State aid control and insolvency

Introduction:

Community Competition Policy is one of the pillars upon which the action of the European Commission in the economic field rests. This action is inspired by the principle laid down in the Treaty, of "*an open market economy with free competition*". The Treaty thus acknowledges the fundamental role of the market and of competition in guaranteeing consumer welfare, in encouraging the optimal allocation of resources and, in providing the appropriate incentives for the pursuit of productive efficiency, quality and innovation. By way of this policy therefore, the Commission seeks to reinforce the growth and competitiveness of European industry by ensuring effective competition in the Internal market and creating the conditions for markets to function well, whilst accounting for Europe's particular social market economy.

A key element of Competition policy is Community State aid control. State aid can frustrate free competition by preventing the most efficient allocation of resources and posing a threat to the unity of the internal market. In many cases, the granting of State aid reduces economic welfare and weakens the incentives for firms to improve efficiency. Aid also enables the less efficient to survive at the expense of the more efficient. It can shift an unfair share of the burden of structural adjustment and the attendant social and economic problems onto other producers who are managing without aid and to other Member States.

However in a period of economic slowdown, Member States are tempted to grant aid to firms in difficulty because their disappearance would be likely to lead to serious social consequences. This poses particular problems from a state aid discipline point of view. The purpose of this presentation is to give an overview on the rules on state aid control in the European Union with special reference to recovery, the situation of firms in difficulty and national insolvency rules.

1. STATE AID CONTROL IN THE EUROPEAN UNION

1.1. The notion of state aid within Article 87(1) EC Treaty

The point of departure of EU State aid policy is laid down in Article 87(1) EC Treaty. This article provides that State aid is, in principle, incompatible with the common market.

"Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market. "

The authors of the Treaty did not suggest that all types of measures that could affect companies were to be considered as State aid. In order to be considered as State aid in the meaning of Article 87 EC Treaty, there must be:

- *A transfer of State resources:*

State aid rules cover only measures involving a transfer of State resources (including national, regional or local authorities, public banks and foundations, etc.). Furthermore, the aid does not necessarily need to be granted by the State itself. It may also be granted by a private or public intermediate body appointed by the State. Financial transfers that constitute aid can take many forms: not just grants or interest rate rebates, but also loan guarantees, accelerated depreciation allowances, capital injections etc.

- *An economic advantage:*

The aid should constitute an economic advantage that the undertaking would not have received in the normal course of business. Less obvious examples of transactions satisfying this condition are given below:
-A firm buys/rents publicly owned land at less than the market price;
-A company sells land to the State at higher than market price;
-A company enjoys privileged access to infrastructure without paying a fee;
-An enterprise obtains risk capital from the State on terms, which are more favourable than it would obtain from a private investor.

- *Selectivity:*

State aid must be selective and thus affect the balance between certain firms and their competitors. "Selectivity" is what differentiates State aid from so-called "general measures" (namely measures which apply without distinction across the board to all firms in all economic sectors in a Member State (e.g. most nation-wide fiscal measures)).

- *An effect on competition and trade:*

Aid must have a potential effect on competition and trade between Member States. It is sufficient if it can be shown that the beneficiary is involved in an economic activity and that he operates in a market in which there is trade between Member States. The nature of the beneficiary is not relevant in this context (even a non-profit organisation can engage in economic activities).

1.2. General principle of prohibition of state aid and exemptions

- *General principle of prohibition*

Aid measures as defined by Article 87(1) EC Treaty are, in principle, incompatible with the common market. However, the principle of incompatibility does not amount to a full-scale prohibition. Articles 87(2) and 87(3) EC Treaty specify a number of cases in which State aid could be considered acceptable (the so-called "*exemptions*").

- *Aid which is compatible with the common market (Art. 87(2) EC Treaty)*

According to Article 87(2) EC Treaty, the following shall be compatible with the common market:
(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
(b) aid to make good the damage caused by natural disasters or exceptional occurrences;
(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, insofar as such aid is required in order to compensate for the economic disadvantages caused by that division.

If conditions are met, the aid must be considered compatible.

- *Aid which may be compatible with the common market (Article 87(3) EC Treaty)*

According to Article 87(3) EC Treaty, the following may be considered to be compatible with the common market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;
(e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.

