EU State Aid Control

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Law and Economics

Edited by

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Wolters Kluwer

Published by:
Kluwer Law International B.V.
PO Box 316
2400 AH Alphen aan den Rijn
The Netherlands
Website: www.wklawbusiness.com

Sold and distributed in North, Central and South America by:
Wolters Kluwer Legal & Regulatory U.S.
7201 McKinney Circle
Frederick, MD 21704
United States of America
Email: customer.service@wolterskluwer.com

Sold and distributed in all other countries by:
Turpin Distribution Services Ltd
Stratton Business Park
Pegasus Drive, Biggleswade
Bedfordshire SG18 8TQ
United Kingdom
Email: kluwerlaw@turpin-distribution.com

Printed on acid-free paper.

ISBN 978-90-411-5147-6
e-ISBN 978-90-411-5148-3

Printed in the United Kingdom.

Chapter 5

Distortion of Competition and Effect on Trade

*Jacques Derenne and Vincent Verouden**

1. INTRODUCTION

Public support to companies is prohibited under Article 107(1) TFEU only if it "distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods" and only insofar as it "affects trade between Member States".

Even if the two relevant conditions – potential distortion[1] of competition and effect on trade – are formally distinct elements of the notion of aid, in practice they are often treated jointly in the assessment of State aid as they are, as a rule, considered inextricably linked.[2]

In keeping with the distinct nature of the two concepts, however, this chapter will (separately) consider the two concepts in further detail. Section 2 first deals with the concept of potential distortion of competition. Section 3 will address under which circumstances the aid is deemed to potentially affect trade. Section 4 zooms in on the role of market definition in the context of State aid control. Section 5 provides some concluding remarks.

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1. The concept of "favouring certain undertakings or the production of certain goods" is discussed in other chapters – they refer to other State aid conditions which are cumulative: advantage ("favouring"), selectivity ("certain"), existence of an undertaking being the addressee of the aid and transfer of State resources attributable to the State.

2. Cf. Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJEU C 262, 19.7.2016, pp. 1-50 (hereinafter: "Notion of Aid Communication"), paragraph 186. *See also* judgment of 4 April 2001, *Regione autonoma Friuli-Venezia Giulia v Commission*, T-288/97, EU:T:2001:115, paragraph 41; judgment of 15 June 2000, *Alzetta and others v Commission*, T-298/97, T-312/97, T-315/97, T-600/97 to T-607/97, T-3/98 to T-6/98 and T-23/98, EU:T:2000:151, paragraph 81 (appeal rejected: judgment of 29 April 2004, *Italy v Commission*, C-298/00 P, EU:C:2004:240). For more discussion and general analysis on the two conditions, *see*, in particular C. Quigley (2015), *European State Aid Law and Policy*, Hart Publishing, Third Edition, pp. 792, spec. pp. 76-91; M. Karpenshif (2015), *Droit européen des aides d'Etat*, Competition Law/Droit de la concurrence, Bruylant, pp. 417, spec. pp. 56-61. *See also* S. Medgouhl (2016), Distortion of Trade and Competition in: *EU Competition Law – Volume IV: State Aid* (N. Pesaresi, K. Van de Casteele, L. Flynn and C. Siaterli, eds.), Claeys and Casteels, Leuven.

2. DISTORTION OF COMPETITION

2.1 Legal treatment

The European Commission (the "Commission") and the European courts have traditionally taken a very broad approach towards the question as to when State aid distorts competition between undertakings within the meaning of Article 107(1) TFEU. A measure granted by the State is considered to distort or threaten to distort competition when it is liable to improve the competitive position of a firm in competition with other firms.[3] For all practical purposes, this is generally found to exist when the State grants a financial advantage to a company which is active in a liberalised sector where there is, or could be, competition.[4]

Early judgments by the Court have lent support to this strict approach, even if they did not in themselves necessitate it.[5] In the landmark judgment in *Philip Morris of* 1980, the Court ruled on a Commission Decision prohibiting the granting of a Dutch investment subsidy to Philip Morris, a large tobacco products manufacturer. In its action for the annulment of the Decision, Philip Morris maintained that

> "*in order to decide to what extent specific aid is incompatible with the common market, it is appropriate to apply first of all the criteria for deciding whether there are any restrictions on competition under Articles 85 and 86 of the Treaty* [now Articles 101 and 102 TFEU]. *The Commission must therefore first determine the 'relevant market'* [...]. *It must then consider the pattern of the market* [market structure] *in question in order to be able to assess how far the aid in question in a given case affects relations between competitors.* [...]. *The decision does not define the relevant market either from the standpoint of the product or in point of time. The market pattern* [market structure] *and moreover for that matter, the relations between competitors resulting therefrom which might in a given case be distorted by the disputed aid, have not been specified at all.*"[6]

The Court did not follow Philip Morris' position. Even if it referred to the rather large share of production of the company in the Netherlands, it did not embark upon any deep review of the impact of the aid. It held:

3. Judgment of 17 September 1980, *Philip Morris*, 730/79, EU:C:1980:209, paragraph 11; *see also* judgment in *Alzetta*, paragraph 80.
4. Notion of Aid Communication, paragraph 187. This excludes markets that, under both Union and national law, are closed to competition. *See also* judgment in *Alzetta*, paragraphs 141 to 147; judgment of 24 July 2003, *Altmark Trans*, C-280/00, EU:C:2003:415. For a case where the Commission concluded to the absence of aid for lack of distortion of competition and of effect on trade between Member States owing to the absence of a liberalised market, *see* Decision of 17 July 2002, N 356/2002 – *United Kingdom, Network Rail* (at the time, the UK railway network was essentially a natural monopoly and there was no developed market in the EU for railway infrastructure management. The Commission therefore concluded that there was no competition *on* the market for operating and managing the national rail network or competition *for* that market.
5. C.-D. Ehlermann and A. Vallery (2005), Giving Meaning to the Condition of Effect on Trade: The Court's Judgment in Xunta de Galicia, a Missed Opportunity?, *European State aid Quarterly* 4|2005, p. 709.
6. Judgment in *Philip Morris*, paragraph 9. The French and Dutch language versions of the judgment suggest that the term "pattern of the market" must be understood as "market structure".

> *"It is common ground that when the applicant has completed its planned investment it will account for nearly 50% of cigarette production in the Netherlands and that it expects to export over 80% of its production to other Member States. The 'additional premium for major schemes' which the Netherlands government proposed to grant the applicant amounted to HFL 6.2 million (2.3 million EUA) which is 3.8% of the capital invested. When State financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-community trade the latter must be regarded as affected by that aid. In this case the aid which the Netherlands government proposed to grant was for an undertaking organized for international trade and this is proved by the high percentage of its production which it intends to export to other Member States. The aid in question was to help to enlarge its production capacity and consequently to increase its capacity to maintain the flow of trade including that between Member States. On the other hand the aid is said to have reduced the cost of converting the production facilities and has thereby given the applicant a competitive advantage over manufacturers who have completed or intend to complete at their own expense a similar increase in the production capacity of their plant. These circumstances, […] justify the Commission's deciding that the proposed aid would be likely to affect trade between Member States and would threaten to distort competition between undertakings established in different Member States."*[7]

One could argue that the above case involved a significant aid amount given to a large, internationally active company and that the Court even referred to these facts.[8] In subsequent judgments, however, the Commission and the Court have followed a more formal line and have made it clear that the mere fact that the aid leads to a financial advantage is liable to distort competition in the sense of Article 107(1) TFEU. This is well illustrated in the *Holland Malt* case, where the Court pointed out that since the measure "at issue is an investment subsidy for the modernisation of and increase in the applicant's production capacity, it *necessarily* strengthens the applicant's competitive position compared with its competitors who have to finance such investments from their own resources or forgo them altogether" (emphasis added).[9]

Likewise, in relation to operating aid, the Court has made it clear that "aid intended to relieve undertakings of all or part of the expenses which they would normally have had to bear in their day-to-day management or usual activities, *in principle* distorts competition"[10] (emphasis added).

