



Publicly-funded projects: Procurement and State aid issues

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INTRODUCTION

1. Even in times of austerity, there are numerous sources of European Union and UK Government funding available to local authorities, businesses (including small, medium-sized and micro-enterprises) and 'third sector' organisations for a wide variety of projects, investment and the provision of services.
2. These sources include:
 - a. the European Regional Development Fund;
 - b. the European Social Fund;
 - c. the Regional Growth Fund and the Local Growth Fund;
 - d. the Heritage Lottery Fund and the National Heritage Memorial Fund;
 - e. the Coastal Communities Fund;
 - f. the Growing Places Fund;
 - g. the London Energy Efficiency Fund;
 - h. the Wales Economic Growth Fund;

- i. the Mayor of London First Steps Challenge Fund; and
 - j. prudential borrowing by local authorities from the Public Works and Loans Board.
3. A common feature of funding under these, and other, schemes is that all funding provided (irrespective of its form) must comply with the EU State aid rules. In some cases, compliance may also be required with either the EU procurement rules or national procurement rules and policies (including those of devolved administrations, such as the Welsh Assembly Government). Compliance with the procurement rules may be required of the awarding authority (e.g. if it falls within the scope of the EU Procurement Directives) or of the beneficiary (whether in the public or private sectors).
4. Many projects are funded using European Union funding. This includes projects undertaken by both public authorities and the private sector. National governments (which include the Welsh Assembly Government, as a devolved administration) are responsible for managing EU Structural and Investment Funds ("**ESI Funds**"), i.e. the European Regional Development Fund ("**ERDF**"), the European Social Fund ("**ESF**"), the Cohesion Fund, the European Agricultural Fund for Rural Development ("**EAFRD**") and the European Maritime and Fisheries Fund ("**EMFF**").
5. ESI Funds are treated as 'State resources' for the purposes of State aid law, as the funds are under the control of the Member State. It is notable that the largest reason for recovery of funding for non-compliance with ERDF rules relates to non-compliance with procurement rules and one of the fastest growing reasons for recovery is the grant of funding in contravention of the State aid rules.

See generally the following guidance published by the Department for Communities and Local Government:

Procurement Law: ESIF Compliance Guidance Note (ESIF-GN-1-004, 16 July 2015), ("**DCLG ESIF Procurement Guidance**")

State Aid Law: European Regional Development Fund Guidance Note for Grant Recipients (ESIF-GN-1-006, January 2016) ("**DCLG ESIF State Aid Guidance**")

PROCUREMENT OBLIGATIONS OF BENEFICIARIES OF FUNDING FROM EUROPEAN STRUCTURAL AND INVESTMENT FUNDS

6. Procurement issues may arise both at the awarding authority level and at the beneficiary level:
 - a. at the awarding authority level, the authority may award a contract to provide services, the consideration for which is funded by one of the ESI Funds. For example, a local enterprise partnership may award a contract to provide services to a disadvantaged section of the community, such as the long-term unemployed, that is funded by the ESF. To ensure no over-compensation, this should be awarded using a tender process. Alternatively, this may also fall within the scope of the rules on services of general economic interest. This is considered below in the section addressing State aid issues.
 - b. at the beneficiary level, the beneficiary of ESI Funds will be required to disburse them in accordance with EU law.

Procurement obligations of ESI Funds beneficiaries

7. Article 6 of Regulation 1303/2013 provides that "*Operations supported by the ESI Funds shall comply with applicable Union law and the national law relating to its application ('applicable law')*": Regulation 1303/2013 laying down common provisions on the ESI Funds, (2013) OJ L 347/320. This repeals and replaces

Regulation 1083/2006, Article 9(5) of which provided that *"operations financed by the [Structural] Funds shall comply with the provisions of the Treaty and of acts adopted under it"*.

8. It is clear that 'applicable law' includes both the internal market rules and principles laid down in the EU Treaties (i.e. the Treaty on European Union and the Treaty on the Functioning of the European Union ("**TFEU**")) and also the Public Procurement Rules.
9. The obligation to comply with EU procurement law will be set out in the funding agreement entered into with the beneficiary of the ERDF funding (the "Grant Recipient"). A typical funding agreement for ERDF funding may contain the following clauses:

"The Grant Recipient warrants that it has complied with EU Procurement Requirements to date in relation to the Project.

The Grant Recipient shall comply with current EU Procurement Requirements at all times in relation to the Project.

Where the Grant Recipient is not a Contracting Authority the Grant Recipient shall comply with the provisions of the EU Procurement Requirements as if it were a Contracting Authority if it is the case that 50% or more of the consideration to be or expected to be paid will be expenditure comprising of either ERDF grant and/or Public Sector Financial Assistance."

The key term in these clauses is *EU Procurement Requirements*, which include but are not restricted to:

"The Public Contracts Regulations 2015, [the Utilities Contracts Regulations 2016 and the Concessions Contracts Regulations 2016], the EU Commission Interpretative Communication (2006/C 179/02) and the

principles of transparency, non-discrimination, equal treatment, proportionality and mutual recognition in the EU Treaties"

10. Where the project is more than 50% publicly funded (whether from EU and/or UK sources), the beneficiary may be required to follow the procedures laid down in the Public Contracts Regulations 2015, even if it would not be a 'contracting authority'. This reflects the provisions of the Public Procurement Directive (Article 13) and the Public Contracts Regulations 2015 (Regulation 13) in relation to contracts subsidised by contracting authorities for certain engineering activities or building work for hospitals, facilities intended for sports, recreation and leisure, school and university buildings and buildings used for administrative purposes.

11. A funding agreement will also typically contain the following clause:

"The Grant Recipient shall follow the procedures for tendering set out in the National ESI Funds Rules on Procurement as are notified to the Grant Recipient"

12. Funding agreements in relation to funding from other sources, whether or not ESI Funds (for example funding provided under the Local Growth Fund), may also contain the same or a similar clause, imposing procurement obligations upon the beneficiary, in order to ensure value for money. A more straightforward clause may be that *"the Grant Recipient shall comply with all applicable EU Procurement Requirements in connection with the procurement of the works or any services relating to the Project."*

13. In essence, this means that, even if the Public Procurement Directives do not apply, the beneficiary must comply with EU procurement principles when implementing a project that is funded (in whole or part) by one of the ESI Funds. This is clear from national guidance published by both the UK Government and the Welsh Assembly Government:

- a. the Department of Communities and Local Government's guidance (which applies only in England) is set out in the DCLG ESIF Procurement Guidance, Chapter 6. This states that recipient of ESIF grant funding must demonstrate compliance with "*Treaty principles*", including equal treatment, transparency, non-discrimination, mutual recognition and proportionality. Even where there is no cross-border interest in a contract and the contract is not being let by a 'contracting authority', DCLG expects grant recipients to conduct open, fair and transparent procurement processes before awarding contracts and to select the winning bidder on merit.
- b. the Welsh European Funding Office's guidance, set out in its WEFO, Eligibility rules and conditions for support from the European Structural Funds 2014 – 2020 (April 2015), pages 92 to 102 is that

"compliance with applicable EU rules and policies is a fundamental condition of the eligibility of expenditure for reimbursement from the Structural Funds" [p.92], which includes the procurement rules, such that "beneficiaries must comply with all applicable EC, UK and Welsh laws/government policies when letting contracts partly funded by the EU funds, including the UK Public Contracts Regulations 2015 that implements European Public Procurement Directives 2014" [p.95]

Compliance with the EU Public Procurement Directive

14. A beneficiary of ERDF funding must comply with the EU Public Procurement Directive if:
 - a. it is a 'contracting authority' or, if it is not a public authority, if 50% or more of the contract value is obtained from either funding from the ESI Funds or other "*Public Sector Financial Assistance*", whether of EU or UK public sector origin, which will include funding by national, devolved or local administrations in the UK and bodies in receipt of National Lottery funding;

and

- b. the contract falls within the scope of the EU Public Procurement Directive;
 - and
 - c. the contract value exceeds the applicable financial thresholds.
15. The EU public procurement rules harmonise the rules and procedures for procurement undertaken by public authorities, including government departments, devolved administrations and local authorities.
16. New directives were adopted in 2014, which must be transposed into national law by 18 April 2016 (September 2018 for e-procurement) to replace directives adopted in 2004, viz.:
- a. Directive 2014/23/EU on the award of concession contracts, (2014) OJEU L 94/1 ("**Concessions Directive**");
 - b. Directive 2014/24/EU on public procurement, (2014) OJEU L 94/65 (the Commission refers to this as the "**Classical Directive**", but in practice the terms "**Public Contracts Directive**" or "**Public Procurement Directive**") are more commonly used); and
 - c. Directive 2014/25/EU on procurement by entities operating in the water, energy, transport and postal services sectors, (2014) OJEU L 94/243 ("**Utilities Directive**").

See generally:

Cabinet Office, Transposing EU Procurement Directives

<https://www.gov.uk/guidance/transposing-eu-procurement-directives>

Welsh Assembly Government, Procurement

<http://gov.wales/funding/eu-funds/2014-2020/looking/procurement/?lang=en>

European Commission, Public Procurement,

http://ec.europa.eu/growth/single-market/public-procurement/index_en.htm

17. The application of the Directives is subject to specified financial thresholds being exceeded. From 1 January 2016, these are:
 - a. contracts for the supply of goods (i.e. 'public supply contracts' for the purchase, lease, rental or hire of products) and the provision of services (i.e. 'public service contracts' for specified categories of services): € 135,000 (£ 106,047);
 - b. contracts for works (i.e. 'public works contracts' for construction or civil engineering works): € 5,225,000 (£ 4,104,394); and
 - c. concessions contracts (i.e. contracts for the award of a concession): € 5,225,000 (£ 4,104,394).

