort to reconcile the concept of collective benefits with the requirements of Article 101(3). Unfortunately, it is not enough.

Third, market failure analysis has also revealed insights into the use of market failure as a *diagnostic tool*.²⁷⁴⁸ Notably, Article 101(3) lacks a market diagnostic test that assesses both the existence and magnitude of market failure. It is thus conceivable that, in principle, any market failure may be subsumed under Article 101(3) since the only condition is that it produces efficiency. As elaborated upon in Chapter 2, externalities are ubiquitous in nature.²⁷⁴⁹ Consequently, efficiency gains can be made by internalising these externalities, making such gains equally ubiquitous. This stands in contrast with the Commission's interpretation of Article 101(3) as only applying in 'exceptional cases'.²⁷⁵⁰ The opposing perspectives on the prevalence of market failure can only be explained

²⁷⁴⁸ See, Chapter 3, sections 3.3.2 and 3.3.3. The use of market failure as a diagnostic tool refer to an assessment of two key aspects: firstly, the identification of the presence of a market failure, and secondly, the assessment of the significance of that market failure (establishing a threshold to counteract the ubiquity of market failure).

²⁷⁴⁹ See Chapter 3, section 3.2.1.

²⁷⁵⁰ Commission Decision (76/172/EEC) 'Bayer/Gist-Brocades' (n 977), para III(1) (emphasis added).

by a dissonance between economic normative theory and legal reality. Economics acknowledges the ubiquity of market failure and the importance of addressing them for optimal efficiency. However, legal reality seemingly restricts the application of Article 101(3) to exceptional circumstances.

Notwithstanding the absence of a market diagnostic test (or *prima facie* proportionality),²⁷⁵¹ Article 101(3) encompasses facets of a double market failure test²⁷⁵² assessing the efficacy of public intervention (double market failure proportionality).²⁷⁵³ The indispensability criterion, as interpreted by the EU Courts, requires not only an efficacious remedy but also the absence of less restrictive alternatives.²⁷⁵⁴ It is incumbent upon the agreement to generate efficiencies that can be evaluated via a counterfactual, and no other less intrusive alternatives should be available. This robust dual market failure test underscores the significance of both the efficiency and efficacy of public policy intervention in EU antitrust law.

Fourth, the *balancing exercise* (substantive proportionality)²⁷⁵⁵ in Article 101(3) cannot be construed as a pure *stricto sensu* test balancing between, on one hand, the social utility generated by the agreement and, on the other, the restriction of competition. Instead, it is an antitrust-laden balancing exercise, which is ultimately manifested by the 'no elimination of competition' criterion. The presumption that EU antitrust law brings about the most optimal and efficient solution for society is powerful.²⁷⁵⁶

In conclusion to Article 101(3), competition law's status quo²⁷⁵⁷ is deeply embedded in the balancing test. The 'multi-valued tradition of [EU] competition law' gives rise to difficult trade-offs in case of inconsistencies.²⁷⁵⁸ This thesis has underscored that whilst narrow competition efficiencies are preferred, broader

²⁷⁵¹ i.e., a legal test centred around market failure to determine (1) whether the market is indeed failing and (2) the significance of that failure. See Chapter 3, section 3.3.2.

²⁷⁵² Defined in Chapter 3 as an appropriateness and necessity test of the measure itself remedying the market failure. See Chapter 3, section 3.3.3.

²⁷⁵³ See Chapter 5, section 5.3.1.3.

²⁷⁵⁴ *ibid.*

²⁷⁵⁵ Which is the ultimate part of the market failure test framework. See Chapter 3, section 3.3.4.

²⁷⁵⁶ See, Chapter 5, section 5.3.1.4.

²⁷⁵⁷ (n 2723).

²⁷⁵⁸ Van den Bergh and Camesasca (n 321) 17.

efficiencies are not entirely disregarded. However, the fair share criterion narrows the analysis to a market-governed lens. Trying to solve the dilemma of safeguarding both ‘consumer-citizens’ and consumers as such, the Commission has devised a complex methodology around the ostensibly irreconcilable concepts of collective benefits and ensuring a fair share for the consumers in the relevant market. To effectively address this dilemma, legal scholarship must, as stated above, shift its focus away from the artificial dichotomy between non-economic and economic benefits and instead turn its attention to the fair share criterion. Only then can a more comprehensive understanding be established, alongside the development of a more nuanced framework for evaluating and assessing antitrust issues within the broader context of market dynamics and public policy objectives. My take on this issue will be addressed subsequently.²⁷⁵⁹

Moreover, the prevalence of competition law’s status quo highlights the absence of a welfare analysis adhering to the principles of Pareto or Kaldor-Hicks efficiency. Instead of accommodating broader efficiencies on an equal basis, antitrust analysis remains fixated on the traditional concepts of perfect or workable competition. This adherence to a neo-classical static view of competition reinforces the objectives of consumer welfare and the protection of the competitive structure as such.²⁷⁶⁰ As Markham astutely noted, competition policy should aim to produce ‘the best competitive arrangement practically attainable’.²⁷⁶¹

Fifth, the thesis shows that market failure as a test *for justification under Article 101(1)* is only of minor relevance. Due to the absence of a proper balancing test, it remains unclear whether Article 101(1) offers an alternative route for public policy intervention.

Regarding the *Wouters* doctrine, the research shows that there is no proper market failure test.²⁷⁶² This is primarily attributed to an insufficient application of the principle of proportionality. However, it has been shown that the *Wouters* doctrine has the potential to shoulder a broad market failure test that extends beyond the narrow scope of Article 101(3). In this sense it could serve as a pivotal

²⁷⁵⁹ See section 10.3 of the current chapter.

²⁷⁶⁰ See Chapter 2, section 2.1.

²⁷⁶¹ Jesse W Markham, ‘An Alternative Approach To The Concept Of Workable Competition’ (1950) 40 *American Economic Review* 349, 349-350.

²⁷⁶² See Chapter 6, section 6.2.2.1.

element in EU competition law ‘modernisation 2.0’.²⁷⁶³ In contrast to the usual market-governed approach adopted by the antitrust provisions, the rule of reason may accommodate both narrow and broader efficiencies, as well as external objectives, beyond the relevant market.²⁷⁶⁴ Despite its potential, the current state of the *Wouters* doctrine lacks a mechanism for balancing competition against other objectives.²⁷⁶⁵ Instead it is limited to a mere formal proportionality assessment (double market failure).²⁷⁶⁶ Moreover, there is no market diagnostic test under *Wouters* assessing the existence and magnitude of market failures.²⁷⁶⁷ However, the scope of a potential double market failure test under *Wouters* remains uncertain. Although the Court occasionally employs a strict double market failure standard by using a LRM standard of necessity, the use of the principle of proportionality is not consistent, similar to its application in free movement law.