- *Illustration: the Community Guidelines on State aid for the rescue and restructuring of firms in difficulty (OJ C 67 of 10.3.1999, p. 11)*

These are of particular relevance to firms in difficulty. They set up the criteria the Commission uses when deciding whether aid measures to firms in difficulty qualify for exemption. They are summarised below[1]:

Concepts:	▪ A **company in difficulty** is a company that is unable to stem losses which without outside intervention by public authorities will almost certainly condemn it to go out of business in the short or medium term. ▪ **Rescue aid** is temporary assistance. It should make it possible to keep a company in difficulty afloat for the time needed to work out a restructuring or liquidation plan and/or for the length of time needed by the Commission or the competent national authorities to reach a decision on that plan. ▪ **Restructuring aid** is based on a feasible, coherent and far-reaching plan to restore a firm's long-term viability.
Conditions:	▪ **Rescue aid** has to meet the following conditions:

[1] From Vademecum Community rules on state aid

- Consists of liquidity help in the form of loan guarantees or loans bearing normal commercial interest rates;
- Restricted to the amount needed to keep the firm in business
- Only for the time needed (max. 6 months) to devise the recovery plan;
- Be warranted on the grounds of social difficulties and have no adverse effects on the industrial situation in other Member States
- Should be a one-off operation

▪ **Restructuring aid** can be granted only if the following criteria are met:
- A viable restructuring/recovery programme is submitted to the Commission (does not apply to SMEs if aid is granted under an approved scheme);
- Measures are taken to avoid undue distortions of competition (e.g. appropriate reduction of capacity);
- Aid is limited to the minimum needed for the implementation of the restructuring measures. Beneficiaries have to make a significant contribution.
- The company has to implement the restructuring plan in full.
- Restructuring aid can be granted once only ('one time, last time principle').
- Strict monitoring and annual reporting is required.
- SME's and firms in assisted regions: The capacity reduction criteria and reporting requirements can be applied with a greater degree of flexibility.
- The Commission takes a favourable view of State aid to cover the **social costs** of restructuring.

1.3. Supervision of State aid by the European Commission

Community supervision of State aid is based on a system of ex ante authorisation. Under this system, Member States are required to inform ("*ex ante notification*") the Commission of any plan to grant or alter State aid and they are not allowed to put such aid into effect before it has been authorised by the Commission (*"Standstill-principle"*) (Article 88(3) EC Treaty). Under the Treaty, the Commission is given the competence to assess whether or not the notified aid measure constitutes State aid in the sense of Article 87(1) EC Treaty, and if it does, whether or not it qualifies for exemption under Article 87(2) or (3) EC Treaty. Member States shall not grant any State aid unless it has been notified *and* authorised by the Commission. Any aid, which is granted in absence of Commission approval, is automatically classified as "*unlawful aid*". The Commission will still have to examine its compatibility. Under the present procedural rules, the Commission is under the obligation to order the recovery from the beneficiaries of any unlawful aid that is found to be incompatible with the common market.

2. THE CONSEQUENCE OF THE GRANTING OF ILLEGAL INCOMPATIBLE AID: THE DUTY TO RECOVER

2.1. Historical development

- *Nothing was foreseen in the EC Treaty*

The EC Treaty rules on state aid had not foreseen any specific sanction for the non-respect of the recovery obligation of Article 88(3) EC Treaty. Article 88 EC Treaty assumes that the Member States would abide to the 'normal procedure'.

Reality was however different, and the Commission had to take notice of the fact that Member States 'forgot' to notify the aid, and put the aid into effect before the Commission had taken a decision on the aid.

The possibility to order the recovery of illegal incompatible aid was conceived by the Commission as a remedy to the distortion of competition created by the aid. The aim of the recovery of State aid is to restore the ex-ante situation, and to put the beneficiary on the same level as its competitors, who did not benefit from the aid granted. Two judgements of the Courts have indicated this in a very clear manner[2].

- *First recovery decision : mid-eighties*

The first case where the Commission set out the basic principles governing the recovery of State aid was the case Commission/Germany[3]. This case concerned aid granted by a Member State despite a final Commission decision that the aid is incompatible with the Common market. It is only in the middle of the eighties that the Commission decided to take its first "real" recovery decision[4]. It appeared very quickly that the obligation made to the beneficiary to reimburse the aid was not sufficient to remedy the distortion of competition caused by the illegal aid. Therefore, in a second step, the Commission started to require recovery not only of the aid amount itself, but also of interests to be paid from the award of the aid until its effective reimbursement.

- *Court of Justice supported the Commission policy*

The Court of Justice has played an important role in the evolution of the recovery policy in setting-up several principles. It has in particular enounced that the Commission is obliged to take a decision on the compatibility of the aid before ordering the recovery. Another principle issued by the Court is the fact that national courts can and must order recovery in the absence of a Commission decision on compatibility[5].