The GBP (sterling) thresholds are updated annually by the Commission. The thresholds for 2016 are set out in its Communication of 12 December 2015, (2015) OJEU C 418/1.

18. The Public Contracts Regulations foresee the following different possible procurement procedures from which contracting authorities may choose, in accordance with Regulation 26:
 - a. open procedure (Regulation 27): any interested economic operator may submit a tender in response to a contract notice. The successful bidder is selected once bids are received.
 - b. restricted procedure (Regulation 28): any interested economic operator may submit a request to participate in response to a call for competition, with the authority inviting selected operators to submit a tender. This a two-stage procedure: (i) bidders are short-listed after receipt of pre-qualification

questionnaires and (ii) the successful bidder is selected after full tenders are submitted.

- c. competitive procedure with negotiation (Regulation 29): any interested economic operator may submit a request to participate in response to a call for competition, with the authority inviting selected operators to submit a tender with negotiation thereafter to improve tenders. This is a two-stage process: (i) negotiations with all bidders after tenders are submitted and (ii) selection of the successful bidder after revised tenders are submitted.
 - d. competitive dialogue (Regulation 30): any interested economic operator may submit a request to participate in response to a call for competition, with the authority inviting selected operators to engage dialogue as to identifying and defining the means best suited to satisfy the authority's needs. This is used where the authority cannot identify the solution to its requirements at the outset. After potential bidders complete pre-qualification questionnaires, dialogue occurs with bidders before formal tenders are submitted.
 - e. innovation partnership: (Regulation 31) any interested economic operator may submit a request to participate in response to a call for competition, with the authority inviting selected operators to participate in developing an innovative product, service or works.
 - f. negotiated procedure without prior publication (Regulation 32): exceptionally, suppliers may be approached directly to negotiate, without publication of an OJEU notice or call for competition.
19. Where the Public Procurement Directive applies, it is necessary to follow the processes and procedures set down in the Public Contracts Regulations 2015. This includes each of the following stages:
- a. preparation and planning of the procurement process;
 - b. publication of a notice in the Official Journal of the European Union;

- c. submission of tenders and selection of tenderers;
 - d. evaluation of tenders;
 - e. awarding the contract; and
 - f. contract implementation.
20. The European Commission has published guidance on how the procedures should be applied in projects that are part funded by the ESI Funds, Public Procurement - Guidance for Practitioners on the avoidance of the most common errors in projects funded by the European Structural and Investment Funds (2015), which is published at: http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/guidance_public_proc_en.pdf ("**Commission Public Procurement Guidance**"). This document provides comprehensive guidance for procurement officers and others managing procurement procedures in order to avoid procurement irregularities that may lead to the imposition of substantial financial corrections (of up to 100%) for non-compliance with the ESI Fund rules.
21. Further guidance on procurement has been provided by the Department for Communities and Local Government, including:
- DCLG, Procurement Law ESIF Compliance Guidance Note (December 2015) ESIF-GN-1-001
 - DCLG, Procurement Aide Memoire for Applicants and Grant Recipients (February 2016) ESIF-GN-1-007
22. According to the Commission Public Procurement Guidance, errors in applying the public procurement rules are the single largest source of irregularities detected by national and EU auditors when checking how ESI Funds have been spent. Therefore, considerable care should be taken in ensuring compliance with the Public Contracts Regulations 2015, whether they are applicable because the

beneficiary is a 'contracting authority' or as a result of the operation of EU law applicable to the ESI Funds and contractual obligations contained in a funding agreement.

Procurement obligations when the Public Procurement Directive is not applicable

23. The Public Procurement Directive may not be applicable where:
 - a. if the beneficiary is a 'contracting authority', the applicable thresholds are not satisfied, such that no duty to advertise the contract in the Official Journal of the European Union arises (a so-called 'sub-OJEU procurement'); or
 - b. the beneficiary is not, and is not deemed to be, a 'contracting authority', i.e. it is not a public body.
24. In these circumstances, the beneficiary of ESI Funds funding (whether or not a public authority) must still comply with general principles of EU law, in particular:
 - a. equal treatment;
 - b. transparency;
 - c. non-discrimination;
 - d. mutual recognition;
 - e. proportionality; and
 - f. the Treaty rules on the free movement of goods, the freedom to provide services and the right of establishment.
25. This is clear from the Commission Interpretative Communication on the Community law applicable to contract awards not or not fully applicable to the Public Procurement Directives (2006) OJEU C 179/2 ("Commission

Interpretative Communication"). This explains how the beneficiary conducts the procurement procedures by which it spends the funding received by it from the ESI Funds to implement the project.

26. The DCLG's (now superseded) ERDF National Procurement Guidance (July 2014, ERDF-GN-1-004)¹ made clear that:
- a. it expected all grant recipients, irrespective of their status as a 'contracting authority' under the Public Procurement Directives, to comply with EU Treaty principles when spending funds provided by the ERDF (at para [3.3]);
 - b. grant recipients should conduct open, fair and transparent competitions before awarding contracts (at para [7.1]);
 - c. the EU Treaty principles apply to all sub-OJEU procurement, regardless of contract value (at paras [9.1] – [9.3]);
 - d. all bidders must be treated fairly and impartially, using fair, objective and transparent criteria (at para [10.21]); and
 - e. the criteria for short-listing of bidders must be made clear in the advertisement and be objective, transparent and non-discriminatory, and sufficient bidders must be short-listed to ensure both adequate competition and value for money (at paras [10.22] and [10.23]).

Contract advertising

27. In particular, the obligation to comply with the principles of transparency, equal treatment and non-discrimination requires beneficiaries to undertake "*a degree of advertising sufficient to enable the services market to be opened up to competition*": Case C-324/98 *Teleaustria v Telekom Austria*, EU:C:2000:669 (at

¹ These Guidelines have been superseded by the ESIF Compliance Guidance Note (July 2015, ESIF-GN-1-001), which do not address directly the issue of compliance with the EU Treaty Principles, but they remain a useful summary of the position under EU law.

[20]) and Case C-458/03 *Parking Brixenv Gemeinde Brixen and Stadtwerke Brixen* EU:C:2005:605 (at [49]).

28. The level of advertising required will depend upon the value of the contract. According to the DCLG's (now superseded) ERDF National Procurement Guidance, the advertisement must be 'sufficiently accessible' to potentially interested economic operators, and may include the use of websites, procurement portals, newspapers and/or a voluntary OJEU notice (at para. [10]).
29. Merely contacting potential suppliers directly is not sufficient, as it is selective and may be discriminatory: Commission Interpretative Communication (at point [2.1.2]).
30. The obligation to advertise the contract is subject to the proviso that the contract "*might potentially be of interest to economic operators in other Member States*": Case C-231/03 *Coname v Commune di Cinglia de' Botti* EU:C:2005:487 (at [20]). Relevant factors to take into account include the subject-matter of the contract, its value, the specifics of the sector concerned, the geographic location of the place of performance, and evidence of tenders or expressions of interest by companies from other Member States: Commission Guidelines for determining financial corrections to be made to expenditure financed by the Union under shared management, for non-compliance with the rules on public procurement (19 December 2013) ("**Commission Financial Correction Guidelines**"), which are annexed to Commission Decision of 19 December 2013 (C(2013) 9527 final).
31. In order to demonstrate a failure to comply with the Treaty principles regarding procurement, in particular the obligation to advertise a contract not subject to the Public Procurement Directive, it is necessary to substantiate that the contract *might have been* of 'cross-border interest' to operators in other Member States, i.e. that the contract was of "*certain interest to an undertaking located in a different Member State [which was] unable to express an interest in that contract*": Case C-507/03 *Commission v Ireland* EU:C:2007:676 (at [33]).