In sum, it becomes evident that the prevailing scholarly discourse, which heralds *Wouters* as a balancing act, may be somewhat overstated. The findings of this research reveal a different narrative. The *Wouters* doctrine, whilst incorporating an inconsistent application of a formal proportionality assessment, does not contain any balancing between competition and broader efficiencies/external objectives. The notable absence of balancing can largely be attributed to procedural constraints. Given that nearly the entirety of cases have been rendered under the preliminary ruling procedure, the latitude of the Court is inherently circumscribed, precluding any *stricto sensu* balancing. This trend remains unbroken even in the *Meca Medina* judgment, a direct action of annulment, where the Court refrained from engaging in *stricto sensu* balancing

²⁷⁶³ See (n 49). This thesis has underscored the ongoing process of modernisation within competition law. Beyond the buzzword of ‘modernisation’ there is evidence supporting the notion that competition law is continuously evolving. Wish and Bailey (n 440) 53 noted that ‘[i]t seems that a significant further modernisation of the EU competition rules is now taking place. Governments worldwide face challenges of a seriousness rarely experienced other than in times of war. These include, among others, problems resulting from the economic crisis of the late 2000s, rapid changes in technology and the digitisation of markets, the stresses caused by globalisation, climate change and environmental degradation and the calamity of coronavirus.’

²⁷⁶⁴ See Chapter 6, sections 6.2.1.1.1.1 and 6.2.1.1.2.1.

²⁷⁶⁵ At least on an EU level. See, to this effect Chapter 6, section 6.2.1.4.

²⁷⁶⁶ See Chapter 6, sections 6.2.1.3.1 and 6.2.2.1.

²⁷⁶⁷ See Chapter 6, sections 6.2.1.2.1 and 6.2.2.1.

without elucidating the contours of its reasoning.²⁷⁶⁸ Therefore, if *Wouters* is a balancing act, it appears to mostly be a matter of national jurisdiction.

However, akin to Article 101(3), a market failure analysis of the rule of reason doctrine has provided a clearer understanding of the case law. This examination reveals that this doctrine encompasses objectives that promote efficiency, particularly via information asymmetries and externalities, in addition to external objectives. Consequently, the *Wouters* rule of reason is not limited to public policy in the shape of broad efficiencies or external objectives. Nonetheless, this fact does not diminish the glaring absence of a market failure test within *Wouters*.

The section now moves on to the insights gained through the application of a market failure analysis to legal qualification under Article 101(1), namely in relation to the definition of an ‘undertaking’. This thesis posits that the doctrines of public authority and solidarity do not accommodate a market test for two primary reasons.²⁷⁶⁹

On one hand, these doctrines do not justify intervention in the market, but rather delineate the very boundaries of the market. In simple terms, where there is no market, there can be no market failure. Whilst the normative function of market failure may shed light on the reasons why these activities are retracted from the market, market failure theory has no further role to play in this context.²⁷⁷⁰ Although public authority rationales may be explained to a certain extent by public goods theory,²⁷⁷¹ the Court has maintained an orthodox approach by emphasising that the defining factor is whether these activities are typically undertaken by the State.

Equally, solidarity-based activities can be explained by distributional failures. Solidarity corresponds to a form of distributional failure, signifying a failure to maximise social welfare from a broader perspective, including the

²⁷⁶⁸ Case C-519/04 P *Meca-Medina* (n 660). See, to this effect, Chapter 6, section 6.2.1.4.

²⁷⁶⁹ See Chapter 6, section 6.2.2.2.

²⁷⁷⁰ *ibid.* Whilst several AGs have addressed the market’s incapacity to carry out the activities profitably, the Court gave no attention to this aspect. See, to this effect, Chapter 6, section 6.2.1.1.1.2 and 6.2.1.2.2.

²⁷⁷¹ See Chapter 6, section 6.2.1.1.1.2. As previously explored in Chapter 2.2.1.4, in scholarship, a common factor of non-economic activities rooted in public authority is their non-excludable nature. Yet, it worth noting that most goods are excludable, which renders this exception overly narrow.

society's preference for the distribution of income and/or wealth.²⁷⁷² The Court seems to have shown reluctance in the area, possibly due to its political sensitivity. Nevertheless, it should be noted that this exception has limited applicability as undertakings in the welfare sector are typically subject to the antitrust provisions of the Treaty.²⁷⁷³ This research reveals that the solidarity doctrine is not merely a traditional categorisation exercise in the sense of legal qualification. Instead, it serves as a tool to assess the degree of market retraction of these activities via a sliding scale.²⁷⁷⁴

On the other hand, since these activities are left outside of the scope of EU competition law, there is no formal or *stricto sensu* proportionality assessment. Thus, within the doctrine of non-economic activities, there exists an absence of any identifiable proportionality analysis or market failure test.

10.2 Constraining Market Failure in EU State Aid Law

This subsection initially explains the argument that market failure in State aid law is constraining (the *why* question). Subsequently, it provides the reader with the main insights into the functioning of market failure in EU State aid law (the *how* question).

10.2.1 *Why Market Failure: The State Aid Rationale*

In comparison to the expansive potential of market failure in antitrust law, its use in State aid law strikes a different chord. In the realm of State aid law, market failure is employed to restrict the scope of public policy intervention,²⁷⁷⁵ calling for a closer scrutiny of national aid measures. Thus, its potential role in State aid analysis is decidedly *constraining*.

As explored in Chapter 7, State aid modernisation aimed to establish clear, transparent, and uniform rules.²⁷⁷⁶ Harmonising with the leitmotif of competition

²⁷⁷² Marciano and Medema (n 46) 4. On the distributional nature of a broad market failure standard, see Chapter 2, section 2.2.2.2.

²⁷⁷³ Article 3 TEU and Protocol no 27.

²⁷⁷⁴ See Chapter 6, section 6.1.3.2.2.

²⁷⁷⁵ See e.g., 2005 SAAP (n 20), point 18 advocating 'less and better targeted aid'.

²⁷⁷⁶ See Chapter 7 section 7.4.1.

law modernisation, it introduced a ‘refined economic approach’.²⁷⁷⁷ The constraining effect of market failure analysis is visible in the CAP which establishes a strong presumption:

In the absence of evidence to the contrary in a specific case, the Commission considers that markets deliver an efficient allocation of resources in the economy.²⁷⁷⁸

The market failure approach in State aid law places the burden of proof on the Member States to demonstrate that their public policy interventions are remedying a ‘significant market failure’,²⁷⁷⁹ be it in terms of efficiency, equity or stability. The restrictive nature of market failure in State aid is twofold.

