Giving Meaning to the Condition of Effect on Trade: The Court's Judgment in Xunta de Galicia, a Missed Opportunity?

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I. Introduction

In a judgment of 21 July 2005, the European Court of Justice (ECJ) ruled that State aid to the shipbuilding and ship conversion sector in Galicia was subject to prior notification to the Commission pursuant to Article 88(3) EC. The Autonomous Spanish Region of Galicia issued a decree establishing an aid scheme in favour of the building and conversion of small metal-hulled vessels. The Administración del Estado, the Spanish State Administration, lodged an action for annulment against the Galician decree before the competent national courts. It challenged the decree on the basis that it had been adopted in violation of the obligation of prior notification under Article 88 (3) EC. The Spanish Supreme Court referred to the Court of Justice for a preliminary ruling a question as to the proper scope of the obligation of prior notification.

Three issues of interest arose in this case. First, the use of Article 89 EC as a means of derogation from the need to notify to the Commission under Article 88(3) EC. Second, the concept of State aid itself and its link to the notification obligation. Third, and within the concept of State aid, the notion of effect on trade between Member States. Further, as a preliminary observation, the case offers an intriguing example of national enforcement of State aid control.

II. Using national federal systems to enforce control of aid measures enacted by regional entities

The case is remarkable to the extent that the issue of failure to notify the regional decree did not come to light through the usual ways, i.e. a Commission initiative, a competitor's action or another Member State's complaint. The violation of Article 88(3) EC was raised by the Spanish State itself against one of its own regional entities.

Advocate General Jacobs, in his opinion, briefly discusses whether the Spanish State's action in this case does not conflict with the State's liability at Community level for the violation of Community law committed by the Galician region. In particular, the learned Advocate General wonders whether the Spanish State is allowed in effect to rely upon its own failure to fulfill its obligations under the Treaty, although he does not reach a conclusion on this point.

The action of the Administración del Estado appears to us to be welcomed as a proper implementation of the Spanish State's duty of faithful cooperation, pursuant to Article 10 EC. Effective enforcement of Community law may demand that a party to a violation of Community law be allowed to seek judicial redress of the situation[1].

While the Spanish State's action is probably explained by the specificities of the Spanish constitutional order, it is conceivable that such enforcement initiative may also be undertaken in non-federal States by entities such as the Ministry of Finance or the national Court of Auditors. In its recent State Aid Action Plan, the Commission underlines the need, in an enlarged Community, to rely on available national structures to "play a role as regards facilitating the task of the Commission in terms of State aid enforcement (detection and provisional recovery of illegal aid, execution of recovery decisions)"[2]. On the other hand, any such initiative could never have as a consequence the decentralization of the power to authorize or prohibit a properly notified aid measure, which must remain with the Commission, as a supranational authority.

III. Importance of the legal basis: Article 87(3)(e) versus Article 89 EC

The Government of the Galician region argued that prior notification was not required, because the

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1 See for instance the possibility for a party to an agreement contrary to Article 81 EC to invoke its nullity before the national courts. See, for example, Crehan v. Interpreneur Pub Company [2004] EWCA 637 at http://europa.eu.int/comm/competition/antitrust/national_courts/court_2004_009_en.html and The Competition Authority v. ILCU [2004] IRLHC 330 at http://www.tca.ie.

2 http://europa.eu.int/comm/competition/state_aid/others/action_plan/saap_en.pdf at para. 51.

aid directed at shipbuilding and ship conversion did not fall within the scope of Directive 90/684[3]. This Directive declares that certain aid measures in favour of shipbuilding and conversion of large vessels are compatible with the Common market, while subjecting these measures to special notification rules.

The Court clarifies that the Directive, which was adopted pursuant to Article 87(3)(e) EC, cannot relieve Member States of their obligation of prior notification under Article 88(3) EC. Article 87(3)(e) EC only allows the Council to define categories of aid that are deemed to be compatible with the Common market and thus escape the prohibition laid down in Article 87(1) EC. The proper legal basis for the Council to adopt regulations as to the scope and conditions of the notification obligation is Article 89 EC.

The Council has adopted Regulation 994/98[4], on the basis of Article 89 EC, empowering the Commission to enact block exemption regulations. So far the Commission made a relatively conservative use of its powers by adopting four block exemption regulations of limited scope dealing with de minimis aid measures, aid to SMEs and training and employment aid[5].

IV. Definition of State aid and obligation to notify

In its judgment, the Court confirms, in accordance with consistent case law, that the condition of effect on trade between Member States is part of the definition of State aid. This question was first clarified in the Altmark judgment[6]. In this judgment, the Court ruled that the definition of State aid under Article 87(1) EC includes four elements. "First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition"[7].

