State Aid Modernization: Institutions for Enforcement of State Aid Rules

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The European Commission has embarked on a reform of State aid rules. One of the objectives of this reform is better application of State aid rules in the Member States. This article examines how the problem of incorrect application of State aid rules can be solved. If their application can be improved, the Commission is willing to expand the scope of the General Block Exemption Regulation so that fewer measures are notified for approval. This would result in considerable savings in administrative costs. The article proposes a system of institutional certification similar to those that exist in other policy areas such as the common agricultural policy and structural funds. A fundamental component of such certification is the establishment of transparent institutional procedures to cover all types of funding, not only those that may contain State aid. It will then be easier for competitors to identify and challenge non-notified aid or aid that is incorrectly applied.

1 INTRODUCTION

How should Member States be made to apply properly EU State aid rules? This is the perennial question facing the European Commission. It is an important question that goes beyond the typical advantages from uniform application of common rules such as fairness and a level playing field in the internal market. This is because any answer to that question is bound to affect the structure of institutions within Member States and how competences are shared between the EU and Member States.

Over the past two decades or so the Commission has tried three different approaches to incentivizing Member States to improve their compliance with State aid rules: i) closer cooperation between Commission services and Member States in resolving ambiguities in State aid rules; ii) more detailed scrutiny of State aid measures by the Commission before their implementation and more extensive ex post audits and iii) encouragement for more involvement of national courts in the enforcement of the notification requirement of aid measures and in the recovery of incompatible aid. Indeed, the Commission has given much emphasis to action

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Now the Commission appears to be attempting a fourth approach that may be termed ‘institutional’. The Commission has recently announced a major reform of State aid policy, involving changes in both substantive and procedural rules. In an intriguing statement, the Commission in its Communication on State Aid Modernisation makes the following observations:

> 21. Should the Commission decide to increase the size and scope of aid measures exempt from notification obligation, responsibilities of Member States for ensuring the correct enforcement of State aid rules would increase. With more measures exempt from the notification requirement, Member States will have to ensure the ex ante compliance with State aid rules of de minimis measures and block-exempted schemes and cases, in strict coordination with the Commission which will continue to exercise ex post control of such measures. The Commission will expect better cooperation from Member States in terms of quality and timeliness of submission of information and notifications’ preparation, as well as effective national systems (including private enforcement) to ensure that State aid measures exempt from ex ante notification obligation comply with Union law. A lower administrative burden through less notification obligations can only be envisaged if it is accompanied by increased commitment and delivery on the part of the national authorities in terms of compliance. Consequently, ex post control by the Commission will have to be increased, also because the current results of the monitoring of the implementation of block exempted measures by Member States reveal frequent lack of compliance with State aid rules. In such a way, effectiveness of enforcement can be ensured.\footnote{Commission Communication on EU State Aid Modernisation, COM(2012) 209 final, May 8, 2012} [emphasis added]

This statement reflects, as itself reveals, the experience of the Commission from ex post checks of State aid measures that it has carried out in the Member States. Apparently, faults have been detected in a non-negligible proportion of these measures. In addition, the statement reflects, I believe, an implicit admission from the Commission that at least part of the criticism of the system of State aid enforcement by the European Court of Auditors was well-founded.\footnote{European Court of Auditors, Special Report 15/2011: Do the Commission’s Procedures Ensure Effective Management of State Aid Control?}

This criticism came in a Special Report issued in 2011. The ECA identified three weaknesses in the State aid control and enforcement system:

- (i) the Commission did not systematically carry out *ex ante* checks to ensure that Member States complied with their obligation to notify State aid;
(ii) the Commission did not systematically carry out *ex post* tests on grants of *de minimis* aid, on cases withdrawn by the Member States and on the economic impact of approved State aid; and

(iii) the Commission carried out *ex post* tests on approved aid in only a small sample.

About ten years ago I explored the issues of compliance and enforcement of State aid rules in two articles that were published in this journal.  

