COMMUNITY OWNERSHIP SUPPORT SERVICE
Development Trusts Association Scotland

Briefing Note

EC State Aid Rules and Community Asset Transfers

A - Introduction

European "State Aid Rules", which regulate financial support from the public sector to businesses, could emerge as a key issue as community groups pursue potential asset transfers from the public sector. This is likely to be of particular relevance where the aim is to have an asset transferred at a discounted value, and it is to be used for trading purposes.

The level of awareness and understanding of these Rules is currently variable across the public sector and there is a tendency for public agencies and organisations to interpret and apply them in a risk-averse, cautious, manner, as the penalties for breaking the rules can be quite serious. Such an approach risks incurring unnecessary constraints and delays, and could even prevent entirely legitimate transfers taking place. This note therefore aims to brief community groups on the topic so they are in an informed position to engage in discussions regarding the applicability and potential impact of the State Aid Rules on a proposed asset transfer.

The note outlines what the Rules are and offers a decision flow-chart, together with explanatory notes and a brief discussion of some key issues, to help community groups assess whether, and how, the Rules might impact on a planned community asset transfer.

DTA Scotland has prepared this note for the Community Ownership Support Service as a **generic** briefing, and it is informed by a wide range of sources. While every effort has been made to ensure the information is accurate and up to date, the note does not offer exhaustive or detailed guidance, nor advice specific to any individual circumstance. It is anticipated that any key issues will soon emerge as the investigative pathway set out in this note is followed. Groups are **recommended to consider these issues carefully and objectively in arriving at their provisional view on the applicability and potential impact of the State Aid Rules.** Groups may then consider seeking further advice from sources such as the Scottish Government's State Aid Unit as well as organisations that are potentially transferring an asset to them or providing other forms of support or assistance.

B - Context

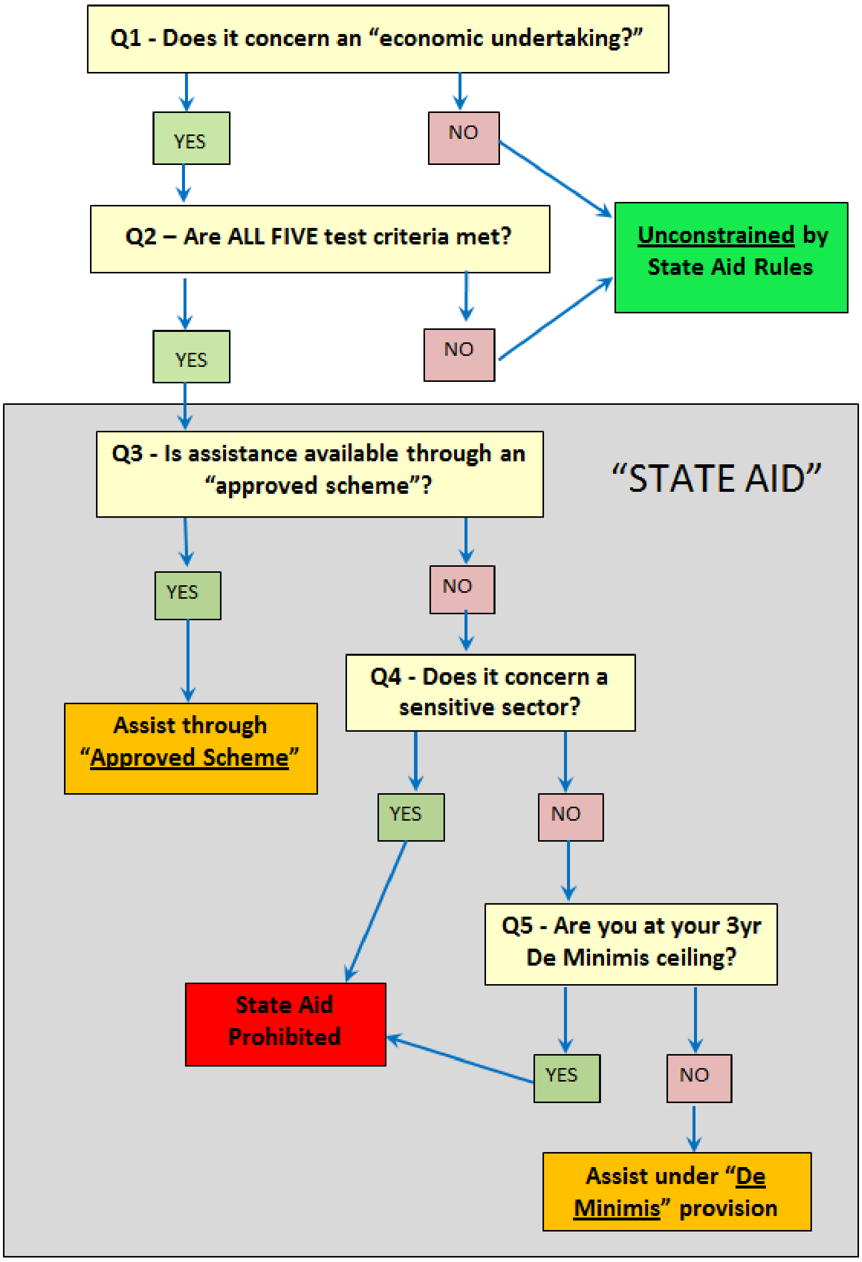
"State Aid" is a European Commission term with a narrower definition than simply "public sector assistance", in that it only applies to **public sector assistance that has the potential to distort competition in trade between member states** of the European Union. The EC has passed legislation (the "State Aid Rules") to **identify and regulate** all such support, and these Rules should be taken into account where discretionary public sector funding is potentially being offered, whether at local, regional or national level.