The Xunta de Galicia judgment makes clear that only those measures that constitute State aid within the meaning of Article 87(1) EC are subject to the prior notification requirement of Article 88(3) EC. Although the Court refers to the Heineken judgment of 1984[8] as precedent, this question was once the subject of heated debate in State aid circles[9]. The Heineken judgment was indeed not entirely explicit on the issue and some, including Advocate General Slynn[10], argued that the scope of Article 88(3) EC was broader than that of Article 87(1) EC. The Court rightly rules that the scope of application of these two provisions is identical.

V. Condition of effect on trade

The judgment provides a comprehensive summary of the Court's recent case law on the interpretation of the condition of effect on trade.

Thus, the Court, quoting Altmark, recalls that effect on trade does not depend on the local or regional character of the services supplied or on the scale of the field of activity concerned. Aid to an undertaking active locally may still affect trade because undertakings established in other Member States have less chance of providing their services in the sector of the local market where the beneficiary is active. Effect on trade is not subject to any threshold. The small size of the aid amount or of the beneficiary does not exclude the possibility that trade between Member States may be affected, in particular where the sector in which the beneficiaries operate is characterized by strong competition, or where most of the undertakings active in that sector are small and the aid is available to all or a very large number.

The Court further relies on Philip Morris[11] to hold that aid which strengthens the competitive position of an undertaking competing with other undertakings in intra-Community trade must be regarded as affecting trade between Member States.

In the case at hand, the preamble to the Regional decree stated that the aid was meant to allow Galician shipyards to serve domestic and foreign customers and to benefit from the same advantages as their competitors. In such circumstances, the Court held that it

3 Council Directive 90/684/EEC of 21 December 1990 on aid to shipbuilding, OJ 1991 L 121/39.

4 Council Regulation (EC) No. 994/98 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid, OJ 1998 L 142/1.

5 Commission Regulation (EC) No. 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to de minimis aid (OJ 2001 L 10/30); Commission Regulation (EC) No. 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises (OJ 2001 L 10/33); Commission Regulation (EC) No. 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid (OJ 2001 L 010/20); Commission Regulation (EC) No. 2204/2002 of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment (OJ 2002 L 337/3).

6 Note that as late as 2003, learned commentators were of the view that effect on trade "is not, properly speaking, an aspect of the definition of State aid in Article 87(1) of the EC Treaty. Rather it is the standard by reference to which the compatibility of aid with the common market is to be assessed" Plender, Definition of Aid, in Biondi, Eeckhout and Flynn, The Law of State Aid in the European Union, Oxford University Press, 2003, page 31.

7 See Altmark judgment at paragraph 75.

8 Joined Cases 91 and 127/83 – Heineken Brouwerijen BV v Inspecteur der Vennootschapsbelasting, Amsterdam and Utrecht, [1984] ECR, page 03435.

9 See for example, Lenaerts/Pittie, "Problématique générale de la procédure de contrôle des aides d'Etat", in Les aides d'Etat en droit communautaire et en droit national, Rapport du 48ème séminaire, Commission droit et vie des affaires, Liège, 14 and 15 May 1998, § 28, page 15.

10 Opinion of Advocate General Slynn, Joined Cases 67, 68 and 70/85 – Van der Kooy, [1988] ECR, page 219 (255).

11 Case 730/79 – Philip Morris Holland BV v. Commission, [1980] ECR 02671.

was "conceivable" that the beneficiaries of the aid were in competition with shipyards established in other Member States and that the condition of effect on trade was consequently fulfilled.

The underlying analysis in the annotated judgment is thought to be rather short. At the same time, on the basis of the facts available, it appears that the conclusion reached by the Court must be correct.

Ever since the Philip Morris case, commentators have generally found that the condition of effect on trade would almost always be met, in view of the Court's fairly flexible attitude to the amount of evidence that must be adduced to demonstrate a likely effect on trade[12]. In Philip Morris, the Court held:

> "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.
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> 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 State. 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."[13]

Arguably, this reasoning seems to contain the basic building blocks for a competitive analysis, in particular in order to assess effect on trade between Member States. However, the Philip Morris judgment is always relied upon for the proposition that effect on trade can be assumed as soon as the position of an undertaking active in Community trade is improved. This presumption in turn became a way to skip market analysis altogether, resulting in a very broad interpretation of the condition of "effect on trade" which in some cases led to a situation where that condition was deprived of any independent meaning and merged into the condition of distortion of competition.

This situation is not entirely satisfactory. It stands to reason that, in order to determine whether the beneficiary is involved in intra-Community trade in competition with other Community operators, the relevant geographic and product markets must first be defined. Once this is done, the position of the beneficiary as well as that of its competitors must be determined so as to be able to assess the likely impact of the State measure under consideration. Support for this view can be found in an isolated judgment of the Court[14], where the Court found fault with the reasoning of a Commission's decision, which contained no information as to the situation on the market concerned, the beneficiary's share on that market or the position of competing undertakings. The Court also noted that the decision did not provide information on the beneficiary's share in intra-community trade. Recently, elements of this approach appear to emerge in the Commission's practice in parallel with the stated intention of the Commission's State Aid Action Plan to introduce more economic analysis in State aid control.

