

Agenda

Advancing economics in business

State aid practice under challenge? Implications of landmark court judgments

Is standard state aid practice under challenge? National courts in the EU are playing an ever more significant role in the application of state aid law, with litigation on state aid issues increasing considerably in recent years. Landmark court judgments raise important questions about the role of EU national courts in this area, and about the assessment of aid recovery. These judgments have potential consequences for every state aid decision

Under EU legislation, measures by the state that confer an economic advantage, favour certain undertakings, distort or have the potential to distort competition, or affect trade between member states, are deemed to constitute state aid. This aid can take different forms, ranging from government funding or tax exemptions to an implicit financial guarantee.

State aid must be notified to the European Commission, and is presumed to be illegal unless deemed by the Commission to be compatible with state aid rules.¹ Illegal state aid must be repaid by the beneficiary to the relevant member state.

The aim of recovering state aid is to make the beneficiaries forfeit the advantage they had received over their competitors, in order to re-establish the market situation that existed prior to the granting of aid. In principle, the amount of aid to be repaid is equivalent to the economic advantage obtained by the beneficiary.

Private litigation on state aid matters has increased considerably over the last few years, with courts playing an important role in state aid enforcement.² This article discusses a recent judgment from the General Court that concluded that the Commission had inappropriately estimated the amount of aid. The General Court concluded that the Commission did not assess whether any alleged advantage was actually passed on to customers, or to what degree.³ This judgment could have consequences for every state aid case assessed by the Commission and by national courts.

Suspension and recovery of aid: what is the role of the courts?

National courts play a significant role in applying EU state aid law, ranging from actions brought by a member state against the beneficiary of aid, to actions brought by private parties

against member states, or aid recipients alleging that the aid granted in a specific case was unlawful.

Alongside the development of state aid law, parties have become more sophisticated in invoking it in court proceedings. Actions before national courts can offer a means of redress for competitors and other third parties affected by unlawful state aid. Remedies available before these courts include preventing the payment of unlawful aid; recovering unlawful aid; and demanding damages for competitors and other third parties.⁴

The number of cases in which private parties have brought direct actions alleging that competitors have received aid is growing.⁵ In relation to one such case, a landmark judgment was passed by the European Court of Justice in 2013 that set important precedent for the role of national courts.⁶ According to that judgment, when the Commission opens an in-depth investigation, national courts in the EU must assume the existence of aid. Furthermore, national courts must take all necessary measures to stop the implementation of the aid, which may include ordering its suspension and repayment, before the Commission reaches its final decision.⁷

This is despite the fact that, at the point of starting the in-depth investigation, the Commission will not have reached any definite conclusion about whether the measure in question does indeed constitute aid, and it is possible that the measure could be found not to constitute aid when the Commission reaches its final decision.⁸ Indeed, in the 2013 landmark case the Commission concluded that the arrangements did not constitute state aid.⁹

This judgment could lead to an increasing role for courts in state aid proceedings, and a further rise in private actions in state aid, as it allows competitors of alleged aid recipients to

adversely affect the operations of these recipients while the Commission undertakes its investigation.

The assessment of the quantum of aid to be repaid therefore represents a key issue to be addressed by courts in state aid proceedings. A landmark judgment from the General Court is discussed below in relation to the Irish Air Travel Tax (ATT) case, which challenges the current practice in determining the amount of aid to be recovered.

Determining the aid quantum: the passing-on defence

Since March 2009, ATT has been payable by commercial airlines for every passenger (excluding transfer and transit passengers) departing from an Irish airport, as described in the first box opposite.

In July 2012 the Commission concluded that, as the tax rates were based on the distance travelled from Dublin Airport, the rates constituted incompatible state aid and conferred a selective economic advantage on domestic flights over most cross-border flights.¹⁰ The Commission ordered the recovery of unlawful aid from three Irish airlines, Ryanair, Aer Lingus and Aer Arann. The Commission concluded that the amount of recoverable state aid was the difference between the lower rate of €2 and the standard rate of €10 levied on each passenger.

In February 2015, following an appeal by Ryanair and Aer Lingus, the General Court annulled the Commission's Decision, as summarised in the second box opposite.¹¹ According to the General Court:

It must be held that, in a situation such as that in the present case, **where the ATT was intended to be passed on** to the passengers and **where the economic advantage** arising from the application of the reduced tax **could also have been passed on** to the passengers, the Commission cannot presume that the advantage actually obtained and retained by the airlines amounted, in all cases, to EUR 8 per passenger.¹² [emphasis added]

This judgment has important implications for state aid cases, since it implies that passing-on effects need to be taken into account when calculating the amount of state aid to be recovered. In contrast, the standard approach in Commission state aid decisions is that the alleged competitive advantage is equal to the 'negative' amount of the incremental cash flows, and that the recovery of this negative amount is required in order to re-establish the status quo.¹³ There is typically no consideration of whether any aid is passed on in the form of lower prices to customers.