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[2] ECJ, 4.4.1995, C-348/93, *Commission/Italy*, *ECR*, 1995, I-673 ; ECJ, 4.4.1995, C-350/93, *Commission/Italy, ECR,* 1995, I-699, pt. 21 : '*The Court has consistently held that the obligation on a State to abolish aid regarded by the Commission as being incompatible with the common market has as its purpose to re-establish the previously existing situation'*.

[3] ECJ, 12.7.1973, 70/72, *Commission/Germany*, *ECR*, p. 913. '*Such a request is admissible since the Commission is competent, when it has found that aid is incompatible with the common market, to decide that the state concerned must abolish or alter it .To be of practical effect, this abolition or modification may include an obligation to require repayment of aid granted in breach of the treaty, so that in the absence of measures for recovery, the Commission may bring the matter before the Court. Moreover an application from the Commission, within the scope of the procedure under articles 169 to 171, for a declaration that in omitting to take specific measures, a Member State has failed to fulfil an obligation under the Treaty, is equally admissible.*

[4] Commission decision 86/366/EEC, 10.6.1986, concerning aid which the Belgian Government has granted to a ceramic sanitary ware and crockery manufacturer, OJ, 9.8.1986, L 223, p. 30-33.

[5] G. FRIDEN, 'The current case law of the Court of Justice on recovery of illegal State aid', in *European Competition Law, a new role for the Member States*, Bruxelles, Bruylant, 2001, p. 91.

The evolution of the Court case-law has led to the necessity of 'codifying' the different statements of the Court into the Procedural regulation.

- *The contribution of the Procedural regulation (659/99)*[6] *:*

The main achievement of the Procedural regulation as far as it concerns the recovery, is the explicit mention that the Commission has an obligation to order recovery for every negative decision on unlawful aid (article 14.1). This goes a step further than the former Court decisions, where it was stated that the Commission 'might' order the recovery.

The Procedural regulation has also introduced procedural and methodology elements that are detailed below.

2. 2. <u>Principles of recovery</u>

- *Inclusion of interest at the Commission reference rate– since 2003 : application of compound interest (OJ,* C 110, 08.05.2003, p. 21-22*)*

The interests were originally calculated according to the different rules of the Member States. As this system has been leading to substantial differences between the Member States, the Commission decided in 1995 to apply a uniform system for calculating the interests, the so-called 'reference rate'[7]. Following a recent communication of 8 May 2003, it was decided by the Commission to apply a compound interest[8], for all pending recovery cases.

- *Recovery shall be made in accordance with national procedural rules provided that they allow the immediate and effective execution of the Commission's decision (Article 14(3) of the procedural regulation)*

It was decided in the Procedural regulation that recovery should only be made in accordance with national procedural rules, taking into account the respect of the general principles of Community law. An example of the use of these procedures is the obligation made to the State to register as a creditor in the bankruptcy proceedings, and to have a close follow-up of the whole proceedings. Of course, this provision may create differences in delay between the Member States, especially because some national procedures have a suspensive effect. Therefore, it was established by article 14(3) of the Procedural regulation that 'national procedures should only apply provided that they allow the immediate and effective execution of the Commission's decision'.

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[6] Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, Official Journal L 83, 27.03.1999, pages 1-9

[7] http://europa.eu.int/comm/competition/state_aid/others/reference_rates.html

[8] '*In market practice, simple interest would normally be calculated where the beneficiary of the funds does not have use of the interest amount before the end of the period, for example where interest is only paid at the end of the period. Compound interest would normally be calculated if each year (or period) the amount of interest can be considered as being paid to the beneficiary and so accruing to the initial capital amount. In this case, the beneficiary would earn interest on the interest paid for each period.'*

2.3. The instruments of the recovery

- *At Community level :*

- Provisional measures : Suspension injunction and recovery injunction Two means are at the disposal of the Commission to prevent the granting of illegal aid, or to recover the aid illegally granted, until the Commission has taken a decision on the compatibility of the aid with the Common market.

  As far as concerns the suspension injunction (article 11(1) of the Procedural regulation), the Commission is allowed to adopt a decision requiring the Member State to suspend any unlawful aid until the Commission has taken a decision on the compatibility of the aid measures. This injunction has been used very rarely, and not since the entry into force of the Procedural regulation. It seems that a threat to use this suspension injunction is sufficient to force a Member State to delay the disbursement of the aid (see Alstom).