32. The concept of 'cross-border interest' in a contract outside of the scope of the procurement rules was considered by the Court of Appeal in *R (oao Chandler) v Secretary of State for Children, Schools and Families* [2009] EWCA Civ 1011, in which the CJEU's judgment in *Commission v Ireland* was considered and applied. *Chandler* concerned a challenge to the Secretary of State's approval of University College London's involvement as the sponsor of a new academy school to be established in the London Borough of Camden.
33. Ms Chandler (an opponent of academy schools) argued the Secretary of State had approved UCL's proposal without first undertaking a procurement procedure to determine which organisation should be appointed as the sponsor of the new academy, which it was argued could include organisations established in other Member States. In relation to the question of whether there was 'cross-border interest', Arden LJ (giving the judgment of the Court of Appeal), referred to *Commission v Ireland* and held as follows (at [30]):

"The Court of Justice uses the words 'of certain cross-border interest'. We doubt whether the Court of Justice intended to hold that cross-border interest had been shown beyond reasonable doubt.... it is clear from Commission v Ireland that there is no presumption that cross-border interest exists. Clearly there must be a realistic prospect of cross-border interest... we will proceed on the basis most favourable to the appellant that if there is a realistic prospect of cross-border interest, the principles of the Treaty are engaged" (emphasis applied)

34. The Court of Appeal provided further guidance (at [66]):

"... there must be an evidential basis for the conclusion that any cross-border interest exists. A contracting authority is not bound to comply with the obligations derived from the Treaty simply because there is an outside possibility that an economic operator from some other member state might be interested. Furthermore, it is inevitable that the time for ascertaining whether economic operators outside the Member State would be interested is at the time the contract is to be made. The

contracting authority has to come to its conclusion on the basis of the circumstances then existing. In addition, the issue whether any economic operator from another member state would be interested is to be determined by reference to the specific contract in hand, and not by reference to other similar contracts" (emphasis applied)

Other obligations arising from the Treaty principles

35. The Commission Interpretative Communication (at point [2.2]) identifies a number of other procurement obligations that beneficiaries must respect when awarding the contract, in order that there is fair competition between all businesses that may be interested in the contract:
- a. non-discriminatory description of the subject-matter of the contract, using general descriptions and avoiding the use of specific technical requirements with which some potential bidders (which can satisfy equivalent requirements) might be unable to comply whilst otherwise being able to meet the contracting entity's requirements;
 - b. ensuring equal access for businesses from all Member States, for example by not requiring providers to be established the same Member State as the contracting entity;
 - c. mutual recognition of qualifications;
 - d. using appropriate time limits for expressions of interest and for submissions of offers, so that all bidders can make meaningful assessments and prepare their offers; and
 - e. ensuring a transparent and objective approach as to the award criteria and the assessment of offers.

Avoiding conflicts of interest

36. One of the important aspects of any procurement process is avoiding and managing a potential conflict of interest.

37. According to the European Commission:

"A conflict of interest exists where the impartial and objective exercise of the functions of a financial actor or other person is compromised for reasons involving family, emotional life, political or national affinity, economic interest or any other shared interest with a recipient"

Commission Public Procurement Guidance, at page [16].

38. The avoidance of a conflict of interest is a key part of treating all bidders in an equal, non-discriminatory and transparent way. These are fundamental principles of EU law and they lie at the heart of EU public procurement law: Joined Cases C-21 and 34/03 *Fabricom v Belgian State* EU:C:2005:127 (at [26]).

39. In Case C-538/13 *eViglio* EU:C:2015:166 the CJEU confirmed that:

- a. the principle of equal treatment promotes competition, such that all tenderers must be afforded equality of opportunity and thus be subject to the same conditions (at [33]);
- b. the principle of transparency precludes the risk of favouritism or arbitrariness in assessing tenders (at [34]);
- c. a conflict of interest gives preference to one bidder, so infringing the principles of equal treatment and transparency (at [36]);
- d. a contracting authority must determine if a conflict of interest exists and must take measures to prevent, detect and remedy any conflict (at [43]); and

- e. there is no need for actual bias to be proven (at [43]), provided that there is evidence calling into question the impartiality of the procedure (at [44]) and this may itself be sufficient to render unlawful the evaluation of tenders (at [47]).
- 40. Beneficiaries of grants funded by ESI Funds must therefore take steps to ensure that no conflict of interest can arise and to manage any potential risks that may arise. They and their advisers must ensure that no person in a position to influence a tender process (for example because of a relationship with a bidder) is in any way connected with the process, including in the provision of information to tenderers, the selection or shortlisting of tenderers, the evaluation of tenders and the contract award.
- 41. Measures taken should include obtaining conflict of interest declarations from members of evaluation committees and from tenderers, and also developing and maintaining appropriate policies to identify and manage any conflicts.
- 42. Further guidance may be obtained in the European Commission's European Anti-Fraud Office (OLAF) publication Identifying conflicts of interests in public procurement procedures for structural actions (2013).

Consequences of a failure to comply with procurement obligations

- 43. Failure by a beneficiary to comply with the public procurement rules constitutes an 'irregularity' that will lead to a 'financial correction' being imposed, i.e. a claw-back of some or even all of the funding received by the beneficiary: see Commission Financial Corrections Guidelines.
- 44. Different corrections are applied for specific irregularities. These are set out in the DCLG ESIF Procurement Guidance, Chapter 3 and also in the Commission Financial Corrections Guidelines.
- 45. Corrections of 100% can be imposed for serious irregularities, including for:

- a. failure to publish a contract notice when one is required by the Public Procurement Directives;
 - b. artificially splitting contracts to avoid publishing a contract notice; and
 - c. conflict of interest.
46. Corrections of up to 25% can be imposed for other irregularities, such as:
- a. non-compliance with time limits;
 - b. improper use of the negotiated procedure;
 - c. failure to state the selection criteria in a contract notice or tender documents;
 - d. unlawful, discriminatory or disproportionate selection or award criteria; and
 - e. improper evaluation of tenders, including a lack of transparency or equal treatment during evaluation.
47. In most cases, irregularities are the result of common errors arising from:
- a. inadequate preparation, e.g. changing the scope of the contract during the tender process or failure to set out clearly how bids will be scored and assessed;
 - b. sub-standard advertising, e.g. no, insufficient, inaccurate or discriminatory advertising;
 - c. express breaches of public procurement law, e.g. failing to apply time limits, mixing up selection and award criteria, accepting non-compliant bids and failing to score bids;

- d. not following the Treaty principles, e.g. providing additional information to only some bidders, not using the same criteria to assess each bid and failing to put in place procedures to address conflicts of interest; and
 - e. lack of documents to demonstrate compliance.
48. Both the European Commission (through the Court of Auditors) and the UK national authorities (through audit investigations carried out by, e.g. the Government Internal Audit Agency on behalf of the Department of Communities and Local Government) undertake audits to ensure compliance with all applicable rules.
49. Case C-465/10 *Chambre de Commerce et de l'Industrie de l'Indre* EU:C:2011:867, concerned procurement irregularities in a project part-funded by the ERDF. Whilst the beneficiary, CCI de l'Indre, had organised a procurement procedure, it had already entered into an agreement with the 'successful' bidder and had only implemented the procedure in an attempt to regularise the irregular award of the contract. The French authorities therefore sought repayment of the subsidy.
50. The CJEU confirmed that failure to comply with the procurement rules was an irregularity or negligence and the Member State in question (France) was obliged to take action to recover the sums lost as a result, including by requiring repayment of the ERDF-funded grant (at [30] – [32]). The Member State has no discretion in this regard and should it not do so, the Commission can require the Member State to reimburse the sums in question (at [34] to [36]). Therefore, the Member State could require repayment of the grant even though the project had been implemented (at [37]). The CJEU warned that "*the complete cancellation of the aid can produce the deterrent effect required to ensure the proper management of Structural Funds*" (at [40]). Furthermore, the misuse of a subsidy by infringing the procurement rules involved unjustified expenditure that seriously prejudices the EU budget, even if it has no specific financial impact (at [46] and [47]).

51. An (admitted) failure to advertise contracts for a project which had received ERDF funding was considered by the High Court in *Mansfield District Council v Secretary of State for Communities and Local Government* [2014] EWHC 2167. The Council had received (through DCLG) ERDF funding of almost £ 160,000 for the improvement of Mansfield town centre. The Council did not advertise the contracts for this work (which, at around £ 900,000, were below the Public Procurement Directive thresholds). It directly approached bidders using the "Construction Line" website to create a 'long list', in accordance with its usual practice for contracts below the EU thresholds, before issuing an invitation to tender to 'shortlisted' suppliers and then awarding the contracts. It did not advertise the contracts, whether on the "Construction Line" website, its own website or elsewhere. Indeed, there was no evidence that the Council had ever considered whether the contracts might have been of interest to suppliers located in other Member States.
52. Foskett J upheld the imposition of a 25% correction for an irregularity: failure to even consider whether there was cross-border interest in the contract was itself a breach of the EU procurement requirements (at [43]). This omission could not be rectified by an *ex post facto* justification.
53. In *Mansfield*, the Court concluded (at [57]) that:
- "the EU requirements are demanding and the onus is on the Grant recipient to get its own processes right. The help given by [DCLG] is, of course, always important, but the ultimate responsibility for complying with the procurement obligations lies on the Grant recipient" (emphasis applied)*
54. It is therefore clear that a failure to comply with the procurement rules, even when the Public Procurement Directive is not applicable, will result in the beneficiary having to repay some – or, in extreme cases, all - of the funding provided by the ESI Funds. The national authorities have no real discretion not to impose a correction once an irregularity has been detected: if they were to do

so, the Commission would be entitled to reduce the amount of future ESI Fund funding to take account of any sums not recovered.

STATE AID CONSIDERATIONS

55. Member States are responsible for distributing ESI Funds. Funding under ESI Funds programmes is therefore from 'State resources' for the purposes of the State aid rules. In addition, it is a requirement of the rules applicable to ESI Funds that they are disbursed in accordance with the State aid rules. Where funding is provided from national programmes (for example under the Regional Growth Fund or the Local Growth Fund), it must also be disbursed in accordance with the State aid rules.
56. The Department for Communities and Local Government has published guidance on how the State aid rules are to be applied in projects funded by ESI Funds: [ERDF State Aid Law Guidance](#) (7 January 2016, ESIF-GN-1-006) ("**DCLG State Aid Guidance**").
57. Compliance with the State aid rules is therefore any essential part of any publicly-funded project or contract, whether or not it uses ESI Funds. Therefore, applicants for funding will be required to complete a State aid analysis as part of their application and grant recipients will be required to comply with the State aid rules throughout the project.
58. By way of example, the application form for the Big Lottery Fund's "Building Better Opportunities" programme (which is co-funded by the Big Lottery Fund and the European Social Fund) contains the following wording:

"If our funding could give you or other organisations an advantage over other organisations offering similar services, or if the activities you want us to fund could affect trade between Member States, then our funding might be considered to be 'State Aid'.