Firstly, market failure serves as a touchstone, circumscribing the legitimacy of interventions of the Member States via State aid in scenarios bereft of a demonstrable market failure. By imposing an explicit market failure criterion, the Commission seeks to ensure that interventions are justified, ensuring that potential negative effects on competition are commensurably outweighed by the positive effects of the intervention. This market failure requirement is echoed and reiterated across various Guidelines.²⁷⁸⁰ Although certain Guidelines may adopt a narrower notion of the manifestations of market failure within their scope,²⁷⁸¹ the function of the concept remains intact.

Secondly, the use of market failure as a diagnostic tool has, generally, enabled more rigorous scrutiny of aid measures. By mandating the unequivocal identification of a ‘significant market failure’²⁷⁸² and the concomitant implementation of an appropriate remedy, resulting in so-called ‘incentive effects’, the Commission is conferred with a broad margin of discretion to assess

²⁷⁷⁷ *ibid.*

²⁷⁷⁸ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 19.

²⁷⁷⁹ *ibid.*

²⁷⁸⁰ See Chapter 9.

²⁷⁸¹ As is the case with the CEEAG, see to this effect, Chapter 9, section 9.1.1.1 and 9.1.2.5.

²⁷⁸² This term may vary across sectorial regimes. The CEEAG, for instance, mandates a ‘residual market failure’ see to this effect, 2022 CEEAG (n 1771), para 36. The exception to this rule is the RAG, which operates on a market failure presumption, see Chapter 9, section 9.2.2.1.4.

the proportionality of aid measures.²⁷⁸³ This character of the market failure analysis is further underscored by the 2005 SAAP, one of the objectives of which is ‘less’ aid.²⁷⁸⁴

The following section provides a detailed analysis of the specific function of such a market failure analysis in State aid law.

10.2.2 *How Market Failure: The State Aid Modus Operandi*

In view of the distinctive attributes of State aid law, coupled with its inherently evolutionary nature, the test applied under Article 107(3) TFEU is based on the Commission’s discretion in making complex socio-economic evaluations. Nevertheless, the Commission is required to operate within a minimum standard test prescribed by the case law of the EU Courts.²⁷⁸⁵ In this regard, Chapter 8 identified two sets of market failure tests: a comprehensive test applied by the Commission and an overarching broader test applied by the EU courts.²⁷⁸⁶

The comprehensive test applied by the Commission under Article 107(3)(c) can be construed as encompassing both an explicit and implicit market failure assessment. Similarly, the criteria established in the case law also embody a very broad market failure test. Within the assessment of the Commission, market failure is mostly employed as a suitability and necessity test providing closer scrutiny of national aid measures. Market failure, therefore, functions primarily as a diagnostic tool rather than a normative rationale for public policy intervention. Market failure analysis, according to the Commission, can help to ‘investigate the reasons why the market by itself does not deliver the desired objective [...]’.²⁷⁸⁷ In other words, ‘identifying the market failure at stake will help evaluate better whether state aid could be justified and acceptable’.²⁷⁸⁸

The overarching test applied by the EU Courts, in contrast, evokes the contours of an overarching suitability analysis. Whilst affirming the mainly analytical aspect of market failure (as a diagnostic tool), it merely requires,

²⁷⁸³ See Chapter 8, section 8.2.2.1.

²⁷⁸⁴ 2005 SAAP (n 20), para 18.

²⁷⁸⁵ See Chapter 7 section 7.3.2.2.2 and Chapter 8, section 8.2.2.3.

²⁷⁸⁶ See Chapter 8, section 8.2.2.1 and 8.2.2.3.

²⁷⁸⁷ 2005 SAAP (n 20), point 22.

²⁷⁸⁸ *ibid.*, point 23.

implicitly, a demonstration that the market on its own cannot achieve the objective as efficiently.²⁷⁸⁹ Although the presence of a market failure may might serve as compelling evidence that the conditions of Article 107(3)(c) are satisfied, it does not constitute a strict condition.²⁷⁹⁰

Before delving into the analytical aspects – i.e., market diagnostics – of market failure, certain findings concerning its *normative character* should be noted. The thesis has shown that, whilst not explicitly relying on market failure as a normative tool, the assessment of the Commission could encompass both a narrow market failure and a broader standard based on macroeconomic stability failures on one hand, and equity or cohesion failures on the other.²⁷⁹¹ The Commission explicitly states in the CAP that State aid can be justified based on an ‘objective of common interest’, which is understood as either an efficiency enhancement or an improvement in equity.²⁷⁹² The concept of efficiency, as delineated in the Commission’s soft law, expands beyond narrow efficiency, explicitly recognising broader efficiencies such as R&D and environmental externalities.²⁷⁹³ However, it has been shown that under the direct assessment, priority appears to be given to narrow efficiency objectives. In the case study on digitisation, narrow competition efficiencies were retained, such as ‘better services and wider consumers choice’ over broader objectives in a similar fashion to antitrust analysis.²⁷⁹⁴ Yet, in cases where no such narrow efficiencies were present, the measures were exempted based on broader efficiencies or external objectives going beyond narrowly construed consumer welfare.²⁷⁹⁵

This pattern of favouring narrow efficiencies, where feasible, is also discernible within sector-specific aid frameworks. Chapter 9 unveiled that the CEEAG embraces a sustainability-laden welfare standard, departing from the total

²⁷⁸⁹ e.g., Case T-162/13 *Magic Mountain* (n 2040), para 81; Case T-356/15 *Austria v Commission* (n 2099), para 151.

²⁷⁹⁰ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 67.

²⁷⁹¹ See Chapter 7, section 7.4.2.1 and Chapter 8, section 8.2.1.1.

²⁷⁹² Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 18.

²⁷⁹³ *ibid.*, paras 19-25. See also in relation to the CEEAG Chapter 9, section 9.1.2.1.

²⁷⁹⁴ Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), para 134. See Chapter 8, section 8.1.1.