  Concerning the recovery injunction, (article 11(2) of the Procedural regulation), the Commission is allowed to take a decision requiring the Member State to recover provisionally the unlawful aid until the Commission has taken a decision on the compatibility of the aid with the common market. This possibility is subject to three cumulative criteria :
  1. There are no doubts about the aid character of the measure concerned, according to an established practice
  2. There is an urgency to act
  3. There is a serious risk of substantial and irreparable damage to a competitor.

  It must be underlined that these measures are provisional measures. They do not in any manner prejudge of the substance of the case.

- Infringement proceedings against the Member State
  According to art. 88 (2) EC Treaty, the Commission may take a Member State to the Court of Justice if it fails to recover the aid. On basis of Article 12 of the Procedural Regulation, the Commission can also take a Member State to Court if there is no compliance with a suspension or a recovery injunction.

- No direct sanction of the stand-still obligation (88(3) EC Treaty)
  The Commission is exclusively competent to apply Articles 87 (3) and 88 (1) and (2) of the EC Treaty. The Commission is entitled to assess the compatibility of an aid, but not directly to enforce the recovery of illegal aid[9]. There is no possibility for the Commission to ensure a total respect of the stand-still obligation mentioned in Article 88(3) EC Treaty, where it is explicitly stated that Member State may not put an aid into effect until the Commission has taken a decision on the compatibility of the aid.

[9] J. DERENNE, 'Point de vue d'un praticien en système civiliste', in *European Competition Law, a new role for the Member States*, Bruxelles, Bruylant, 2001, p. 131.

It is worth noting that the procedures are strictly bilateral. There is no possibility in the Treaty for the Commission to take directly the beneficiary to Court, even if the beneficiary is allowed to take part in the challenge before the Court of Justice.

- *At national level :*

- Direct application of art. 88(3) EC Treaty

As mentioned earlier, the Commission is not competent to ensure an effective application of the stand-still obligation (apart from the provisional injunctions mentioned before). The application of Article 88(3) if the exclusive competence of national courts. Such a competence includes the necessity to assess in a very broad manner whether the measure at stake constitutes aid or not. The direct application of Article 88(3) EC Treaty implies the possibility for a competitor of an aid beneficiary to challenge the aid measure before the national judge. This possibility is not well known by the national judges and by the interested parties. But things might be changing: a recent provisional judgement from the Court of Strasbourg, confirmed by the Cour administrative d'appel de Strasbourg on 18.09.2003 suspended the aid granted by the Chambre de Commerce to Ryanair. It must be noted that the competence of the national judge is not influenced by the fact that the Commission is examining the same case on the compatibility with Article 87 and 88 EC Treaty.

- Use of national procedures

National procedures should be used to order the recovery from the beneficiary. As said before, this may create a distortion between the different Member States. The differences in the national procedures should not necessarily be incompatible with effective recovery, especially because the Court has ruled that national law only applies as long as it does not render recovery practically impossible. Furthermore, the Court has indicated that the national procedures used to order recovery may not result in a treatment which would be less favourable than similar actions of a domestic nature[10].

2.4. Limits

The procedural regulation has introduced two limits to the principle of recovery of illegal incompatible aid:

- *Existence of a general principle of Community law*

Recovery is not required if it is contrary to a general principle of Community law. This exception has been rarely used. As far as concerns the principle of 'legitimate expectation', for instance, the Court has usually considered that aid recipients may normally not have any legitimate expectations when aid is granted in breach of art. 88(3) EC Treaty[11].

- *Ten year limitation*

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[10] ECJ, 16.12.1976, C-33/76, *Rewe-Zentrale/Landwitschaftskammer für das Saarland, ECR*, 1976, p. 1989.

[11] A. SCHAUB, *o.c.*, p. 73.

The second exception, contained in art. 15 of the Procedural Regulation, is that the Commission's possibility to recover the aid is subject to a period of ten years. This period is starting from the award of the aid to the beneficiary. However, it must be underlined that any action of the Commission with regard to the measure makes the limitation period starting afresh.

- *Non-compliance with recovery obligation by Member State is allowed only in the case of absolute impossibility to recover the aid*

The Court has stated that the only argument which could be invoked by the Member State to avoid the recovery of illegal aid, is the absolute impossibility to recover the aid[12]. This exception should be interpreted in a very narrow way: the absolute impossibility cannot be invoked at the stage of the implementation, but must be assessed from the beginning[13]. The Court indicated also that the co-operation between the Commission and the Member State is essential to determine how to solve the difficulties of the recovery[14].

