UK Response to Commission Roadmap for State Aid Reform

I. Summary

1. The UK welcomes Commission recognition of the need for State aid reform and is willing to help in any way it can in designing, applying and if necessary trialling any new approach.

2. Our view is that the State aid regime requires more simplicity and clarity, more flexibility for Member States within safeguarded limits, more transparency and a more economics-based approach. We need much faster approval of economically insignificant aid and tighter controls on distortive aids. Member States especially need to be able to implement economically sound measures aimed at achieving the Lisbon objectives with less delay where there is little risk of serious distortion of competition. The Commission emphasis is rightly on eliminating the most distortive aids rather than on requiring the notification of as many aids as possible.

3. The UK supports State aid discipline and recognises the need for vigorous and principled enforcement of the rules by an authority independent of the Member States. However, we agree with the Commission that the current system has many flaws. In our view these include:

   - Much too complex – uncertainties over what constitutes aid and ignorance over detailed application of the rules are real obstacles to uniform application of coherent state aid principles across Europe;
   - Assessments involve insufficient economic assessment, markets are often not analysed in detail and the potential impact of aid on competition is sometimes not examined carefully – the result is that innocuous aid is sometimes blocked while highly distortive aids are sometimes allowed through;
   - The rules are too intrusive, catching aid involving small amounts being offered to local undertakings performing public interest activities on the periphery of markets with no appreciable distortion resulting. This is disproportionate.
   - State aid investigations are too slow, creating a serious disincentive to notify in the many cases where there is doubt over whether State aid is present and imposing serious delays even when measures are clearly unlikely to have a material impact on cross-border competition and trade.
   - The rules are perceived to apply differently in practice to public bodies and private and non-profit bodies performing the same activities. State aid complexities seem to multiply when Member States seek to engage the private or social economy sector to offer education, health, social and cultural services or to develop land. The rules must be seen to apply equally whether activities are performed in the public, private or non-profit sector.
   - Sometimes the Commission tries to apply the regional aid guidelines to aid which is not investment aid, but rather designed to meet a market

failure or steer the market towards results which are socially, environmentally or culturally more desirable. In these cases Member States should be allowed to pay the minimum necessary to achieve their legitimate objective, as long as they can do so without appreciable market distortion.

4. In our view the key to resolving these problems lies in a more economic approach to State aid control, assessing early whether aid has the potential to seriously distort competition, taking account of the desirability of remedying market failures and focusing resource on combating the most distortive aids. State aid procedure also needs to be tightened.

Market Failure

5. We therefore welcome the Commission's recognition in its State Aid Action Plan that State aid policy must take account of the desirability of tackling market failures. In fact the UK would suggest that State aid is generally **only** justified as a response to market failure and exceptions to this (such as regional aid and restructuring aid) should be tightly defined.

6. There is a huge economic difference between on the one hand a gratuity or "subsidy" (payment without consideration), which clearly distorts competition, and on the other a payment to obtain a particular behaviour, which is in the broader public interest and which the market would otherwise fail to deliver. The UK often supports payments to undertakings to procure a change of market behaviour for the public good, whilst retaining the fundamentals of competitive, market-based delivery. These solutions involve payments or tax incentives to businesses or often non-profit bodies to achieve social, environmental, educational, cultural and sometimes economic objectives. Such payments will not significantly distort competition if the following conditions are met:

- The market failure is genuine
- They are the minimum necessary to procure the desirable change of behaviour
- They are auctioned or offered equally to all relevant market participants, with no risk of upstream or downstream distortions.

7. Revised "horizontal" guidelines should set out how such tests should be applied in practice and thus how such responses to market failure could be easily approved. They should contain economic tests and indicators designed to reveal whether payments would genuinely be distortive of competition. As far as possible the tests should be underpinned by common principles, making the various Guidelines and Block Exemptions easier to integrate and consider together, but this should not be at the expense of having the right Guidelines for each type of horizontal aid.

8. The UK therefore welcomes the Commission's willingness to analyse relevant markets in future and the future emphasis on whether aid is **appropriate**, **effective** and **proportionate** to the problem it is designed to

remedy. We believe that aid will be **appropriate** if targeted at a market failure, **effective** if paid at the minimum necessary level and **proportionate** if offered equally or competitively to all market players. These three tests therefore closely resemble our proposed three conditions outlined above.

9. We also welcome the Commission's recognition that distortions of competition will be different according to:

- The method of selecting aid beneficiaries
- The market characteristics
- The amount and type of aid

10. We look forward to these factors being better taken into account by the Commission in its case handling and incorporated into the new Guidelines and Frameworks. New Guidelines must also give greater scope for a wider range of market failures to be tackled. Market failures in land and property are hard to address under the current rules and there are gaps in relation to environmental aid and aid to support innovation and enterprise.

Improved procedure

11. In terms of procedure we welcome the Commission'c commitment to review this area. We would like to see the Commission placing more emphasis on there being a much lower burden of state aid administration where competition is not or is hardly distorted at all. Such aid should be covered by Block Exemptions or approved rapidly, if that is not possible. On the other hand, we would like to see more market impact assessments so that the most distortive aids can be readily identified.

12. The revised horizontal Guidelines should acknowledge that market failures can arise in particular circumstances and that State payments to offset such failures can be justified, subject to certain conditions. The conditions would be designed to ensure that the payments did not give rise to undesirable distortions of competition, Our preference would be for most Guidelines to operate on two levels.

- At the lowest levels there would be Block Exemptions, with clear limitations on which aids fall under the bar. We support an increase in De Minimis levels and looser, more practicable requirements on cumulation. We also favour increased Block Exemption limits in other areas and extension of Block Exemptions into new areas such as environmental aids and risk capital, if possible, but we accept that many relatively innocuous aids will fall outside the Block Exemption limits nevertheless.
- A second level would cover aid which goes beyond Block Exemption levels, but which falls within the revised, economically-focused Guidelines These should set out principles and indicators for assessment of cases, rather than being interpreted as detailed, prescriptive and limitative laws on what can and cannot be approved.