Both articles argued that the system of EU State aid control was vulnerable to abuse by Member States because there were not sufficiently dissuasive safeguards which could be applied in a gradated manner. After ten years of developments in the policy and case law on State aid, the EU still has largely the same enforcement system, almost the same procedures and no new instruments to use against non-compliant Member States. The procedural Regulation 659/99 is the same. The only difference is the establishment of SANI, the electronic notification system. As far as sanctions are concerned, the only major change in the case law concerns the recovery of non-notified aid that is later found by the Commission to be compatible with the internal market. Now, a national judge may order payment of interest on the amount of aid granted during the period of illegality; i.e. until the Commission finds it to be compatible.

So, if the Commission wants to incentivise Member States to properly apply State aid rules, how can it pursue its aim of ‘increased commitment and delivery on the part of the national authorities in terms of compliance’? The purpose of this article is to attempt to provide an answer to this question by considering how changes in the institutional structure of national authorities can lead to increased compliance. Apparently, this is an aspect of State aid enforcement that has received no attention in the literature. Despite the fact that there is a voluminous body of work on enforcement procedures and that several journals specialize in issues of anti-trust and State aid, there seems to be no analysis of the institutional aspects of compliance with State aid rules.

2 WHAT IS THE PROBLEM?

Is there a problem of compliance? The answer is yes. There are three aspects to it. First, about 10%–15% of the State aid cases that the Commission examines every

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4 Decentralised State Aid Control in an Enlarged European Union: Feasible, Necessary or Both?, 26 World Competition 263–276 (2003); Control of State Aid in the EU: Compliance, Sanctions and Rational Behaviour, 25 World Competition 249–262 (2002).

5 See C-368/04, Transalpine Ölleitung; C199/06, CELF v. SIDE.
year concern non-notified cases. These are cases which are brought to its attention mostly by competitors of State aid recipients. Article 108(3) TFEU requires Member States to obtain the approval of the Commission before they implement a State aid measure. Non-notification automatically makes a measure illegal. So, the first aspect of the failure to comply with the requirement for notification is the distortion of competition and the illegality of the measure in question with all the consequences that stem from infringement of Article 108(3). Since Article 108(3) creates rights for individuals and has direct effect, a consequence of such illegality is that non-notified aid is actionable before national courts which must take all necessary steps to put an end to that illegality.

This means recovery of aid, which is always a complex process with significant administrative costs.

The second aspect of the problem is that measures which are not notified have a much higher probability to be found to be incompatible with the internal market. When the Commission receives information about non-notified measures, it normally opens the formal investigation procedure. Annual State aid statistics indicate that about half of such procedures result in a negative or conditional decision. This implies that non-notified measures have a high rate of defects. This is confirmed by the Spring 2012 version of the Commission’s Scoreboard on State aid. It has revealed that over the period 2000–2010, the rate of negative decisions in the case of non-notified aid is about ten times higher than for notified aid. Again this results in extensive administrative procedures both at the level of the Commission and the level of Member States with concomitant costs.

Third, if half of non-notified measures have problems of compatibility, it follows that the probability of distortion of competition is much higher than for other State aid measures. It also follows that any benefits they may generate are less likely to be in the common interest.

Irregularities with possibly similar impact on competition have also been detected by the Commission and the European Court of Auditors in approved aid measures. Irregularities have also been found in block-exempted measures. The Commissioner responsible for competition, Mr Joaquin Almunia, has recently said that ‘over 40% of the cases we have monitored are potentially problematic’. The problem with non-compliance either at the design stage and/or implementation stage of a State aid measure is that competition and the interests of the rest of the Member States are likely to be harmed to a disproportionate degree.

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6 See the various State aid Scoreboards on DG Competition’s website whose address is provided below.
7 See the judgment of the Court of Justice in Case C-526/04, Laboratoires Boiron v. ACOS.
There is no definitive study or report why Member States do not apply State aid rules correctly. However, information on the various causes of the underlying problem can be extracted from a number of sources such as the ECA Special Report, the Annual Competition Reports, the on-line Scoreboard on State Aid, Commission decisions on illegal aid measures or, more rarely, on misuse of aid and the impact assessment report on the recent reform of the rules on services of general economic interest.  