- *Responsibility of Member State for granting of illegal aid?*

The question raises whether a Member State could be considered responsible for the failure to comply with its obligation to notify. According to a settled case-law, the responsibility of a Member State can be invoked by individuals, in general, when the rule of Community law breached is intended to confer rights upon them, when the breach is sufficiently serious and when there is a direct causal link between the breach and the damage sustained by the individuals[15].

The application of those principles to the breach by a Member State of the obligation contained in article 88(3) EC Treaty could lead in theory to the possibility for a competitor or even for the beneficiary, to ask the Member State for reparation of the damages[16]. It has not been invoked yet. In certain cases, the concrete application of this possibility appears to be very difficult because the notion of State aid is in constant evolution and it is not always clear whether the measure granted by the State will be qualified as State aid in the meaning of Article 87(1) EC Treaty.

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[12] ECJ, 4.4.1995, C-348/93, *Commission/Italy, ECR,* 1995, p. I-689, pt. 16.

[13] ECJ, 17.6.1995, C-75-97, *Kingdom of Belgium/Commission, ECR*, 1999, p. I-3671, pt. 86 : '*The Commission, which claims that this plea is inadmissible, rightly points out that the alleged absolute impossibility cannot invalidate the contested decision where it emerges only at the stage of implementation. According to the case-law of the Court, any procedural or other difficulties in regard to the implementation of the contested measure cannot have any influence on the lawfulness of the measure (Joined Cases C-278/92 to C-280/92 Spain v Commission, cited above, paragraph 80). However, the Commission may not impose, by a decision such as the contested decision, which would then be invalid, an obligation whose implementation would, from the beginning, be impossible in objective and absolute terms. Consequently, the Belgian Government's plea could be accepted only if recovery could never objectively have been carried out.*'

[14] *Ibidem*, pt. 88.

[15] ECJ, 5.3.1996, Brasserie du Pêcheur SA v Bundesrepublik Deutschland and The Queen v Secretary of State for Transport, ex parte: Factortame Ltd and others, ECR, 1996, p. I-1131.

[16] J. DERENNE, 'Point de vue d'un praticien en système civiliste', p. 131, in *European Competition Law, a new role for the Member States*, Bruxelles, Bruylant, 2001.

3. THE CASE OF RECOVERY OF ILLEGAL INCOMPATIBLE AID TO A FIRM IN DIFFICULTY

The issue of illegal aid often appears in the case of aid awarded to firms in difficulty. Member States, especially during a period of economic difficulty, are very tempted for social reasons to award aid to firms in difficulties. Very often due to the emergency situation of the firms, Member States do not wait for the prior authorisation of the Commission and award illegal aid. In the event that the aid awarded cannot be considered compatible with the EC Treaty, and in particular do not meet the criteria of the Rescue and Restructuring Guidelines, the Commission will close the formal investigation procedure of Art. 88(2) EC Treaty with a negative decision containing a recovery order.

For a firm in difficulty, repaying the aid may have serious consequences which are considered below.

3.1. Obligation of restitution despite the situation of firm in difficulty

The financial situation of the firm and the possible risk of insolvency cannot be invoked to escape the recovery obligation. This was confirmed several times by the Commission and confirmed by the European Court of Justice.

In the case Commission v. Belgium[17] in 1986, the ECJ declared that: *"the Commission's objective is to abolish the aid, and that objective can be attained by proceedings for winding-up the company".*

This was repeated by the ECJ recently which stressed in the case of Commission v. Spain[18]

"The Court has (...) ruled that the fact that, on account of the financial situation of the beneficiary of the aid in question, the authorities of the MS concerned could not recover the sum paid could not constitute proof that implementation was impossible, since the Commission's objective was to abolish the aid, which could have been achieved by the liquidation of the company."

- *Stay of execution in the event of risk of insolvency*

The risk of insolvency and liquidation of the company is not sufficient to shirk the recovery obligation. However in the case Transacciones Maritimas SA[19], The Court of First Instance (the CFI) exceptionally granted a stay of execution to the debtor of the repayment obligation because its immediate *execution "would very probably entail the forced dissolution of the firms and have serious personal consequences for their managers and shareholders. There is therefore a risk that the damage which the applicants would suffer as a result of the immediate operation of the Commission's decisions would be serious and irreparable."*

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[17] ECJ, 15.01.1986, C-52/84 Commission v.Kingdom of Belgium; ECR. p.9

[18] ECJ, 2.7.2002, C-499/99, Commission v. Spain (Magefesa)

[19] CFI, 26.10.1994, T-231, 232, 234/94, Transacciones Maritimas SA, Recursos Marinos SA and Makupesca SA v. Commission, ECR 1994 p. II-885

This stay is however exceptional. The President of the CFI made the stay of execution subject to the granting of a bank guarantee in favour of the Commission, covering the total amount of the aid granted.