Initial investigations must focus on whether such aids give rise to a risk of **significant** distortion of competition. If there is no such risk, there must be much more rapid decision-making within fixed timeframes for approval of these aids. (We propose some options for this in the section on Modernising Practices and Procedure below). If there is a risk of serious distortion of competition, an article 88(2) investigation should be opened promptly.

13. Notifications of proposed aids falling outside the revised Guidelines should be required to contain an analysis of the market failure they are designed to correct and an assessment of how the proposed payment will remedy that market failure. Subject to this, they should be handled in the same way as aid dealt with under the Guidelines at the second level described above.

II. State aid and Innovation and Entrepreneurship

14. We strongly support the broad shift in the Commission's emphasis away from the more distortive aids and towards the Lisbon/horizontal objectives, including innovation, entrepreneurship. The State aid rules must seek to facilitate Member State efforts to tackle market failures which inhibit innovation and balance the risk of distortion of markets against the EU's wider policy agenda.

15. Particularly where Member States seek to encourage universities and entrepreneurs to commercialise technology and start-up and develop small, technology-based companies, the risk to competitive markets is very small and the benefit to the EU's knowledge economy base is potentially great. The State aid rules must not delay innovative projects which carry little risk to competitive markets by 18 months or, for example, squeeze support for incubation and innovation centres into an inappropriate regional aid framework, which is not designed to remedy innovation or land and property market failures.

16. The UK will comment in detail when the Commission issues its draft Communication on State aid and Innovation later this year and welcomes the Commission commitment in this regard. We have already submitted detailed comments on reform of the R&D guidelines.

17. Some of the issues where we will be seeking clearer rules and in some cases a different approach are as follows:

- **Innovation-related activities of Universities and Public Sector Research Establishments**

18. The close proximity of businesses and universities/public research centres can result in substantial innovation spillovers and external benefits which are economically advantageous. It is in this context that

measures to support universities and university/business clustering must be considered.

19. Many universities and research centres conduct their own public function research activity and perform joint research services with businesses. The R&D Guidelines offer substantial clarity on the State aid status of funding for this work.

20. But universities and public sector research establishments (hereafter called "universities") also conduct proof of concept tests on innovations to see if they have market potential and license out ideas which have value. Sometimes they fund some of the seed capital which spin-out companies require, and establish incubators in which such companies may grow. Some have built small-scale science parks on University land into which successful companies may expand or to which other companies may be attracted with a view to exploiting synergies with the University research efforts. Some have established "open access" facilities for business R&D, making it easier for businesses to co-locate with universities and/or make use of the research infrastructure they possess. The revenue from such operations enables the university to invest in infrastructure and academic human resources it might otherwise not be able to afford.

21. All of the above are potentially "economic activities" which can result in Unversities being classified as undertakings in certain circumstances, and their funding classed as state aid. The Universities (and university-owned non-profit subsidiaries with these functions) are, however, performing all such activity in the public interest with a view to furthering their academic research and teaching functions. Any revenue is ploughed back into the public function activity of the university. The risks to distortion of competition at the level of the university are very low and the benefits for European economic competitiveness are substantial.

22. The UK would like to see a relaxed approach to all this university activity, in state aid terms, with more clarity and legal certainty on where the universities stand. Ideally the Commission would clearly state that any such activities be block exempted to the extent that they might involve State aid at the level of the University. In order to prevent abuse there could be Block Exemption limits on amounts to be invested in spin-out companies, for example, and rules to ensure that users of incubators and science parks be charged market rates.

23. On the other hand, external businesses collaborating with universities or receiving services from them will be in receipt of state aid if not charged commercial rates for services received. The UK favours the maintenance of robust rules on subsidies for competitive businesses. Clearly the spin-outs will be subject to the rules as well, once established, and aid to them must fit within the relevant frameworks.

- **The application of the R&D Guidelines to collaborative research**

24. The Guidelines on State aid for R&D and the Block Exemption on R&D aid for SMEs broadly work well. The UK supports the current distinction between different stages of research and the current aid intensities. These broadly reflect the market failures attached to R&D activity. The Commission could consider, however, extending the Block Exemption to cover some R&D aid to larger businesses and/or introducing a second level of cases outside the Block Exemption but unlikely to raise substantial distortions on a European scale, where decisions could be taken subject to strict time limts.

25. Further clarity could be offered on how finance for public research bodies and aid to businesses for collaborative R&D may interact in practice. A clearer definition of collaborative research would help. The UK also welcomes the Commission intention to make the rules take better account of the variety of mechanisms for sharing access to and exploitation of intellectual property in collaborative research scenarios. Flexibility in support for collaboration between public research establishments and businesses is important for cluster development and encouraging SME involvement in the EU Framework programmes. The rules must allow private retention of IPRs or a share of IPRs as long as fair, market-based payments or risk and cost-sharing is offered.

26. The current SME definition is also a problem in an R&D aid context. Both scheme administrators and businesses find it confusing and unnecessarily complicated, and are especially concerned that it has the potential to prevent companies from securing investment. Aid is often critical for technology and R&D-based SMEs with significant external funding needs. The current rules cause companies to lose SME status if they are more than 25% owned by a business angel holding more than a Euro1.25m stake (but not if a similar investment is held by venture capitalists.) This impacts on the ability of angels to protect their investment in high-growth companies seeking capital increases and thus deters business angel investment at the lower end.

- **The new concept of aid for Innovation**

27. The UK accepts that there may be market failures in relation to certain types of innovation, which are not caught by the definition of R&D. We welcome Commission attention to this issue and will await the Commission's proposals with interest, but have concerns that it will be difficult to define "innovation" such that desirable combatting of market failures can be encouraged, without opening the door to distortive aid. Most businesses already face commercial pressures to innovate so aid to them for this purpose has the potential to be distortive.

28. It is possible that a large part of any relative failure by the EU to produce innovative business may relate to market failures in financial services markets, regulatory and perhaps fiscal barriers to the growth of young, innovative businesses, barriers to takeovers and new market entry and the entrenchment of relatively less innovative national champions. These

problems cannot be resolved by means of a new facility for State aid for innovation.

29. The UK does support, however, (as explained above) state aid flexibility for the generation of innovative ideas in public sector research bodies and universities and clear, simple and generous rules governing attempts to transfer such ideas and expertise to business and to generate further innovation through public/private collaboration.

