Briefing

State aid

January 2014

European Commission takes further steps to modernise the application of the State aid rules

In this Briefing, we examine a number of important recent developments in the State aid field, which have been undertaken by the European Commission as part of its drive to modernise and simplify the application of the State aid rules. They are of relevance and interest to public authorities and to both companies in receipt of public funding and their competitors. This raft of new measures marks the culmination of several years of work by the Commission to modernise and simplify the State aid process.

These developments will affect whether public funding is exempt from the obligation to notify the European Commission for approval. They will also make changes to how the State aid rules will be applied in the energy sector, as well as to environmental and research and development aid and to public support for investment in small and innovative companies.

The Commission has also published draft guidance on the concept of aid, which will provide further clarity on when measures adopted by public authorities are subject to the State aid rules.

Should you wish to discuss any of the proposed changes, please contact one of our State aid team or your usual Burges Salmon contact.

Commission publishes draft new guidance on the concept of "aid"

The European Commission ("Commission") has published draft guidance on the notion of aid. This is intended to provide assistance in determining whether a public measure falls within the EU State aid rules. Measures within the rules must, unless exempt from notification (for example under the De Minimis Regulation or the General Block Exemption Regulation ("GBER"), both considered below) be notified to and approved by the Commission before they can be implemented. The guidance is based upon the case law of the European Courts.

For a measure to be "aid", it must satisfy the following requirements:

- the beneficiary must be carrying on an economic activity, which is broadly defined and includes, for example, the activities of non-profitmaking organisations that supply goods and services for remuneration
- the measure must be imputable to the state, e.g. because it is granted by a public authority or body or, in certain circumstances, a state-owned company
- the measure must involve state resources, for example, through grants, loans, guarantees, recapitalisations, debt write-offs or the provision of goods at below market rates
- the measure confers, whether directly or indirectly, on the beneficiary an "economic advantage" that it would not have obtained under normal market conditions
- the measure is "selective" in that it benefits specific undertakings, categories of undertakings or economic sectors
- the measure must be liable to distort both inter-state trade and competition

The application of these requirements is often complex, for example when: the beneficiary provides "public" services, such as health, social services or education or receives compensation for providing services of general economic interest; the measure in question is provided by a state-owned company; the public authority considers that it has acted in the same way as a private investor, creditor or vendor and thus on a market basis; the measure concerns the imposition of, exemptions from or the settlement of disputes concerning taxes; there is discretion in the provision of funding; or the beneficiary is active only in a local area.

Whilst the Commission's guidelines will provide some guidance, in many cases it will nevertheless be necessary for both the public authority and the beneficiary undertaking to receive specific legal advice on the application of the State aid rules.

New regulation for *de minimis* aid

On 1 January 2014, the new De Minimis Regulation entered into force. This Regulation disapplies the State aid rules in respect of small amounts of aid.

The Commission has retained the *de minimis* threshold of €200,000 for the amount of aid that a single undertaking may receive per Member State over any period of three fiscal years (€100,000 in the road freight transport sector). In addition, subsidised loans of up to € 1 million may also benefit from the exemption if certain conditions are met. Where aid is provided otherwise than as a grant (e.g. a loan or guarantee), the aid must be calculated as its gross grant equivalent. Aid granted in instalments must be discounted to its value when granted.

If the applicable threshold is exceeded, none of the aid can be exempted and the State aid rules will apply in the ordinary way, although the aid may be still benefit from another exemption, notably the GBER.

Unlike its predecessor, the new Regulation applies to aid to undertakings in financial difficulty. However, it does not apply to loans or guarantees to companies subject to collective insolvency proceedings or which fulfil the criteria under domestic law for being placed in insolvency proceedings.

Member States are obliged to monitor the provision of *de minimis* aid, to ensure that the thresholds are not exceeded. This can be either through maintaining a central register or, before granting aid, requiring beneficiaries to declare any *de minmis* aid granted in the previous two and current fiscal years.

Whilst the new Regulation is welcome, the amount of aid covered remains modest. In particular, both public authorities and beneficiaries must take care to ensure that the thresholds are not exceeded, particularly if *de minimis* aid is being received from different sources and/or at different times.

Commission publishes final proposals for the new GBER

In our **May** and **September** 2013 Briefings, we examined detailed proposals by the Commission to update the GBER, which exempts a number of categories of aid from being notified to the Commission. The Commission is now undertaking a third round of public consultation, consolidating its earlier proposals and reflecting comments received, before adopting the new GBER, which will take effect from 1 July 2014.

