

State Aid Issues for Local Authorities

Is state aid a relevant concern for local authorities?

The Treaty on the Functioning of the European Union provides that certain government activities may be prohibited because they give an advantage in a selective way to certain entities, which might affect competition within the internal market. Those advantages may amount to prohibited state aid, or may be state aid which is either expressly allowed by the Treaty, or which may be allowed, dependent on the circumstances.

For a measure to be considered prohibited state aid it must have the following characteristics (taken from Article 107 TFEU):

- “Aid” granted by a Member State of the EU, or through State resources
- In any form
- Which distorts or threatens to distort competition
- And which favours certain undertakings or the production of certain goods.

Of relevance to local authorities, it is important to note that “through State resources” includes the use of local authority funds as well as central government funds. Likewise, the test of distorting or threatening to distort competition, appears *prima facie* to be a test unlikely to be met on the basis that the measure is likely to involve local, rather than cross border activities. However, the test has a very low threshold and, in particular, it is only necessary for there to be a threat to distort competition. “In any form” is also very flexible and can take account of as wide a range of activities as grants, subsidies, giving a relief from a particular charge, putting in place local rules which allow a particular group to have advantageous treatment or making an investment.

Given the broad range of activities which could amount to state aid and that the use of state resources includes the activities of local government it is clear that state aid is an important consideration in the economic activities of local authorities.

How might state aid issues affect local authorities?

There are two risks for local authorities here.

First, let us consider the situation where the local authority has simply granted the benefit to a commercial operator and has not taken account of potential state aid risks in doing so. Although the local authority will not itself be liable to pay the amount which might be assessed as state aid, not having given proper consideration to whether something is state aid may leave the local authority open to legal action on the part of the aid recipient, particularly in relation to whether the local authority gave a legitimate expectation to an aid recipient. There is also the possibility that a competitor of the commercial operator may seek to take legal action against the commercial operator and the local authority in order to obtain the same advantage for itself. Types of action include injuncting a competitor from obtaining a particular treatment, seeking suspension of the measure or seeking money from the local authority to put the competitor in the same position as the aid recipient.

In some (relatively unusual) circumstances damages may be payable. Needless to say, such litigation is likely to be expensive and unpredictable, both in terms of timescale and potential exposure.

Second, let us consider the situation where the local authority has granted the benefit to itself, by using state resources in projects of its own. In these circumstances, a local authority may use funds (either from central government or its own) to fund local authority projects. Where the authority is engaged in an economic activity (rather than simply carrying out the functions of state), the authority could be considered to be an undertaking which has received state aid. In this example, the consequence is that the local authority is the aid recipient, rather than the aid grantor and as such, recovery of the benefit could be ordered against the authority itself.

What are the consequences of being in breach of state aid rules?

Recipients of advantageous treatment are obliged to repay the benefit received by them, with compound interest. Recovery can be ordered going back to a period of 10 years, considerably longer than ordinary liability to repay). Since the rationale for requiring repayment of any aid granted is to repair any distortions to the market which occur because of the advantage given, it is no defence that the recipient may go out of business as a result of having to repay the amounts received.

What mitigating steps or defences are possible?

In certain specific circumstances, the local authority may be able to ensure that particular activities do not fall within the scope of state aid.

As set out above, where it is granting an advantage to itself, a local authority is likely to only fall within the definition of state aid in so far as the activities are ones which are **economic activities** or commercial in nature. For example, the administration of justice will not fall to be state aid, but investments in particular activities may do.

Certain activities are considered to be **compatible with EU law**. Those are “aid having a social character” and “aid to make good the damage caused by natural disasters or exceptional circumstances”. Certain other activities may be compatible with EU law, dependent on whether further tests are satisfied. These include aid to “promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment”, “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”, “to facilitate the development of certain economic activities...” in specified circumstances, for culture and heritage conservation.

A **de minimis** threshold exists. It runs over a period of 3 years but relates to the total aid received by the local authority in that period and it is therefore important to be aware of all potential receipts of state aid. Dependent on the particular circumstances, the de minimis threshold will either be 200 000 euro or 500 000 euro, each cumulative over a period of 3 years.

Aid which has been **notified to the European Commission** and which has received approval is not prohibited state aid. This is not strictly a defence, but a step to ensure that recovery cannot be ordered

against a local authority. Notification can be a lengthy process, so may not be an appropriate or proportionate solution where the project is limited in scope or urgent. Retrospective notification is a substantial risk as aid granted in the period before the approval is granted is technically considered to be non notified aid and therefore recoverable.

Steps may be taken in **defence of recovery** which has been ordered. Arguments which might be of particular relevance are those on legitimate expectation and legal certainty. It should be noted, however, that these are arguments to be made relatively late in proceedings.

Services of General Economic Interest (“SGEI”) are also subject to a different regime. Subject to certain restrictions, these may be approved as allowable state aid. SGEI are where public authorities engage in economic activities that are of particular importance and would not be supplied without public intervention. In very simplified form, where there are public service obligations, clearly defined, which must be fulfilled, the parameters for calculating the compensation are objective, transparent and established in advance, and where the compensation does not exceed the necessary costs, such an amount will not be considered to be state aid.

Current Issues

With an increase in quasi commercial activities on the part of local authorities, the question of state aid is increasingly a concern, particularly where the local authority is the recipient of the aid.

The recent case of R (Sky Blue Sports & Leisure Ltd & Others) v Coventry City Council [2014] EWHC 2089 (Admin) has been of particular recent interest in respect of the commerciality of the terms of a loan made by the Council.

Article 107

1. Save as otherwise provided in the Treaties, 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, in so far as it affects trade between Member States, be incompatible with the internal market.

2. The following shall be compatible with the internal 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, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.

3. The following may be considered to be compatible with the internal market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;

(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 Union 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 on a proposal from the Commission.

Article 108

1. The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the internal market.

2. If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the internal market having regard to Article 107, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission.

If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 258 and 259, refer the matter to the Court of Justice of the European Union direct. On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered to be compatible with the internal market, in derogation from the provisions of Article 107 or from the regulations provided for in Article 109, if such a decision is justified by exceptional circumstances. If, as regards the aid in question, the Commission has already initiated the procedure provided for in the first subparagraph of this paragraph, the fact that the State concerned has made its application to the Council shall have the effect of suspending that procedure until the Council has made its attitude known.

If, however, the Council has not made its attitude known within three months of the said application being made, the Commission shall give its decision on the case.

3. The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the internal market having regard to Article 107, it shall without delay initiate the procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.

4. The Commission may adopt regulations relating to the categories of State aid that the Council has, pursuant to Article 109, determined may be exempted from the procedure provided for by paragraph 3 of this Article.