30. Demonstration projects might also merit more favourable treatment under any new Innovation Guidelines, but Member States would have to provide evidence of the market failure to be addressed including explaining the novelty of the application of technology in the particular way, setting out the public interest to be achieved and indicating how lessons from the demonstration would be widely disseminated. There should always be competitive process to select the business to perform the demonstration.

31. Another area that may merit attention would be support for innovation (and R&D) networks between companies as well as between companies and universities. As long as such networks are open, they will create minimal distortions of competition and yet may generate external benefits.

- **Support for business infrastructure**

32. The Commission has always taken a pragmatic approach to aid for basic infrastructure such as roads. The UK supports the view that the benefit to end-users is so diffuse in such cases that it is generalised and lacks specificity and that there is no aid to the intermediary supplying the road or operating it under a concession as long as the contractor/concessionaire is selected through a competitive process and paid the minimum necessary.

33. There is increasing recognition in Member States, however, that the supporting "infrastructure" for successful knowledge economy businesses is much more complex than just transport and energy. The UK considers that the Commission has missed an opportunity in its recent cases to extend the principles underpinning aid for infrastructure to cover payments for a range of other physical assets and services, which offer a generalised benefit.

34. Broadband infrastructure, for example, could perhaps have been introduced faster, if Member States had clearer guidance on how to avoid State aid problems when supporting the infrastructural investment. Next generation networks may provide new examples of market failure, with the potential to widen the "digital divide". Clearer guidance and faster approvals where market failure justifies intervention would help to transform Europe's knowledge-based infrastructure.

35. The telecoms sector is a particularly difficult one in competition law terms, because of the market dominance of the former monopoly providers. This

perhaps justifies caution in some cases about whether an element of aid may be present, even when a competitive tender has been held. Advantage beyond the normal course of trade for a successful bidder for funds to to extend telecoms infrastructure may be difficult to rule out, but competitive procurement should at least minimise the aid and ensure that no distortion is serious as long as the public expenditure is clearly related to a market failure. And the possibility of distortions must be set against the benefit of wider infrastructural provision.

36. In principle, the UK believes that all infrastructure-type cases should be looked at the same way:

- Is there proof of market failure
- Is there evidence that remedying the market failure would be in the Community interest and that a State payment would be effective in procuring that result?
- Has the intermediary to deliver the infrastructure been chosen through a genuinely competitive process taking into account the relevant market dynamics? (If so, it is arguable that there is no aid (as the Commission itself argues in road transport funding cases). If not, or in cases of doubt, the payment might contain an element of aid but would be approvable if the payment can be shown to be broadly the minimum necessary). If the Member State conducted a competitive tender in compliance with EU procurement rules, this should be sufficient evidence for approvability.
- Will the contract protect wholesale access to infrastructure for service companies seeking to compete at the retail level with the infrastructure supplier?
- Will end-users of the infrastructure be charged market rates or if not, will the benefit be general, rather than specific or clearly De Minimis?

37. The UK believes that any payment for supply of physical infrastructure will create no serious distortion of competition as long as it is made available to any potential end user at market price (i.e. not in practice for the benefit of particular, identifiable businesses) and the intermediary building and delivering it is chosen through a genuine competitive process in a competitive market. Alternatively, the intermediary could be a state or non-profit body performing the particular investment on behalf of the State, but where there is no competitive process, there is always the possibility of distortive State aid if the activity is "economic".

38. The principles used to assess aid for infrastructure could also be used to determine approvability of aid for the broader supply of support services to small business. Where Member States set up incubators and incubator services, cluster support bodies or financial advisory services for growth businesses, for example, the benefits are often diffuse (or can be caught by the *De Minimis* Block Exemption) and there should be little or no aid to the intermediaries as long as they are chosen competitively. If the market does not supply the necessary intermediaries and the services are deemed to be in the public interest, the State could alternatively appoint

and finance public bodies or non-profit organisations to supply the necessary infrastructure with little risk to competition.

39. Greater clarity over the application of the principles governing aid to infrastructure in other scenarios thus offers an opportunity for the Commission to take a range of state payments with little or no discernible impact on competition outside the realm of State aid controls or into Guidelines or Block Exemptions which allow easy approvability.

40. The UK would like to see aid to support small business enterprise dealt with in this way and through Guidelines which allow the targeting of market failures in small business finance, wherever they occur, rather than trying to cover such matters in the Regional Aid Guidelines.

- **Support for Risk Capital**

41. The existence of market failures preventing optimal supply of risk capital to certain small business is now widely accepted. The Commission's recent approval of the UK's proposed Enterprise Capital Funds was very much welcomed in that it showed the Commission's willingness to be flexible over the application of the risk capital guidelines when faced with evidence about the extent of the market failures.

42. It is however, regrettable that that Decision took over 18 months to emerge. This highlights the need for less burdensome procedures. Member States need to be allowed to react more speedily to market failures. The clear lack of concern over such measures expressed by businesses and Governments across the EU indicates that the distortion of competition they entail is probably minimal.

43. The UK would wish to ensure that faster approvals can be managed in future at least where the evidence of market failure is persuasive, the intermediaries and funds suppliers are chosen competitively, the measures are aimed at SMEs, the funds are commercially managed and where private capital must be put at risk alongside any Government funds. There should be room for block exemption treatment of small-scale aid on this basis. The UK has already submitted comments to the Commission on this subject in March of this year.

III. Services of General Economic Interest

44. The UK is broadly content with the Commission's approach towards aid for SGEI at present and welcomes the recent adoption of the 3 Commission texts in this area. Much uncertainty remains, however, even after the Commission's Decision granting an exemption from notification for several types of aid. Clarification of how the Commission intends to interpret the "Altmark" test is still needed but clarity may in the end only be achieved through expanded case law from the European Courts.

45. It sometimes feels that the Commission is always looking for arguments for why “Altmark” does **not** apply, rather than looking for practical ways of applying the principles to take cases with low risk of distortion of competition outside State aid territory.