The Rules focus on the economic **activity that will benefit** from the aid receiving the state aid **rather than the organisation**, so they apply equally to non-profit-distributing community enterprises and voluntary organisations, as to individuals, private businesses or listed public companies. The Rules must be considered for "in kind" support (eg through discounted prices/rates, provision of services, facilities) as well as for more explicit support through grants, gifts of assets or low/no interest loans. Support provided towards the costs of assets' post-transfer development is also covered by the Rules.

The Rules recognise, however, that **not all public sector assistance is "State Aid",** and also that **there are circumstances under which awards of State Aid should be permitted -** where it will have a minimal impact on competition, and/or where it is key to economic and social development. **The EC State Aid Rules do not, therefore, represent a blanket ban on public sector assistance, nor asset transfer at discounted value, and may not impact at all on certain community asset transfers**. It is essential therefore to examine the individual circumstances of a proposed asset transfer before any judgement can be made regarding the potential impact of the State Aid Rules.

C - State Aid Rules Decision Flow Chart

The flowchart below sets out a pathway through which groups may be able to establish for themselves a) whether the State Aid Rules are likely to apply to a proposed asset transfer and b) if so, what the potential impact might be. The process focuses on five key questions (cream coloured boxes), which are explained more fully following the chart, where a range of possible outcomes are also discussed.



The **first two questions determine whether the proposed public sector support meets the definition of "State Aid" and is therefore subject to the Rules or not**. If the answer to either test question is "No", then the proposed asset transfer will not be impacted by the Rules (green box). If the answer to **both** is "Yes", then the public sector assistance is deemed to be "State Aid", and the flow chart moves into the "grey zone" where all assistance is subject to the Rules.

In the context of asset transfers, **there are only two mechanisms through which State Aid can legally be awarded** (orange boxes), namely through the **"De Minimis" provisions** for lower value awards, or through a **pre-approved EC Scheme**, although the latter may have limited applicability for community asset transfers. Questions three to five should determine whether either of these options are appropriate, or whether an award of "State Aid" will not in fact be permissible (red box).

Q1 : Does it Concern an Economic Undertaking?

The **State Aid Rules only apply to activities that are part of the EC's definition of the economy (i.e. to "economic undertakings").** A key preliminary filter is therefore to confirm whether or not the proposed aid would in fact be supporting an economic undertaking. the EC defines an "economic undertaking", ***"activity that offers goods or services on a given market that could (potentially) be carried out by a private operator in order to make profits."***

If an economic undertaking is not involved, according this definition, then any assistance is deemed not to be State Aid, and the Rules do not apply. For example, some community social activities and public services could not potentially be run by a private operator for profit, and would thus fall outwith the definition of an economic undertaking.

If the proposed activity falls within this definition of an "economic undertaking" a set of five test criteria are then used to determine whether any public sector aid provided to that undertaking will in fact constitute State Aid and be subject to the Rules.

Q2 : Are ALL FIVE State Aid Test Criteria Met?

These **five test criteria** concern the origins of the assistance provided and its potential impact on the market for the supported economic activity, and **ALL FIVE test criteria require to be met in order for the assistance to be considered "State Aid":**

1. ***Is the measure granted by the state or through state resources?***
   As well as central government departments and agencies, the "state" includes regional or local authorities and other public sector bodies that are controlled or funded by the state. Private or community organisations providing aid are also included if their funding comes from the public purse, as are awards from funds not belonging to the state but under state control, e.g. lottery funding.

2. ***Does it confer an advantage to the enterprise?***
   A commercial advantage could be conferred through the awarding of grants, of loans/investment at less than commercial rates, tax exemptions, or contracts and leases at less than market rates/ without open tendering. Aid in this context also includes the state transferring an asset at less than fully commercial rates.

3. **Is it selective, favouring certain businesses or organisation?**
   Aid that targets particular businesses, groups, locations, types of firm or sectors is considered selective. A general measure affecting the whole of the state's economy e.g. nation-wide fiscal measures is not considered State aid.

