

State aid update

January 2012

Our State aid update provides information on the most recent developments in State aid law and provides practical guidance to help your organisation, whether you operate in the public or the private sector and whether you are a provider or recipient of aid or a competitor to a recipient.

In this update we report on two developments which give a boost to the “Big Society” idea that local charities and community organisations will be best placed to deliver certain local services. We also consider an important decision concerning the financing of a privatised company’s pensions and report on a public consultation regarding possible changes to the rules applicable to public assistance for research and development activities.

New package of rules for public funding of Services of General Economic Interest

The European Commission has adopted a new, updated package of rules concerning the provision of State aid for services of general economic interest (SGEI) whilst avoiding distortions of competition.

These measures will be of particular benefit to local authorities and other public bodies which are perhaps seeking to transfer responsibility for the provision of social services to the private sector and to open up the provision of social services to a wider number of providers. However, the new rules also enhance the Commission’s ability to review larger amounts of aid for services other than social services.

The new rules apply to public funding of all services which are classified by a Member State as being an SGEI. Subject to supervision by the Commission, Member States have a broad discretion in determining which services are to be regarded as an SGEI.

Background

The Commission’s new rules identify those circumstances in which State funding of the provision of public services will involve aid: not all funding for the discharge of a public service obligation will do so.

The new rules also identify when aid for an SGEI should be automatically exempted from the State aid rules and the factors to be applied in assessing aid that does not qualify for an automatic exemption.

In adopting the new rules, the Commission recognises the important contribution of SGEIs and the fact that SGEIs are unlikely to be provided on a commercial basis or only terms unacceptable to private companies.

The exemption works in a similar way to the General State Aid Block Exemption (“GBER”), by providing an automatic exemption from notification to public bodies for compensation paid to certain providers of public services. This allows public bodies to pay private undertakings for the delivery of certain categories of SGEI under certain conditions, without the need to seek prior approval from the Commission.

Key points of the new package

The new package comprises:

- a revised Decision exempting certain public funding of SGEIs¹;
- a new Commission communication setting out guidance on the application of the State aid rules to SGEIs;
- a revised Framework for assessing the compatibility of public funding of SGEIs other than social services, which do not fall under the automatic exemption provisions of the new Decision²; and
- a proposal for a new Regulation setting out revised thresholds for ‘de minimis’ aid (of € 500,000 over three years) which does not require prior Commission approval, which will be adopted in the Spring, after further public consultation.

Under the new Decision, SGEIs are divided into two categories:

- ‘social services’ and hospital and emergency services. These benefit from the exemption, irrespective of the value of the payment for the services. The new Decision extends the list of SGEIs to include all social services meeting needs for health and long term care, child care, access to and reintegration into the labour market, social housing and the care and social inclusion of vulnerable groups; and
- *other public services that are designated as SGEI*. These are automatically exempted only if the compensation is below €15 million (and not, as previously, €30 million). Therefore, there will be greater scrutiny of funding of larger contracts for public services, for example some subsidised public transport, postal, energy or leisure services.

¹ Commission Decision of 20.12.2011

² C(2011)9406 final

Application of the exemption under the Decision remains subject to the nature and duration of the SGEI being set out in a contract or other instrument and ensuring that the level of compensation payable is limited to repayment of the provider's incurred costs, together with a level of reasonable profit.

The new rules apply from 31 January 2012.



Commentary

Although the existing State aid rules already provided for an exemption for public funding of certain categories of public services, in practice the scope of the rules has been uncertain and the conditions for exemption difficult to apply.

The new package should make it easier for public bodies and, importantly, for the providers of SGEIs to identify when their funding involves State aid and, if so, when they may rely upon the exemption. For example:

- The new guidance is helpful in making it clear that whilst the onus of demonstrating that a particular service is an SGEI lies with a particular Member State, the Commission recognises that the designation of an SGEI will vary from Member State to Member State and that the Commission's role is limited to ensuring that there is no manifest error in implying the definition.
- Further clarity is provided on how to calculate the reasonable repayment of costs and a reasonable element of profit. The Commission has imposed a new methodology for calculating costs, the 'net avoided cost methodology' (i.e. the difference between the net costs of providing the service as an SGEI and without a public service obligation), to ensure that compensation is paid only for the proper economic costs of meeting a public service obligation.
- The new rules also confirm that where an undertaking carries out an activity that is partly within and partly outside the scope of an SGEI, this does not of itself prevent the undertaking receiving State aid, provided that there is a clear separation of accounts and compensation is paid only for the net costs of the SGEI part. This will be particularly helpful for local authorities setting up public private partnerships for the provision of certain types of services.

Commission Consultation on Research and Development and Innovation Framework

The European Commission wishes to promote investment in research, development and innovation, as this is critical to the EU's competitiveness and future economic growth. Therefore, in 2006, it adopted the Framework for State aid for research and development and innovation (R&D&I Framework), which sets out rules for the assessment of such aid and guidance on when aid for R&D&I projects may qualify for exemption under the State aid rules, including under the General Block Exemption Regulation for State aid (GBER).