It is worth recalling in this context that the concept of "aid" is quite a broad one.[11] In particular, it is not confined to situations where a firm obtains a *net* financial advantage (i.e. is financially better off with the measure than without). Some measures do not provide a net financial advantage to the firm in the sense that the aid merely compensates the firm for taking an action it would not have taken otherwise (e.g. increasing production or building

7. Judgment in *Philip Morris*, paragraphs 10-12.
8. Cf. C-D Ehlermann and A. Vallery (2005), p. 709.
9. Judgment of 9 September 2009, *Holland Malt v Commission*, T-369/06, EU:T:2009:319, paragraphs 37, 47-48, 50.
10. Judgment of 6 March 2003, *Westdeutsche Landesbank Girozentrale v Commission*, T-228/99 and T-233/99, EU:T:2003:57, paragraphs 298-300.
11. On the concept of advantage, *see also* the chapters by Conte and Kavanagh (2017) and Verouden and Werner (2017) in this volume.

extra production capacity).[12] However, even if the *net* financial advantage for the beneficiary may be small or even zero, the aid will have an impact on rivals as they will be confronted with extra production or extra capacity in the market. In that sense, such measures do “distort” competition under Article 107(1) TFEU.[13]

Furthermore, for a measure to fall under Article 107(1) TFEU, the Court does not require the distortion to be either actual or appreciable. According to the Court, it is not necessary to demonstrate that competition is actually being distorted, but only to examine whether that aid is liable to distort competition.[14] Public support is liable to distort competition even if it does not help the recipient company to expand and gain market shares. It is enough that the aid allows it to maintain a stronger competitive position than it would have had if the aid had not been provided.[15]

Moreover, if the Commission has correctly explained how the aid in question was capable of having such effects, it is “not required to carry out an economic analysis of the actual situation on the relevant market, of the market share of the undertakings in receipt of the aid, of the position of competing undertakings and of the trade flows in question between Member States”.[16] The fact that an economic sector has been the subject of liberalisation at EU level “will suffice to indicate the real or potential effect of the aid on competition”.[17] This includes the situations where the authorities have assigned a public service to an in-house provider (even if they were free to entrust that service to third parties). The financing of such a provider may give rise to distortions of competition.[18]

As regards the significance of the aid measure, the Court has held that even when the overall amount of aid in question is small and that it is divided between a large number of firms, each of whom receives a negligible sum in national or EU terms, it is settled case-law that the relatively small amount of aid or the relatively small size of the firm which receives it does not

12. On the absence of any concept of “net advantage” in the State aid notion, *see* V. Di Bucci (2007), Comments on the paper “selectivity, economic advantage, distortion of competition and effect on trade”, in Derenne and Merola (Eds.), *Economic analysis of State aid rules – Contributions and limits*, Proceedings of the third annual conference of the Global Competition Law Centre, College of Europe, 21–22 September 2006 (Lexxion), pp. 220, spec. p. 159.
13. One exception is the treatment of compensation given for services of general economic interest (SGEI). As regards such compensation, the Court made clear in the 2003 *Altmark* judgment that the granting of an advantage can be excluded if the four cumulative conditions are met. *See* Werner and Verouden (2017), Services of General Economic Interest, in Chapter 13 of this volume for further details.
14. Judgment of 30 April 2009, *Commission v Italy and Wam*, C-494/06 P, EU:C:2009:272, paragraphs 50-53 (with reference to the judgment of 10 January 2006, *Cassa di Risparmio di Firenze and Others*, C-222/04, EU:C:2006:8, paragraph 140 and the case-law cited). Taking a different approach would ultimately favour those Member States which grant aid in breach of the duty to notify laid down in Article 108(3) TFEU, to the detriment of those which do notify aid at the planning stage, judgment of 14 February 1990, *France v Commission*, C-301/87, EU:C:1990:67, paragraph 33.
15. Notion of Aid Communication, paragraph 189.
16. Judgment of 15 December 2009, *EDF v Commission*, T-156/04, EU:T:2009:505, paragraphs 144-148 (and the case law cited).
17. Judgment of 15 December 2005, *Italy v Commission*, C-66/02, EU:C:2005:768, paragraphs 110-111, 114-119 (and the case law cited).
18. For further details, *see* Notion of aid Communication, paragraph 188.

prima facie exclude the possibility that competition be distorted.[19] On this basis, almost any amount of aid can be considered to meet the condition of "distortion of competition". In the words of the Court: "Where the benefit is limited, competition is distorted to a lesser extent, but it is still distorted".[20]

Even so, the Commission has used the possibility allowed under Article 109 TFEU to determine certain categories of aid that are exempted from the notification requirement, including so-called *de minimis* aid. On that basis, *de minimis* aid, being aid granted to a single undertaking over a given period of time that does not exceed a certain fixed amount, is deemed "not to meet all the criteria laid down in Article 107(1) of the Treaty and is therefore not subject to the notification procedure".[21] The current rules specify the ceiling of EUR 200 000 as the amount of *de minimis* aid that a single company may receive per Member State over any period of three years. In the words of the *de minimis* Regulation, that ceiling is necessary to ensure that "any measure falling under this Regulation can be deemed not to have any effect on trade between Member States and not to distort or threaten to distort competition."[22] However, in order to take account of the small average size of companies active in the road freight transport sector, a ceiling of EUR 100 000 is used. Aid applied in the sectors of primary production of agricultural products, fishery and aquaculture are not covered by the regulation, nor is export aid.[23]

From the above description, it seems that a basic tenet of the EU State aid policy is that a distortion of competition arises when the competitive balance between firms is affected, given that the aid beneficiary receives a financial advantage. This rather strict approach towards establishing the effect on competition is, from the legal side, justified by the fact that Article 107(1) TFEU prohibits State aid which distorts *or threatens to distort* competition (insofar it affects trade between Member States, see further below). The legal hurdle is not very high therefore.

2.2 Economic considerations

From the economic angle, the notion that a distortion of competition arises when the "competitive balance" between firms is affected would seem to accord with intuition, even if the notion of competitive balance probably needs to be made more precise.[24] In general, the competitive

19. Judgment of 29 April 2004, *Greece v Commission*, C-278/00, EU:C:2004:239 paragraphs 69-70 (and the case law cited).
20. Judgment of 30 April 1998, *Vlaamse Gewest v Commission*, T-214/95, EU:T:1998:77, paragraph 46. *See also* judgment of 9 September 2009, *Diputación Foral de* Álava *and Gobierno Vasco v Commission*, T230/01 to T232/01 and T267/01 to T269/01, EU:T:2009:316, paragraph 158.
21. Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union, recital 1, OJ L 352/1, 24.12.2013, pp. 1–8.
22. Commission Regulation (EU) No 1407/2013 of 18 December 2013, recital 3.
23. As will be discussed in the section 3.1, one can question the exact nature of the *de minimis* rule in State aid, as it is neither pro-vided by primary law (the Treaty) nor by the case-law.
24. Cf. D. Neven and V. Verouden (2008), Towards a more refined economic approach in State aid control, in: *EU Competition Law Volume IV: State Aid* (W. Mederer, N. Pesaresi and M. Van Hoof, eds.), Claeys & Casteels, Leuven. For a general description, *see also* R. Nitsche and P. Heidhues (2006), Methods to Analyse the Impact of State aid on Competition, *European Economy* No. 244, February 2006; Office of Fair Trading (2004), Public subsidies; P. Papandropoulos, R. Nitsche, B. van de Walle de Ghelcke, D. Waelbroeck,

balance among firms will be affected by State aid when recipient firms are led to behave in ways which reduce the profit of their competitors or impair their ability to compete. State aid is in turn likely to influence the market behaviour of recipient firms when it changes the costs or benefits associated with taking a particular action.