This stay is all the more very exceptional as the risk of bankruptcy tends to strengthen the validity of the characterisation of the aid given by the Commission[20]. It does not however prejudge on the substance of the case.

- *Lack of effect of prior insolvency on the recovery obligation*

The fact that a firm is subject to bankruptcy proceedings has no effect on its obligation of refunding. This was reaffirmed in the case Spain v. Commission[21] (Merco) in 1994 : *"The removal of the obligation to repay in the event of a company's liquidation would render meaningless the rules on state aid".*

As creditor of the incompatible illegal aid, the Member State must register its claim in the bankruptcy proceedings. The recovery is done according to national bankruptcy rules. This was reaffirmed in the case Belgium v. Commission[22] (Tubemeuse) in 1990 where the Court declared that "*by registering its claims as unsecured creditor, Belgium had fulfilled its obligation".* According to the ECJ, the registration of the debt into the bankruptcy proceedings is sufficient even if this means that the recovery will not be immediate. The State debt is thus refunded only by virtue of the status given to it by national law.

However steps taken by the Member State according to its national law needs to be effective. In the case Commission v. Spain[23] (Magefesa) in 2002, Spain had argued that as the companies recipient of the aid had ceased to trade, there is no longer any prejudice for their competitors, and the demand for repayment no longer serves that purpose. The ECJ concluded however that the mere fact that the company is not trading any more is not enough. It is only if there are no assets to be recovered that the impossibility of recovery could be proved. In any event, the Member State must take all possible actions to recover the aid by way of national bankruptcy and insolvency procedure.

In rare situations, the ECJ accepted that full recovery could not be effected because of the specificity of bankruptcy laws. This was the case in the case Kingdom of Spain v. Commission of 12 October 2000[24]. According to Spanish law, the debts of the firm which are declared bankrupt cease to produce interests from the date of the corresponding declaration. The Commission had however required that these were refunded with interest due from the date of award of the aid until the effective date of repayment, and in addition the interest outstanding subsequent to the declaration of bankruptcy. Given that this second requirement was contrary to Spanish law, the ECJ annulled the decision of the Commission on this point.

[20] See Fouquet Thierry, "La restitution des aides d'Etat accordées aux entreprises en difficulté en violation du droit communautaire", Revue de droit des affaires internationales, n°8, 2002
[21] ECJ, 14.09.1994, C-42/93, Spain v. Commission (Merco) of 14 September 1994, ECR I-4175
[22] ECJ, 21.03.1990, C-142/87, Belgium v. Commission, ECR I-959
[23] footnote 18
[24] ECJ, 12.10.2000, C-480/98, Kingdom of Spain v. Commission, ECR.I-8717

3.2. The treatment of the recovery in case of the sale of the assets of an insolvent company by the bankruptcy administrator

The evolution of insolvency laws towards laws enabling the continuation of the firm activity poses certain questions as regards the implementation of state aid law. This is in particular the case where the assets of the firm beneficiary of the aid are taken over. The question of the addressee of the recovery order arises then. Different scenarios need to be considered.

- *The "classical" asset sale*

Under this scenario, the assets are sold unbundled following the liquidation of the company. Within the selling company that received the illegal and incompatible State aid, the assets are replaced with cash. The cash is available to repay the creditors, including the Member State, to which the State aid has to be reimbursed. The buyer takes the assets without having to concern itself with or whether or not the selling undertaking has received an illegal and incompatible state aid. The distortion of competition is considered as remedied since the company has ceased its activity and its competitors can bought its assets at market price.

Under this scenario, the Commission considers that no obligation to repay State aid attaches to the assets that are sold if the sale of assets occurs in a transparent way and at market condition. The Commission ensures in particular the proper conduct of the transfer of assets and the independence of the administrators with respect to the granting authorities.

It is sometimes possible that the assets of the beneficiary of the aid are transferred under conditions more favorable than those of the market in order to try to circumvent the recovery order. This is particularly the case when the assets are sold below market price or when they are sold together with liabilities, which reduce the assets' value. Under these circumstances, the recovery obligation does not follow the assets but there is an aid to the purchaser of the assets, which will have to be recovered.