It appears that misapplication or non-application of State aid rules can be attributed to the following factors: i) non-awareness of the relevant rules; ii) non-appreciation of how the rules may apply to a particular authority or measure; iii) faulty analysis that leads to the mistaken conclusion that a measure does not satisfy one or more criteria of Article 107(1) TFEU or that it complies with the relevant rules on compatibility; iv) intentional infringement of the rules either at the design stage of a measure or at the application stage.

The first three factors concern incorrect understanding of the rules. In principle, the problem can be remedied with better education. The fourth factor is about breaking the rules. In this case the problem cannot be remedied with the provision of more information or better training. What is necessary is improved detection and deterrent sanctions.

The question that arises is whether it is sufficient to embark on training missions across the European Union and, assuming that Member States agree, adopt new legislation that imposes harsher penalties against Member States that infringe State aid rules. I believe that, for the following reasons, the answer is negative to both parts of the question.

First, training and transmission of knowledge may have only a transitory effect. Public officials change positions regularly. Training will certainly make an improvement, ceteris paribus, but unless there is a permanent programme in place, its impact will slowly decline over time as officials move to other positions and tasks. Moreover, the Commission is not very keen to commit resources on a permanent basis to training programmes in the Member States. It would be an expensive option.

Second, training that improves knowledge of the rules does not automatically result in better compliance. Knowledge is a necessary but not sufficient condition for compliance. What matters is how the improved knowledge is applied. If, for example, a public authority intends to flout State aid rules, better understanding of

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9 All of these documents, with the exception of the first and last ones, can be found on the website of DG Competition: http://ec.europa.eu/competition/index_en.html. The impact assessment report can be found on the website of the Secretariat General of the Commission: http://ec.europa.eu/governance/impact/index_en.htm.

how the rules work may enable it to circumvent these rules more shrewdly by designing and implementing measures that are more convincing in appearing to be State aid compliant or more effective in concealing misuses of aid. For instance, a public authority may implement a scheme by claiming that it is in conformity with the General Block Exemption Regulation [Regulation 800/2008], but in fact intending to diverge from the requirements of that Regulation when it actually implements it (e.g., by subsidising replacement investment, which is operating aid, rather than initial or expansion investment). It is very difficult for the Commission to detect irregularities in the implementation of a block-exempted scheme that provides for multiple awards of aid to many different undertakings.

Third, with respect to raising the severity of sanctions, it would be rather impossible for the Commission to have any such proposal approved by the Member States in the Council. Its legality would also be questionable. When a measure clearly falls within the scope of Article 107(1) TFEU, one can reasonably argue that the Member State concerned is aware that it constitutes State aid and that it has to be notified to the Commission for authorization. It is implausible that that Member State does not understand the consequences of non-notification. This type of illegality should in principle be automatically sanctioned.

Indeed, it is precisely according to this line of reasoning that the Commission successfully managed to persuade the Member States to introduce a new provision in the Treaty to make it possible for the Court of Justice to impose penalties at the first finding of infringement. This is Article 260 TFEU as amended by the Treaty of Lisbon. In the past the Commission first had to prove before the Court that there was an infringement on the basis of Article 226 TEC and, only if the Member State concerned failed to comply with the judgment of the Court, proceed to request the imposition of penalties on the basis of Article 228 TEC. Now, Article 260 TFEU allows for penalties when a Member State fails to notify measures for the transposition of a directive. It is impossible for a Member State to claim that it was not aware it was infringing EU law because each directive defines an explicit deadline for transposition and notification of the national implementing measures.

However, the same cannot be said for all conceivable public measures that may include State aid. The evolution in the interpretation of Article 107(1) TFEU and the twists and turns in the case law indicate that some times there is genuine uncertainty as to what may constitute State aid. Therefore, it is not reasonable to penalize the application of a measure whose qualification as State aid depends on novel and unpredictable interpretation of EU courts.