A prime example of that phenomenon is when a subsidy (to use this "generic" term to include both types of State measures, cash grants and reductions of the charges of a business)[25] lowers the marginal costs of the recipient firm. Reductions in marginal cost increase the profit margin that companies obtain on their products, thereby inciting them to produce more than they otherwise would have done. For instance, the marginal costs of an electricity firm are reduced when it is exempted from paying fuel or energy consumption taxes. It will then want to produce more electricity.

Likewise, State aid can change investment and entry decisions. Whereas without the prospect of aid, a company may not wish to expand its production facilities or its scope of activities because it would not be profitable to do so, a subsidy may tip the balance in favour of making the investment. For instance, a State subsidy may incite the beneficiary to invest in new production capacity, whereas it would otherwise not have done so because the additional benefits would not weigh up against the additional costs.

Exit decisions are a further category of decisions that may be distorted by State aid. If a company finds it unprofitable to continue a specific business line, for instance because it is loss-making in the short or longer run, then a subsidy by the State with the aim of convincing the company to stay active in that line of business obviously has a real impact on the market. Likewise, the decision whether or not to continue production at a particular site may be influenced by the prospect of receiving State aid.

A distinct question is that of appreciability. Even if State aid can be understood to distort competition, when will it do so in a way that has a significant effect? As described above, the case law appears to take a strict line in the sense that, with the possible exception of the *de minimis* measures, any aid amount given to any type of firm is likely to distort competition in the sense of Article 107(1) TFEU.

It is not immediately clear how small amounts of aid or aid to small firms, considered in isolation, can significantly distort the outcome of competition. From this point of view, one could argue – similar to other domains of competition policy such as antitrust or merger control – that "small aid cases" could be largely ignored for enforcement purposes. However, it would appear to us that it is justified to maintain a fairly strict approach towards the concept of distortion of competition in the field of State aid, including in those cases where the individual aid amounts or the firms involved are not so large.

J. Derenne, F. Louis, M. Merola, P. Ibáñez Colomo, J. De Beys and J. Bousin, Selectivity, economic advantage, distortion of competition and effect on trade, in Merola and Derenne (2007, eds.) *Economic Analysis of State Aid Rules – Contributions and Limits*. Lexxion, Berlin, pp. 119-155.

25. *See* the chapter on the concept of "advantage" and the broad concept of "aid" in the first definition given by the case law (in an ECSC case): judgment of 23 February 1961, *De Gezamenlijke Steenkolenmijnen in Limburg*, 30/59, EU:C:1961:2 ("*The concept of aid is nevertheless wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in the strict meaning of the word, are similar in character and have the same effect*" (p. 19)).

First of all, it is important to bear in mind that the wide interpretation of the concept of distortion of competition reflects the fact that State aid, unlike agreements between firms and concentrations, can be presumed distortive because it is an external intervention in the normal operation of the markets.[26] Indeed, the authors of the Spaak report[27] (the report which prepared the ground for the negotiation, drafting and conclusions of the 1957 EEC Treaty) believed it to be essential that the playing field for firms was not distorted by "artificial advantages" enjoyed by competitors.[28]

Economists may rightfully argue that subsidies that correct a market failure (e.g. related to a negative environmental externality) do not bring about a distortion but rather correct a distortion (e.g. overproduction by polluting firms).[29] In other words, an external intervention in a market may not at all be bad for market efficiency, on the contrary. However, it normally entails some degree of assessment before being able to reach the conclusion that a subsidy is detrimental or beneficial for market efficiency. In the absence of more insight into the presence of positive effects, it is appropriate to rely on the basic idea that State aid is *prima facie* distortive, and to subject the measure to a degree of scrutiny to control the potential negative effects (i.e., State aid control by an supranational, and independent, authority such as the Commission, as recommended by the Spaak Report). This logic still explains the exclusive competence entrusted with the Commission for the compatibility assessment of State aid under Article 107(3) TFEU and the prior notification and standstill obligations bearing on Member States under Article 108(3) TFEU, safeguarded by national courts – the distinct but complementary roles of the Commission and the national courts, the two fundamental pillars of State aid control.

Second, unlike in the context of antitrust or merger control,[30] the competition concerns are not primarily related to market power or the exploitation thereof – which leads one to naturally focus on large firms or firms becoming too powerful – but by firms' market positions being artificially kept in place or expanded, compared to what would have happened in the absence of the aid. Even where individual aid amounts and/or the beneficiaries involved are not so large, it is difficult to exclude that a measure will have an impact that is appreciable, even where the firm is not very large. This holds all the more true for the cumulative impact of such measures (either in the form of a scheme or simply as the accumulation of many individual measures).

26. *See* V. Di Bucci (2007), Comments on the paper "Selectivity, economic advantage, distortion of competition and effect on trade, in Merola and Derenne (2007, eds.), p. 159; S. Medgouhl (2016), Distortion of Trade and Competition, in: *EU Competition Law – Volume IV: State Aid* (N. Pesaresi, K. Van de Casteele, L. Flynn and C. Siaterli, eds.), 2016.
27. The Brussels Report on the General Common Market (so-called *Spaak Report*), June 1956, English summary available at http://aei.pitt.edu/995/1/Spaak_report.pdf. Full text in French available at http://aei.pitt.edu/996/1/Spaak_report_french.pdf.
28. Spaak Report, p.57. French original text: "*Une des garanties essentielles qui doivent être données aux entreprises, c'est que le jeu ne risque pas d'être faussé par les avantages artificiels dont bénéficieraient leurs concurrents*."
29. Cf. R. Nitsche and P. Heidhues (2006), Methods to Analyse the Impact of State aid on Competition, *European Economy* No. 244, February 2006.
30. On the distinction between State aid rules and other competition rules (antitrust and merger rules, more and more directed at an effect-based approach relying on economics), *see*, in particular, J.L. Buendia Sierra and B. Smulders (2008), The Limited role of the "Refined Economic Approach" in Achieving the Objective of State Aid Control: Time for some Realism, in *Liber Amicorum in Honour of Francisco Santaolalla Gadea*, Kluwer, pp. 1-26; *see also* Th. Kleiner and A. Alexis (2005), Politique des aides d'État: Une analyse économique plus fine au service de l'intérêt commun, *Concurrences*, No. 4-2005, pp. 45-52.

At the level of product markets, one can distinguish at least three main kinds of distortions of competition induced by State aid.[31]

Firstly, it is well documented in the economic literature that many successful sectors in the economy do not witness productivity growth necessarily because all firms present in the market gain in productivity, but rather because the more efficient and innovative firms grow at the expense of the less well performing firms (e.g. firms that are less efficient or have less appealing products).[32] That process of market entry, expansion and exit is known as the "churn process". State aid, by interfering with the allocation of rents through markets, may inhibit that process and thus have long term dynamic effects. Where it has the effect of maintaining in business firms or groups of firms that otherwise would have lost market share or would have exited the market, State aid acts as a break on other firms' incentives to invest and compete, resulting in distortions across the economy and a reduction in long term productivity growth.

Secondly, at a more specific level, one can expect that the change of behaviour of the aid recipient in the product markets will affect competitors and will trigger different adjustments in their behaviour. In particular, competitors might react by reducing their own sales and investment plans (crowding out effect). For instance, competitors might reduce capacity or potential entrants may decide not to enter in a new market. However, competitors will react to a different degree depending on market circumstances and aid characteristics: if competitors sell products that are close substitutes for those sold by the aid recipient, they will be more affected and one can thus expect that the magnitude of their adjustment will be greater.