In August 2011, the Commission announced a mid-term review of the R&D&I Framework, which will expire in 2013.

The initial results of the Commission's mid-term review indicated the need for clarification of some of the terms used in the R&D&I Framework and to get a better understanding of why organisations are not using up their full intensity allowances under the GBER.

Member States, public authorities, research organisations and other interested parties have been invited to respond to a public consultation regarding the scope and effectiveness of the Framework. The Commission is seeking facts on public authorities' policies and rationales for and funding of R&D&I, and the effectiveness of aid for R&D&I. It also seeks views on the functioning of the R&D&I Framework and whether any changes are required. The Commission's Consultation paper can be found at:

http://ec.europa.eu/competition/consultations/2012_stateaid_rdi/index_en.html

The deadline for submitting responses is **24 February 2012**. The Commission will take account of the responses in revising the R&D&I Framework.

Commission green light for Big Society Capital

Background

- Big Society Capital (**BSC**) is a financial organisation, set up as part of the Government's Big Society policy, to increase investment in society where market failures have adversely affected the funding of the social sector.
- The BSC scheme was notified to the Commission for clearance under the State aid rules to allow government funds, in this case monies held in dormant back accounts, to be made available to BSC for onwards distribution to social sector organisations.
- BSC funds will be invested in social investment companies, which often find it difficult to obtain affordable funding.
- The Commission has given clearance for up to £400m of funding to be made available through BSC over five years.

Facts

Both BSC and the social investment companies are potential beneficiaries of State aid under the arrangements. Unless otherwise exempted, State aid which has not been notified to and approved by the Commission is unlawful. Therefore, Commission approval was an essential step in the establishment of BSC.

The UK Government has ensured compatibility with State aid law by:

- Including in BSC's business plan sufficient safeguards to ensure that competition is not distorted by its funding of social enterprises. For example, applicants must demonstrate that private funding is not obtainable;
- Structuring the scheme to guarantee that the aid provided to individual recipients will be of small amounts that constitute 'de minimis' State aid and consequently do not require individual approval by the Commission.

The Commission has also recognised that the measures fall within the Block Exemptions for investment aid provided for SME's, employment, regional aid and the environment.

Key points of the decision

- This decision emphasises the importance of carefully structuring State aid plans to ensure that they are compatible with EU law.
- The full decision will be published in English on the Commission website in due course:
http://ec.europa.eu/competition/state_aid/register
- This decision, together with the recently announced package of measures on the funding of SGEIs, means that charitable and other not-for-profit organisations should find it easier to access funding to provide essential social and other public services.

Commission conditionally approves financing of pensions for France Télécom's state employees working

Background

- The Commission has recently ruled on whether contributions by a State body towards a privatised company's employees' pensions can amount to State aid and, if so, under what conditions such financial assistance is compatible with EU law.
- The Commission's decision follows a lengthy investigation, following a complaint by a competitor, into an agreement by the French State to assume responsibility for France Télécom's legacy pension obligations.
- The decision will have potentially wide application, given the current funding difficulties faced by many pension schemes.

- The case is also a good example of the use by competitors of the State aid rules to ask the Commission to ensure that any State funding of a company's normal operating costs is consistent with EU law and does not distort competition.

Facts

France Télécom operates a two-tier pension scheme whereby employees who joined the company prior to its privatisation are guaranteed public sector pension rights. These rights do not apply to employees who joined the company after its privatisation.

In 1997, the French authorities agreed to assume liability for the pensions of former state employees in return for a €5.7 billion cash payment from France Télécom. The object of the change was to bring France Télécom's future pension contributions in line with those of privately owned competitors.

The Commission launched an investigation in May 2008 after receiving a complaint from a competing telecoms operator that the reform of France Télécom's pension arrangements amounted to State aid, which has not been notified and was thus illegal aid.

Key points of the decision

- The Commission held that France Télécom benefitted from the change, because it resulted in it paying lower pension contributions and transferring liability for the pensions of its public sector employees to the French State. It also did not need to pay social security contributions to cover the payment of wages to those employees in the event of its bankruptcy, unlike private competitors. Consequently France Télécom had received an economic advantage and the arrangements constituted State aid.
- However, the Commission considered that the pension arrangements were compatible with State aid, as France Télécom had made an exceptional payment of € 5.7 billion, which offset the reduction in its pension payments. In addition, the changes were justified because it covered liabilities incurred by France Télécom when it was a monopoly public service operator, rather than a private company active in a liberalised and competitive market.
- The Commission's approval of the aid is, however, subject to France Télécom bringing its annual pension and social security contributions in respect of its public-service employees entirely into line with those of its competitors by July 2012.

Please see the next page for contact details for the State aid team.

Contact

For further information on the issues described in this update or on any other State aid matter, please speak to your usual contact or one of the members of our State aid team.



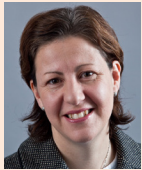
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