Furthermore, it is neither wise, nor possible to oblige Member States to notify every measure that may include State aid for purposes of legal certainty. It is not wise because it will impose a heavy administrative burden on both the Member
States and the Commission. Nor, is it possible to ask Member States, at the risk of sanction, to comply with State aid rules when such rules may not be applicable.

These considerations inevitably lead to two conclusions. First, even if sanctions could in theory be made more punitive, they would not necessarily solve the problem of preventing the implementation of measures where the implementing authority is not aware that they contain State aid. Second, it follows that any effective solution should, at minimum, be able to address both aspects of the problem: increasing awareness/knowledge and reducing wilful non-compliance.

3 THE DESIGN AND APPLICATION OF EFFECTIVE STATE AID MEASURES

The design and application of State aid measures are not just issues of legal compliance. State aid law allows for many different measures of widely varying degree of success. Because of the leeway allowed to Member States by EU law, the design and application of State aid measures are primarily economic tasks in the sense that State aid ought to correct market failure or to induce a desirable change in the behaviour of market participants. A successful State aid measure either effects change in a market or region or prevents change (e.g., exit or relocation of a company). Therefore, a successful State aid measure has to be effective. It has to be capable of achieving its objective. This requires that the design of an effective State aid measure is preceded by thorough study of prevailing market conditions and by analysis of likely impacts. The measure then has to be designed in such a way so that the most efficacious or appropriate aid instrument is chosen.

At a later stage, the application of such a measure should be followed by assessment of its actual impacts in order to verify that the intended objectives have indeed been achieved. This means that overall policy objectives, which can be rather general and abstract, have to be translated into verifiable operational targets which can be shown later that they have indeed been achieved. The design and application of effective State aid measures requires both ex ante and ex post assessment.

Irrespective of whether a public authority grants aid to promote broader social welfare or to further narrow political interests, it must have the institutional capacity to design and apply effective measures. At all times, it should be able to explain the purpose of its actions and provide evidence of achieving whatever objectives it has set out to achieve. Compliance with EU State aid rules does not really require much more. In fact it does not require proof of actual achievement

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11 See, for example, R. Nitsche & P. Heidhues, *Methods to Analyse the Impact of State Aid on Competition*, 244 Eur. Econ. (2006), and references cited therein.
of the objectives of State aid measures. So in this sense, EU State aid rules are less strict.

Conflict between EU rules and national measures arises when the national policy objectives are at odds with the objectives of EU rules. The latter limit the uses of State aid. For example, aid may not be used to subsidise operating expenses, promote exports or support domestic products. This means that occasionally, aid which is in the national interest may be contrary to the European interest. But since EU rules are intended to safeguard the common interest, aid that can be declared compatible with the internal market has to be in the common European interest.

The Commission Communication on State Aid Modernisation sets the following overall objective: ‘Modernised State aid control should facilitate the treatment of aid which is well designed, targeted at identified market failures and objectives of common interest, and least distortive (‘good aid’). These characteristics of ‘good aid’ are not new. In fact, since the State Aid Action Plan of 2005, the assessment of the compatibility of State aid has been based on the principles of necessity, proportionality and limitation of distortion of competition. As argued above, the first two principles are essential components of effective State aid design and application. This means that EU principles of compatibility and the components of any system for granting State aid have two important similarities and two important differences.

The similarities are the principles of necessity and proportionality of aid which are ensured through \textit{ex ante} assessment. The differences are the possible divergence between national and European interests and the absence of any requirement in EU rules for \textit{ex post} assessment of aid. The rest of this article ignores the differences, because they are not relevant to the recently launched State aid reform, and focuses on the similarities. The task of the next section is to consider how they can be translated into features of institutional capacity for national authorities and institutional cooperation between the Commission and Member States.