There are strict rules governing State Aid so it's important that you get your own advice about whether your project is affected. We ask you tell us about this in question 23.

Any funding we offer is based on the assumption that, although the money provided by us constitutes state resources, the purpose for which it is used will not lead to it being considered unapprovable State Aid. If the purpose of the funding is subsequently deemed to be unapprovable, then we may withdraw it. (emphasis applied)

Question 23 asks the following:

"How have you considered whether your project may be subject to the State Aid rules? Give details of:

- where your advice about State Aid came from and how you've taken account of this in developing your project*
- any organisations in your area providing similar goods or services*
- how our funding would affect your competitive or financial position in relation to other organisations providing similar goods or services*
- the amount of funding that you've received in the last three years that was classed as State Aid"*

59. In any funding agreement, the grant recipient will be required to comply with the State Aid rules. A typical clause is:

"The Grant Recipient has undertaken its own independent assessment of the compatibility of the Project with State Aid Law and confirms to the Authority that the Project is structured so it is compliant with State Aid Law. Where the Authority has provided its views on any aspect of State

Aid Law, the Grant Recipient confirms that it has considered this information alongside all other sources of State Aid Law available at the time of entering into this Funding Agreement (including regulations and decisions published on the European Commission website) in undertaking its own assessment of the Project's compliance. The Authority has taken into account the Grant Recipient's representations on State Aid Law compliance in deciding to offer the Grant.

The Grant Recipient shall procure and maintain the necessary expertise and resources to deliver the Project in accordance with the State Aid Law for the full term of the Project. The Grant Recipient agrees to maintain appropriate records of compliance with the State Aid Law and agrees to take all reasonable steps to assist the Authority to respond to any investigation(s) instigated by the European Commission into the Project.

A finding of State Aid non-compliance in respect of the Project by the European Commission or a Court of competent jurisdiction may lead to Grant Recipient being ordered to repay the Grant with interest in accordance with the European Commission's reference rates."

60. More complex clauses may be inserted into agreements for projects that raise specific issues under State aid law, for example a funding agreement relating to a service of general economic interest (where, to avoid over-compensation, either the requirements of the Court of Justice's judgment in *Altmark Trans* or the provisions of the Commission's SGEI Decision must be implemented) or funding for a broadband network (where, again to avoid over-compensation, a 'claw-back' provision must be inserted to recover any excess profits, in accordance with the Commission's Broadband Communication).

What is 'aid'?

61. The EU State aid rules are contained in Articles 106 to 109 of the Treaty on the Functioning of the European Union ("**TFEU**"). Their purpose, according to the Commission, is to prevent Member States providing aid to companies or

businesses so as to provide them with an advantage over their competitors, as this would distort competition, trade and investment within the EU. State aid is therefore, in principle, prohibited. Nevertheless, in some circumstances government interventions is necessary for a well-functioning and equitable economy and to off-set market failure; in these circumstances, aid may be permitted. The Commission, in particular the Directorate General for Competition (“**DG COMP**”), is responsible for supervising the provision of aid and for approving aid.

62. In a very brief nutshell, the scheme of the State aid regime is as follows:
- a. State aid is in general prohibited: Article 107(1) TFEU.
 - b. State aid measures must not be implemented until they have been notified to and approved by the Commission: Article 108(3) TFEU (the so-called ‘standstill’ obligation).
 - c. As an exception to the standstill obligation, aid measures do not need to be notified to the Commission if they benefit from an exemption.
 - d. The Commission alone can approve aid, in accordance with the criteria set forth in Articles 107(2) and 107(3) TFEU.
 - e. The Commission may prohibit aid if it is not in the Union interest: Article 108(2) TFEU.
 - f. Aid that is not exempt from notification and which is not notified in accordance with Article 108(3) TFEU or which is implemented before approval is ‘unlawful’ aid. If such aid is subsequently prohibited by the Commission, it will order its recovery from the beneficiary. The Commission and national courts may restrain the provision of unlawful aid pending a final decision by the Commission.

g. Commission decisions in State aid cases may be appealed to the General Court of the European Union (“**GCEU**”) and from there to the Court of Justice of the European Union (“**CJEU**”).

63. Article 107(1) TFEU provides as follows:

“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.”

64. This has been interpreted by the EU courts as follows:

“the classification as ‘aid’ within the meaning of Article [107(1) TFEU] requires that all the conditions set out in that provision are fulfilled... Thus, for a national measure to be classified as State aid, 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”

See for example, Case C-399/08P *Commission v Deutsche Post* [2010] ECR I-7831, [38] and [39] and case law cited therein.

65. Therefore, the following criteria must be satisfied for a measure to constitute ‘aid’ within Article 107(1) TFEU:

(1) the measure must be an intervention by the State or through State resources;

(2) the measure must confer an advantage on the recipient;

(3) the measure must favour certain undertakings or the production of certain goods (selectivity);

(4) the measure must be liable to affect trade between Member States; and

(5) the measure must distort or threaten to distort competition.

How can funding not constitute aid?

66. Public funding (including from the ESI Funds) does not constitute 'aid' if any of the above criteria are not satisfied. This may arise in a number of different circumstances, some of which are considered below.

67. In this regard, the DCLG ERDF State Aid Guidance states as follows:

"The Market Economy Investor Principle is applied in order to establish whether or not a transaction between the State and the private sector involving an exchange of property (purchase of land/buildings or shares at a certain value [involves aid]). If the State can show that it is operating in the same manner as a private investor, usually by adopting the same terms of investment as a commercially driven comparator, then it is considered that no advantage accrues. Independent valuation of the property in question will normally settle the matter.

"A loan provided at the European Commission's reference rate will be considered to be at market conditions.

"An appropriately advertised open tender process (procurement) that is used to select the supplier of goods, works or services will allow suppliers to be outside the scope of State aid on the basis that their benefit is obtained on normal market conditions. Note that this approach only negates State aid at the level of the supplier and any party which benefits from the procured goods, works or services will need to be considered as a separate potential beneficiary of State aid"

DCLG, ERDF State Aid Guidance Note, page 8.

68. The DCLG advises applicants for ERDF funding to consider whether the funding could be restructured so as to fall outside of Article 107(1) (as not being aid) or, alternatively, to design the funding to meet either an existing approved non-GBER State aid scheme, a notified GBER State aid scheme or the GBER. (Schemes and the GBER are considered below). See DCLG, ERDF State Aid Guidance Note, pages 9 and 10.

The beneficiary is not an undertaking

69. A measure can constitute State aid only where the recipient beneficiary is an 'undertaking'. The concept of an 'undertaking' has a broad scope. An 'undertaking' is an entity engaged in an economic activity, i.e. offering goods and services on a market; this depends on the nature of the beneficiary's activities and not its legal form or how it is financed: Case C-41/90 *Höfner and Elser v Macrotron* [1991] ECR I-1979 (German state employment office an undertaking, even though it provided its services for free, as such services were also provided by private entities).
70. There is no need for an entity to be profit-making in order to be an undertaking and indeed, even an entity that provides its services free of charge may constitute an undertaking if it competes with other entities that do charge for their services: *Höfner and Elser* and Case C-475/99 *Ambulanz Glöckner* [2001] ECR I-8089 (provision of ambulance services an economic activity, even though providers, such as the German Red Cross, were non-profit-making).
71. An entity may carry out both economic and non-economic activities; if so, the State aid rules apply only to its economic activities. The concept of an 'undertaking' does not extend to the activities of public authorities in the exercise of their sovereign public powers, for example, the provision of infrastructure for general use, public security, social security financed through the principle of 'solidarity' and pollution control.
72. Further guidance may be found in the Commission Communication on Services of General Economic Interest (2012), points [26] to [30].

