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What Next for EU State Aid?

Louise Rowntree, Philipp Brüchert and Robert McGruer of Hill & Knowlton examine the EU state aid regime



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WHAT NEXT FOR EU STATE AID?

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examine the EU state aid regime

The EU state aid regime has been propelled into the broader political arena since the economic crisis began and following a number of high-profile and contentious bailouts by EU Member States – often under the new EU Temporary Framework. The banking sector has come under particularly close scrutiny as critics draw links between bailouts and bonuses.

The European Commission has given limited indication of next steps. This is understandable, given that Joaquín Almunia and his many of his EU colleagues have only just taken up their new mandates. As a result, Mr. Almunia has not yet kick-started state aid discussions, whether within DG Competition (DG Competition services plan to start discussions with him in March) or outside (Internal Market Commissioner Michel Barnier; ECON commissioner Olli Rehn; Commission President Barroso and EU President Herman Van Rompuy).

This article is therefore not intended to provide an exhaustive list of upcoming changes to the state aid regime; but rather to give a selection of ideas which have been floated to date. These cover a number of horizontal issues before addressing the particular case of the banking sector.

Potential changes to the current EU state aid regime

Commissioner Almunia set out, during his hearing in the European Parliament, his vision for state aid as being (i) not to encourage companies to keep receiving state aid, (ii) to ensure real, long-term, viability and (iii) not to penalise the good performers. Sources at DG Competition predict that Almunia's state aid priority will be developing a strategy for exit from the economic crisis, with a particular focus on banks, the temporary framework and aligning the rules to better fit the EU's general economic framework. Many also expect him to be particularly precise and economically rigorous: "Almunia's economic background, together with his previous focus on economic recovery measures as EU ECON Commissioner, means that he takes a strong interest in how state aid works in practice. I would expect him, in particular, to want to crank up the economic rigorosity of the assessment process," says Crowell & Moring counsel Sean-Paul Brankin.

Temporary framework

In December 2008, in order to deal with a worsening economic crisis, the EU adopted a Temporary Framework for state aid.¹ The framework's main feature is that it enables aid to be granted before the European Commission has approved it (the European Commission reserves the right – but is not obliged – to investigate retroactively).

Most of the recent criticisms of the current EU state aid regime are linked to aid granted under the Temporary Framework. This is partly because it is a new concept and there is therefore still a great deal of uncertainty – and according to some lack of transparency – over how it works in practice. "All these banks have received state aid: the question is on what conditions was it allowed?" asks DLA Piper partner, Bertold Bär-Bouyssièrè. It is also because the concept of retroactive assessment has led to a large increase in the sheer volume of aid packages and several of these are alleged to distort EU internal market rules or lead to negative social costs (plant closures, loss of jobs, company relocations).

The framework is due to expire on 31 December 2010. Frequently raised questions relate to the EU's exit from the Temporary Framework: is this expiration date carved in stone, and how the phase out will work in practice? Will it, for example, end at the same time for all EU Member States, or will it be uneven and tailored to the particular economic situation of each Member State? And if the latter, how to avoid related distortions in the internal market?

While Neelie Kroes had a strict view on the December 2010 deadline,² Commissioner Almunia is more cautious: 'be careful, because we're not yet out of the crisis'. 'We must be prudent in the gradualisation of withdrawal [...] we need more economic analysis of state aids.'³

Transparency

No matter the area, the European Commission regularly addresses criticisms relating to transparency. But transparency is a particularly sensitive issue when it comes to state aid, as the aid comes from public funds. The Commission has been

quick to blame EU Member States.⁴ But as British MEP and Chairwoman of the European parliament's ECON Committee, Sharon Bowles, points out, while there may be regular communication between Member States and the Commission, too little of this is made available to the public: "Whilst our impression is that, overall, DG competition is doing a good job, there are concerns that current levels of transparency are not sufficient: more needs to be done to allow people like myself to see that due process is being followed."