²⁷⁹⁵ Chapter 8, section 8.1.2. These cases granted exemptions to aid measures that delivered a high social utility extending beyond mere price reductions and increased output.

welfare standard enshrined in the CAP.²⁷⁹⁶ However, this sustainability-driven welfare standard is limited to decarbonisation measures.²⁷⁹⁷ In contrast, measures promoting energy efficiency continue to be assessed under the traditional total welfare standard, emphasising traditional narrow efficiencies.²⁷⁹⁸ Central to this separation between these welfare standards is the interpretation of consumer welfare. Diverging from a narrow approach based on efficiency maximisation as the primary vehicle for consumer welfare, the CEEAG's approach to decarbonisation measures appears to revolve around the promotion of broader efficiencies through environmental improvements. This stands in contrast to conventional factors like lower prices or increased output.²⁷⁹⁹ In a similar vein, the RAG provides Member States with the latitude to promote external objectives, such as stability and equity, at the expense of narrow competition law efficiencies, albeit with a requisite balancing act in place.²⁸⁰⁰

Consequently, if market failure is (implicitly) employed as a normative tool, the State aid regime embodies a broad standard transcending economic efficiency. The assessment in State aid represents a balance between conventional market failures and the imperative to integrate external goals, such as equity and cohesion objectives. It is argued that rather than viewing equity and efficiency as separate grounds of justification adhering to distinct logics, they intertwine within the evaluation. Even though these two sets of objectives are generally separated by both the Commission and scholarship, they undergo the same assessment.²⁸⁰¹ Thus, this separation is not a methodological distinction but rather a formal one. This argument is supported by the application of the CAP principles to both efficiency and equity considerations within the RAG.²⁸⁰² Therefore, this thesis suggests that a broader Musgravian standard of market failure can provide a normative explanation for not only efficiency rationales, but also stability and

²⁷⁹⁶ See Chapter 9, section 9.1.2.1.

²⁷⁹⁷ 2022 CEEAG (n 1771), para 65.

²⁷⁹⁸ *ibid.*, para 26. See also Chapter 9, section 9.1.2.1.

²⁷⁹⁹ Such as those triumphed by the 101(3) Guidelines, see Chapter 5, section 5.2.2.2.1.

²⁸⁰⁰ See Chapter 9, section 9.2.2.2.4.

²⁸⁰¹ e.g., Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 9; see also the similar assessment of external objectives and efficiency objectives in the 2022 Guidelines on regional State aid (n 1768).

²⁸⁰² See Chapter 9, section 9.2.2.2.5.

equity failures. However, regardless of the analytical perspective adopted, one fact is evident: State aid is not confined to efficiency considerations alone.

The Commission's prerogative to rely on a broad spectrum of objectives relating to efficiency, stability and equity under Article 107(3)(c) remains unrestricted by the case law of the EU Courts. Chapter 8 conducted a thorough examination of the judgments of the EU Courts in *Hinkley Point C*.²⁸⁰³ This landmark case confirmed that the Commission cannot reduce the scope of Article 107(3)(c) by requiring an 'objective of common interest'.²⁸⁰⁴ Instead, what is required is that State aid contributes to 'the development of certain economic activities or of certain economic areas'.²⁸⁰⁵ This has been argued to be even broader in scope than market failure. Whilst it is broad enough to cover all kinds of market failures,²⁸⁰⁶ it can also cover a multitude of other circumstances. Thus, although market failure might indirectly be a rationale for State aid, the case law suggests that State intervention might also find justification on other grounds. However, the central question is whether this reality actually alters the legal assessment, especially considering the diagnostic aspect of the test, which might be capable of precluding any instance of intervention in the absence of market failure. Chapter 9 demonstrated that such an alteration in the assessment appears unlikely. The revised Guidelines of 2022 essentially incorporate the methodology enshrined in the CAP, with modifications being largely semantic in nature.²⁸⁰⁷

This segues into the *diagnostic aspects* of market failure analysis under Article 107(3). At its core, this thesis underscores a disparity: whilst antitrust law emphasises efficiency through the double market failure criterion, State aid law, despite its extensive application of economic principles, does not echo this emphasis.²⁸⁰⁸ However, the examination in Chapter 9 reveals a deviation. Within sectorial regimes, the RAG efficiency especially is not merely an afterthought, but a central concept. This gravitation towards efficiency appears to be more

²⁸⁰³ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129).

²⁸⁰⁴ *ibid.*, para 20. An objective of common interest was interpreted either as a market failure in terms of efficiency or equity-enhancing measures. See Chapter 7, section 7.4.2.1.

²⁸⁰⁵ In accordance with the wording of Article 107(3)(c).

²⁸⁰⁶ See Chapter 8, section 8.1.4.

²⁸⁰⁷ See Chapter 9, sections 9.1.1, 9.1.2.5 and 9.2.2.1.9.

²⁸⁰⁸ This rule, however, has an exception, which relates to the efficiency considerations enshrined in the RAG. See Chapter 9, sections 9.2.2.2.3 and 9.2.2.2.5.

pronounced when State aid pivots towards equity and the Commission's discretion narrows.

Within the proportionality assessment of aid measures, market failure as a *diagnostic tool* (analytical role), rather than a normative concept, is present both in the CAP and in the various Guidelines.²⁸⁰⁹ In State aid law, the distinction between the normative and analytical roles of market failure is fundamental, as it is intrinsically woven into the legal assessment.²⁸¹⁰ State aid law does not perceive market failure as an intrinsic part of the objective of public policy intervention. Instead, it is predominantly reflected in the proportionality test of the aid measure. Whilst the distinction becomes readably discernible when the aid measure pivots on equity,²⁸¹¹ drawing such a distinction can be challenging when the rationale of the aid is rooted in narrow efficiency.

For instance, in *Hinkley Point C*, the promotion of nuclear energy was considered a legitimate objective capable of justifying the intervention, without any allusion to a market failure as the normative basis for the measure.²⁸¹² Notwithstanding this, market failure emerged, with the endorsement of the Grand Chamber, as a diagnostic tool – a lens to assess if market forces alone were insufficient to achieve the objective of nuclear energy promotion.²⁸¹³ This shifts the paradigm.²⁸¹⁴ Market failure does not primarily regulate *when* aid can be granted but *how* aid can be granted.²⁸¹⁵ In this context, the Commission typically conducts a two-pronged analysis that evaluates the appropriateness and necessity of the State aid measure in light of the identified market failure.

²⁸⁰⁹ (n 2725).

²⁸¹⁰ See Chapter 8, section 8.2.2.1 and Chapter 9, sections 9.1.2.5 and 9.2.2.2.5.

²⁸¹¹ In other words, when the objective itself is not centred around pursuing efficiency.

²⁸¹² Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 62.

²⁸¹³ *ibid.*, para 67: 'the General Court accordingly did not err in law when, in paragraph 151 of the judgment under appeal, it held that, while the existence of a market failure may be a relevant factor for declaring State aid compatible with the internal market [...]'.

²⁸¹⁴ Traditionally, market failure is a normative theory, see Chapter 2, section 2.2.2 and Zerby Jr and McCurdy (n 97) 558.

²⁸¹⁵ In other words, a 'double market failure test' including a diagnostic test of the market conditions. See Chapter 3, sections 3.3.2 and 3.3.3.