Thirdly, State aid may affect competition in the input markets and, in particular, the location of investment. Certain aid may result in lower costs for inputs (e.g. aid for training or to compensate high energy costs) and/or changes in the choice of inputs (e.g. firms switching to equipment with lower energy consumption). While such aid may benefit consumers, the beneficiary and the input market participants involved (who will see demand for their products and services grow), it may harm the suppliers of competing inputs. As in the case of product markets, the overall effect on input markets may be negative if it discourages competitors' investment to a significant enough degree. Alternatively, such aid may also indirectly affect other sectors which use the same inputs. Consider, for instance, aid which would subsidize the cost of electricity for certain energy intensive sectors. While this would help these specific sectors, it would also lead to increased demand for electricity and thereby to higher electricity prices. This would in turn negatively affect users of electricity active in other sectors.[33] Likewise,

31. *See* e.g. H.W. Friederiszick, L.-H. Röller and V. Verouden (2007), European State aid Control: an economic framework, in *Handbook of Antitrust Economics*, (P Buccirossi, ed.), MIT Press; Commission's Draft Communication 'Common principles for an economic assessment of the compatibility of State aid under Article 87.3 EC' (2009), paragraph 49 (available at http://ec.europa.eu/competition/consultations/2009_common_principles/index_en.html). One could argue that State aid may also lead to increased market power where it strengthens the position of a very strong (dominant) incumbent. This concern appears not very frequent however in State aid cases.

32. *See* e.g. Economic Advisory Group on Competition Policy (EAGCP; B. Lyons, J. Van Reenen, F. Verboven, X. Vives), Commentary on EU Rescue and Restructuring Aid Guidelines (2008). For further references, *see* Verouden and Werner (2017) in this volume.

33. For a broader discussion about these effects and the trade-offs involved, notably in the context of aid to compensate firms in certain energy intensive sectors for the consequences of the EU Emissions Trading Scheme (ETS), *see also* Struckmann and Sapi (2017), in Chapter 18 of this volume.

large scale support to financial public broadcasters may lead to price inflationary effects in the markets for TV-content (e.g. sports, films), which in turn may have knock-on implications in other markets.[34]

The main (or most visible) distortion in the input markets probably arises with respect to the investor's choice of a particular location (which can be viewed as a bundle of inputs consisting of local supply networks, labour markets and capital markets). Aid to attract investment may have a negative impact in the region where the investment has been withdrawn. Apart from distributional concerns (concentration of activity in one area at the expense of other areas), it may lead to a waste of resources, if the latter region has a comparative advantage for this specific type of production.

All these distortions of competition will affect the distribution of economic activities among sectors and among Member States and have detrimental impact on the internal market, by affecting trade and disturbing the efficient allocation of activities across national borders. In fact, the very possibility of State aid in one Member State being authorised may create incentives for other Member States to also make use of State aid measures in order to strategically attract activity to their territories, thereby prompting the risk of a subsidy race (this is why "compatible aid" still results in "distortions of competition", although approved by the Commission following the overall balance of interest of the compatibility assessment in the Union's interest).

Indeed, while in its origin, the notion of "competition" in Article 107 TFEU relates to competition among firms, it can also be understood as relating to competition between Member States.[35] It is interesting to note in this regard that already in 1956, the authors of the Spaak Report saw State aid control not only as an integral part of EU competition policy, but also as a natural companion to the rules governing the internal market, as a means to ensure that the location of economic activity within the Union would not be artificially (and unduly) altered by the use of State aid. Specifically, the Spaak Report set out that "the general principle is that aid, no matter in what form it is granted, is incompatible with the common market if it distorts competition *and the distribution of economic activity* in the market by favouring certain enterprises or certain types of production" (emphasis added).[36] In more recent times, the

34. Examples of "distortions between sectors" in the case law can be found in recent cases which raised specific issues of selectivity. In examining that condition, the Court considered the element of distortion not in relation to the companies belonging to the same sector concerned by the aid measure but in relation to a differentiated treatment between sectors, even if these were not in direct competition with each other. *See* e.g. judgment of 30 June 2016, C-270/15 P, *Kingdom of Belgium v Commission*, EU:C:2016:489 (where the situation of operators in the bovine sector was compared to that of all the companies which, like them, are subject to inspections which they are required to perform before placing their products on the market); *see also* Commission Decision of 21 January 2016 in SA.25338 – *the Netherlands – Corporate tax exemption for public undertakings.*

35. For similar views, J.L. Buendia Sierra (2015), EU State aid control: Competition between Undertakings or between Member States?, Input Statement to the workshop "An Enquiry into the Forces Shaping Subsidy & State Aid Laws" University of Birmingham, 18 & 19 May 2015; A. Biondi (2013), State aid is falling down, falling down: An analysis of the case law on the notion of aid, 50 *Common Market Law Review*, Issue 6, pp. 1719–1743.

36. Spaak Report, p. 57. French original text: "*La règle générale est que sont incompatibles avec le marché commun les aides* […] *qui faussent la concurrence et la répartition des activités en favorisant certaines entreprises ou certaines productions*".

concern that (richer) Member States would be able to attract too much economic activity at the expense of other (poorer) Member States, has been labelled "deep pocket distortions".[37] In a sense, therefore, the EU State aid rules are placed between the internal market rules addressed to the Member States and antitrust rules addressed to companies. They are also competition rules, albeit addressed to the Member States.[38]

3. EFFECT ON TRADE BETWEEN MEMBER STATES

3.1 Legal treatment

Public support to undertakings only constitutes State aid under Article 107(1) TFEU insofar as it "affects trade between Member States". As with the distortion of competition element, however, the effect on trade element in Article 107(1) has typically been applied in a rather broad manner. It is not necessary to establish that the aid has an *actual* effect on trade between Member States but only whether the aid is liable to affect such trade.[39] Indeed, where State aid strengthens the position of a company as compared with other companies active in intra-Union trade, the latter must be regarded as being affected by the aid.[40] Public support can also be considered capable of having an effect on trade between Member States even if the recipient is not directly involved in cross-border trade. For instance, the subsidy may make it more difficult for operators in other Member States to enter the market (through direct supply or via establishment), by maintaining or increasing local supply.[41]

Over the years, the European courts have considered the approach towards the effect on trade criterion in many cases. A lot of insight can be gained from the well-known *Altmark* case.[42] This preliminary ruling not only dealt with the State aid assessment of SGEI compensation, but also expressed clear indications on the effect on trade criterion under Article 107(1) TFEU.

The main proceedings concerned the grant, in 1996, by the Regierungspräsidium (regional government) of Magdeburg of a new license to Altmark Trans GmbH, the long-standing operator of scheduled bus transport services in the region of Stendal. The Regierungspräsidium at the same time rejected the application by a competitor, Nahverkehrsgesellschaft, for licences to operate those services on the grounds that Altmark Trans was the incumbent operator and that with a shortfall of only DM 0.58 per timetabled kilometre, it required the lowest additional financing from the public authorities. Nahverkehrsgesellschaft brought a complaint against the decision of the Regierungspräsidium. Ultimately, the Higher Administrative Court of Saxony-Anhalt (Germany) allowed Nahverkehrsgesellschaft's application and therefore set

37. J. Almunia "Doing more with less – State aid reform in times of austerity: Supporting growth amid fiscal constraints", speech given at King's College, London, 11 January 2013.
38. Buendia Sierra (2015), *supra* note 35 above.
39. Judgment of 14 January 2015, Eventech, C-518/13, ECLI:EU:C:2015:9, paragraph 65; Judgment of 8 May 2013, *Libert and others*, Joined Cases C-197/11 and C-203/11, ECLI:EU:C:2013:288, paragraph 76; Notion of Aid Communication, paragraph 190.
40. Notion of Aid Communication, paragraph 190. *See also* judgment in *Friulia Venezia Giulia*, T-288/97, cited above, paragraph 41.
41. Notion of Aid Communication, paragraph 191.
42. Judgment of 24 July 2003, *Altmark Trans*, C-280/00, EU:C:2003:415.

aside the issue of licences to Altmark Trans. It considered in particular that at the time when the decision was taken the financial solvency of Altmark Trans was no longer guaranteed, as it needed subsidies from the Landkreis of Stendal for operating the services licensed. It further held that those subsidies constituted State aid. Altmark Trans appealed this judgment to the Bundesverwaltungsgericht (Federal Administrative Court). Since it considered that, in the case before it, the extent of the EU law rules was uncertain, the Bundesverwaltungsgericht asked the following central question: "Are subsidies to compensate for deficits in local public transport subject at all to the prohibition on aid contained in Article [107(1) TFEU] or are they incapable from the outset of affecting trade between Member States on account of their regional significance? Does this possibly depend on the specific location and significance of the relevant local transport area?"