Market distortion

Despite one of EU state aid rule's key aims being to avoid distortions to the EU internal market, the European Commission's decisions have regularly been accused⁵ of doing just that. The influx of investment into Irish banks from other EU Member States following the Irish government's unilateral announcement in September 2008 that all deposits would be guaranteed was a wakeup call. While the Commission has tried to adapt its practices to avoid further distortions (by, for example, moving away from a model of imposing divestment of all but the core business to one which tries to preserve foreign operations), the past year has seen an increase in the number of alleged distortions.

Although challenges on the basis of alleged discrimination can be taken to the European courts, these are, according to Freshfields lawyer Fabian Kaisen, hard to prove: "The Community courts recognise that the European Commission has a wide margin of discretion when assessing the economic details of a case. As the facts of each case differ, challenges on the basis of discrimination are not easy to substantiate and thus rather unlikely to succeed."

Concerns have also long been voiced about the EU's unique position among WTO members in applying a tough internal state aid (or subsidy) regime and the resulting competitive advantage to third-country companies benefiting from the sorts of state aid which would be banned in the EU.⁶ Keen to avoid a global subsidy race, the Commission uses its trade policy, rather than a loosening of its state aid policy, to address the issue. But because WTO rules are broadly more lenient than EU ones, the Commission is increasingly turning to its bilateral agreements to address the problem: the recent EU-Korea free trade agreement – which contains substantial WTO-plus rules on subsidies on goods that are enforceable through bilateral dispute settlement – has been hailed by the Commission as a subsidy success story and the way forward for the future.⁷

Investigation procedure

The EU state aid investigation process is slow. As one senior competition lawyer put it, "traditionally, state aid

investigations took ages and Member States which were slow tended to be the ones granting the illegal aid." There are two main reasons for this. First, the state aid process necessarily involves seeking information from EU governments, who can be slower at providing responses than the private sector. Second, state aid rules don't provide strict deadlines for the investigations.

"One of the flaws of the current state aid regime is that you never know when the investigations will end," says Bär-Boussière. "The European Commission is not to blame: they need to gather information from EU Member States and that takes time."

Commissioner Almunia indicated during his European Parliament hearing that he plans to examine ways to make the state aid investigations procedure more efficient.

Enforcement tools

Current EC state aid rules do not provide strong incentives against illegal state aid as, should the aid be deemed illegal, the main penalty is simply that the beneficiary has to pay it back. One idea is that illegal aid be refunded to the Commission, rather than the EU Member State. But this would necessitate the approval of EU Member States which, as one senior competition lawyer put it, "would be like asking turkeys to vote for Christmas."

Theoretically, the Commission could take a Member State to court for infringement. However in practice the European Commission only does this if the Member State repeatedly fails to recover illegal aid.

National laws can sometimes provide a better deterrent but, as Fabian Kaisen points out, this is not always the case: "National rules providing for aid instruments to be void unless the aid has received prior authorisation by the Commission have proven to be a very efficient deterrent against illegal aid. However, as some national rules are more lenient, there is not necessarily a level playing field in this respect."

Commissioner Almunia indicated in his European Parliament hearing that he would consider a number of cases where state aid should potentially be repaid. While there is nothing unusual in this per se, the infrequency with which the Commission uses this remedy coupled with public demands for paybacks begs the question of whether Almunia's comments imply a steep increase in refunds ordered: "the European Commission has, since 1957, been able to order companies to pay back state aid. But the fact is, to date, they have very rarely done it," adds Bär-Boussière.

Almunia indicated during his European Parliament hearing that he plans to examine the state aid investigations procedure to make it more efficient

The concept of private enforcement has also been floated. As Neelie Kroes pointed out last year, “if private enforcement worked well I think it could do a quicker and better job at stopping illegal aid than the Commission itself, given the limited powers we have to act.” However, Chris Bryant, Senior Associate at Berwin Leighton Paisner, believes this reform is probably still a long way off: “Although the proposed legislation for antitrust damages actions doesn’t concern state aid, there might be a slight cultural shift towards this – although not in the near future.”