Infrastructure: State aid rules apply only to funding of economically exploited infrastructure

73. The traditional approach to the application of the State aid rules to public funding for infrastructure projects was that this fell outside of the scope of the State aid rules. This was because the provision of infrastructure was regarded as a typical function of the state, which would construct infrastructure in the general interest as part of the exercise of its public powers. This would include airports, motorways, bridges and the like.
74. However, reflecting changes in the economy as a result of which certain types of infrastructure (such as airports) are operated commercially and in competition with each other, this approach was revised in the *Leipzig-Halle* case. Leipzig-Halle Airport is a regional airport in Germany, owned, through a public holding company (Mitteldeutsche Flughafen) by two regions (*Länder*) and three cities (Dresden, Halle and Leipzig).
75. The shareholders made a substantial investment to facilitate the construction of a second runway and related infrastructure. This would enable the airport to be expanded, primarily to attract DHL to use it as a freight hub, instead of Brussels. The Commission considered that this was aid. As the investment would not be profitable, the market economy investor principle was not satisfied. However, the aid was approved as being compatible aid. The Commission decision was challenged in the EU courts by the holding company and the airport.
76. The GCEU upheld the Commission's finding that this constituted (in part) aid, holding that the construction of the new southern runway was an economic activity, such that its financing constituted State aid.
77. The CJEU dismissed a further appeal: Case C-288/11P *Mitteldeutsche Flughafen and Flughafen Leipzig-Halle v Commission* EU:C:2012:821. The CJEU held that:
 - a. in the prevailing factual and legal situation, the construction of the second runway constituted an economic activity (at [39]);

- b. the activities of construction and operation of the runway were indissociable, and the operation of the airport was an economic activity in which airport services are offered for remuneration in competition with other regional airports (at 40);
- c. the new runway formed part of the airport's economic activity, such that the new (publicly financed) infrastructure would be used for commercial purposes and the income from it would be used to finance it, so allowing the airport to increase its capacity and extend its business (at [41]); and
- d. the construction of the second runway did not fall within the exercise of public authority, although certain related activities did so (security and police, fire protection and public security measures, the German meteorological service and air traffic control) and their financing could not be treated as State aid (at [42]).

78. What does this mean? In summary:

- a. public financing of infrastructure that will be exploited commercially is itself an economic activity and thus subject to the State aid test;
- b. the transfer of state resources to a public sector (or publicly owned organisation) operating within a commercial market is subject to the State aid rules; and
- c. the exception from the State aid rules for acts in the exercise of public authority must be construed more narrowly, covering only activities that are both reserved to the state and non-economic in nature.

79. DG COMP subsequently sent a note to DG REGIO (i.e. the Commission Directorate General responsible for regional policy). Its view was that:

"... after the Leipzig/Halle ruling, it cannot be denied anymore that the financing of any type of infrastructure (excluding infrastructure related to

security, safety, etc.) that is later commercially exploited is State aid relevant. This also means a contrario that only the financing of infrastructure that is later not commercially exploited and built in the interest of the general public is in principle excluded from the application of State aid rules.

The latter would include, for instance, public roads/motorways that are not operated by a concessionaire, open to the general public; or public, non-dedicated, parks, playgrounds, etc., open to the general public.

The financing of infrastructure that is commercially exploited related to ports, airports, stadiums, waste treatment plants, as well as certain R&D, energy and broadband infrastructure prima facie falls within the scope of application of the State aid rules and should be notified to DG COMP

In conclusion, there remain very few types of infrastructure where the financing falls outside the scope of State aid rules. As soon as the infrastructure is exploited commercially, also its construction constitutes an economic activity and the project should be assessed as to its compatibility with the State aid rules."

DG COMP Note to DG REGIO: Application of State aid rules to infrastructure investment projects (2011) (emphasis applied)

80. DCLG has also published guidance, advising that:

"State Aid should always be considered early in any public financed project. For example, any organisation (regardless of whether it is public or private funded) that applies for ERDF [funding] must explain how it will structure and deliver its project in line with State Aid law"

DCLG, State Aid Law: The Application of the Leipzig-Halle Principle in ERDF Infrastructure Projects (26 October 2015) (emphasis applied)

81. The DCLG guidance also reproduce analytical 'grids' produced by the Commission that explain how to assess whether public funding for different types infrastructure projects is subject to the State aid rules. Although prepared for use in connection with projects co-financed by the ESI Funds, these grids but have a wider application.
82. This does not mean that all publicly funded infrastructure projects involve State aid. The key issue is whether the infrastructure will be exploited commercially. For example, the construction and maintenance of roads (including bus lanes intended to reduce congestion and make efficient use of road space) is a non-economic activity: Case C-518/13 *R (on the application of Eventech) v The Parking Adjudicator* EU:C:2015:9.

The measure has no effect on trade between Member States

83. In some cases, an aid measure may not affect trade between Member States. However, the threshold for such an effect to be established is very low. It is sufficient that aid may be liable to affect inter-State trade, which will be the case if it strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade, even if the beneficiary is not involved in intra-Community trade: *Eventech v The Parking Adjudicator*, at [65] to [68].
84. Thus, preferential access to bus lanes in London granted to black cabs could affect trade between Member States by rendering less attractive the provision of minicab services in London by undertakings established in other Member States: *Eventech*, at [70] and [71].
85. Likewise, a loan to the operator of the Ricoh Arena in Coventry was liable to affect inter-State trade, as the stadium was designed to be a facility that would attract national and international events, and thereby compete with stadiums in other Member States: *R (oao Sky Blue Sports and Leisure v Coventry City Council* [2014] EWHC 2089, at [137].

86. This does not, however, mean that every aid measure will have an effect on inter-State trade. As Advocate General Wahl observed in *Eventech*:

" if the service in question has any cross-border potential, then inter-State trade can be assumed to be affected. With local services, such a cross-border potential does not always exist, in which case there cannot be any cross-border effect"

Eventech, opinion of AG Wahl, 24 September 2014, EU:C:2014:2239, at [83] (emphasis applied)

87. On 29 April 2015, the Commission adopted seven decisions under the State aid rules finding that public financial support for purely local operations did not involve State aid as the projects were unlikely to have a significant effect on trade between Member States.
88. In its press release, entitled "*State aid: Commission gives guidance on local support measures that can be granted without prior Commission approval*", the Commission stated that:

"Today's decisions provide Member States and stakeholders with additional guidance to determine which cases do not need to be cleared by the Commission under EU State aid rules.

... if State support is granted to an activity which has a purely local impact, there may not be an effect on intra-EU trade, e.g. where the beneficiary supplies goods or services to a limited area within a Member State and is unlikely to attract customers from other Member States"

European Commission Press Release, *State aid: Commission gives guidance on local support measures that can be granted without prior Commission approval* IP/15/4889 (29 April 2015) (emphasis applied)

89. Therefore, the State aid rules will not be applicable where the following criteria are satisfied:

- a. the beneficiary is active only in a limited area within a Member State, such that the services provided by the beneficiary recipient are purely local in nature;
- b. the beneficiary's services are aimed at the local population and are unlikely to be of interest to and attract customers from other Member States; and
- c. there is no evidence of current or foreseeable cross-border investment in the relevant sector or of the establishment of providers from other Member States in the relevant region.

Case SA. 37963 (2014/NN) (ex-2013/CP) *United Kingdom: Alleged State Aid to Glenmore Lodge*, at [14] and Case SA.33149 (2014/NN ex 2011/CP) *Germany: Städtische Projektgesellschaft "Wirtschaftsbüro Gaarden – Kiel"*, at [19]

90. The decisions referred to in the Commission's press release concerned:

- a. public financing for a business advisory centre operated by the local authority and providing advice services to micro-enterprises in a deprived local district in Kiel: *"Wirtschaftsbüro Gaarden – Kiel"*;
- b. public financing for the Scottish National Outdoor Training Centre at Glenmore Lodge, Aviemore: *Glenmore Lodge*;
- c. tax exemptions for member-owned golf clubs in the United Kingdom that were established as 'community amateur sports clubs': Case SA.38208 (2014/NN) (ex 2014/CP) *United Kingdom: Alleged State aid to UK member-owned golf clubs*;
- d. in three cases, financial support to local general hospitals that provided health services to their local populations, such that, in each case, competition

took place only at a local level; e.g. Case SA.37432 (2015/NN) *Czech Republic: Funding to Hospitals in the Hradec Králové Region*; and

e. investment to upgrade a municipally-owned fishing port at Lauwersoog in the north of the Netherlands: Case SA.39403 (2014/N) *Netherlands – Investment Aid for Lauwersoog port*.

91. In each case, the beneficiary undertakings' activities were provided to and catered for a local, regional or at most national customer base. There was no evidence of either (i) any, or any significant provision, of services to customers located in other Member States or (ii) cross-border investments or establishment for the types of services offered by the respective beneficiaries. Accordingly, the measures did not have an effect upon trade between Member States and thus did not fall within the scope of Article 107(1) TFEU.

Market economy operator

92. It is perhaps unlikely that the provision of funding (whether by way of a grant or subsidised loan) will be on market terms: the need for the grant or the loan is generally indicative of a market failure necessitating the intervention of public authorities, whether through the use of national funds or ESI Funds.

93. Nevertheless, where funding is provided through an equity investment, a loan or a repayable advance it is potentially possible that this may be on market terms, in accordance with the 'market economy operator' principle. This could also be the case where a loan is made available on market terms.

94. The Commission has provided guidance on how it may be established that a measure is on market terms: Commission Draft Notice on the notion of state aid (2014) at [86] to [108].

95. State aid law applies only where an *economic advantage* is conferred upon a beneficiary: *Eventech*, at [48]. There must be a sufficiently direct link between the advantage given to the beneficiary and the reduction in the State budget (or

risk of burdens on that budget), although it is not necessary that the advantage and the reduction/risk are equivalent: Joined Cases C-399 and 401 P *Bouygues Télécom v Commission* EU:C:2013:175, at [108] to [110].