First, the intensity of the market diagnostic test²⁸¹⁶ – i.e., the appropriateness of the intervention – falls within the discretion of the Commission.²⁸¹⁷ The CAP stipulates that any identified market failure must, generally, be deemed ‘significant’.²⁸¹⁸ Prior cases relating to digitisation set a benchmark requiring a ‘true market failure’ that obstructs the market from achieving economic efficiency.²⁸¹⁹ However, later cases appear to have shifted the emphasis from efficiency to efficacy of the measure. The core requirement becomes whether a project would remain unexecuted without the aid measure.²⁸²⁰ This shift engenders a much broader diagnostic tool. With the emphasis placed on the efficacy of the aid measure, there is only minimal, if any, consideration of the magnitude of the market failure (i.e., its inefficiencies). As a result, the Commission’s practice has acknowledged more dubious market failure from an efficiency standpoint, such as ‘risk’ and ‘uncertainty’.²⁸²¹ Within this broader diagnostic test, it is sufficient to demonstrate that market actors may be hesitant to finance a project without government support.²⁸²² Such a requirement bears scant relevance to the notion of economic efficiency and ostensibly allows for the provision of State aid even to projects that are possibly inefficient or carry a significant level of risk in relation to return.

The exploration of sectorial regimes in Chapter 9 offers further insights. Whilst the RAG operates under the presumption of market failure without requiring any market diagnostics,²⁸²³ the CEEAG appears more attuned to the CAP. The CEEAG requires the existence of a ‘residual market failure’.²⁸²⁴ Merely identifying a market failure does not suffice. The onus shifts to demonstrating its persistence despite the potential presence of regulatory mechanisms and policies

²⁸¹⁶ i.e., is the market failing? And, if so, is the market failure significant? See Chapter 3, section 3.3.2.

²⁸¹⁷ See Chapter 8, section 8.2.1.2.

²⁸¹⁸ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 19.

²⁸¹⁹ Commission Decision (2007/374/EC) ‘purchase of digital decoders’ (n 2004), para 142.

²⁸²⁰ This concept has been broadly interpreted and it might suffice that the measure cannot be realised in ‘sufficient time’. See, Case T-356/15 *Austria v Commission* (n 2099), para 151.

²⁸²¹ Commission Decision (EU) 2015/658) ‘Hinkley Point C’ (n 2075), para 247.

²⁸²² See Chapter 8, section 8.2.1.2.

²⁸²³ 2022 Guidelines on regional State aid (n 1768), para 77.

²⁸²⁴ 2022 CEEAG (n 1771), paras 35-36.

targeting that specific market failure.²⁸²⁵ Consequently, the CEEAG's requirement of a 'residual market failure' transcends a mere quantitative assessment of significance, demanding evidence that the market failure has remained unremedied. Any aid measure introduced under this framework must ensure that it does not obfuscate or conflict with alternate policies designed to address the identical market failure.²⁸²⁶

Second, the test employed under Article 107(3) typically involves a double market failure test in the shape of an appropriateness and necessity analysis of the aid measure in question.²⁸²⁷ The notion of double market failure is integral to both the direct assessment and the various Guidelines.²⁸²⁸ On the whole, it is argued that the double market failure criterion within State aid law is poised more towards assessing the efficacy of the aid measure in altering the behaviour of the recipient undertakings rather than its efficiency.²⁸²⁹ In this context, the analysis predominantly narrows down to affirming that the aid measure has a 'limited' impact on competition and trade, eschewing a more in-depth assessment of the measure's efficiency.²⁸³⁰

In the efficacy dimension, a salient element of State aid modernisation hinges on ensuring that the aid measure brings forth so-called 'incentive effects' – a requirement also underscored by the EU Courts. The aim of that analysis is to verify that the aid alters:

the behaviour of a beneficiary undertaking in such a way that it engages in activity that contributes to the achievement of a public-interest objective that (i) it would not carry out without the aid, or (ii) which it would carry out in a restricted or different manner.²⁸³¹

²⁸²⁵ See Chapter 9, section 9.1.2.3.

²⁸²⁶ *ibid.* See the 2022 CEEAG (n 1771), paras 40–42.

²⁸²⁷ In contrast to the market diagnostics test, which assesses the appropriateness of the intervention itself without taking the design of the measure into account.

²⁸²⁸ See Chapter 7, section 7.4.2.2, Chapter 8, section 8.2.1.3 and Chapter 9, sections 9.1.2.3 and 9.2.2.2.3.

²⁸²⁹ See Chapter 8, section 8.2.1.3.

²⁸³⁰ See Chapter 8, section 8.2.1.4 and Chapter 9, section 9.1.2.4.

²⁸³¹ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 32.

Hence, within the setting of a formal proportionality assessment, the effectiveness of the intervention stands paramount.²⁸³² Chapter 9 showed that the efficacy evaluation is accentuated even more within the ambit of both the CEEAG and the RAG, with both enforcing rigorous LRM standards.²⁸³³ In contrast, the necessity test under the direct assessment manifests a degree of flexibility and rarely takes the shape of a LRM standard.²⁸³⁴

With the exception of the RAG,²⁸³⁵ the least amount of aid criterion emerges as the sole measure of pure efficiency in the proportionality assessment under the direct assessment. Yet, this seems to bear a closer resemblance to a form of ‘budget efficiency’ than a balance between the costs of intervention and social utility in terms of efficiencies. This interpretation aligns with the Commission’s modernisation ethos within the SAM, which states that ‘State aid control is crucial in order to improve the efficiency and effectiveness of public spending’.²⁸³⁶

Third, the nonexistence of a proper efficiency assessment is further supported by the absence of a balancing exercise within the *stricto sensu* limb of proportionality. Analogous to the antitrust regime, the Commission underscores the need to quantify the positive effects of the aid in order to balance them against the restriction of competition and trade.²⁸³⁷ Notwithstanding the CAP, which states that the final step is to balance positive and negative effects to achieve an equilibrium,²⁸³⁸ this thesis has demonstrated that such a balancing exercise does not materialise in practice.²⁸³⁹ An evident reticence permeates the Commission’s approach, with discernible reluctance to embark upon a resource-intensive balancing act. From this observation, two points can be made.

²⁸³² Conversely, a general market failure test involves a balancing exercise (*stricto sensu* or ‘substantial’ proportionality) with the aim to maximise social utility.

²⁸³³ See Chapter 9, sections 9.1.2.3 and 9.2.2.2.3.

²⁸³⁴ See Chapter 8, section 8.2.1.3.

²⁸³⁵ See Chapter 9, section 9.2.2.2.5.

²⁸³⁶ Communication on State aid modernisation (n 20), para 12.

²⁸³⁷ See Chapter 7, section 7.4.2.3.2.