46. There is a risk that because the Commission Decision only block exempts SGEI payments to companies with turnover below certain thresholds, that competition might be distorted by public authorities avoiding paying larger companies to perform SGEIs, even if the larger companies offer the best economic terms or lowest price. If a tender has been held, in particular, it is probably undesirable that the result be distorted by fear of greater State aid bureaucracy and delay if one option is chosen over another. In these cases, interpretation of “Altmark” may determine the outcome.

47. The Commission should investigate, after a period of time, whether its recent Decision may be having such unwanted effects and be prepared to review the scope of the Block Exemption, for example by exempting any notification even when large companies are selected to perform SGEIs, as long as genuinely competitive tenders have been held.

48. The UK views the principle underpinning the Ferring and Altmark decisions as economically sound. There cannot be a State aid if there is no element of advantage outside the normal course of trade and where an undertaking is simply paid a commercial price to perform an activity in the public interest which it would not otherwise perform, there will be no advantage outside the normal course of trade.

49. Indeed this principle is economically sound also in some other cases which are not technically SGEI. This has been explored in relation to infrastructure (above). There are other potential applications.

50. The minimum necessary payment to a property developer to develop an unfavoured plot of land in a particular, socially beneficial way will not confer a subsidy if the market would not have delivered that outcome by itself. For example, a developer may face a cost, applied through the planning system, in terms of a restriction on his freedom of use of his asset. He is asked to develop the plot in a particular way on a non-economic basis. It is reasonable that he should be compensated for his direct loss and loss of opportunity. As long as the minimum necessary is paid to procure the socially desirable development, there should be no advantage outside the normal course of trade and the State aid rules should recognise this.

51. The problem in all such cases and in “pure” SGEI cases is how it can be **proved** that the minimum necessary has been paid. In our view a competitive tender or auction in a competitive market and following EU procurement rules offers such proof. If that is not possible, we accept the need for independent assessment of whether the minimum has been paid and whether, as a result, competition is distorted.

52. Any independent assessment would, of course, have to look at "the minimum necessary" in the context of administrative efficiency of aid delivery. Tax incentives, for example, offer an efficient way of combatting certain market failures, but cannot be calibrated to vary for each beneficiary, so any assessment would have to look at "minimum necessary" within this context, taking account of the benefits to be achieved and the risk of distortion of competition.

IV. Regional Aid

53. The UK will be commenting separately and in more detail on the Commission's revised proposals for reform of the Regional Aid Guidelines. Generally we support the Commission's overall approach and welcome the revised set of guidelines, particularly the fact that the Commission has taken on board our idea of allowing for additional coverage to be allocated at the national level.

54. The UK accepts that regional investment aid may distort competition. Apart from anything else, the need for compensation for offsetting negative regional factors will be different in every single case and impossible to quantify with any accuracy. There can therefore be no guarantee that there has been no overcompensation, though Government Accounting Rules in the UK at least seek to ensure that the minimum necessary is nevertheless paid.

55. The UK recognises, however, the importance of differentiated regional aid in a European context and the need to concentrate investment aid in the least developed regions. We believe also that there is a residual place for regional aid in a national context. Some investments (e.g. distribution centres for the national market) are in practice bound to be tied to particular countries and Member States value some flexibility in encouraging such investment to flow to their own least favoured regions.

56. So regional aid has an important role to play in targeting underperforming areas and the guidelines are a suitable way of assessing and approving or rejecting proposed investment subsidies. But the regional aid guidelines should not be used in inappropriate circumstances.

57. One of the biggest problems with state aid enforcement in recent years has been the tendency of the Commission to try to assess almost all State aid within a regional aid context. Much of what Member States try to achieve is to remedy market failures, which may be national or regional and may not coincide with assisted area maps. Other payments to undertakings may be designed to nudge markets in directions favourable to public policy but may not distort markets like an investment aid. Much intervention in designed to secure suitable "infrastructure" and public services for societal and business development in the broadest sense. Such infrastructure needs to be supplied in all areas, not just the assisted ones.

58. In all the above areas the amount of public finance required to achieve the objective will depend on the extent of the market failure, the extent of the market impediment to change or the extent to which the necessary “infrastructure” cannot be supplied by the market. Member States should be able to (and in fact only allowed to) pay the minimum necessary to achieve the desired result. Regional aid maximum aid intensities (or regional bonuses under some other aid frameworks) in these situations could lead to excessive subsidy being awarded or to projects being cancelled because inadequate support is available to overcome the market barriers. The Commission has recognised this to some extent by introducing other types of guidelines and routes for state aid approval, but too often the default setting of the Commission machine is still on regional aid, even when this is inappropriate.

59. The UK has accepted that certain types of aid framework outside the regional aid Guidelines themselves, can legitimately offer regional top-ups. This is because they reflect problems which are likely to be at their most acute in assisted areas and are a response to market failures which are in any case impossible to measure exactly. Thus we accepted regional top ups for risk capital in some circumstances, training aids are more generous inside assisted areas as is employment aid to support the recruitment of the long-term unemployed. Investment aid for SMEs is regionally based as well. But where a market failure can be more accurately quantified, there is no case for paying more than the minimum necessary and aids for social, cultural and environmental benefit, for example, should be available across all regions in the Community interest.

V. Environmental Aid

60. The UK view is that the current approach to environmental aid is a good example of the Commission’s wish to push too much State aid into the regional aid mindset. The current environmental aid guidelines are good in places but in others they are too prescriptive and much too limited in scope and do not permit the awarding of many types of aid which the UK believes would improve the environment and which would not lead to serious distortions of competition.

61. Particularly in the area of environmental technologies, there is also an overlap between environmental and innovation aid. The Commission's own Environmental Technologies Action Plan (ETAP) makes clear that developing and making better use of environmental technologies will contribute to technological innovation and increase European competitiveness as well as improving the environment. In such cases our views on aid for innovation and entrepreneurship above also apply. The ETAP acknowledges that the current environmental aid guidelines are 'not properly adapted to the increasing sophistication of investments in environmental technologies, nor to new forms of public/private partnership.' We support this view.

62. The UK has prepared a paper on environmental aid reform, which is attached to this document as Annex 1. It illustrates the practical application of many of the theoretical arguments floated here. The main line is as follows:

63. The UK believes that the Commission should allow Member States more flexibility of response and assess proposed measures according to simple economic criteria designed to avoid serious distortions of competition.