The Court of Justice held the following:

> *"77.* [...] *it must be observed, first, that it is not impossible that a public subsidy granted to an undertaking which provides only local or regional transport services and does not provide any transport services outside its State of origin may none the less have an effect on trade between Member States.*
>
> *78. Where a Member State grants a public subsidy to an undertaking, the supply of transport services by that undertaking may for that reason be maintained or increased with the result that undertakings established in other Member States have less chance of providing their transport services in the market in that Member State.* [...]
>
> *81. Finally, according to the Court's case-law, there is no threshold or percentage below which it may be considered that trade between Member States is not affected. The relatively small amount of aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that trade between Member States might be affected.* [...]
>
> *82. The second condition for the application of Article* [107(1) TFEU]*, namely that the aid must be capable of affecting trade between Member States, does not therefore depend on the local or regional character of the transport services supplied or on the scale of the field of activity concerned."*

A similar message comes from the recent *London black cabs* case, in relation to certain road regulations favouring London taxis (Black Cabs).[43] In London, both London taxis and private hire vehicles (minicabs) carry passengers on a commercial basis. Only Black Cabs are permitted, however, to "ply for hire" (i.e. solicit or wait for passengers without any pre-booking). In contrast, minicabs can only pick up people who have pre-booked their services. Across London, Black Cabs are permitted to use bus lanes, whereas minicabs are not. Eventech, an operator of minicabs in London appealed against two penalty charge notices issued by the relevant public authority (Transport for London, or "TfL") due to the fact that two drivers of its minicabs had used a bus lane in central London. Eventech challenged those notices, claiming inter alia that

43. Judgment of 14 January 2015, *Eventech*, C-518/13, EU:C:2015:9.

the bus lanes policy constitutes State aid to the operators of Black Cabs, which is contrary to EU law. The Court of Appeal, before which an appeal was brought, referred to the Court of Justice questions for a preliminary ruling.

In its judgment, the Court declared that the practice of permitting Black Cabs to use bus lanes, while prohibiting minicabs from doing so, did not appear to be such as to involve a commitment of State resources, not did it seem to provide any selective advantage, given that because of their legal status, London taxis would be in a factual and legal situation distinct from that of minicabs.[44] The case also featured the question of effect on trade. According to the defendants (TfL), the bus lane policy would not be liable to affect trade between Member States, since it was a local measure, applying solely to London. Interestingly, the EFTA Surveillance Authority, too, had suggested that the Court should "reconsider its approach to the requirement of an effect on inter-State trade as that requirement is interpreted so broadly that hardly any measures escape it".[45] According to the Authority, the decisive point should be whether undertakings established in other Member States have less chance of providing their services in the market in the Member State where the advantage is conferred.

The Court recalled that, in accordance with settled case-law, when aid granted by a Member State strengthens the position of an undertaking compared with other undertakings competing in intra-EU trade, the latter must be regarded as affected by that aid,[46] and that the condition that the aid must be capable of affecting trade between Member States does not depend on the local or regional character of the transport services supplied or on the scale of the field of activity concerned.[47] In the case at hand, it took the view that it is conceivable[48] that the effect of the bus lanes policy is to render less attractive the provision of minicab services in London, with the result that the opportunities for undertakings established in other Member States to penetrate that market are thereby reduced. This, however, would be for the referring court to determine, a standard way of proceeding in preliminary rulings.

The two above judgments (and many others) show that, even in small cases or regionally confined contexts, an effect on trade cannot be excluded. State aid is liable to affect trade whenever an advantage is conferred on the recipient, maintaining or increasing its market position. Such aid may have an effect on trade where companies from other Member States could provide such services (either directly, or through the right of establishment).

From this observation, one can question the exact nature of the de minimis rule in State aid. It is neither provided by primary law (the Treaty) nor by the case-law (which nevertheless

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44. The drivers of Black Cabs are subject to strict standards in relation to their vehicles, their fares and their knowledge of London, whereas those standards do not apply to minicabs. Notably, they are subject to the rule of "compellability", they must be recognisable and capable of conveying persons in wheelchairs, and their drivers must set the fares for their services by means of a taxi meter and have a particularly thorough knowledge of the city of London.
45. *See* the opinion of Advocate-General Wahl delivered on 24 September 2014 before judgment in *Eventech*, paragraph 86.
46. At paragraph 65 of the judgment (and case-law cited).
47. At paragraph 69 of the judgment (with reference to the *Altmark* judgment, paragraph 82).
48. This notion of "conceivable character" is often referred to by the case-law. In *Altmark*, the Court said that it was "not impossible" that (the trade between Member States be affected; in *Heiser*, the Court ruled it was "*not inconceivable* […] *that medical practitioners specialising in dentistry, such as Mr Heiser, might be in competition with their colleagues established in another Member State* [an effect on trade …] *must be considered to be fulfilled*" (judgment of 3 March 2005, *Wolfgang Heiser*, C-172/03, EU:C:2005:130, paragraph 35).

refers to the *de minimis* Regulation where appropriate). The terms of the *de minimis* Regulation, stating in substance that *de minimis* aid does not show all the elements of aid could be regarded as surprising when compared to the strong statements of the Court in particular with respect to the condition by which an aid must be capable of affecting trade between Member States: "[…] [this condition] *does not depend on the local or regional character of the services supplied or on the scale of the field of activity concerned* […]. *There is no thresh-old or percentage below which it may be considered that trade between Member States is not affected. The relatively small amount of the aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that trade between Member States might be affected* […]."[49]

3.2 The Commission's change in emphasis

Over the years, the Commission has tried to put limits to the scope of the "effect on trade" requirement. In a limited number of cases it has considered that, due to their specific circumstances, certain activities had a purely local impact and consequently had no effect on trade between Member States. Common features of such decisions are that the beneficiary supplied goods or services to a limited area within a Member State and was unlikely to attract customers from other Member States, and that it could be foreseen that the measure would have not more than a "marginal effect" on the conditions of cross-border investments or establishment.[50] Some of the early examples related to swimming pools and other leisure facilities intended predominantly for a local catchment area;[51] museums or other cultural infrastructure unlikely to attract visitors from other Member States;[52] hospitals and other health care facilities aimed at a local population;[53] news media and/or cultural products which, for linguistic and geographical reasons, have a locally restricted audience;[54] and conference centres, where the location and the potential effect of the aid on prices is unlikely to divert users from other centres in other Member States.[55]

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49. Referring to cases such as *Altmark Trans and Heiser* (both cited above), the judgment of 21 July 2005, *Xunta de Galicia*, C-71/04, EU:C:2005:493, paragraphs 41 to 44, contains, among others, a concentrated amount of features which could lead one to believe that a "*de minimis* aid" is not conceivable. One can wonder to what extent the *de minimis* Regulation complies with that case law (and its validity could be put into question one day by virtue of an exception of illegality) if it means that a State measure covered by that Regulation does not constitute aid (and is not merely an aid measure dispensed from the notification obligation). It is, however, constant that the Court itself has never raised this objection and even refers to the existence of *de minimis* Regulation (e.g. whilst ruling that in the circumstances of a case, it cannot be excluded that the measure in question will exceed the Regulation's *de minimis* threshold (such as in *Heiser*, paragraph 32)).
50. Notion of Aid Communication, paragraph 196.
51. Decision of 12 January 2001 , N 258/2000 *Leisure Pool Dorsten*.
52. Decision of 18 February 2004, N 630/2003 *Local Museums Sardinia* and Decision of 7 November 2012, SA.34466 *Cyprus – Center for Visual Arts and Research*.
53. Decision of 27 February 2002, N 543/2001 *Ireland – Capital allowances for hospitals* or Decision of 7 November 2012, SA.34576 *Portugal – Jean Piaget North-east Continuing Care Unit*.
54. Decision of 27 June 2007, N 257/2007 *Subsidies for theatre productions in the Basque country,* OJ C 173, 26.07.2007, p. 1; Decision of 14 December 2004, N 458/2004 *Editorial Andaluza Holding;* SA.33243 *Jornal de Madeira*.
55. Decision of 21 January 2003, N 486/2002 *Sweden – Congress hall in Visby.*