The financial services sector

The European Commission has been praised by practitioners for its pragmatic approach to dealing with the crisis – particularly in the financial services sector: “I think there’s a general perception that the Commission has dealt the best it could with a particularly unusual and difficult situation. The sheer volume of cases they had to deal with was mind-boggling,” says Slaughter & May competition partner, Isabel Taylor. “There was a period in the autumn of 2008 when it might have seemed like a bit of a free-for-all and that pretty much anything went. But this was on the understanding that there was a price to be paid later.” Cases that would normally have lasted months were dealt with within a matter of weeks – partly assisted by a number of guidelines for state aid in the financial sector.⁸

Non-practitioners – especially members of the European Parliament – have used the banking sector as a test case for everything that they believe is wrong with the EU state aid regime. When questioned on the link between recent bailouts and big bonuses,⁹ Almunia’s reply was that in 2004 the Commission adopted a recommendation on remuneration schemes, but only one Member State followed it. He added

that “the main task now is to restructure the banks and ensure that they recover the necessary medium and long-term viability to play their role fully and finance the real economy without the need for public support. We must now prepare a strategy for withdrawing the aid received although this must be applied gradually, taking account of market conditions and the risks to financial stability.”

How this translates into concrete next steps is as yet unclear. According to Isabel Taylor, “One of DG competition’s major state aid tasks in the coming months and years will probably be monitoring compliance with agreed bank restructuring plans.”

Conclusion

The economic crisis and related measures have moved the EU state aid regime firmly into the general political discussion arena. The European Commission can expect, in coming years, to be intensely lobbied by both EU and third-country governments; business; the European Parliament and non-governmental organisations. Some will want current state aid rules to be lenient, others will push for them to be made stricter.

Commissioner Almunia will be in the driving seat when it comes to most EU state aid reforms. While he is expected to consult widely with stakeholders, his previous experience – both as ECON Commissioner and elsewhere – means that he no doubt already has concrete ideas for how he thinks the system would work better, and he is unlikely to bow to public pressure. ■

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Footnotes

- 1 Consolidated version OJ C83, 7.4.2009, p1.
- 2 “If we don’t end the Temporary Framework as planned at the end of 2010, it could be a slippery slope back into protectionism,” Neelie Kroes’ keynote address at conference organised by EStALI (European State Aid Law Institute) London, 27 November 2009 (hereafter “EStALI speech”).
- 3 Remarks by Mr. Almunia during his hearing in the European Parliament, Brussels, on 12 January 2010 (hereafter “European Parliament hearing”).
- 4 “We need more transparency in state aid. Member States still share too little information, and have to be pushed to provide it,” EStALI speech.
- 5 See, for example, questions to the Commission from Marianne Thyssen MEP (2 February 2010), Eniko Gyori MEP (4 January 2010), Corien Wortmann-Kool MEP (22 December 2009), Herbert Reul MEP (25 November 2009).
- 6 “The interface between EU state aid control and the WTO disciplines on subsidies, Claus-Dieter Ehlermann and Martin Goyette, WilmerHale, EstALI 4/2006; for more recent examples see a speech by French president Sarkozy in Marignane of 4 March 2010 and a written question by Werner Langen MEP to the Commission dated 19 January 2010 “Motorway project in Poland – award of the contract to a Chinese consortium.”
- 7 EStALI speech.
- 8 The “Banking Communication” (OJ C 270, 25.10.2008 p.8); the “Recapitalisation Communication” (OJ C 10, 15.1.2009 p.2); the “Impaired Assets Communication” (OJ C 72, 26.3.2009 p.1) and the “Assessment of restructuring measures Communication” (OJ C 195 19.8.2009, p.9).
- 9 Arlene McCarthy, Vice-Chairwoman, European Parliament ECON committee, European Parliament hearing.