64. Where a company is under no obligation to undertake environmental improvement, which is in the broader public interest, and such improvement involves a net cost to the company, the relevant permitted aid intensity should be "the minimum necessary", within the context of what is administratively efficient.

65. Where companies are subject to a regulatory obligation or environmental tax, helping some of them to meet the cost may at times be necessary to maintain fair competition, depending on the situation of their competitors. The Commission should allow state aid to counterbalance higher environmental standards in order to encourage such higher standards to exist.

66. In both the above cases the application of arbitrary maximum aid intensities, especially those which vary by region, is inappropriate. Such an approach risks leading to far more aid than is necessary being paid in some circumstances and too little aid being available to meet the environmental challenge in others. It permits selectivity and therefore distortion of competition and the EU does not want to see environmental gain only in its assisted areas.

67. The Commission should instead focus on ensuring the following:

- That the environmental purpose is valid
- That the environmental purpose would not be delivered by the market by itself (i.e. that there is a market failure)
- That the payment is the minimum necessary to achieve the objective, taking into account the need for administrative effectiveness in delivering the aid
- That the payment is offered equally or competitively to all companies in the same position and that there are no upstream or downstream distortions

68. If the Guidelines consisted of largely economic tests such as the above, the Commission could envisage review beyond Block Exemption limits of all but the biggest cases according to fixed timescales.

69. If the total amount of the aid and/or the aid intensity and/or the size or market share of the beneficiary, for example, were below certain "safe harbour" limits, for example, the Commission might only need to verify that no serious risk of distortion of competition was present. If market

impact analysis had been performed and proposed aid was also more transparent, allowing rival undertakings chance to complain, for example, decisions should be able to be made very quickly.

VI. Public versus Private Delivery and Partnership

70. The UK supports the Commission desire to offer greater clarity on how the State aid rules apply to PPPs. UK PPPs have always been designed as far as possible to avoid State aid and distortion of markets, but often the State aid assessment has been complex. Many of the principles outlined above would in our view be relevant. In particular:

- The private partner must be selected by competitive tender process in compliance with EU procurement Directives
- The PPP must operate financially at arm's length from its "parent" public body
- The end users or customers must (if they are undertakings) be charged commercial prices, or if there is aid to them, this must be approvable under the normal state aid frameworks.

71. The UK view is that payments to companies to deliver services must be assessed for State aid purposes in exactly the same way as payments to state bodies to perform the same services. This equality of treatment is mandated by the European treaty (article 295). In practice, however, the Commission is apt to only intervene when an activity is privatised or awarded to a specific body outside the mainstream public sector.

72. The ultimate example of this is in relation to land development, where public authorities all over Europe are directly engaged in the purchase and development of specific pieces of land which would not otherwise be developed in the desired way by the market. This is seen as an essential part of local planning and infrastructure provision. State aid questions are never or hardly ever raised.

73. But the Commission's approach to payments to spun-off public undertakings or to private companies or non-profit bodies to develop land in particular ways is usually to apply the regional aid guidelines, which prevents the regeneration of many pieces of land in the private sector and drives public authorities into public ownership of the land to achieve the necessary objectives. This is not only inequitable and arguably a breach of article 295 of the treaty, it ties up large amounts of public finance in land ownership and development, an activity where private companies might be able to perform more efficiently and certainly with less commitment of public resources. There is no difference in terms of the impact on competition between the two methods as long as the payment in either case is the minimum necessary to secure the desired outcome.

74. The answer in our view is to treat the speculative development of land (where no specific end-user is foreseen or foreseeable) as analogous to

the supply of infrastructure. Member States could allow public authorities to develop the land themselves or encourage them to pay private owners the minimum necessary to secure the development which is required and then sell it or rent it on the open market.[1]

75. Similarly, some Member States finance the provision of basic services to small businesses, including incubation services and financial advisory services for example, through State agencies. In other Member States there is a belief that such services should be supplied nearer to the market, but if the market will not supply the services in full or at an acceptable price by itself, there is a need for an element of state resource to nudge the market in the right direction. The latter solution should distort competition far less than the market replacement model of state intervention, but is typically treated more harshly by the Commission when it comes to State aid issues.

76. The UK approach would be to allow the minimum necessary to be paid, whether to the private or the public provider of property or services, to overcome the market failure and achieve the market outcome which is desired. As long as the intermediary is paid the minimum necessary, to achieve that which the market, left to itself, would not deliver, all residual aid (if there is any) will flow to the end user and the aid to the end user is the same in both private and public models. Where it can be shown that the end user pays a full market price, the State finance can be shown to have simply met the market failure

77. The UK has prepared a paper explaining these arguments in the context of land and property redevelopment and setting out why we believe a new approach is needed towards aid for improving the physical infrastructure of deprived communities, whether inside or outside Assisted areas. This is attached as Annex 2.

VII. Modernising Practices and Procedures

78. The UK welcomes the Commission's recognition of shortcomings in the practices and procedures of state aid administration. However, the Action Plan limits itself largely to proposals to combine and simplify the various State aid Guidelines, Frameworks and Block Exemptions. More ambition is required in due course, because the current procedures do not work well.

79. In particular, it is important that decisions should be taken faster. Delays can mean that by the time clearance is given, the recipient has already

[1] If the end user **is** identified in advance, and especially if a price is agreed in advance with the developer, there is a much greater risk of State aid either to the developer or the end user or both. Any such aid would have to be considered as investment aid. However, it should be open for Member States even in these cases to prove that the intermediary is only compensated for market failure and that the end user has paid a market price. If so there could be little if any aid and the payments should be approvable.

had to take decisions, so the aid has reduced impact and less "additionality".

80. The UK believes that many payers of what is potentially State aid currently prefer to take the risk of non-notification, especially if they perceive the risk of distortion of competition to be low and/or the likelihood of a complaint to be low, rather than seeing their projects delayed, perhaps by up to 2 years. The figures for notified cases vary substantially by Member State, indicating inconsistency of application of the notification obligation.

81. This undermines respect for European law and damages the EU's reputation. But the Commission could not possibly cope with the massive increase in its workload, which would occur if all Member States rigorously notified everything which might be a State aid, regardless of its real impact on competition or cross-border trade.