We set out below the key changes made by the Commission in this final draft, concerning: the inclusion of a number of new categories of aid; revised notification thresholds for certain categories of aid; and revised rules for large aid schemes.

The Commission expects that approximately three-quarters of aid measures and two-thirds of all aid granted will be within the scope of the new GBER. This will increase legal certainty, allow aid to be disbursed more quickly and to a wider group of projects, and reduce the resources incurred in notifying aid to the Commission. However, both public authorities and aid recipients will need to consider carefully whether their project is eligible for exemption under the GBER, taking account of the applicable eligibility criteria, maximum aid thresholds and maximum aid intensity (proportion of aid to eligible project costs), which vary considerably between aid categories.

It should be noted that, to increase transparency, Member States will be required to publish information on aid that is granted pursuant to the GBER.

New categories of aid to be covered by the GBER

The Commission has confirmed (as proposed in September 2013 and covered in our **September Briefing**) that seven new categories of aid will now fall within the GBER, with the following thresholds, some of which have been increased from the September proposals:

- **natural disasters:** up to 100% of an undertaking's losses
- **transport in remote regions:** up to 50% of a return ticket can be paid to residents of remote regions (including islands) for air and sea transport
- **broadband infrastructure:** maximum aid of €70 million per project
- **innovation clusters:** maximum aid of €7.5 million (increased from €5 million)
- **process or organisational innovation:** maximum aid of €7.5 million (increased from €5 million)
- **culture and heritage conservation:** maximum investment aid of €100 million (increased from €70 million) and maximum operating aid of €50 million (increased from €25 million). This category also includes for aid schemes for audio-visual works, with a maximum of €20 million per scheme per year
- **sports and multifunctional infrastructure:** maximum aid of €15 million or, alternatively, a maximum aid intensity of 75% of a project with maximum costs of €50 million

New notification thresholds, particularly for R&D projects and SMEs

The GBER sets thresholds above which an aid measure must be notified to the Commission; these thresholds are set to ensure that the Commission does not receive notifications of aid that will not distort competition, but does review projects receiving larger sums of aid, where the risk of competition being distorted is higher.

The Commission has made a number of changes to its earlier proposals, in particular as regards aid for research and development, where the thresholds have doubled to € 40 million for fundamental research and € 20 million for industrial research. These are further doubled for projects under the EU's EUREKA programme. This is welcome and should see an increase in funding for R&D projects.

Whilst the thresholds for SME investment aid (€7.5 million) and participation in fairs (€2 million) have remained unchanged, new provisions have been added to exempt aid to support SMEs' cooperation costs linked to European Territorial Cooperation projects, risk finance aid, aid for start-ups and innovation aid for SMEs. This should help governments support SMEs in their start-up and development.

Large aid schemes

Whilst the Commission is generally expanding the GBER's coverage, it is also proposing to exclude certain categories of large aid schemes from the scope of GBER. This will affect aid for certain regional development projects, SMEs, environment protection, R&D and broadband infrastructure schemes if (a) the annual State aid expenditure exceeds 0.01% of the national GDP for the Member State concerned and (b) the expenditure of the scheme exceeds €100 million. Such schemes will need to be notified to the Commission for approval.

Commission proposes revised Framework for State aid for research and development and innovation

The Commission has proposed a draft revised framework for State aid for research and development and innovation ("R&D&I"). The new Framework will apply from 1 July 2014. It set out how the Commission will assess aid for R&D&I that falls outside the scope of the GBER, which, as discussed above, will exempt from notification much aid for fundamental research, industrial research and experimental development.

The Framework is therefore important in providing guidance on the circumstances in which the Commission is likely to grant approval for R&D&I aid notified to it. It also explains when public funding of R&D&I projects is unlikely to constitute aid, for example funding of research organisations and educational establishments and contract R&D undertaken by them in return for a market remuneration. Additionally, in order to facilitate public/private R&D collaboration and knowledge transfer, the new Framework will establish greater legal certainty for support to public/private R&D&I projects.

Developing new technologies or processes can involve significant technological and commercial risks, leading to a funding gap or other market failure and R&D&I projects not proceeding due to a lack of funding. To overcome this, the Commission proposes that aid for R&D&I projects that exceeds the GBER thresholds should be exempted after notification and individual assessment if it facilitates R&D&I projects that would not otherwise take place, contributes to economic growth, is the minimum necessary and does not have negative effects on competition. The Framework provides detailed guidance on how the Commission will assess individual aid for R&D&I projects.