The judgment therefore raises a critical question in the assessment of aid recovery payments about whether, under state aid law, an advantage has been passed on when

Overview of the Irish ATT

Over the period from March 2009 to February 2011, a tax of €10 per passenger was applied to all flights from Irish airports to airports located more than 300km from Dublin Airport. For airports within this vicinity, a tax of €2 per passenger applied.

In 2011, the Irish government amended the legislation to remove any differences in the tax rate, and instead imposed a uniform €3 charge for all passengers (excluding transfer and transit passengers), irrespective of the distance of the flight.

Source: European Commission (2012), 'Commission Decision of 25.7.2012 on State aid case SA.29064 (2011/C, ex 2011/NN), Differentiated air travel tax rates implemented by Ireland', 25 July.

The General Court's judgment

The General Court concluded that:

- the Commission should have determined the extent to which the airlines had actually passed on the benefit of the lower ATT to their passengers;
- the Commission should have ordered only the recovery of the advantage actually enjoyed by the airlines.

Source: General Court (2015), 'State aid — Irish tax on air passengers — Lower rate for destinations no more than 300 km from Dublin', Case T-473/12, 5 February, para. 97.

calculating the amount of aid to be repaid. To address this question, insights can be obtained from private antitrust damages actions where the role of pass-on represents an issue that needs to be considered. In the damages context, pass-on refers to the extent to which the purchaser of a cartelised product passes on the overcharge to customers.

Insights about the role of pass-on from antitrust damages actions

According to the European Court of Justice, any citizen or business that suffers harm, directly or indirectly, as a result of a breach of EU antitrust rules should be able to claim compensation from the party that caused the harm.

The Commission's Damages Directive has established a rebuttable presumption of pass-on in a damages claim, provided there is a basic level of evidence that passing-on was likely to occur.¹⁴ The Directive on antitrust damages actions, signed into law on 26 November 2014, highlights the importance of pass-on:

Member States shall ensure that, where in an action for damages the existence of a claim for

damages or the **amount of compensation** to be awarded **depends on whether, or to what degree, an overcharge was passed on** to the claimant... the burden of proving the existence and scope of such a passing-on shall rest with the claimant¹⁵ [emphasis added]

The objective is to ensure that no party that has been harmed is under- or over-compensated.¹⁶ In other words, purchasers or competitors that have suffered harm in the form of higher costs are not entitled to damages if they have passed the higher costs on to their own customers in the form of higher prices.

In practice, it is possible to estimate pass-on rates, based on data on actual prices and costs at the relevant layers of the supply chain, as discussed in the box opposite.¹⁷

There does not appear to be any strong economic reason why the quantification of pass-on would be different in the case of an 'undercharge' caused by alleged state aid compared to an overcharge caused by an upstream cartel. As concluded by the General Court, the quantum of aid in the Irish ATT case should take into account the extent to which the lower taxes were passed on to customers in the form of lower prices.

Following the adoption of the Damages Directive, in 2016 the Commission is expected to publish official guidelines for national courts on quantifying the pass-on of overcharges.¹⁸ These guidelines may be useful in assessing pass-on in the context of antitrust damages actions, but also for state aid cases.

Conclusion

Based on the precedent from the European Court of Justice, EU national courts can now order the implementation of any alleged aid to be stopped and the alleged aid to be recovered at the point at which the Commission starts an in-depth investigation (i.e. prior to the Commission reaching its final decision as to whether an arrangement actually constitutes aid).

The message from the General Court in the Irish ATT case is that the amount of aid recovered should take into account

How can the degree of pass-on be quantified?

Pass-on rates vary according to the market in question, but the existence and degree of pass-on can be determined using the following models.

- **Empirical models.** Statistical techniques can be used to quantify the degree of pass-on, using data on prices and costs of products. There are a number of advantages of empirical approaches: short- and long-run effects can be estimated separately; price lags can be considered (to take into account the fact that a seller may not be able to alter prices immediately in response to a change to its costs); and pass-on can be estimated separately for price increases and price decreases.
- **Theoretical models.** Standard industrial organisation theory can be used to determine how much of a cost shock is passed on to customers, and theoretical models can provide a substitute for empirical models when data is limited or unavailable. The advantage of theoretical models is that they can allow more flexibility in terms of the assumptions, such as the number of firms and/or the relationship between price and demand, at different levels of demand. However, the weakness of such models is that the estimates can be sensitive to the assumptions adopted, such as how demand responds to changes in price.