96. An advantage is therefore either a positive benefit (such as a subsidy) or another measure that mitigates the charges that are normally included in the budget of an undertaking and therefore is of similar character and effect to a subsidy.
97. No aid will arise where the State acts as a market economy operator, as there is no advantage to the beneficiary. This is the case whether the State is acting as an investor, creditor or vendor. The principle cannot, however, be applied when the State acts a public authority, for in this situation the conduct of the State can never be compared to a private investor in a market economy: Case T-196/04 *Ryanair v Commission (Charleroi)* EU:T:2008:585, at [84] and [85].
98. In Case C-124/10 P *Commission v France (Electricité de France)* EU:C:2012:318, the Court of Justice held that:

" the conditions which a measure must meet in order to be treated as 'aid' for the purposes of Article [107 TFEU] are not met if the recipient public undertaking could, in circumstances which correspond to normal market conditions, obtain the same advantage as that which has been made available to it through State resources. In the case of public undertakings, that assessment is made by applying, in principle, the private investor test" (at [78])

and that

"The applicability of the private investor test ultimately depends... on the Member State concerned having conferred, in its capacity as shareholder and not in its capacity as public authority, an economic advantage on an undertaking" (at [81])

99. The Court of Justice provided the following further guidance in the *EDF* case on how the 'private investor test' is to be applied:
- a. the assessment to be made is "*whether the same measure would have been adopted in normal market conditions by a private investor in a situation as close as possible to that of the State*" (at [79]);
 - b. only the benefits and obligations linked to the situation of the State as shareholder may be taken into account, to the exclusion of those linked to its situation as a public authority (at [79] and [80]; and
 - c. whilst the Commission (in assessing aid) is obliged to consider whether the test may be applicable (at [104]), it is for the Member State to prove that it acted as a rational private investor, by producing unequivocal, objective, verifiable and contemporaneous evidence that it acted as a rational market economy investor (at [81] to [85]).
100. A Member State may, in accordance with the market economy investor principle, take a long-term view of the profitability of its investment: it need not be motivated by a short term view of profitability, provided that that the measure achieves a commercially acceptable over the longer-term. This may include incurring short-term losses if there are prospects of longer-term profitability: *Joined Cases T-124 etc./95 Neue Maxhütte Stahlwerker and Lech Stahlwerke v Commission* [1999] ECR II-17.
101. In the case of loans made by public authorities, the Commission has published guidelines to help assess whether the rate of interest is at a market rate: Commission Communication on the revision of the method for setting the reference and discount rates ("**Reference Rate Communication**") (2008). The reference rate is only a proxy for the 'market rate' and is not binding.
102. In essence, a loan will be on market terms if the rate of interest exceeds the 'reference rate', which is calculated by taking the national 1 year base rate (1 year LIBOR in the United Kingdom) and adding a risk premium, which depends

on the credit-worthiness of the borrower and the security provided. This may require the lender to obtain independent professional advice as to the appropriate reference rate.

103. The Reference Rate Communication cannot be relied upon where there is evidence that banks have refused to lend on any terms (even if the rate is above the applicable reference rate) or if the rate is below that for comparable loans advanced by private banks: Case C-457/00 *Belgium v Commission (Verlipack)* [2003] ECR I-6931 and Case T-1/12 *France v Commission (Sea France)* EU:C:2015:17.

Purchasing of services using tender procedures

104. Public funds (including from the ESI Funds) may be used to fund the provision of services. For example, a local enterprise partnership may use ESI Funds to support the provision of services of a social nature to disadvantaged citizens, such as the disabled or long-term unemployed, in order to assist them back into work.
105. If the public authority uses a tender procedure to select the provider, this may mean that no State aid arises, as the award would be considered to be on market terms and therefore not confer any advantage on the chosen contractor.
106. As noted above, the market economy operator test can be applied in circumstances where the State, or a public authority, is the seller of assets, including in a privatisation. The Commission has published guidance on the sale of assets by public authorities: Commission Communication on State aid elements in sales of land and buildings by public authorities (1997). Further guidance is to be found in the draft Commission Notice on the notion of State aid (at [91] to [99]). The same principles apply when the public authority is purchasing services, or funding services to be provided on its behalf to third parties.

107. For no State aid to arise, the transaction must be undertaken by way of a tender process that is:
- a. open, i.e. that allows all interested and qualified bidders to take part (e.g. either an 'open' or 'restricted' procedure under the EU Public Procurement Directives). However, 'competitive dialogue' and the 'negotiated procedure' cannot be used, as these give the public authority considerable discretion in the choice of parties with which it will deal, which may restrict participation of interested participants;
 - b. transparent (e.g. in terms of equal access to information);
 - c. well-publicised;
 - d. non-discriminatory (i.e. all bidders must be treated equally and in a non-discriminatory way; selection and award criteria must be objective and published; and all bids must be compared and assessed objectively); and
 - e. the only relevant criterion for selecting the buyer should be either the lowest price or the 'most economically advantageous tender'.
108. Furthermore, the tender process must be competitive, i.e. it is established in a way that allows multiple bids to be submitted. Where it is structured in such a way that only one provider is realistically able to submit a credible bid, the tender is not competitive and cannot establish the market price: draft Commission Notice on the notion of aid (at [98] and [99]).

Service of general economic interest: no aid if the conditions laid down in the Altmark Trans judgment are satisfied

109. It is common that many services are not or cannot be provided by the market, whether at all or to the quality and/or extent that the State requires. Such services will therefore often require a subsidy and may be provided under a 'public service obligation'. Such services may, if they are economic in nature, be

'services of general economic interest' ("SGEI") where they are provided in the general interest and not in the particular interest of specific persons or groups.

110. If the service is not economic in nature, then the State aid rules will not apply in any event, as the beneficiary will not be carrying out an economic activity. This will include:
- a. acts of in the exercise of public powers or where authorities emanating from the State act in their capacity as public authority, such as: the army or police; air navigation safety and control; anti-pollution surveillance; and criminal justice;
 - b. social security, where funded on the basis of 'solidarity', i.e. compulsory non-profit-making schemes where contributions are unrelated to risk and benefits are unrelated to contributions;
 - c. healthcare services, where these are not provided for remuneration and funded on the basis of the principle of 'solidarity' and providers are not in competition with each other; and
 - d. education organised within the national education system and not financed predominantly by fees or commercial revenues.

Commission Communication on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012) ("Commission SGEI Communication"), at [8] to [30].

111. Whilst the Member States have a broad discretion in designating a service as an SGEI to meet "*the needs of its citizens*" and to reflect "*technological and market developments and social and political preferences*", the Commission considers that it "*would not be appropriate to attach specific public service obligations to an activity which is already provided or which can be provided satisfactorily and under conditions, such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest, as defined by the State,*

by undertakings operating under normal market conditions”: Commission SGEI Communication, at [45] to [48].

112. Public financial support is often provided to undertakings that are subject to public service obligations. In *Altmark Trans*, the CJEU confirmed that where such financing is provided to compensate an undertaking for discharging such obligations, there is no aid, provided that four cumulative conditions are satisfied: Case C-280/00 *Altmark Trans v Nahverkehrsgesellschaft Altmark* [2003] ECR I-7747.
113. The rationale for this is that in such circumstances the undertaking concerned does not receive an advantage putting it in a more favourable economic position than compared to other undertakings.
114. The four *Altmark* conditions are as follows:
 - (1) *entrustment act*: the State must entrust the undertaking to provide the service, by way of legislation, regulatory act or contract. This act must define the obligations of the undertaking and the public authority;
 - (2) *the parameters for calculating compensation*: these must be established in advance in an objective and transparent manner, taking account only of direct costs of provision of the SGEI and a reasonable profit and taking account of all revenues received. These criteria must be specified in any tender documents;
 - (3) *avoidance of over-compensation*: the compensation must not exceed the extra costs of discharging a public service obligation, taking account of revenues and a reasonable profit (i.e. a typical rate of return in the relevant sector, taking account of the level of risk, by reference to comparable undertakings); and
 - (4) *selection of provider*: the compensation payable must be the result of either:

- a. a public procurement procedure (e.g. an open, transparent and non-discriminatory procedure in line with the EU Public Procurement Directives, where the successful bidder is selected “at least cost to the community” in which the lowest priced tender or the “most economically advantageous tender” is accepted, with a mechanism to claw-back excessive profits), or
- b. a benchmarking exercise with a typical (i.e. average) undertaking that is well run and provided with the means to fulfil its public service obligations, taking account of revenues and a reasonable cost. The comparator must be efficiently-run, measured using appropriate productivity and financial standards.

Further guidance is provided in the Commission SGEI Communication, at [42] to [77].

115. It may be difficult to demonstrate compliance with the *Altmark* criteria, particularly the third and fourth ones, given the imprecision inherent in terms such as ‘reasonable profit margin’. If there were to be a complaint or litigation by a third party, the Commission or a national court might take a different view, and find that there was in fact (non-notified and thus illegal) aid. Therefore, many awarding authorities may prefer to use other means of ensuring that their financing of SGEIs is lawful, in particular a block exemption from notification.

What if there is aid?

116. If a measure is found to constitute State aid, it is in principle subject to notification to the Commission and may not be implemented until approved by it: see Article 108(3) TFEU. However, the majority of aid measures can be implemented without having first been notified to the Commission by falling within an exemption.