Separately, the Commission also explored possibilities such as the "Significant Impact Test" and its main constituents, the "Limited Amount of State Aid" test (LASA) and the "Limited Effect on Trade" test (LET). These initiatives did not relate to the existence of aid, however, but were made with respect to the compatibility assessment of aid measures of relatively minor importance.[56]

In April 2015, the Commission took the bolder step to adopt a package of seven decisions declaring measures granting public support as not involving State aid within Article 107(1) TFEU, because of no effect on trade. The decisions concerned the Czech Republic, Germany, the Netherlands and the UK. The Commission also referred in this context to its wider objective to "further reduce the administrative burden for public authorities and companies, and focus the Commission's resources on enforcing State aid rules in cases with the biggest impact on the Single Market", in line with the Commission's State Aid Modernisation (SAM) initiative. Interestingly, while the press release highlighted that the measures were "unlikely to have a significant effect on trade",[57] the Commission in its decisions remained within the strict legal confines of the "no effect on trade" doctrine. It translated the doctrine, however as implying that (i) the beneficiary supplies goods or services to a limited area within a Member State and is unlikely to attract customers from other Member States and that (ii) the measure should have no – or at most marginal – foreseeable effects on cross-border investments in the sector or the establishment of firms within the EU. In doing so, it allows itself some more flexibility than what appears, *prima facie*, allowed under the strict case law of the Courts.[58]

In May 2016, the Commission codified its (new) practice in relation to the effect on trade in its Communication on the notion of aid.[59] Apart from the general orientations on the effect on trade (no effect on trade in case of a predominantly local catchment area as well as evidence that cross-border investment is unlikely to be affected more than marginally), it also included specific indications on the effect on trade in relation to the public funding of infrastructure.[60] The Notion of Aid Communication specifies that an effect on trade between Member States or a distortion of competition (again, the two conditions are inextricably linked and considered together) is normally excluded as regards the construction of the infrastructure in cases where at the same time (i) an infrastructure typically faces no direct competition,[61]

56. *See also* P. Lowe (2003), State Aid: The Commission's Plans for Reform, speech given for the British Chamber of Commerce, Brussels, 1 December 2003. Arguably, these initiatives ultimately found their (partial) implementation in the adoption of the Global Block Exemption Regulation (GBER) in 2008 and its extension in 2014.

57. Press release, "State Aid: Commission gives guidance on local public support measures that can be granted without prior Commission approval" (Brussels, 29 April 2015). On 21 September 2016, the Commission adopted a further set of Decisions in which it deemed that public measures for purely local operations in Spain, Germany and Portugal involved no State aid because they were unlikely to affect trade between Member States (Press release "State aid: Commission gives guidance on local public support measures that do not constitute state aid" (Brussels, 21 September 2016)).

58. For similar views, *see also* C. Dekker (2015), *Staatssteun en tussenstaatse handel: bijbuigen van een criterium om de werklast te verminderen?*, Markt & Mededinging, Aflevering 5 2015.

59. Notion of Aid Communication, Section 6.3 as well as Section 7.2.2 (for the public funding of infrastructure).

60. Notion of Aid Communication, Section 7.2.2.

61. The Commission notes that certain infrastructures, such as comprehensive network infrastructures, are natural monopolies, not facing direct competition from other infrastructures (of the same kind or offering services with a significant degree of substitutability).

(ii) private financing is insignificant in the sector and Member State concerned and (iii) the infrastructure is not designed to selectively favour a specific undertaking or sector but provides benefits for society at large.

It is worth considering one of these cases in more detail to assess the implications. In the case of *Lauwersoog port*,[62] the Commission assessed an investment aid given by the province of Groningen to the port of Lauwersoog. The investment entailed an extension of the quay for fishing boats and a better separation between the fishing harbour and the yacht harbour (marina). The aid covered 80% of the investment cost of about EUR 4.2 million. In this assessment, the Commission focused on services offered by the port of Lauwersoog and came to the conclusion that competition on this market had a purely local character. As regards the fishing harbour, the Commission observed that that port is typically used by vessels fishing for shrimps and that these vessels tend to rely mostly on Lauwersoog port as this port is located closest to the fishing grounds. The share of foreign vessels using the harbour was less than 5%. Furthermore, the Commission observed that the harbour did not lead to a significant capacity expansion, but rather to a more efficient functioning of the harbour (reduced waiting times). In relation to the marina, the Commission indicated that it had only few spaces for yachts available and that the percentage of foreign users was again low, less than 5%.

While it is in principle defendable that the Commission takes the view that subsidies with a purely local character should escape the qualification of State aid under Article 107(1), a couple of comments can be made in relation to the Commission decision in *Lauwersoog port*. First, the Commission analysis focuses entirely on the services offered by the port and the near absence of cross-border competition within this market. The decision remains relatively silent on the possible impact on the downstream market for shrimps. Presumably, there is significant cross-border competition and trade in this market. It is true that the decision notes that vessels will pay the "market price" for the port services (based on a benchmarking with prices paid in other ports) and that total capacity in the port will not be expanded. It remains unclear, however, how reliably this market price has been established. From the decision, it seems not excluded that the vessels will be able to enjoy a more efficient infrastructure at a price that may well be unlikely to cover the cost of construction (given that 80% of the cost is subsidised). To exclude effect on trade, one could argue that the Commission decision should have considered the downstream market for shrimps in more detail.

The second reservation one could have against this decision is that the Commission considers the investment on a stand-alone basis. The decision necessarily only addresses the project notified. Looked upon in isolation, one may indeed argue that the aid has a very limited cross-border impact (leaving aside the potential impact on the market for shrimps). However, the cumulative effect of similar initiatives by other ports (in the Netherlands or abroad), possibly even in reaction to the aid given to Lauwersoog port, remains unaddressed.

This observation brings us to a broader point. Negative effects can be analysed from two different perspectives. First, one can look at an *individual subsidy* (and its effect) in isolation. It entails assessing the extent to which the specific subsidy engenders a negative effect. Second, one can look at the *equilibrium effect* (taking into account that subsidy policy will also be determined by the expectations of subsidy policy in other Member States). When relying on

62. Decision of 29 April 2015, SA.39403, *Netherlands – Investment aid for Lauwersoog port*.

a "no effect on trade" argument in one individual case, it is necessary to take into account the extent to which this policy approach may (implicitly or explicitly) allow similar investments to be subsidised in other locations, which cumulatively will lead to an effect on trade.[63] This perspective further brings into the picture that a support measure taken by one Member State may provoke a subsidy race between Member States. Authorising measures in isolation is in itself appropriate, but there needs to be an awareness of these wider effects.

4. MARKET DEFINITION VS. THE DUTY TO MOTIVATE

We have already seen in the landmark judgment *Philip Morris* of 1980 that the Court did not deem it necessary to define the "relevant market" when it comes to establishing the existence of a distortion of competition and an effect on trade.[64] Rather, it applied the strong (legal) presumption that competition is distorted (or threatened to be distorted) and trade (potentially) affected whenever when the State grants a financial advantage to a company which is active in a liberalised sector where there is, or could be, competition.