The Framework also sets out maximum aid thresholds. In the case of fundamental research, aid can cover up to 100% of eligible costs; for applied research (including the costs of building and demonstrating prototypes), aid of up to 70% of eligible project costs for large companies and 90% for small companies can be exempted. Lower intensities apply to industrial research and experimental development, since they are closer to market and aid is thus more likely to distort competition. Aid can be provided as a grant, as a repayable advance or through fiscal measures.

Commission proposes new rules on energy and environmental aid

The Commission published for final consultation draft guidelines on how the State aid rules will be applied to environmental and energy aid, to the extent that they do not fall within the scope of the new GBER, which will cover some types of aid in these sectors (including aid to remediate contaminated sites and for some district heating schemes). It is expected that the new guidelines will apply from later in 2014 until 2020.

The new guidelines will replace and expand (to cover aid to energy projects) the existing guidelines on environmental aid, as well as simplifying how the rules are applied. The new guidelines will set out the conditions under which aid will be permitted, so assisting governments and other public authorities in providing aid that is compatible with the EU rules. They are also intended to promote investment, but aspects of the guidelines, particularly in the energy sector, are controversial and could harm investor confidence. Therefore, given the impact that these guidelines will have in shaping energy regimes and their attractiveness to industry and investors, stakeholders will be scrutinising the detail of the draft guidelines.

General principles

The Commission has developed 'common assessment principles', which all energy and environmental aid must satisfy. These include that aid must:

- contribute to the EU objectives of (for the energy sector) a competitive, sustainable and secure energy market and (for environmental aid) a high level of environmental protection and an efficient, competitive low-carbon economy
- respond to a genuine market failure that prevents or discourages investment
- be appropriate, as compared to other policy instruments, to address the market failure
- incentivise investment that would not otherwise be made or be required in any event under EU or national law
- be proportionate, in being no more than necessary to achieve the desired energy or environmental objective
- avoid undue negative effects on competition and trade, whether by distorting markets (e.g. by increasing market power or supporting inefficient production) or decisions on where to locate businesses

Renewables

A key, and potentially controversial, focus of the proposals is tighter rules on the financing support renewable energy.

The Commission accepts that public support for renewables will remain important if the EU is to achieve its challenging climate change and energy sustainability objectives by 2020. However, it is concerned that very substantial amounts of public money have been used to support the development of renewables; although increased generation from renewables is a key part of EU energy policy, many support schemes have increased electricity costs, distorted competition and harmed the international competitiveness of intensive energy users. With the increase in renewables capacity, the Commission intends to promote a move towards public funding based on market premiums (supplements to wholesale prices) and tradable certificates, which it hopes will lower prices and support the integration of EU energy markets.

Aid to energy from renewable sources can be granted in the form of investment aid or operating aid. Compatible forms of operating aid include: feed-in premiums and feed-in tariffs; aid granted by way of certificates, such as "green certificates"; and aid for biofuels and bioliquids. Detailed rules apply in each case.

In particular, support through feed-in tariffs will be permitted only if: it is awarded after a competitive bidding process open to all renewables generators; beneficiaries are subject to standard balancing responsibilities; it is not paid once the plant is fully depreciated (other than for biomass plants, given low investment but high operating costs); and any investment aid is deducted.

The maximum aid that can be granted (as a proportion of total costs) varies according to the size of the aid recipient: small enterprises (65%); medium enterprises (55%); and large enterprises (45%). It is proposed that notification to and approval by the Commission will be required where generating capacity exceeds 125 MW (for renewables projects) or 200 MW (for cogeneration projects); for biofuel projects, the notification threshold will be production capacity of 150,000 tonnes.

In certain circumstances, the Commission may approve assistance to mitigate the costs imposed on industry through charges to support renewable energy, for example to prevent companies relocating outside the EU to avoid such charges, which could lead to 'carbon leakage'. Aid will be permitted only if: renewables charges would increase production costs by 5%; the aid is objectively necessary, transparent and applied in a non-discriminatory manner; and aid beneficiaries pay part of the additional costs arising from renewables charges.

Infrastructure and capacity payments

Another key focus of the proposals is on infrastructure funding: public support should be focused on projects that improve cross-border energy transport and reinforce infrastructure development in poorer and/or peripheral regions, where usage tariffs may not be sufficient to support investment. As a rule, aid cannot be provided to gas and electricity infrastructure projects that are exempt from EU internal market legislation, for example the obligation to provide third party access. Approval of infrastructure aid may be conditional on provision of third party access.