82. A way must be found for more potential State aid cases to be taken outside the notification obligation, where risk of serious distortion of competition is low. This would allow increased legal certainty for those cases currently not notified at all and, if done properly, a greater likelihood that genuinely distortive aid would come to the Commission's attention. This means first extending the Block Exemptions.

- **Block Exemptions**

83. The UK welcomes the Commission's proposals to broaden and expand the various Block Exemptions. The Commission's State aid resources must be focused on the most distortive aids and the notification bureaucracy and delay must be proportionate to the risk of serious distortion of competition arising from the aid in question.

84. The UK would favour the development of more Block Exemptions under the various horizontal Guidelines, such that the smallest cases of each type of aid no longer need to be notified. This would include some environmental aid, for example and small-scale support for venture capital investments. Small-scale culture and heritage payments could also usefully be covered by a new Block Exemption.

85. The UK also supports the integration of the different Block Exemptions as long as this does not lead to over-generalisations such that different approaches and tests for different types of aid are lost in the need to come up with common text. Where the tests for approvability and susceptibility to Block Exemption treatment make sense to be harmonised across different types of horizontal aid, then integration of Block Exemptions and guidelines makes sense. But integration is less important than getting the policy right for each type of aid on its own.

86. The UK supports a raising of the *De Minimis* threshhold. If the cumulation issue (see below) is not addressed, we would probably favour a limit of Euro 250,000 – 300,000.

87. Better still, however, would be for the Commission to address the cumulation problem in relation to *De Minimis* aid. We believe that no Member State, certainly no large Member State, possesses the administrative resources to be certain of avoiding cumulation of aid between different Ministries and agencies of Government and different levels of Government. Attempts to keep track of De Minimis aid over 3 years and apply the cumulation rules are bureaucratic, time-consuming, usually ineffective and totally disproportionate to the risk of distortion of competition if the cumulation rule were broken.

88. The UK would prefer to focus the De Minimis limit on a project basis. Restricting the cumulation rules to the individual project and relying on the low level of the De Minimis ceiling would offer a lighter mechanism. Alternatively a one year cumulation period would be better than the impractical 3 year period we currently face. Deliberate sub-division of aid to manipulate the De Minimis limit could still be outlawed.

89. No system of state aid control can be absolutely perfect and these options would not be water-tight if Member States were determined to abuse them. But the UK believes that the current mechanism is not enforced properly and is therefore also open to abuse in practice and this is an area where administrative efficiency gains would more than compensate for the slight increase in risk of distortion of competition.

90. If progress could be made on reducing or eliminating the burden of cumulation control, a lower limit for De Minimis aid would be more appropriate – say, Euro 150,000.

- **Notifications**

91. Where cases still need to be notified, a way must be found to quickly identify which cases raise serious competition concerns and to rapidly approve those which do not raise such concerns. This means improving the quality of notifications.

92. The UK accepts that Member States have an obligation to supply detailed and comprehensive notifications, but our experience is that the more we supply, often the more questions and demands for further documentation we face in the next stage. However diligently we attempt to prepare notifications, it does not seem to appreciably reduce the timeframe for Commission decision-making at present.

93. More clarity is needed in advance of what information is required in a notification. The required information will vary according to the type of aid measure, so under each new Guideline the Commission should set out

how proposed aid will be assessed under that Guideline and what information the Commission will need.

94. The UK would like to see much more focus in notification documents and in Commission assessments on the market impact of the measures. The content of each notification should depend on the framework or guideline under which it is notified, but for most of the horizontal aid measures the following structure would, we think, be appropriate:

- What is the desired outcome that the payment(s) are designed to procure?
- Where is the evidence of market failure?
- How else might the market failure be removed and why is state funding the only or the best option?
- What is the nature of the aid and who is the intended recipient?
- What steps have been taken to assess the relevant market and the impact on that market of the proposed payment?
- How has the Member State ensured that the minimum necessary is being paid?
- How has the Member State avoided upstream or downstream consequences of aid measures?

95. The first three of these questions need not be answered in cases which fall within Guidelines where the relevant market failures are already recognised at EU level and the Commission accepts the validity of State aid to remedy these failures.

96. These questions are often much more pertinent than the financial minutiae of the proposed payment, which have traditionally occupied the centre ground, but which we accept are more important when considering a proposed payment under the regional aid Guidelines or other guidelines where aid intensity levels are the key criterion for approvability. The Commission's Action Plan gives little indication of how the Commission proposes to make greater use of market assessments. This is a major gap in our view.

97. In cases which fall outside any guidelines, Member States should have to prove in particular that such measures are clearly aimed at tackling a market failure and are unlikely to cause significant competition distortions. Member States wishing to propose such measures should prepare a competition impact assessment. If the competition assessment shows there will not be any significant distortions, approval should be able to be given for the aid without an 88(2) investigation being needed. This would give Member States greater flexibility to introduce relatively small, targeted state aids.

98. At present the Commission sometimes seems to work on the assumption that any aid which is not covered by the guidelines is likely to be incompatible with the Treaty and at least requires a full 88(2) investigation before it can be approved, regardless of its likely impact on competition.

This ignores the fact that Commission guidelines do not comprehensively cover all market failures which Member States might wish to tackle with state aid in the Community interest.

- **Speeding up Assessments of Notified Aid**

99. To take account of those cases where, despite improved guidance on the required content of notifications, Member States still might not submit the information the Commission needs, there must remain scope for the Commission to ask for more information. But there should only be one such opportunity and the Commission should make such request within six weeks of the date of notification, giving the Member State one month to supply it, perhaps six weeks if there is uncertainty over what is needed and both sides agree to the extension.

100. The Commission should then take a decision within a maximum of six weeks of the Member State reply, based on the information available. This may, of course, mean rejecting some proposed aids because the Commission lacks the information to be able to make a proper assessment. These cases would then have to be re-notified or dropped. If the Commission fails to take a decision within the six weeks, the aid should be deemed to be approved.

101. No preliminary case should therefore last more than 18 weeks from the date of notification and this should be a formal maximum, unless an article 88(2) investigation is launched. If complex merger control decisions can be taken within a tighter time frame, there is no reason why preliminary state aid investigations should not be subject to a timetable at least as strict as this.