De minimis aid

117. The first exemption from notification is contained in the De Minimis Regulation: Commission Regulation (EU) 1407/2013 on the application of Articles 107 and 108 TFEU to *de minimis* aid (18 December 2013).
118. This exempts aid of small amounts to undertakings in all sectors (with some exceptions, such as aid to the agriculture and fisheries sectors and aid contingent upon exports). The aid can be used for most purposes, including for operating aid. It cannot be used to fund costs already supported under another block exemption (such as the GBER) if this would exceed the applicable exemption threshold.
119. Aid is *de minimis* aid where the total amount of aid (irrespective of its form or objective) to a 'single undertaking' is less than € 200,000 over any period of three years (€ 100,000 in the road freight transport sector). The concept of a 'single undertaking' ensures that the *de minimis* threshold is applied to corporate groups, to prevent aid being artificially split up: see Article 2.2.
120. The aid threshold is calculated in cash terms, so aid other than in the form of a grant must be converted to a gross grant equivalent: De Minimis Regulation, Article 3.
121. Aid other than grants and interest rates subsidies must be 'transparent aid' through the calculation of a gross grant equivalent. This includes aid in loans, capital injections, risk finance measures and guarantees. Specific rules apply to each type of measure: De Minimis Regulation, Article 3.
122. Before *de minimis* aid is awarded, the awarding authority or body must verify that the recipient will not (including the proposed aid) exceed the *de minimis* ceiling. It must receive a declaration from the intended recipient of any other aid (including *de minimis* aid) received in the previous two and current fiscal years. *De minimis* aid must not be granted if it would exceed the ceiling: De Minimis Regulation, Article 6.

123. If the ceiling would be exceeded by a particular measure, none of the new aid may qualify as *de minimis* aid: Article 3.7. The beneficiary must be informed that they are receiving *de minimis* aid. The awarding authority must keep records of all *de minimis* aid provided by it.

De minimis aid for SGEIs

124. Small amounts of aid provided to an undertaking entrusted with the provision of an SGEI may be exempt from notification (and thus be capable of being implemented without notification to and approval by the Commission) under the SGEI De Minimis Regulation: Commission Regulation 360/2012 on the application of Articles 107 and 108 TFEU to de minimis aid granted to undertakings providing services of general economic interest (2012). This Regulation applies until 31 December 2018: Article 5.
125. The SGEI De Minimis Regulation exempts aid of up to € 500,000 provided to an undertaking providing an SGEI over any period of three fiscal years: Article 2.2.
126. The following points should be noted:
- a. the aid must be expressed as cash grant: aid other than a grant must be expressed as the gross grant equivalent ("**GGE**"): Article 2.3;
 - b. if the overall amount of the aid exceeds the threshold, none of it benefits from the exemption: Article 2.5;
 - c. there are limits on the cumulation of *de minimis* aid with other aid: Articles 2.6 and 2.7; and
 - d. the aid may not be cumulated with compensation for the same SGEI: Article 2.8.

127. The aid must also be 'transparent' aid, i.e. it must be possible to calculate precisely the GGE of the aid: Article 2.4. This means that:
- a. in the case of loans, the GGE must be calculated using the applicable reference rate;
 - b. capital injections are transparent only if the total injection is less than the aid ceiling (i.e. € 500,000);
 - c. risk capital aid is transparent only if the capital is below the aid ceiling; and
 - d. guarantees are transparent only if provided to a firm that is not in difficulty, the guaranteed part of the loan does not exceed € 3,750,000 and the guarantee does not exceed 80% of the value of the loan.
128. Member State must monitor the grant of *de minimis* aid, inform the beneficiary of the prospective amount of aid (expressed as a GGE) and obtain a declaration from the beneficiary of other aid received in the previous two and current fiscal year: Article 3.

Aid schemes

129. Member States may notify an 'aid scheme' to the Commission for approval. Alternatively, an 'aid scheme' may fall within the scope of the General Block Exemption Regulation ("**GBER**") and have been notified to the Commission on that basis. An 'aid scheme' sets out the terms and conditions on which a Member State may fund a specific project or provide a particular category of aid. Provided that individual aid is granted in accordance with the terms of the scheme (and in accordance with any Commission approval decision), such individual aid is also compatible with the internal market and does not need to be notified to the Commission for approval.
130. A number of different aid schemes have been implemented for England and also by the devolved administrations. Both the providers and beneficiaries of aid

should consider whether an aid scheme is available for the aid. In order to benefit from scheme, the project and the funding measure must meet *all* of the applicable conditions.

131. In England, the following aid schemes have been implemented, and each covers grants, loans below the reference rate (i.e. subsidised loans) and repayable advances. In each case, aid may be awarded in accordance with (i) the relevant provisions of the GBER and (ii) the conditions of the Scheme. Each scheme covers both funds from the ESI Funds and national funds. Each Scheme has a financial limit of aid that may be disbursed each year and a maximum amount of aid that may be provided to a single undertaking.
- a. The English aid for access to finance for SMEs State Aid Scheme
 - b. The English aid for Cultural and Heritage Conservation State Aid Scheme
 - c. The English aid for disadvantaged workers and workers with disabilities State Aid Scheme
 - d. The English aid for environmental protection State Aid Scheme
 - e. The English aid for local infrastructures State Aid Scheme
 - f. The English aid for SMEs State Aid Scheme
 - g. The English regional aid State Aid Scheme
 - h. The English research and development and innovation State Aid Scheme
 - i. The English training aid State Aid Scheme
132. Further information on each of these Schemes is available on the DCLG website, at <https://www.gov.uk/government/publications/european-regional-development-fund-2014-to-2020-state-aid-schemes>.

133. Other schemes in England and/or the United Kingdom as a whole (which have been notified to and approved by the Commission on an individual basis) include:
- a. Enterprise Capital Funds (aid to promote the establishment of venture capital funds for SMEs)
 - b. Climate Change Levy reduction for metal recycling activities
 - c. Renewable Heat Incentive Scheme (aid for heating installations from renewable sources)
 - d. The National broadband Scheme for the UK – Broadband Delivery UK
 - e. Enterprise Investment Scheme (EIS) and Venture Capital Trusts Scheme (VCTS)
 - f. Business Premises Renovation Allowance
 - g. Aid Scheme for CCS Commercialisation Programme FEED Studies
 - h. Areas of Outstanding Natural Beauty Landscape Protection and Enhancement Support Scheme
 - i. Aid for indirect carbon price floor costs
134. The Welsh Assembly Government has implemented a number of aid schemes under the GBER. Information is available at: <http://gov.wales/funding/state-aid/gber/schemes/?lang=en>. These schemes cover broadly the same subject matter as their English counterparts, with the following additional schemes:
- a. Welsh Government support for sports, multifunctional and local infrastructure projects scheme

- b. Welsh Books Council – Culture and Heritage Conservation Scheme (Literature)
 - c. Welsh Government Wales Screen Fund
 - d. Welsh Government Property Development Scheme
135. The Welsh Local Government Association has also registered a number of schemes that can be used by local authorities in Wales. Information is available at: <http://www.wlga.gov.uk/competition-and-state-aid>.

General Block Exemption Regulation

136. The General Block Exemption Regulation provides an exemption for numerous different categories of aid: Commission Regulation (EU) 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 TFEU (General Block Exemption Regulation) (17 June 2014).
137. The Commission has also published FAQs, General Block Exemption Regulation (GBER) – Frequently Asked Questions (July 2015), which provide detailed guidance on various provisions of the GBER.
138. The GBER consists of general provisions and specific provisions for different categories of aid. The GBER is a ‘cornerstone’ of the Commission’s ‘State Aid Modernisation Agenda’, which has implemented a thorough reform of the application of the State aid rules, including through simplification of the rules and enabling the Commission to focus its resources on cases that matter most for competition and the internal market.

General provisions

139. The GBER has a number of general provisions that are applicable to the different categories of aid that are covered by it.

140. Whilst the GBER is of general application, there are some exceptions to this, including that: with some exceptions, it does not apply to aid schemes with an annual budget of over € 150,000,000 (Article 1.2(a)); and it does not apply to aid in the fisheries and agricultural sectors (Article 1.3).

Notification thresholds

141. The GBER sets down notification thresholds, above which aid must be notified to the Commission even if it would otherwise fall within the GBER: Article 4. This is to ensure that larger projects, which are more likely to have adverse effects on competition, continue to be notified on an individual basis to, and are reviewed by, the Commission. These should be checked carefully.

Transparent aid

142. The GBER applies only to 'transparent aid': Article 5. The GBER therefore applies only to:
- a. grants and interest rate subsidies;
 - b. aid comprised in loans, when the gross grant equivalent is calculated on the basis of the prevailing reference rate;
 - c. aid comprised in guarantees, where the gross grant equivalent is calculated;
 - d. aid in the form of tax advantages, if these are capped to the applicable threshold;
 - e. aid for regional urban development;
 - f. aid comprised in risk finance measures;
 - g. aid for start-ups;
 - h. aid for energy efficiency projects;

- i. aid for premiums in addition to the market price for renewable energy; and
- j. aid in the form of repayable advances, if the nominal amount does not exceed the relevant threshold.

Incentive effect

- 143. Aid covered by the GBER must have an *incentive effect*. Article 6. This means that the written application for the aid must have been made *before* work on the project or activity starts.
- 144. In the case of aid to large enterprises (i.e. not SMEs), it must be demonstrated that either the project would not have been carried out without the aid (for regional investment aid) or the aid will lead to a material increase in project scope, project expenditure or the speed of project completion (other aid).
- 145. Some forms of aid are deemed to have an incentive effect: Article 6(5).