Still, there is a minimum standard of reasoning the Commission must apply.[65] Even in cases where the very circumstances in which the aid has been granted show that it is liable to distort competition and affect trade, the Commission must at least set out those circumstances in its decision.[66] For instance, in the case *Leeuwarder Papierwarenfabriek* the Court annulled the Commission's decision since "[…] *the contested decision does not contain the slightest information concerning the situation of the relevant market, the place of Leeuwarder in that market, the pattern of trade between Member States in the products in question or the undertaking's exports*."[67] In *Le Levant*[68] the General Court held that "*regarding the condition relating to distortion or threat of distortion of competition, it is clear* […] *that there is nothing in the contested decision explaining how and on what market competition is affected or likely to be affected by the aid*". Likewise, in *WAM,*[69] the Commission had failed to state any reasons as to the potential existence of the

63. See by analogy the case law of the Court regarding cumulative effect in antitrust cases, in particular judgment of 28 February 1991, *Stergios Delimitis v Henninger Bräu AG, C-237/89,* ECLI:EU:C:1991:91 in which the Court held that "*the cumulative effect of several similar agreements constitutes one factor amongst others in ascertaining whether, by way of a possible alteration of competition, trade between Member States is capable of being affected*" (paragraph 14).
64. Judgment in *Philip Morris Holland*, paragraphs 9 to 12; judgment in *Alzetta*, paragraph 95; judgment in *Holland Malt*, paragraphs 59, 63-64.
65. S. Medgouhl, "Distortion of Trade and Competition" in: EU Competition Law – Volume IV: State Aid (N. Pesaresi, K. Van de Casteele, L. Flynn and C. Siaterli, eds.), 2016.
66. Judgment in *Holland Malt*, paragraph 59.
67. Judgment of 13 March 1985, *Netherlands and Leeuwarder Papierwarenfabriek v Commission*, 296 and 318/82, EU:C:1985:113, paragraph 24. *See also* judgment of 19 October 2000, *Italy and Sardegna Lines v Commission*, C-15/98 and C-105/99, EU:C:2000:570, paragraphs 64-69.
68. Judgment of 22 February 2006, *Le Levant 001 and others v Commission*, T-34/02, EU:T:2006:59, paragraph 123.
69. Judgment of 6 September 2006, *Italy and Wam v Commission*, T-304/04 and T-316/04, EU:T:2006:239, paragraph 69 (appeal rejected: judgment of 30 April 2009, *Commission v Italy and Wam*, C-494/06 P, EU:C:2009:272 – *see also* judgment of 7 November 2013, *Wam v Commission,* C-560/12 P, EU:C:2013:726 (on appeal of T-303/10).

effect of the relevant measure on competition and trade between Member States. From the earlier and subsequent case law, it is apparent that the Commission is not obliged to do much more than to state reasons. As indicated in Section 2.1 above, it certainly does not need to show that the distortion is either actual or appreciable.

In a similar vein, in the case of aid schemes, the Commission may confine itself to examining the characteristics of the scheme in question in order to determine, in the grounds of its decision, whether, by reason of the terms of that scheme, it is likely to benefit in particular companies engaged in trade between Member States.[70]

A separate question is how one should define markets in the field of State aid control if one had to. The Commission has in a number of texts outlined the basic principles to be applied in the definition of the relevant market. Indeed, the well-known Commission Notice of 1997 on the definition of the relevant market[71] (the "Market Definition Notice") – in principle, also applicable to State aid cases – defines "relevant product markets" as all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use. Relevant geographic markets are defined as comprising the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those area.[72]

It is important to note, however, that the Market Definition Notice also specifies that the "*focus of assessment in State aid cases is the* ***aid recipient and the industry/sector concerned*** *rather than identification of competitive constraints faced by the aid recipient*" (emphasis added). It furthermore appears to confine the use of the various methods outlined in the Notice to those particular cases where considerations of *market power* are raised.[73]

In view of the differences in perspective which exist between State aid control, on the one hand, and merger control and antitrust policy, on the other (cf. Section 2 above), this nuance appears correct. The central concept set out in the Notice to define markets is that of substitutability. In antitrust and merger control, it is common to assess the relevant market on the basis of the so-called "small but significant and non-transitory increase in price" ("SSNIP") test, where it is examined whether the customers would switch to other products or other suppliers in response to a hypothetical small (in the range 5% to 10%) but permanent relative price increase in the products and areas being considered. If substitution were enough to make the price increase unprofitable because of the resulting loss of sales, additional substitutes and areas are included in the relevant market. This would be done until the set of products and geographical areas is such that small, permanent increases in relative prices would be profitable.[74]

The emphasis on what customers (for demand substitution) and firms (for supply substitution) would do in the event of a price increase makes perfect sense in view of the central concern of anti-trust and merger control, which is concerned with *market power* (more

70. Judgment of 11 June 2009, *ACEA v Commission*, T-297/02, EU:T:2009:189, paragraphs 83-86, 96.
71. Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, pp. 5–13.
72. Market Definition Notice, paragraphs 7 and 8.
73. Market Definition Notice, footnote 1.
74. *See* Market Definition Notice, paragraph 17.

precisely, increases in market power stemming from anti-competitive agreements, concerted practices or obtained through merger) negatively affecting consumers. For this reason, the SSNIP test is framed in terms of hypothetical price increases. By contrast, when considering the distortion of competition and the effects on trade, the emphasis in State aid control – at least in the context of Article 107(1) – is foremost on the direct negative effect that the aid may have on *competitors* of the beneficiary. This perspective requires a more supply-side oriented notion of the definition of the relevant market than may be appropriate in the context of merger control or antitrust. State aid, at least in a short term perspective, typically has the effect of *lowering* prices.[75] It is only after competitors have suffered deterioration in their ability and incentive to compete that consumers/customers *may* be exposed to price rises and other manifestations of market power.[76] Market power may not even be the only concern in State aid cases, indeed it rarely is. More important are the dynamic effects of State aid on innovation and the productive efficiency of markets (e.g. the extent to which markets reduce cost levels over time by "filtering out" inefficient and non-innovative firms).[77]

These considerations mandate a broader, more supply-side oriented perspective towards market definition. As observed by other commentators, measuring the impact of State aid on too narrow a geographic market based only on local demand-side considerations (e.g. national markets) could easily lead one to conclude that competitors would be damaged (to the level of being foreclosed from the market) and competition threatened when firms actually compete over a broader area, e.g. in a series of national antitrust markets.[78] The Commission effectively appears to emphasise supply-side considerations in those State aid decisions where it has defined markets. For instance, in several regional aid cases (which were, admittedly, not on the existence of aid under Article 107(1) but rather about the compatibility of aid), the Commission has indicated that from a customer perspective (i.e. demand perspective), differences in prices and taxation systems should still be considered limiting factors and that penetration rates of major competitors differ across Member States and continents. However, it went on to say that "*for the purpose of State aid decisions on aid to production facilities, which assess the effects of aid on distortions of competition between manufacturers and on trade between Member States, the manufacturing aspects* [i.e. supply side aspects] *are decisive*."[79]

75. Cf. R. Nitsche and P. Heidhues (2006), Methods to Analyse the Impact of State Aid on Competition, *European Economy*, No. 244, February 2006.
76. This concern is akin to the concern of "customer foreclosure" in the context of antitrust or merger control. For instance, the Commission's Non-Horizontal Merger Guidelines set out that the "*negative impact on consumers may take some time to materialise when the primary impact of customer foreclosure is on the revenue streams of upstream rivals, reducing their incentives to make investments in cost reduction, product quality or in other competitive dimensions so as to remain competitive*." (Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C 265, 18.10.2008, pp. 6–25, paragraph 73). In a similar manner to mergers leading to customer foreclosure, State aid which lowers the costs of the beneficiary affects other firms by negatively affecting their ability to sell to customers.
77. *See* e.g. Economic Advisory Group on Competition Policy (EAGCP; B. Lyons, J. Van Reenen, F. Verboven, X. Vives), Commentary on EU Rescue and Restructuring Aid Guidelines (2008).
78. Cf. J. Langenfeld and Ch. Alexander (2013), State Aid and Supply-Side Geographic Market Definition, *EStAL* 2|2013, p. 367.
79. Commission Decision of 13 July 2009, N 671/2008 – Hungary – LIP – Aid to Mercedes-Benz Manufacturing Hungary Korlátolt Felelősségű Társaság, at paragraph 90. *See also* Commission Decision of 2 December