²⁸³⁸ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 57. This is reaffirmed in both the CEEAG and the RAG, see to this effect, 2022 CEEAG (n 1771), para 71; 2022 Guidelines on regional State aid (n 1768), para 104.

²⁸³⁹ Instead, the requirement is that the negative effects should remain ‘limited’, absent any considerations of whether the aid measure is creating a net positive balance. See Chapter 8, section 8.2.1.4.

On one hand, it is clear from the judgment of the Grand Chamber in *Hinkley Point C* that Article 107(3)(c) does not include any general welfare balancing mechanism. The ECJ upheld the ruling of the General Court, underscoring that the requisite balancing within said Article takes place within the context of the internal market.²⁸⁴⁰ Consequently, this balancing act solely considers ‘the negative effects of the State aid on competition and trade between Member States’. In essence, this implies that any adjacent market failure induced by factors other than a restriction of competition and trade, and which cannot be measured in those terms, remains outside the scope of the analysis (e.g., a broader sustainability failure in terms of negative environmental externalities).²⁸⁴¹

On the other hand, notwithstanding the Court’s judgment, it is argued that there is usually an absence of a proper balancing exercise even within the context of internal market – i.e., between the status quo of competition law and the efficiencies/benefits engendered by the aid measure.²⁸⁴² This lack of balancing can plausibly be attributed to the symbiotic interplay between Article 107(3) and Article 107(1).²⁸⁴³ Notably, Article 107(1) does not require the Commission to assess the actual distortions of competition of State aid. Instead, it suffices that the measure is merely ‘liable’ to restrict competition and affect trade.²⁸⁴⁴ Furthermore, the Court has rejected the idea of a general *de minimis* rule in State aid law.²⁸⁴⁵ Given the broad application of the GBER, it might be inferred that State aid often operates via a ‘method of exclusion’, where aid exempted from the GBER’s ambit and satisfying the criteria of Article 107(1) is presumed ‘liable’ to affect competition and trade.

In the realm of sectorial regimes, the balancing exercise is likewise restricted, albeit with nuanced variations. Notably, the CEEAG does not operate within a general equilibrium analysis but rather enforces a sustainability-laden

²⁸⁴⁰ Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), paras 86 and 101.

²⁸⁴¹ For instance, one of the arguments in *Hinkley Point C* was that the construction of the nuclear power plant engendered negative environmental externalities, thereby giving rise to another instance of market failure (Case T-356/15 *Austria v Commission* (n 2099), para 402).

²⁸⁴² Contrary to views in scholarship. See e.g., Friederiszick, Röller and Verouden (n 340) 652.

²⁸⁴³ See Chapter 7, section 7.3.1.4 and Chapter 8, section 8.2.1.4.

²⁸⁴⁴ e.g., Case C-148/04 *Unicredito Italiano* EU:C:2005:774 (n 1723), para 55; Case C-667/13 *Banco Privado Português and Massa Insolvente do Banco Privado Português* (n 1723), para 46.

²⁸⁴⁵ Although the Commission has adopted *de minimis* regulations, see Chapter 7, section 7.3.1.4.

notion of welfare.²⁸⁴⁶ Consequently, if it incorporates a balancing act, it is invariably sustainability-laden. Yet, the CEEAG also remains reluctant to enter into a resource-intensive balancing exercise, preferring to set forth a range of assumptions and balancing principles.²⁸⁴⁷ The RAAG, in contrast, presents a distinct scenario. Whilst equally providing certain balancing principles and presumptions, the Commission seems markedly more amenable to conducting a *stricto sensu* balancing act under the RAG.²⁸⁴⁸ A plausible interpretation of this divergence proffered in Chapter 9 suggests the rationale might lay in the inherent complexities associated with ascertaining a positive balance between efficiency and equity without resorting to a full-fledged balancing test – a process undeniably steeped in value judgments.²⁸⁴⁹

Thus, in light of the absence of any assessment of the restriction of competition under Article 107(1), such an assessment is exclusively conducted under Article 107(3). This thesis has underscored that, under the latter provision, it typically suffices to determine that the effects on trade and competition are limited, without a proper balancing act. Rather, the balancing act comes into play solely when the restrictions of competition exceed a certain magnitude. This approach appears to be based on an argument of enforcement resource allocation, inverting the standard methodology. When the effects of trade and competition are found to be negligible, expending resources on a balancing act is regarded as unnecessary.

In conclusion, within State aid law, the role of market failure analysis is primarily to provide a rigorous examination of the efficacy of the aid measure, chiefly to preclude sub-optimally designed State aid. However, whilst the soft law seemingly promotes a broad efficiency-based assessment anchored in a general equilibrium analysis, the findings of this research suggests this aspiration is not consistently realised in practice.

²⁸⁴⁶ See Chapter 9, section 9.1.2.1.

²⁸⁴⁷ See Chapter 9, section 9.1.1.2.6.

²⁸⁴⁸ See Chapter 9, section 9.2.2.2.4.

²⁸⁴⁹ *ibid.*

10.3 Conclusions and Recommendations

10.3.1 Market Failure: A Paradox or a Double-Edged Sword?

This section aims to answer the main research question of the thesis.

What role and value, if any, does market failure hold within legal analysis of public policy intervention on markets in EU competition law?

Chapter 2 demonstrated that the understanding of market failure lacks a cohesive consensus in economic theory.²⁸⁵⁰ Rather, it is an evolving concept, reflecting diverse perspectives of various academic disciplines and theoretical schools. In Chapter 3, the argument was advanced that market failure may not only serve as a normative rationale but can also provide an analytical framework in the shape of a legal test.²⁸⁵¹ To this end, a market failure framework was developed to critically explore the role and relevance of market failure within EU competition law. Essentially this framework assessed:²⁸⁵²

- Market failure as a rationale for public policy intervention;
- Market failure as a legal test through ‘market diagnostics’;
- Double market failure as a legal test under the principle of necessity;
- Potential trade-offs balancing between narrow and broader efficiencies as well as external objectives.

The exploration of the value and role of market failure in EU competition law unveils two distinct dimensions, encapsulating both theoretical and practical paradoxes. Nearly half a century ago, Bork famously portrayed antitrust policy as fundamentally ‘at war with itself’.²⁸⁵³ This characterisation continues to find relevance, mirroring the present-day contradictions within EU competition law. However, distinct from the problem described by Bork,²⁸⁵⁴ the nexus between

²⁸⁵⁰ See Chapter 2, section 2.3.

²⁸⁵¹ See Chapter 3, sections 3.2.1, 3.2.2, 3.3.2 and 3.3.3.

²⁸⁵² See Chapter 3, section 3.3.

²⁸⁵³ Robert H Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, 1978).