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{12} COM(2012) 209 final, paragraph 12.
\item \textsuperscript{13} Compare, for example, the methods in Nitsche & Heidhues, \textit{Methods to Analyse the Impact of State Aid on Competition}, supra n. 11 with H. Friederszuck, L-H. Roller & V. Verouden, \textit{European State Aid Control: An Economic Framework}, in \textit{Advances in the Economics of Competition} (P. Buccirossi ed., MIT Press 2007) who explain the EU’s ‘refined economic approach’.
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4 INSTITUTIONAL CAPACITY AND COOPERATION BETWEEN THE COMMISSION AND THE MEMBER STATES

In considering what kind of institutional capacity State aid granting authorities should have and how the Commission should cooperate with Member States, the case law can be a source of inspiration because certain principles that can be extracted from it can provide guidance on how public authorities should be structured and how they should act in order to apply effectively EU law, including State aid law. The three principles identified below are not necessarily the only ones that may be derived from the case law. After all, the case law is very rich and very extensive. Although these principles are not exhaustive, they are relevant and useful.

The Court of Justice has repeatedly ruled that at least in the area of internal market, the provisions in the Treaties imply that decisions of public authorities must fulfil the following criteria:

(i) they must be based on objective criteria,
(ii) they must be taken according to transparent procedures and
(iii) they must be motivated, fully explained and subject to judicial review.\(^\text{14}\)

Where secondary legislation defines more precise obligations for Member States, such as in the area of environmental policy, the judgments of the Court are more detailed on the institutions that Member States must put in place. For example, institutional autonomy is a requirement for environmental impact assessment.\(^\text{15}\)

If this is how public authorities are supposed to act when they apply law effectively, then the question is whether these legal requirements can be translated into principles of institutional structure. I believe the answer is in the affirmative and such principles are at least the following three: objectivity, transparency and accountability.

Objectivity means that a public authority defines ex ante the criteria it uses to determine public policy and to manage the specific policy instruments that fall within its jurisdiction. Transparency, of course, means that the decisions of the public authority are clear, communicated to those affected by them and that the views of the latter are taken into account. Finally, accountability means that decisions are not arbitrary but adequately reasoned and based on evidence and those affected by them can challenge them before a higher administrative authority or the courts.

Given that non-compliance with State aid law causes undue distortion of competition and given that it is now understood that the distortion of competition

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\(^{14}\) Case C512/08, Commission v. France; C372/09, Josep Peñarroja Fa; C-182/10, Solvay and others.

\(^{15}\) See for example, C-41/11, Inter-Environment Wallonie; C-474/10 Seaport.
in the area of State aid is the same as the distortion in the internal market, it follows that it is reasonable to apply the three principles above derived from internal market law to public authorities granting State aid. Not only should the quality of their own State aid measures improve, it will also make it easier for competitors to challenge non-notified aid or aid that is misused in the sense of Regulation 659/99. After all, one of the aims of the State Aid Modernization is to strengthen private enforcement. Increased transparency, for example, should make it easier for competitors to initiate proceedings before national courts.

But how can these principles be applied in practice? There are two components of practical application: i) self-reporting and ii) certification. With respect to self-reporting, a public authority that designs and executes public policy objectively and transparently must, by implication, be open about what it does and how it does it. Therefore, a State-aid granting authority must publicise its measures. This is how it ensures that all affected parties can provide it with feedback about the effects of the measures it implements. An accountable State-aid granting authority should also provide confirmation to those affected by its actions that it has taken into account all relevant information, that it acts in the best public interest and that it is compliant with all relevant legislation. In relation to State aid, this means that the public authority can confirm that i) its measures are free of State aid and why, or, if they contain State aid, that ii) they are State-aid compliant and why.

With respect to certification, this entails external verification that indeed a public authority has credible internal procedures that ensure the veracity of what the authority self-reports and that such procedures cover all of the activities of that authority.

Certification of national institutions and authorities is not alien to EU law and policy. In policy areas such as the common agricultural policy or structural funds, national authorities may manage EU funds only after they have been certified to have established the requisite institutional capacity.