- *Intra-group asset sale*

The Commission takes the view that when it is confronted with a group of legal persons which together form an economic unit, it may treat them as such, as the Court confirmed in the Intermills judgement[25]. In the case of a group of companies, if the mother and the subsidiary form an economic unit, both the mother company and the subsidiary are considered to be the beneficiaries of the aid.

For the purpose of recovery, the Commission has applied this principle when the different legal parts of the group were subject to the same control and were deemed to form an economic unit. This is all the more the case when additional legal persons are created within the group during the course of the proceedings. In these circumstances, the creation of additional legal entities within the group may have been motivated by the aim to circumvent the recovery order.

[25] ECJ, 14.11.1984, C -323/82, Intermills/Commission, , ECR 3808

In the three following decisions, the assets of the recipient of the aid were transferred to another company linked to the original recipient of the aid before the Commission had decided on the compatibility of the aid.

- Commission decision of 2 June 1999 concerning State aid granted to Seleco SpA[26]
- Commission decision of 8 July 1999 concerning State aid granted to Gröditzer Stahlwerke GmbH[27]
- Commission decision of 21 June 2000 concerning State aid granted to CDA Datenträger Albrechts GmbH[28]

The Commission considered that this intra-group assets' sales prevented the effective recovery of the incompatible aid. It therefore required that the recovery should not be restricted to the original firm but extended to the firm which continues the activity of the original firm, using the transferred means of production, in cases where certain elements of the transfer point to economic continuity between the two firms. The recovery order was therefore addressed to the original recipient of the aid and, additionally, to any firm which benefited from asset transfers designed to frustrate the effects of the contested decision.

The elements examined by the Commission included the purpose of the transfer (assets and liabilities, continuity of the workforce, bundled assets, etc.), the transfer price, the identity of the shareholders or owners of the acquiring firm and of the original firm, the moment at which the transfer was carried out (after the start of the investigation, the initiation of the procedure or the final decision) and, lastly, the economic logic of the transaction.

All three decisions were appealed before the ECJ. The ECJ has issued a first judgement on the Seleco case[29]. The ECJ recognised that the Commission was right to state in its decision that:

'- ... To ensure that the Commission decision is implemented correctly, the Member State is required ... to recover the aid without delay, using all the legal means at its disposal, including seizure of the firm's assets and, where necessary, its liquidation if it is unable to repay the amounts in question. The proceeds of the sale of the assets allow the creditors, including the Member State, to be repaid even if they are not sufficient to cover all the debts of the firm and even if, consequently, the aid is not recovered in full. In such circumstances, the liquidation of the firm is still important from a competition standpoint as it frees the market segment previously held by the firm and makes it available to creditors, while giving them the opportunity to acquire the assets and reallocate them more effectively.

- There are, however, <u>circumstances which can hamper that process, jeopardise the effectiveness of the recovery decision and frustrate the rules on State aid. Such is the case when, following a Commission investigation or decision, the assets and liabilities of the firm as an ongoing concern are transferred to another firm controlled</u>

[26] published in OJ 2000 L 227, p.24
[27] published in OJ 1999 L292, p.27
[28] published in OJ 2000 L 318 p.62
[29] ECJ, 8.05.2003, C-328/99, Italian Republic and SIM v. Commission

by the same persons at below-market prices or by way of procedures that lack transparency. The purpose of such a transaction can be to place the assets out of reach of the Commission decision and to continue the economic activity in question indefinitely.

- As in any other recovery procedure, the Member State must, like any other diligent creditor, exhaust all the legal instruments available under its own legal system, such as those used to combat fraud against creditors in the form of acts carried out by the firm in liquidation during the suspect period prior to the bankruptcy, which would allow such acts to be declared invalid.' "

However the ECJ ruled that the Commission had not established that the legal entity to which the assets were transferred could be considered as beneficiary of the aid and in particular would form an economic unit with the original beneficiary of the aid. In particular it stressed that the Commission made no mention of the price of the transfer also it referred to it as an element to be taken into account.

- *Assets sale as going-concern*

The sale of assets as going concern is favoured by many insolvency laws. It has socio-economic advantages and might also realise the highest amount in the interest of creditors. From a competition point of view however, the taking over by a third party of assets as going concern from an insolvent firm may under certain circumstances appear less satisfactory than a sale of unbundled assets. One could indeed argue that unlike the classical assets sale, the sale of the assets as "going concern" does not lead to the end of the aided activity. Besides the way the assets are sold – such as including assets of no interest for the competitor- may preclude the competitor to make an offer. Thus there may be a conflict between the requirements of Community state aid law, which protects competitors rather than creditors and the requirements of national insolvency law, which protects creditors rather than competitors and favours the safeguard of the activity.