²⁸⁵⁴ *ibid.* The author of this thesis interprets Bork’s perspective as essentially advocating for competition law to safeguard consumers by promoting efficiency rather than protecting competitors. Any ‘distortions’ that have transformed competition law into a tool for protecting smaller businesses should be overturned.

public policy intervention, market failure and a more economic approach to competition law presents a novel paradox in contemporary competition law: the market failure paradox. As previously indicated, the paradox manifests with clarity both on a theoretical and practical level.

From a theoretical standpoint, whilst market failure is depicted as being ubiquitous in economic literature,²⁸⁵⁵ it is perceived as a rare anomaly in EU antitrust policy.²⁸⁵⁶ This theoretical paradox is reaffirmed in various policy documents, underlining a steadfast inclination toward maintaining the status quo of competition law. The Commission Draft Guidelines, for instance, assert that:

Competition law enforcement contributes to sustainable development by ensuring effective competition, which spurs innovation, increases the quality and choice of products, ensures an efficient allocation of resources, reduces the costs of production and thereby contributes to consumer welfare.²⁸⁵⁷

A similar position is articulated in the CAP:

In the absence of evidence to the contrary in a specific case, the Commission considers that markets deliver an efficient allocation of resources in the economy.²⁸⁵⁸

This position is also reflected in various specific aid regimes, such as the CEEAG:

It is generally accepted that competitive markets tend to bring about efficiencies in terms of prices, output and use of resources.²⁸⁵⁹

Throughout this thesis, it has been demonstrated that such stances foster inconsistent and ambiguous enforcement policies in relation to public policy intervention. Whilst economic empirical research suggests that market failures are endemic to all markets, the Commission seems reticent to open Pandora's box and generally recognise that agreements or aid measures addressing a market failure –

²⁸⁵⁵ As established in Chapter 3, section 3.2.1.

²⁸⁵⁶ Commission Decision (76/172/EEC) 'Bayer/Gist-Brocades' (n 977), para III(1).

²⁸⁵⁷ Draft Guidelines on Horizontal Co-operation Agreements (n 49), para 544.

²⁸⁵⁸ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 19.

²⁸⁵⁹ 2022 CEEAG (n 1771), para 9.

either in terms of an increase of efficiency and/or equity – could be systematically exempted from the competition law framework. Particularly, within the realm of the antitrust provisions – where the paradox is most conspicuous – economic theory suggests that any agreement/measure remedying a market failure might, in theory, fall under Article 101(3) TFEU as a factor of economic efficiency. However, from a legal standpoint, the criteria of Article 101(3) are deemed fulfilled only in exceptional cases, thus circumscribing a pervasive concept through a restrictive interpretation. The precise contours of such an interpretation remain, nonetheless, elusive. As such, the reconciliation between traditional antitrust analysis and a market failure approach reveals inconsistencies. These disparities pose considerable interpretative challenges of market failure within the legal framework, especially when compared to the concept in welfare economics.

From a practical perspective, the role and value of market failure within the framework of EU competition law are largely contingent upon the intensity of the proportionality assessment and the feasibility of balancing between various efficiencies and competitive harm.

In EU antitrust law, market failure, as a legal test, holds a subsidiary role, devoid of proper legal meaning.²⁸⁶⁰ Whilst the predominant emphasis on efficiency improvement in EU antitrust law suggests that market failure theory might explain the rationale of Article 101(3), the narrow scope of the analysis poses numerous challenges. Thus, EU antitrust law does not incorporate a general market failure test. Instead, it appears more as a partial, competition law-specific variation of a market failure test.²⁸⁶¹ However, the emergence of the concept of collective benefits suggests that market failure analysis might have an increasingly important role to play in the future trajectory of EU antitrust law.²⁸⁶² Given the Draft Guidelines' incorporation of a broader analysis,²⁸⁶³ allowing for a balance between narrow efficiencies and external objectives, market failure analysis may offer a more comprehensive framework for navigating current challenges. Through this prism, market failure emerges a potential conduit for *expanding* antitrust analysis.

²⁸⁶⁰ See Chapter 5, section 5.3.1.2 and 5.4.

²⁸⁶¹ *ibid.*

²⁸⁶² See Chapter 5, section 5.4.

²⁸⁶³ See Chapter 5, section 5.2.2.2.3.

In EU State aid law, the role and value of market failure are more accentuated, especially given the Commission's current soft law framework revolves around the concept. It has been demonstrated that the Commission's test can be understood as a broad market failure assessment, encapsulating not only efficiencies but also macroeconomic/stability and distributional failures.²⁸⁶⁴ However, whilst market failure is introduced as an analytical tool, State aid law arguably underscores efficiency to a lesser degree than antitrust law.²⁸⁶⁵ Thus, market failure is best understood as a broad tool for evaluating the rationale (implicitly) and efficacy (explicitly) of State aid, as opposed to a device striving to attain an equilibrium. In this context, market failure analysis within State aid law engenders a more rigorous scrutiny of national aid measures, thereby *constraining* the nature of the operational framework.

Considering the preceding analysis, the concept of market failure embodies fundamental paradoxes within the modernisation approach of EU competition law. Whilst the modernisation framework aims to establish an objective and predictable assessment of the restriction of competition, market failure theory is concurrently wielded to both broaden and restrict the scope of public policy intervention. Consequently, market failure is unveiled as a Janus-faced concept, with multiple possible interpretations and applications. Notwithstanding the palpable juridification of the concept, the role and value of market failure within the assessment appear fragmented, with plausible variances across the diverse realms of EU competition law. The diverse interpretations and applications described above highlight the complexity and multifaceted nature of market failure within EU competition law, oscillating between a constraining doctrine and a theory advocating expansion. In this context, EU competition law seem to oscillate between contrasting, often seemingly incompatible, directions.

10.3.2 Closing Reflections and Future Directions

I do not believe it is my role to cast my lot either in favour or against a broadening of the competition law rules to more widely integrate public policy interventions within markets. Nonetheless, in the spirit of transparency, I concede that the thesis

²⁸⁶⁴ See Chapter 8, section 8.2.2.1.

²⁸⁶⁵ See Chapter 8, section 8.2.1.3 and Chapter 9, section 9.1.2.3.

may bear inadvertent imprints of my predilections – chiefly, an inclination towards the broadening of competition analysis.

That said, allowing personal inclinations to be set aside, the core of this thesis underscores an objective salient legal problem: for public policy interventions, which promote broader objectives such as sustainability and income equality, to gain exemption from the provisions of EU competition law, a broadening of the legal analysis is imperative – one that surpasses the narrow confines of mere economic efficiency and consumer welfare. This subsequently prompts an inquiry: can the concept of market failure serve as a bridge, melding these broader goals with a more economic approach to competition law?