Interestingly, precisely in the context of regional aid cases, one may wonder whether market definition, in its traditional sense, is not orthogonal (i.e. unrelated) to the main potential negative effects of aid as such. After all, especially in those cases where the aid does not change the decision of firms *whether* to invest, but rather *where* to invest, the impact of the aid on product market competition strictly so defined should be rather limited. Indeed, the Commission recognises this point in its 2014 Regional Aid Guidelines: "*If the counterfactual analysis suggests that without the aid the investment would have gone ahead in another location (scenario 2) which belongs to the same geographical market considering the product concerned, and if the aid is proportional, possible outcomes in terms of overcapacity or substantial market power would in principle be the same regardless of the aid*".[80] In the context of regional aid affecting location choices, the impact is not on competition between firms, but on competition between regions. Where one area attracts an investment due to the aid, another area loses out on that opportunity.[81] The Commission appears particularly concerned with such effects, especially where the investment would have been located in a region no less disadvantaged than the target region in question (because it would run counter to the very rationale of regional aid).[82] It is also for this reason that the Commission has dropped the market share criterion which, under the previous Regional Aid Guidelines (for the period 2007-2013), determined whether or not certain aid cases would be subject to the in-depth investigation (as to the precise effects of the measure). Under the current Regional Aid Guidelines (for 2014-2020), *all* notified cases are subject to such scrutiny.[83]

In a different context, it is worth mentioning that questions of market definition (and the related argumentation) have also come up in contexts of "selectivity".[84] For instance, in *British Aggregates III*, when assessing whether the measure (a levy) had a differential impact on producers in a comparable legal and factual situation, the General Court referred to "*a potential link in terms of competition or substitutability*" and that "*demand may be steered away from the taxed to the non-taxed products*".[85] Likewise, in his Opinion in *Eventech,*[86] Advocate-General Wahl indicated that in order to assess whether Transport for London' bus lane policy might

2009, N 674/2008 – Slovakia – LIP – Volkswagen Slovakia, at paragraph 66.

80. Guidelines on Regional State Aid for 2014-2020, OJ C 209, 23.7.2013, pp. 1–45 ("Regional Aid Guidelines"), at paragraph 139.
81. These negative effects in the areas adversely affected by aid may be felt through lost economic activity and lost jobs including those at the level of subcontractors. It may also be felt in a loss of positive externalities (for example, clustering effect, knowledge spill-overs, education and training, etc.).
82. Regional Aid Guidelines, paragraph 121.
83. For more details, *see* K.-O. Junginger-Dittel (2014), New Rules for the Assessment of Notifiable Regional Aid to (Large) Investment Projects under the Regional Aid Guidelines 2014-2020, *European State Aid Law Quarterly*, 13(4), 677-688; Merola and Friederiszick (2017), Regional Aid, in Chapter 10 of this volume.
84. Cf. M. Honoré (2017), Selectivity, in Chapter 4 of this volume; G. Lo Schiavo (2013), The General Court Reassesses the British Aggregates Levy: Selective Advantages "Permeated" by an Exercise on the Actual Effects of Competition, *European State Aid Law Quarterly*, 2013(2), pp. 382-391; M. Lang (2012), State Aid and Taxation: Recent Trends in the Case Law of the CJEU, *European State Aid Law Quarterly*, 2012(2), pp. 411-421, p. 420; P. Nicolaides and I. Rusu (2012), The Concept of Selectivity: An Ever Wider Scope, *European State Aid Law Quarterly*, 2012(4), pp. 791-803.
85. Judgment of 7 March 2012, *British Aggregates Association v Commission,* T-210/02 *RENV*, EU:T:2012:110, paragraphs 72 and 78.
86. Opinion of Advocate-General Wahl delivered on 24 September 2014 before judgment of 14 January 2015 in *Eventech*, cited above, EU:C:2014:2239.

give rise to selective treatment, "*one way of determining this*" is to assess whether "*private hire vehicles and black cabs may be substituted for each other. This, in turn, requires establishing on which relevant market(s) a comparison is to be based.*"

Finally, references on the competitive effects of State aid can also be found in the case-law on the notion of "interested parties", which may submit comments to the Commission under Article 108(2) TFEU. In this context, interested party means "*any Member State and any person, undertaking or association of undertakings whose interests might be affected by the granting of aid, in particular the beneficiary of the aid, competing undertakings and trade associations*".[87] In order to be considered a "competing undertaking", it must be demonstrated that the "competitive position" in the market is "affected" by the grant of the aid. The case law of the Union courts provides various indications to understand when such effect is considered sufficient.[88]

5. CONCLUDING REMARKS

The definition of State aid is an "objective" notion, in the sense that the Commission (just as the national courts, with which it shares the same competence) has no discretion in this regard and where its substantive assessment is subject to *full* judicial review by the EU courts. It contains legal presumptions as to the existence of a distortion of competition and an effect on trade between Member States, provided there is an advantage granted to an enterprise active on the market, thereby necessarily reinforcing its position on the market. The State measure is in that case to be qualified as aid (if the other cumulative conditions – selectivity and transfer of State resources imputable to the State – are met as well).

Although State aid is defined by its effects, not its form, it does not depend on an economic effect-based analysis as in antitrust or merger control. To explain the absence of any such economic effects-based approach to define State aid, it is necessary to return to the roots of the EU project: the 1956 Spaak Report and the stated need to introduce State aid control as a complement to EU market integration. The purpose of State aid control is to limit the negative effects of competition between Member States in terms of giving aid, as much as the negative effects of such aid on competition between enterprises (that dimension is typically closely linked). This also explains the exclusive competence granted to the Commission, a supranational, independent authority, helped by the powers of national courts, to perform the (discretionary) compatibility assessment of aid, subject to EU judicial review.

It emerges from the above discussion that the case law appears to take a strict line in the sense that, with the possible exception of the *de minimis* measures, even small aid amounts given to any type of firm are likely to distort competition and affect trade in the sense of Article

87. Definition provided in Article 1 (h) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (Text with EEA relevance), OJ L 248, 24.9.2015, pp. 9–29. Cf. Honoré (2017), Selectivity, in Chapter 4 of this volume.
88. Cf. M. Honoré (2017), Selectivity, in Chapter 4 of this volume, who refers to cases such as judgment of 10 December 2008, *Kronoply and Kronotex v Commission* T-388/02 , EU:T:2008:556, paragraphs. 72 et seq.; and judgment of 16 September 1998, *Waterleiding Maatschappij "Noord-West Brabant" v Commission,* T-188/95, EU:T:1998:217, paragraph 62.

107(1) TFEU. This legal presumption maintains a level of *a priori* control sufficient not to deprive of any effect the *raison d'être* of EU State aid control.

This being said, it is not immediately clear how small amounts of aid or aid to small firms, considered in isolation, can significantly distort the outcome of competition. From this point of view, one could argue – similar to other domains of competition policy such as antitrust or merger control – that "small aid cases" could be largely ignored for enforcement purposes. However, in view of the above described logic of EU State aid control, it would appear to us that it is justified to maintain a fairly strict approach towards the concept of distortion of competition, including in those cases where the individual aid amounts or the firms involved are not so large. However, the concept of effect on trade between Member States may seem to offer some more flexibility, on a strict case by case basis, to reduce the number of instances subject to prior notification by Member States (cf. the new approach of the Commission with respect to those cases of purely local character).