The present General Block Exemption Regulation, Regulation 800/2008, in recital 6 and Article 10, allows for the withdrawal of the benefits of the Regulation in case Member States do not provide all necessary information on the measures implemented under the Regulation. The Communication on State Aid Modernisation makes an explicit link between the benefits from a future block exemption regulation and institutional capacity. It states that ‘a lower administrative burden through less notification obligations can only be envisaged if it is accompanied by increased commitment and delivery on the part of the national

See T-50/06 RENV, Ireland, France and Italy v. Commission.
It is not a radical change of the State aid control system to require public authorities that want to be able to claim the benefits of any future block exemption regulation to prove first that they have the necessary institutional capacity. Nor, will it be too burdensome for Member States to inform the Commission which national authorities comply with the principles of objectivity, transparency and accountability. This compliance can be confirmed through widely available systems of institutional certification such as ISO or a variation of it.

A more radical change would be to require all public authorities which grant aid notified to and approved by the Commission also to demonstrate that they have the necessary institutional capacity to apply State aid rules properly. Nonetheless, I do not see any major legal impediment to strengthening the system of State aid control in line with the three institutional principles explained above.

One may argue that demanding that national authorities obtain institutional certification would be contrary to another principle – that of subsidiarity. After all, the Court of Justice has said that it is up to the Member States how they organize their administrative systems. However, the Court has also said that the Member States have to give real effect to EU law. Given that the Commission has the right but not the capacity to check full compliance of each individual aid award with the terms of the schemes it approves, the institutional principles suggested here only replace what the Commission could have legally requested and what the Member States would have been obliged to do. Hence it cannot be credibly argued that a regime that imposes a lighter burden on Member States and improves compliance with EU law does not satisfy the principle of subsidiarity.

Lastly, it should be pointed out that ex ante institutional certification is likely to strengthen the application of State aid rules not only in the case of aid granted on the basis of a block exemption or in the context of an approved measure. If a public authority that wishes to grant State aid must first achieve the requisite standards of objectivity, transparency and accountability and establish self-reporting procedures that cover all of its activities, regardless of whether they contain State aid or not, such an authority is less likely to grant aid that is incompatible with the internal market. At present, an authority that wishes to grant incompatible aid will not notify it anyway, nor will it be concerned about conformity with any State aid rules. However, in the presence of established internal procedures, it will be more difficult for a certified authority to design and apply measures that are not State aid compliant.

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18 See C-312/93, Peterbroeck; C-78/98, Preston; C-41/11, Inter-Environment Wallonie.
Commissioner Almunia in a speech on State aid modernization on 7 June 2012 noted that ‘about 80% of the aid is granted through schemes and block-exempted measures, which means that Member States already have to work hard to ensure compliance with the rules set by the Commission. But there is a clear room for improvement. . . . The modernisation initiative is an opportunity for national authorities to take more responsibility for the competences they already have, as a pre-condition for the Commission to streamline its rules and decision-making to focus on the most serious cases. On our side, we will reinforce ex-post control; but Member States will have to reinforce their control mechanisms at all levels of their administrations. . . . In practice, this may mean:

- Stronger ex ante consultation with the Commission to better design the aid measures;
- Better coordination to make sure that the rules are consistently applied inside each country;
- Better compliance when it comes to measures implemented at national level; and
- Proper follow-up systems with monitoring and recovery of illegal aid.\(^{19}\)

All four actions mentioned by the Commissioner should improve compliance. But they are not likely to have the same effectiveness as the direct strengthening institutional structures and incentives for proper application of State aid rules. The aim of the Commission should be, in the first place, to dissuade national authorities from granting incompatible aid and, second, to prevent them from applying incorrectly approved measures. The system of institutional certification proposed in this article seems more suitable for achieving these two objectives.

5 CONCLUSIONS

This article has examined how the problem of incorrect application of State aid rules by the Member States can be solved. If the application of these rules can be improved, the European Commission appears to be willing to agree to further decentralization of enforcement and simplification of the rules. This would result in considerable savings in administrative costs.

The article proposes a system of institutional certification similar to those that exist in other policy areas such as the common agricultural policy and structural

funds. This type of certification need not be limited to the use of block exemption regulations. If the use of block exemption regulations or the application of approved aid is conditional on *ex ante* certification that covers all of the activities of the aid granting authority, then certification should also reduce the granting of incompatible aid.