In addressing this problem, this research has ‘merely’ provided a descriptive and analytical account of the role and value of market failure within the framework competition law. This exploration delves into the potential of competition law to incorporate either a narrow or a broad market failure test. The previous section argued that, from a legal standpoint, market failure resists a uniform interpretation, revealing instead two fundamental paradoxes. It should be noted that such paradoxes may, to some degree, be part of the natural evolution of competition law theory. Over recent decades, EU law has undeniably evolved significantly, however this transformation is not necessarily a rupture from one system to another but rather a process marked by both continuity and change.²⁸⁶⁶

Whilst this research has underscored potential avenues for expanding the scope of competition law analysis to address market failure more comprehensively, there are also compelling arguments to suggest that competition law remains inapt to function as a tool for addressing market failures. Indeed, although competition law is instrumental in ensuring a level playing field and promoting consumer welfare, it can be argued that it would be an overreach to convene competition law as the panacea for every market failure. In essence, competition law cannot be ‘the law of everything’.

I dedicate the remainder of this final section to pinpoint and elucidate the key legal challenges impeding a more well-defined framework for public policy interventions in EU competition law. Recommendations are limited to propositions aimed at refining clarity within the legal field. The following

²⁸⁶⁶ Kiran Klaus Patel and Heike Schweitzer, ‘EU Competition Law in Historical Context: Continuity and Change’ in Patel and Schweitzer (eds) (n 350) 207, 208.

elements emerge as the key issues warranting further examination by legal scholarship in the future.

First, the findings drawn from this research highlight the inadequacy of the traditional dichotomy between economic and non-economic objectives in encapsulating the various objectives inherent to public policy intervention within the market. It is imperative for legal scholarship to establish precise categorisations that accurately reflect the diverse values inherent within EU competition law. Inadequate categorisation of these objectives could inadvertently perpetuate a false dichotomy, culminating in erroneous conclusions. This thesis has suggested a more apt categorisation, consonant with market failure theory, distinguishing between narrow efficiencies, broader efficiencies and external objectives.²⁸⁶⁷ A market failure analysis has revealed that the primary challenge confronting antitrust analysis is not the failure to consider so-called ‘non-economic’ objectives; rather, it is the limited ability to balance broader efficiencies or external objectives with restrictions of competition. This issue is of critical importance, and it is imperative that competition law scholarship channel its endeavours towards devising mechanisms to effectively balance these objectives.

Second, the concept of broader efficiencies within the context of EU antitrust law poses significant challenges, in particular regarding the fair share criterion as interpreted by the ECJ. The Court, in its judgments, has limited the assessment of fair share solely to the impact on consumers within the relevant market.²⁸⁶⁸ Contrastingly, the capacity overlap criterion, as elucidated in Chapter 5,²⁸⁶⁹ is derived from the Commission’s interpretation of the corresponding case law, without any such requirement stemming from the judgments of the EU Courts. Rather, the case law remains silent on the measure to which benefits ought to accrue, directly or indirectly, to the consumers in the relevant market. This research proposes that an effective approach might be to establish a presumption that collective benefits, accruing to society as a whole, also confer benefits upon consumers in the relevant market. Adopting such an approach is indispensable to ensure that these benefits are not eroded by the prevailing ambiguity related to the capacity overlap criterion. Moreover, this criterion requires more detailed clarification, particularly in instances where broader efficiencies elude

²⁸⁶⁷ See Chapter 1, section 1.2.4.

²⁸⁶⁸ Case C-238/05 *Asnef-Equifax* (n 1144), para 70.

²⁸⁶⁹ See Chapter 5, section 5.2.2.2.3.

quantification within the relevant market. The existing framework may prove limited in addressing such efficiencies and therefore requires further refinement.

Third, within the ambit of EU State aid law, the Commission grapples with a significant dilemma in providing a predictable framework whilst concurrently safeguarding its discretionary margin in the compatibility assessment. This challenge is noticeable in the nebulous relationship between a more refined economic approach to EU State aid law and the goal of efficiency. This thesis has demonstrated that, notwithstanding the adoption of a more refined economic analysis within soft law instruments, State aid is markedly less oriented towards efficiency than antitrust law.²⁸⁷⁰ Thus, the precise role of the concept of market failure within the State aid framework remains ambiguous, especially when discerning whether it primarily serves as an analytical tool of, or as a rationale for, public policy intervention.

In this context, although the SAM communication extols the importance of efficiency,²⁸⁷¹ it is uncertain how this goal is prioritised in practice. The recent clarification provided by the Court in *Hinkley Point C* confirms that, albeit not a legal requirement, remedying a market failure may be a legitimate reason for granting State aid.²⁸⁷² This signifies the increased juridification of the concept within State aid law, mirroring its status in antitrust law. However, the diagnostic side of market failure remains obfuscated, particularly in terms of identifying a ‘significant’²⁸⁷³ or ‘residual’²⁸⁷⁴ market failure. Absent a well-delineated threshold for market failure, legitimate public policy interventions through State aid become as ambitious as market failures themselves. Rather than providing new insights into the methodology of the assessment, the new set of Guidelines merely operates within the established framework.²⁸⁷⁵ Moreover, there is a conspicuous absence of guidance on State aid balancing and quantification – mirroring the challenges

²⁸⁷⁰ See Chapter 8, section 8.2.1.3 and Chapter 9, section 9.1.2.3.

²⁸⁷¹ Communication on State aid modernisation (n 20), points 12-14.

²⁸⁷² Case C-594/18 P *Austria v Commission (Hinkley Point C)* (n 2129), para 67.

²⁸⁷³ Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 (n 454), para 19.

²⁸⁷⁴ 2022 CEEAG (n 1771), paras 35-36.

²⁸⁷⁵ e.g., 2022 CEEAG (n 1771) and the 2022 Guidelines on regional State aid (n 1768) analysed in Chapter 9.

encountered in antitrust law. Consequently, the modernisation of this highly political field remains far from lucid and predictable.

In conclusion, the exigencies posed by sustainability failures and other pressing issues facing contemporary society underscore the imperative for competition law to properly define its role within these expectations, and to evolve and adapt accordingly. In pursuit of this, EU competition law must train its lens towards addressing these key issues, delivering solutions that address the complexities of modern markets. Should the Commission maintain its current trajectory, incorporating broader policy objectives into competition law enforcement, it becomes paramount for legal scholarship to focus on developing a coherent framework for evaluating and implementing these objectives. Such a framework would necessitate a thorough analysis of the various objectives, their potential effect on competition, and the practical challenges inherent in implementing these into the existing legal framework. It is my fervent ambition that this thesis serves as a step towards advancing in that direction.

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