Source: Oxera.

the extent to which any advantage derived from it is passed on to customers. The Irish ATT judgment is not yet definitive—the conclusion from an appeal initiated by the Commission is currently pending, and the judgment of the Court of Justice is expected in 2016 or 2017.¹⁹ If the pass-on approach is adopted, this will have important implications for every case before the Commission where aid is involved—and aid repayment demands could potentially be lowered to reflect any reductions in prices passed on to customers.

¹ Certain measures that fall within the scope of the General Block Exemption Regulation are not required to be notified to the European Commission. For further details, see European Commission (2014), 'State aid: Commission exempts more aid measures from prior notification', press release, 21 May, http://europa.eu/rapid/press-release_IP-14-587_en.htm.

² European Commission (2010), 'Enforcement of EU State aid law by national courts: the Enforcement Notice and other relevant materials', Competition Handbook, http://ec.europa.eu/competition/publications/state_aid/national_courts_booklet_en.pdf.

³ Case T-500/12, *Ryanair Ltd v Commission*, [2015], ECR, Judgment of 5 February 2015. This judgment is subject to appeal by the European Commission.

⁴ European Commission (2009), 'Commission notice on the enforcement of State aid law by national courts', *Official Journal of the European Union*, 9 April.

⁵ European Commission (2010), 'Enforcement of EU State aid law by national courts: the Enforcement Notice and other relevant materials', Competition Handbook, http://ec.europa.eu/competition/publications/state_aid/national_courts_booklet_en.pdf.

⁶ Case C-284/12, *Deutsche Lufthansa v Flughafen Frankfurt-Hahn GmbH*, [2013], Judgment of 21 November 2013.

⁷ Case C-284/12, *Deutsche Lufthansa v Flughafen Frankfurt-Hahn GmbH*, [2013], Judgment of 21 November 2013.

⁸ In relation to the *Deutsche Lufthansa v Flughafen Frankfurt-Hahn GmbH* case, the European Commission concluded in late 2014 that Ryanair's arrangements with Frankfurt-Hahn GmbH did not constitute state aid. For further details, see European Commission (2014), 'State Aid: Commission decisions on public financing of airports and airlines in Germany, Belgium, Italy and Sweden – further details', memo, 1 October, http://europa.eu/rapid/press-release_MEMO-14-544_en.htm.

⁹ European Commission (2014), 'State Aid: Commission decisions on public financing of airports and airlines in Germany, Belgium, Italy and Sweden – further details', memo, 1 October, http://europa.eu/rapid/press-release_MEMO-14-544_en.htm. Oxera prepared economic evidence on behalf of Ryanair that demonstrated that Ryanair's arrangements with Frankfurt-Hahn Airport were in line with the market economy operator principle, and therefore did not constitute state aid.

¹⁰ European Commission (2012), 'Commission Decision of 25.7.2012 on State aid case SA.29064 (2011/C, ex 2011/NN), Differentiated air travel tax rates implemented by Ireland', 25 July.

¹¹ General Court (2015), 'State aid — Irish tax on air passengers — Lower rate for destinations no more than 300 km from Dublin', Case T-473/12, 5 February.

¹² General Court (2015), 'State aid — Irish tax on air passengers — Lower rate for destinations no more than 300 km from Dublin', Case T-473/12, 5 February, para. 97.

¹³ In restructuring state aid cases, remedies are often imposed to limit distortions to competition. Such remedies could include the divestment of assets, reductions in capacity, or price monitoring commitments, as well as other restructuring obligations.

¹⁴ A rebuttable presumption refers to an assumption made by the court that is considered to be true unless contested and proven otherwise. For further details on the Damages Directive, see European Parliament and Council of the European Union (2014), 'Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union', 24 October, http://ec.europa.eu/competition/antitrust/actionsdamages/damages_directive_final_en.pdf.

¹⁵ European Parliament and Council of the European Union (2014), 'Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union', <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0104>, Article 14.

¹⁶ European Parliament and Council of the European Union (2014), 'Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union', <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0104>, Article 12.

¹⁷ For further details of possible approaches to estimating pass-on rates, see Oxera and a multi-jurisdictional team of lawyers led by Dr Assimakis Komninos (2009), 'Quantifying antitrust damages: towards non-binding guidance for courts', study prepared for the European Commission Directorate General for Competition, December, <http://www.oxera.com/Latest-Thinking/Publications/Reports/2010/Quantifying-antitrust-damages-Towards-non-binding.aspx>.

¹⁸ European Commission, 'Actions for Damages > Overview', <http://ec.europa.eu/competition/antitrust/actionsdamages/>; and European Commission (2015), 'Tender specifications, COMP/2015/011, Study on the passing-on of overcharges', http://ec.europa.eu/competition/calls/2015_011_tender_specifications_en.pdf.

¹⁹ C-165/15P *Commission v Ryanair*.