102. The UK would like to see cases falling within "safe harbour" limits as set out in revised guidelines being addressed even faster[2]. If a case falls outside a relevant Block Exemption, but squarely within Guidelines and if the Member State can supply convincing evidence from a market impact assessment on why the proposed aid will not appreciably distort competition, the Commission should be able to take a Decision within weeks, not months. We would propose a 6 week limit, unless further information is genuinely required from the Member State before making a decision.

103. If an 88(2) investigation is launched, it must also be conducted much more rapidly. Six months should be the maximum from publication of the notice in the OJ to adoption of the final decision. This would still leave Member States time to comment on third party responses and space for

[2] Revised Guidelines would set out criteria for a second level of cases above Block Exemption levels but where serious distortions of competition are unlikely to occur, ("safe harbour limits"). These could be based on economic criteria, size of aid, size of aid recipient, relevant market share of aid recipient, proof of minimum necessary, degree of selectivity/competition for the aid, etc.

the Commission to ask for one further round of more information after that.

104. The Commission must also sort out the delays in publishing 88(2) notices – in one recent case a delay of 2 months was noted and in another case it took 4 months simply to publish the notice of the investigation. This is obviously unacceptable.

105. 10 months should be the maximum total length of a State aid investigation.

- **Non-notified Aid**

106. Investigations into non-notified aid should also not be allowed to drag on for years. This can have a serious effect on the credit rating or stock market value of a company alleged to have received illegal State aid, even if the final decision is that there was no State aid.

107. The UK would like to see these cases dealt with by requiring Member States to notify within 2 months any *prima facie* case of non-notified aid. The normal notification deadlines would then apply. If Member States failed to notify, the Commission could proceed to open an 88(2) investigation directly, subject to the normal 6 month deadline.

- **Role of Independent Competition Authorities in the Member States in Case Assessment**

108. One option for speeding up assessments could be to offer Member States the option of securing an independent review of the distortion of competition that might result from the proposed payment. Such a paper, if authoritative, could perhaps obviate the need for detailed investigation by the Commission itself in some cases. This could become a role for independent competition authorities (ICAs) in relation to State aid, at least in some Member States. If so, it would hopefully ensure effective, independent economic review and reduce the burden on the Commission, provided that the Commission paid appropriate regard to the assessments made by the ICAs.

109. A more radical alternative would be, over time, to remove the notification obligation for a second tier of cases within Guidelines/block exemptions, that fall outside the conditions for direct block exemption but are nevertheless within broader “safe harbour” limits and therefore unlikely to distort competition seriously on a European scale. These could avoid notification if Member States obtained an opinion from an ICA that the measure was unlikely to distort competition to any significant extent. This could be done gradually and only when the Commission were satisfied that particular ICAs had the necessary expertise and independence. This might even incentivise Member States to ensure that their ICAs were sufficiently robust.

110. The ICA would apply largely economic tests as to be set out in the revised guidelines to check whether cases genuinely fell within the safe harbour limits and to assess whether any serious risk of distortion of competition were present. In case of a serious risk of distortion or an exceeding of safe harbour limits, the ICA would have to refer the case to the Commission. Cases before ICAs would have to be published in the OJEC and could be subject also to a four month time limit, or perhaps less. Decisions would be subject to appeal to the national Competition Appeals Tribunal. The Commission might retain the right to request that any specific case be referred directly to it, even if within the safe harbour limits.

111. The UK can see advantages to such an option, but also disadvantages. Most serious would be the risk of uneven application of the rules, especially given the varying structures and levels of experience and expertise of ICAs. It would be difficult to ask ICAs to take decisions about the Community interest in cases of doubt, so their role might have to be confined to competition and market assessment, so the Guidelines setting out their role would have to be clear and prescriptive subject only to the competition assessment point. Also some ICAs might prove unable to take decisions any faster than the Commission, and if ICA decisions were subject to Commission review or appeal, procedures might even be lengthened, with aid givers facing, in effect, “double jeopardy”.

- **Improving Third-party Input**

112. Another option would be to insist on the publication of a short notice in the OJ every time a proposed aid is notified. Third parties would then have, say, 10 days to request a non-confidential copy of the relevant notification and, say, a further 10 or 15 working days to offer comments or express concerns. The Commission (or eventually ICA)could then consider any comments received when asking Member States for further information. If no concerns were expressed, the Commission could have somewhat greater confidence that the proposed aid would not seriously distort competition.

113. More radical than this would be to have a category of aid again outside the normal block exemption limits but unlikely to distort competition significantly. A short description of such aid could be published and notification made conditional on whether any competing business expressed concern. If no concerns were expressed, the aid could be deemed approved under the relevant Block Exemption.

- **Enforcing State aid Discipline**

114. The UK is not sure that independent competition authorities could have a useful role, in practice, in enforcing state aid discipline, unless they had the delegated authority to approve cases described above. They would not be aware of all the cases under discussions by the national authorities and are not equipped to monitor such activity. They would also have no

authority to challenge an action of a Government Department and would be left, at best, having to apply to national Government, a national Court or to the Commission for action to be taken. They would, in the end, be reduced to acting in this area as the Commission's agents in the Member States, which might detract from their independence in other areas.

115. The UK supports the Commission's idea of examining how judicial enforcement of state aid rules in the Member States could be reinforced. This may or may not be a problem in other Member States, but we believe our own Courts take a robust approach already.

116. Another angle for removing the benefit of illegal receipt of State aid would be to give greater publicity to cases of non-notified aid and especially non-recovered illegal aid. Naming and shaming will lead to firms suffering credit concerns and lower stock market value. Perhaps the Commission could officially notify the company's auditors in cases of clear illegality.

117. The role of national audit offices in raising awareness of state aid risk and examining state aid compliance is important. The UK would support encouragement from the Commission to audit institutions to strengthen their arrangements for raising awareness of the State aid rules. However, any decisions over the means by which audit institutions should monitor and report on State aid compliance should remain matters of audit judgement.