Capacity payments to ensure sufficient generation capacity will be permitted only if there are not more suitable market-based alternatives, such as demand-side management, increased interconnection capacity or electricity storage. Aid can be used to resolve issues such as insufficient peak-load capacity, seasonal capacity shortages and insufficient generation flexibility. It should encourage market responses to capacity shortages and remunerate only the availability of capacity, not the sale of electricity. Aid should not be provided to fossil generation, unless there are no less harmful alternatives to ensure sufficient capacity.

Individual notification of capacity mechanism payments will be required if the payments exceed € 7.5 million per recipient per project; for aid for energy infrastructure, the notification threshold will be € 20 million per recipient per project.

Carbon capture and storage

Carbon capture and storage could play an important part in preventing atmospheric CO_2 emissions and achieving EU carbon reduction initiatives. However, development of CCS technology is at an early stage and its commercial prospects remain uncertain. The Commission will approve aid only for the capture, transport and storage of CO_2 and not for the generating plant itself. Aid can be provided only for the net funding gap that prevents investment on a commercial basis. Approval of aid may be conditional upon whether the CCS infrastructure is open to third parties. It is proposed that aid for CCS projects will require notification if the aid exceeds € 20 million per project.

Other projects

The new guidelines also contain detailed rules on aid for other energy and environmental projects, including: cogeneration; district heating and cooling; resource efficiency and waste management, including recycling and recovery; and exemptions from environmental taxes.

Commission adopts new rules to promote public support for risk finance to SMEs and mid-cap companies, particular start-ups and those investing heavily in innovation

A major issue faced by small and medium-sized enterprises ("SMEs") and companies with medium-sized capitalisation (so-called "mid-caps") is access to finance, in particular to invest in expansion and growth. Bank finance remains difficult to obtain and there are economic and risk barriers to other forms of equity and debt investment.

The Commission has therefore recently adopted new rules on public support to SMEs and mid-caps. These rules are designed to attract the provision of new finance, including through the use of fiscal incentives. They are significantly more flexible than existing rules on risk finance, which were heavily biased toward equity finance and required high minimum levels of private investment.

Aid of up to € 15 million per company will fall under the new GBER (see above). The new guidelines explain how aid above this threshold will be assessed. This will include the provision of finance through equity, quasi-equity, loans and guarantees. For the purpose of the new rules, SMEs are companies with below 250 employees, whilst 'mid-caps' are either small companies with under 500 employees or innovative companies with under 1,500 employees.

The new rules will require that public funding be matched by private investors, so that public funding attracts new investment and does not replace private funding; the proportion of private funding required will vary from 10% to 60% depending on the age of the company and the risks associated with it (which are generally higher for start-ups and innovative companies). They will permit public funds to be used in an investor exit through the purchase of shares, provided that new capital is also injected. However, the funding of take-overs is excluded.

The new rules also cover public support for alternative trading platforms and tax incentives for investments in shares in SMEs listed on such platforms, as well as guidance on tax incentives to both individual and corporate investors in SMEs and mid-caps.

Burges Salmon to host seminar on the provision of State aid to small and medium-sized enterprises, charities and non-profit organisations

On 24 February, Burges Salmon's London office will host a seminar organised by the UK State Aid Law Association that will examine the provision of State aid to small and medium-sized enterprises, charities and non-profit organisations.

Further information is available on our **website**. To confirm your attendance, please click **here**.

Burges Salmon Competition Unit

Burges Salmon's Competition Group is one of the United Kingdom's leading Competition and State aid practices. We undertake the full range of high quality and challenging work. In the State aid field, our lawyers advise public bodies, beneficiaries and third parties on the application of the State aid rules to specific projects, on notification and complaint proceedings before the European Commission and litigation before the EU courts in Luxembourg. Our lawyers' experience includes investigations in and for the funding of major projects, the rescue and restructuring of companies in difficulty and the provision of aid during the financial crisis. In the competition field, we advise on all aspects of UK and EU competition law including: mergers; competition and regulatory investigations; compliance programmes and training; appeals and litigation; in the UK and EU courts; procurement and related litigation and the application of competition law to commercial agreements and strategies.

In 2012, we were awarded *The Lawyer's* "Competition and Regulatory Team of the Year" award for our representation of the Co-operative Group in its successful appeal to the Competition Appeal Tribunal against the Office of Fair Trading's Competition Act decision in **Tobacco**. We were runner-up for this award for 2013 for our successful defence of a substantial follow-on damages action brought against Cardiff Bus.

Should you require any further information on the issues described in this Briefing or on any state aid or UK or EU competition law matter, please contact your usual contact or one of the members of our Competition Group.

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