However it is considered that the sale of the assets on the market following an open, transparent and unconditional bid, the competition situation can be considered as remedied. Therefore in the case of assets sale to a third party (extra-group asset sale), and in particular in case of the taking over of an insolvent firm (going concern asset sale), the sale of the assets at a market price should exclude the transfer of the recovery obligation. The price paid for the assets will serve for the satisfaction of the creditors and the recovery of the aid will occur from the original recipient of the aid (the insolvent company).

Under certain circumstances, the recovery obligation may follow the assets. This may in particular be the case if it follows from the circumstances of the case that there was a circumvention of the recovery obligation.

This was enounced in the case State aid in favour of System Microelectronic Innovation (SMI)[30]. In this case, the Commission recognised the circumvention of the recovery order. SMI was awarded incompatible aid. In the course of the insolvency

[30] Commission decision of 11 April 2000, OJ L 238/50

proceedings, a hive-off vehicle ("Auffanggesellschaft") (SiMI) was created to continue the operation of SMI. All the shares of SiMI were still in the hands of SMI. Two months later, SiMI founded a subsidiary named MD&D which took over the shares of SiMI and the assets of SMI. MD&D was sold to a private investor.

In its final decision adopted in April 2000, the Commission decided that the aid measures to SMI and SiMI had also to be recovered from MD&D. This company also benefited from the aid because it acquired SiMI's shares while still using the assets of the bankrupt company, SMI, thus taking advantage from the illegal and incompatible aid formally awarded to SMI.

Furthermore, the Commission stated that Germany should be prevented to evade the consequences of the recovery decision by setting up a system of successive subsidiaries. To avoid any circumvention of the Commission decision, the Commission decided also to extend its decision and the recovery obligation to any other undertaking to which SMI's, SiMI's or MD&D's assets have been transferred or will be transferred in such a way to evade the consequences of the decision.

Germany appealed against the decision. In its opinion[31], the Advocate-General Tizzano has not questioned the principle according to which the recovery obligation may follow the assets in case of circumvention. He recalls the different elements the Commission looks at to determine the existence of circumvention such as the circumstances of the sale, the transfer price and the identity of the purchaser which must be different from the owner of the aid beneficiary. However he concludes that in the SMI case, the Commission had not produced any element showing that there was circumvention and consequently, SiMI and MD&D could not considered as responsible for the recovery.

The judgement of the Court will certainly bring interesting elements to establish the principle of recovery of incompatible aid granted to a firm in difficulty where the assets are transferred. In any event, in order to avoid any circumvention of the recovery obligation, it is essential that the sale of the bundled assets be realised at market conditions. This requires the launching of an open, unconditional and transparent tender. All competitors must be able to bid so that the sale can be considered as realised at market price.

Conclusion:

Community state aid law is in constant evolution. One of the last important development of this discipline is the priority given to the enforcement of the Commission decisions on state aid and in particular to the recovery of illegal incompatible aid.

With more than 80 pending recovery cases, the present record of enforcement of Commission's negative decision is poor. The difficulty of ensuring a proper enforcement of Commission's decisions undermines the credibility of the Community state aid control policy to the detriment of fair competition in the internal market.

[31] Opinion of the Advocate-General of 19 June 2003 in the case C-277/00, not yet published

This is the reason why Commissioner Monti has decided to declare the enforcement of state aid decisions as a priority. He has therefore decided the creation of an enforcement unit with the mission of ensuring the effective enforcement of state aid decisions and particularly of recovery decisions. One of the tasks of the unit is to develop an enforcement policy and to define instruments ensuring an effective execution of the Commission's decision.

Many issues need indeed to be resolved:

Community law places an obligation on Member States to ensure effective recovery in accordance with national legal procedures. This may lead to a different treatment of recovery orders among different Member States and create a risk of inequality of treatment between firms across the European Union.

Besides these national procedures do not in general give a high priority to the recovery of illegal aid. A better awareness of the Community state aid policy amongst competitors but also amongst national judges and lawyers may also help ensuring a better level of enforcement.

This is in particular true when dealing with recovery orders addressed to firms in financial difficulty. It is important to prevent possible conflicts between national law and EU law and obstruction to the enforcement of EU law. Therefore insolvency practitioners community need to be aware about the evolution of state aid policy and the Commission needs to better understand the national insolvency laws systems.

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