Aid intensity and eligible costs

- 146. The GBER sets a threshold for the aid, known as the 'aid intensity'. This means that the amount of aid, as a proportion of the 'eligible costs' of the project, cannot exceed the applicable 'aid intensity'. The aid intensity and the eligible costs vary for each category of aid covered by the GBER.
- 147. Article 8 sets out some general rules on the calculation of the aid intensity. In particular:
 - a. eligible costs must be supported by documentary evidence;
 - b. aid other than grants must be calculated as a gross grant equivalent; and
 - c. aid paid in instalments and the related eligible costs must be discounted to the value at the time the aid is granted, using the applicable discount rate published by the Commission.

Cumulation of aid

148. All aid received for a project must be taken into account in applying the notification thresholds and the maximum aid intensities: Article 8. This does not include EU funds managed by the EU institutions and agencies, but does apply to ESI Funds managed by national authorities.
149. Exempted aid may not be cumulated with *de minimis* aid.

Publication, reporting and monitoring

150. To ensure transparency, Member States must publish, on a website, information on aid granted under the GBER: Article 9. Member States must also provide to the Commission information on each aid measure and also an annual report: Article 11. They must also maintain detailed records and supporting documentation to demonstrate compliance with the GBER and to enable monitoring by the Commission: Article 12.

Specific exemptions

151. The GBER exempts numerous different categories of aid. Each category has its own specific rules, which should be considered in detail, in order to ensure compliance. These specific rules will cover, inter alia:
- a. projects for which aid may be provided;
 - b. criteria that must be met in order for a project to benefit from an exemption;
 - c. maximum aid intensities;
 - d. eligible costs for which aid may be provided;
 - e. minimum contributions to be provided by the beneficiary and how these may be provided;

152. The GBER covers a wide range of aid measures. The DBIS State Aid Manual, Chapter 5, provides detailed guidance on the different categories of aid measure covered by the GBER:

a. *regional aid*, in so-called 'assisted areas': Articles 13 to 15. The UK Regional Aid map may be found at <http://www.ukassistedareamap.com>. This includes:

- regional investment aid
- regional operating aid

b. *regional urban development aid*: Article 16

c. *aid to SMEs*: Articles 17 to 20):

- investment aid
- aid for consultancy
- aid for participation in fairs
- aid for cooperation costs incurred by SME participating in European Territorial Cooperation projects

d. *aid for access to finance for SMEs*: Articles 21 to 24

- risk finance aid
- aid for start-ups
- aid to alternative trading platforms specialised in SMEs
- aid for scouting costs

e. *aid for research and development and innovation*: Articles 25 to 30

- aid for research and development projects
- aid for research infrastructures
- aid for innovation clusters
- innovation aid for SMEs
- aid for process and organisational innovation
- aid for research and development in the fishery and aquaculture sector

f. *training aid*: Article 31

g. *aid for disadvantaged workers and workers with disabilities*: Articles 32 to 35

- aid for the recruitment of disadvantaged workers in the form of wage subsidies
- aid for the employment of workers with disabilities in the form of wage subsidies
- aid for compensating the additional costs of employing workers with disabilities
- aid for compensating the costs of assistance provided to disadvantaged workers

h. *aid for environmental protection*: Articles 36 to 49

- investment aid enabling undertakings to go beyond Union standards for environmental protection or to increase the level of environmental protection in the absence of Union standards
 - investment aid for early adaptation to future Union standards
 - investment aid for energy efficiency measures
 - investment aid for energy efficiency projects in buildings
 - investment aid for high-efficiency cogeneration
 - investment aid for the promotion of energy from renewable sources
 - operating aid for the promotion of electricity from renewable sources
 - operating aid for the promotion of energy from renewable sources in small scale installations
 - aid in the form of reductions in environmental taxes
 - investment aid for remediation of contaminated sites
 - investment aid for energy efficient district heating and cooling
 - investment aid for waste recycling and re-utilisation
 - investment aid for energy infrastructure
 - aid for environmental studies
- i. *aid to make good the damage caused by certain natural disasters*: Article 50
- j. *social aid for transport for residents of remote regions*: Article 51

- k. *aid for broadband infrastructures*: Article 52
- l. *aid for culture and heritage conservation*: Article 53
- m. *aid schemes for audio-visual works*: Article 54
- n. *aid for sport and multifunctional recreational infrastructures*: Article 55
- o. *aid for local infrastructures*: Article 56

153. On 7 March 2016, the Commission announced plans to extend the scope of the GBER to include some investment aid provided to ports and airports and also to increase the exemption thresholds for aid for culture. The consultation is open until May 2016.

Commission Press Release, *State aid: Commission invites comments on draft provisions to simplify implementation of unproblematic state support for ports and airports* (IP/16/622, 7 March 2016).

154. Whether or not a specific aid measure falls within one of the categories of aid within the GBER is often a complex matter, which must be considered carefully. It may require a multi-disciplinary approach, including legal, finance and technical expertise.

Other block exemptions

155. There are a number of other block exemptions, including for aid:
- a. for passenger transport services by rail and by road: Regulation 1370/2007 on public passenger transport services by rail and by road (2007). See Commission Communication, Interpretative Guidelines concerning Regulation 1370/2007 (2014).
 - b. in the agricultural and forestry sectors, and in rural areas, both a de minimis regulation (Regulation 1408/2013 on the application of Articles 107 and 108

TFEU to de minimis aid in the agriculture sector) and a block exemption regulation (Regulation 702/2014 declaring certain categories of aid in the agricultural and forestry sectors and in rural areas compatible with the internal market in application of Articles 107 and 108 TFEU (2014); and

- c. in the fisheries sector, both a de minimis regulation (Regulation 717/2014 on the application of Articles 107 and 108 TFEU to de minimis aid in the fishery and aquaculture sector (2014) and a block exemption regulation (Regulation 1388/2014 declaring certain categories of aid to undertakings active in the production, processing and marketing of fishery and aquaculture products compatible with the internal market in application of Articles 107 and 108 TFEU (2014).

Commission SGEI Decision: a block exemption for some SGEI aid

156. In December 2011, the Commission adopted a decision on the application of Article 106(2) TFEU to public service compensation: Commission Decision on the application of Article 106(2) TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (2011) ("**SGEI Decision**").
157. The SGEI Decision applies to financing for public service obligations that does not fulfil the four cumulative *Altmark Trans* criteria (see above) and, if the conditions of Article 107(1) TFEU are fulfilled, constitutes aid. In effect, it provides a block exemption for such financing from prior notification in accordance with Article 108(3) TFEU.
158. A number of conditions must be satisfied for the SGEI Decision to be applicable:
 - a. entrustment act (Article 4). This must specify
 - i. the content and duration of the public service obligations
 - ii. the undertaking and the territory concerned

- iii. the nature of any exclusive or special rights assigned to the undertaking
 - iv. a description of the compensation mechanism and the parameters for calculating, controlling and reviewing the compensation
 - v. arrangements for avoiding and recovering any over-compensation (claw-back)
 - vi. a reference to the SGEI Decision
 - b. compensation shall not exceed the net cost of discharging the public service obligation, including a reasonable profit (Article 5). The 'net cost' is either
 - i. the difference between the direct costs incurred (calculated on the basis of accepted accounting principles) and revenues received, or
 - ii. the difference between the net cost of operating with a public service obligation and the net cost or profit of operating without it; and
 - c. control of over-compensation, through undertaking regular checks (at least every three years and at the end of the entrustment period) and a claw-back mechanism to recover any over-compensation (Article 6)
159. The SGEI Decision sets forth different levels of compensation that is covered by the exemption (Article 2.1), provided that the maximum duration of the entrustment period is 10 years, unless significant investment is required that must be amortised over a longer period (Article 2.2), viz:
- a. hospitals and emergency medical services: no limit.
 - b. social services (health and long-term care, childcare, access to an reintegration into the labour market, social housing and the care and social inclusion of vulnerable groups): no limit.

- c. air and maritime links to islands with fewer than 300,000 passengers annually: no limit.
- d. regional airports (less than 200,000 passengers annually) and ports (less than 300,000 passengers annually): no limit.
- e. other SGEIs, other than transport and transport infrastructure: € 15 million per annum.

What if there is aid: notifications to the Commission

- 160. If a public funding measure is State aid within Article 107(1) TFEU and is not exempt from notification (for example under the GBER or the SGEI Decision), it must be notified to the Commission. Notification is very much a 'last resort': under the Commission's State Aid Modernisation Plan, the vast majority of aid should be administered under either the *de minimis* aid regime, the GBER or another block exemption.
- 161. Notification is undertaken in conjunction with the State Aid Branch at the Department for Business Innovation and Skills. Notifications can only be made by DBIS. Further information is set out in Chapter 8 of the DBIS State Aid Manual.
- 162. In reality, DBIS will not wish to make a notification for small projects: DBIS and DCLG consider that "*it is usually only appropriate to undertake notification on large strategic/major projects where no alternative exemption could be used to obtain the same objectives*": DCLG ERDF State Aid Guidance, para. [41].

163. There are various reasons for this. Therefore, for a grant or other funding to be made, it will be necessary to demonstrate to the awarding authority either that the funding does not constitute aid or that it is exempt from notification.

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