The Court has not provided much guidance so far on which criteria can be applied to determine whether a State measure is likely or not to affect trade between Member States. As evidenced by the annotated judgment, the Court's statements in this regard are generally couched in negative sentences meant to indicate which criteria are not necessarily relevant to the conclusion of effect on trade.

This approach has a number of downsides. First of all, it fails to provide positive guidance as to which criteria are relevant and should be applied. Second, it bears the risk of a contrario reasoning. It is certainly true that all instances of small amounts of aid or the relatively small size of the beneficiary do not necessarily imply that intra-Community trade is not affected. On the other hand, it is submitted that there are many instances where aid in small amounts or to small companies is not likely to affect trade between Member States. In these circumstances, it is important to avoid the risk that the Court's negative phraseology be interpreted as denying all relevance to the effect on trade requirement. Another risk is that the Court, following the enumeration of criteria it does not consider relevant, concludes by finding an effect on trade without having conducted any factual analysis of the propensity for such effect.

Arguably, this is what happened in Heiser[15]. In that judgment, the Court first recalled that there is no threshold below which no effect on trade can be

12 See for instance, Keppenne, Guide des aides d'Etat en droit communautaire, Bruylant, Brussels 1999, § 160, page 132.

13 Case 730/79 – Philip Morris Holland BV v. Commission, [1980] ECR 02671.

14 Joined Cases C-329/93, C-62/95 and C-63/95 – Federal Republic of Germany, Hanseatische Industrie-Beteiligungen GmbH and Bremer Vulkan Verbund AG v. Commission, [1996] ECR I-05151.

15 Case C-172/03 – Heiser, [2005] ECR I-0000.

assumed, that the small amount of the aid, the size of the beneficiaries, the local character of the services supplied do not as such exclude a potential effect on trade. The Court then noted that it was not sure that the measures concerned could benefit from de minimis. Immediately thereafter, the Court found that it was "accordingly [...] not inconceivable [...] that [dentists] may be in competition with their colleagues established in other Member States" and thus considered that the condition of effect on trade was fulfilled.

In this context, the choice of the word "inconceivable" in the Court's conclusion, which the Court appears to have borrowed from the referring national court, is noteworthy. The annotated judgment appears to follow the same line, as evidenced by the use of the words "quite possible" and "conceivable" as the operative word in the conclusion on effect on trade. This choice of words must be contrasted with the use of the words "likely to affect" and "reasonably foreseeable" in previous case law[16].

In light of the discretion granted by the Court to the Commission to assess the "possible economic effects of aid"[17], it falls to the Commission to try to define circumstances where aid would not be seen as likely to affect trade between Member States. So far, the Commission has identified two areas where aid measures could be deemed not to affect trade.

The first area is aid of a small amount granted to small undertakings active locally in sectors, which are not characterized by strong competition. Keppenne refers in this context to the Commission's guidelines on State aid for undertakings in deprived urban areas[18], where the Commission listed a number of sectors which by their are nature local, i.e. building, retail trade, car repairs and distribution, hotels and restaurants, taxis, public health and social services, household services, etc. This position is shared by Advocate General Jacobs[19].

> "In economic sectors with little competition in intra-Community trade such as car repairs, taxis services, or sectors with prohibitive transport costs, aid of a relatively small amount granted to small undertakings operating on essentially local market might not affect trade between Member States".

The second area is that where trade between Member States cannot be affected in view of the fact that the sector is not liberalized.

VI. Effect on trade as a criterion to concentrate on the most important cases

The recent case law of the Court of Justice has to be welcomed for its clarification of the identification of effect on trade as a separate element of the State aid definition, distinct from distortion of competition. So far the Court has not provided significant substantive content to this condition, although there are arguably judgments that do give useful indications as to how to conduct an appropriate economic analysis of effect on trade.

In light of the objective of the State Aid Action Plan to allow the Commission to concentrate on the most distortive instances of aid, the question arises, however, whether a resurrected condition of effect on trade would not serve as an appropriate filter. The current case law may make it difficult to define broad criteria of general application, which could be included in a horizontal block exemption regulation. However, it is submitted that the Commission should publish guidelines that would outline the economic framework of analysis for assessing the propensity to affect trade and list categories of measures that are unlikely to affect trade.

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16 Case C-142/87 – Belgium v. Commission, [1990] ECR I-00959, paragraphs 38 and 40; and Case 739/79 – Philip Morris, paragraph 12.

17 Case C-351/98 – Spain v. Commission, [2002] ECR I-08031, paragraph 52.

18 OJ 1997 C 146/6.

19 Case C-126/01 – GEMO, [2003] ECR I-13769, paragraph 145 and Case C-113 and 114/00 – Spain v. Commission, [2002] ECR I-07657, paragraph 25.

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