118. In the UK, the NAO already has three strands of work where State aid rules are considered.

- Financial audit addresses the matter of State aid in that there are EU legal requirements encompassed within regulatory coverage and audits assess the controls put in place by Government departments to ensure regulatory compliance.
- Secondly, State aid issues may also be considered in relation to investigations of major financial support offered by the Government.
- Finally, compliance with or knowledge of State aid rules in specific circumstances may be considered in value for money work. Some recent reports such as: *"Progress on the Channel Tunnel Rail Link"* HC 77 Session 2005-06, *"Emissions Trading Scheme"*, HC 517 Session 2003-04 and *"Regional Grants in England"*, HC 1028 Session 2002-03 dealt with aspects of State aid.

119. The NAO is planning to issue new guidance for its auditors on State aid rules in financial audit, outlining the rules, the risks for Government bodies and the implications for audit work. It will include examples of the high-level controls which may be used by a state body seeking to ensure compliance and guidance on matters to be considered when examining individual aid measures.

120. The UK also supports ideas for forming a closer network of Member State State aid authorities.

121. One focus of such a network could be to improve State aid training across borders and including the involvement of Commission officials. The UK already organises advanced training events involving case studies for experts on State aid within Government departments and regional and devolved authorities. These could be extended to a limited number of other Member State officials or Commission officials capable of operating in English. UK officials would be happy to attend events in other Member States if the languages were appropriate for their abilities. Our events are mainly designed to improve understanding of State aid law and policy around the UK, but they also serve to improve the awareness of DTI advisers and policy leads of the practical obstacles faced by officials trying to deliver economic development "at the coal face".

122. The network could also look at the use of benchmarking, exchanging best practice and especially improved evaluation of the effectiveness of aid, including techniques for *ex ante* assessments.

123. Faster recovery of illegal and incompatible aid is certainly desirable. There are often practical, legal barriers, however, especially if the recipient has since gone bankrupt. It would be a complex exercise to examine how to remove such barriers even in one Member State, let alone all 25. One option to study might be to devise a "Remedies" Directive similar to that for Public Procurement remedies adopted some years ago. The UK would need to study any proposed text very carefully, however, before committing its support to such an instrument.

124. Provisional recovery of aid which has not been notified but may or may not be approvable, presents further problems. We can see the reason for such an approach but would be concerned about the practical implications. There remains significant legal uncertainty about what constitutes a State aid – the recent cases involving SGEI and fiscal aid are testament to that. There are also many areas, such as aid for the supply of health and education services and for the activities of universities, where Member States know that the Commission is sympathetic to their aims and can be confident that any aid arising would be approvable, but cannot be absolutely certain that all of their complex financial interventions would not be found to be State aid by a Court.

125. The introduction of provisional recovery orders could lead to malicious complaints combined with legal uncertainties leading to administrative paralysis and a flood of new notifications to the Commission ("just to be on the safe side") even when the risk of distortion of competition is minor. Until the Commission can make the State aid rules far less intrusive and provide effective legal certainty, it should not lightly impose automatic provisional recovery for non-notified aid.

126. The alternative would be to only impose recovery where it is clear and unambiguous that an illegal aid has been paid and that it is seriously distorting competition. The UK would probably support this line, but it would not be a major change, as we understand it, from current practice.

- **Commission Procedure**

127. The UK welcomes the Commission's proposal to correspond electronically, to look again at translation issues and to gather sectoral and market data with which to assess aid applications. Again, this latter area could be one where national competition authorities could have a role.

VIII. Remaining Issues

128. The UK looks forward to a review of the Rescue and Restructuring aid guidelines. Aid for restructuring is amongst the most distortive types of aid. The UK would like to see stricter rules and stricter enforcement of existing rules in this area. Member States should not prop up failing firms unless there are overwhelming practical reasons why they must, which are independent of industrial policy. Restructuring should normally take place in administration or through acquisition. State intervention should be restricted to dealing with the social consequences of restructuring (retraining, protection of pension rights for workers, etc.) If restructuring aid is allowed, compensatory measures should more clearly be pro-competitive.

129. The UK would like the Commission to issue guidelines, including a block exemption on aid for culture and the scope of Article 87(3) (d). The three decisions on heritage aid from 2003 have removed some uncertainties and there are regular discussions on aid for public sector broadcasting and for films, but State aid for sport and for other cultural pursuits often remains problematic.

130. In our view it is only in the context of an 88(2) investigation that the issue of needing to equip EU "champions" to compete with non-EU rivals can be considered. In our view this is a proper consideration for the Commission to look at only in those cases where an EU company is primarily competing against non-EU competition and the implications for market distortion within the EU are minor. In any event, this factor should not be taken into account unless it is raised as a potential argument in an article 88(2) notice, allowing therefore EU competitors to make their voice heard on the issue.

131. Member States need to do more to assess the value for money of State aid expenditure and evaluate the effectiveness of this spending. The UK believes this is important and should be a focus of Commission interest alongside looking at judicial enforcement and the role of national audit offices. It is also an area where the UK would hope to make use of

the network of Member State aid experts to exchange best practice and ideas.

132. The UK would also like the Commission to reflect on how it can monitor the effectiveness of the State aid rules on an ongoing basis. There should be a mechanism for seeing, with hindsight, whether aid that has been allowed has actually proved very damaging to competition or whether aid has been blocked that would have proved innocuous. Just as Member States should do more to evaluate the effectiveness of their use of public funding, so the Commission should evaluate the effectiveness of its regulatory controls.

133. Transparency of payments to business could be another area of focus. If Member States had to publish all payments to businesses over a certain threshold and an explanation of the nature of the payment and its State aid justification, this would concentrate the mind and help the Commission, other member States and competitors to see which companies are benefitting from funding under approved State aid schemes and programmes with multiple recipients.

134. Finally, the UK would like to see some reflection on how the Commission investigates complaints. It is not currently transparent, for example, how much of a *prima facie* case a complainant has to make before the Commission launches an investigation. The UK does not want to discourage genuine complaints, but the procedure may be open to abuse from malicious complainants simply seeking to delay implementation of Government policy which they happen not to like. The Commission may need to prioritise which complaints it decides to follow-up and perhaps the initial investigation of complaints concerning smaller aids could be delegated to expert consultants or even Independent Competition Authorities in the Member States.

End