4. **Does the measure distort or have the potential to distort competition?**
   If the assistance has the potential to **strengthen the competitive position of the beneficiary relative to others active in the same market**, then this criterion is likely to be met. The potential to distort competition does not have to be substantial or significant, and this criterion may apply to small amounts of aid and firms with little market share.

5. **Is the activity tradable between member states?**
   The Commission's interpretation of this straight-forward question is quite broad in that it concerns whether the specific product(s) or service(s) may be **subject to trade between enterprises in different member states**, even if the beneficiary does not itself export.

If one or more of the answers are "NO", then assistance is not deemed to be State Aid and the State Aid Rules do NOT apply.

However, if the answers to **ALL FIVE** criteria questions are "YES", then the proposed assistance is considered to be State Aid, and the State Aid Rules apply (providing, of course, it concerns an economic undertaking).

Q3 : Is There an Approved Scheme?

The European Commission permits state aid to be awarded for certain economic activities under specified circumstances of market failure, where the economic and social benefits of the aid are such that it can be permitted even if competition is disturbed. But State Aid can only be awarded in this manner through a pre-approved scheme, and must be accounted for to the EC by the awarding organisation.

Some public bodies in Scotland (e.g. the Scottish Government, the Enterprise Networks, Local Authorities & Historic Scotland) have Commission approvals in place to award State Aid in various areas of activity. Further details are available at http://www.stateaidscotland.gov.uk/state_aid/SA_ApprovalsView.jsp?pContentID=340&p_applic=CCC&p_service=Content.show&. It is not anticipated that many community asset transfers will fit with one of the current approved schemes, but there is scope for further approvals, and the potential for a new approval specifically for community asset transfers is currently being discussed at Scottish Government level.

Q4 : Does it Concern a Sensitive Sector?

The State Aid Rules **prohibit state aid assistance to certain sensitive business sectors** that suffer from over-production, unless such assistance is provided for through national or regional schemes already approved by the EC (as in Q3 above). Sensitive sectors include fisheries, transport, agriculture, and any export-based enterprises. A fuller list of sensitive sectors can be found at:
http://www.stateaidscotland.gov.uk/state_aid/SA_MainView.jsp?pContentID=315&p_applic=CCC&p_service=Content.show&

Q5 : Are You at Your 3yr De Minimis Ceiling?

The European Commission has agreed that **discretionary awards of small amounts of State Aid to individual recipients are permissible** as they have a negligible impact on trade and competition. This "De Minimis" provision allows a beneficiary to receive **up to a cumulative total of €200,000 of State Aid (cash grant equivalent) over a rolling 3 fiscal-year period**.

At the time of writing (October 2012) this equates to c.£158,780, and the reference exchange rates can be found at:
http://ec.europa.eu/budget/contracts_grants/info_contracts/inforeuro/inforeuro_en.cfm

It is the responsibility of the awarding organisation to inform the recipient that aid is being awarded through this De Minimis provision, but it is the **responsibility of the recipient organisation to maintain a current rolling total of the amount of such assistance received from all sources** over a 3 year period, and to inform sources of possible further aid, should the threshold be likely to be breached. This 3 year rolling total does not include State Aid provided through an approved scheme (Q3 above), nor other public sector assistance that is not deemed to be State Aid.

D - Discussion

Groups will need to be clear as to the uses the asset will be put to, before a decision is possible of whether the support constitutes State Aid.

As there is little room for interpretation or flexibility within the Rules for awarding State Aid, the key issue for scrutiny will likely be whether or not the proposed support comprises "State Aid" and is consequently subject to the Rules. **The flowchart's initial filter** (whether it an economic undertaking, as defined above, is involved) **may exempt a few simple asset transfer projects from the Rules** where the purpose is clearly to support community/social activities rather than economic ones.

But, given that the bulk of acquired assets will need to ensure financially viability, **the five TEST CRITERIA of the flowchart's second question will probably be the group's main focus**. The first three of the test criteria are very likely to be met by most potential community asset transfers where the asset is being transferred at a discounted value.

The greatest attention will likely be paid to the fourth and fifth criteria, concerning local competition and inter-state trade respectively. For there to be a (potential) distortion of competition **there needs to be a competitive market locally in the goods or services concerned** – and this may not always be the case. Furthermore, there needs to be a **realistic prospect that the proposed activity would adversely impact on the local competition**, rather than simply a remote theoretical possibility.

Where local competition is identified as a potential issue, but the other four criteria are not **all** met, then the Rules will not apply – and any potential local business displacement then becomes an issue for consideration and resolution at a local level and **not** a State Aids issue.

If it can be argued that the trading activities based on the transferred asset concern only **specific local services, and/or products for local/ regional/ national consumption** that do not involve producers or buyers in other EU member states, then the 5th and final test criterion (concerning trade between member states) will not be met and any assistance cannot be deemed State Aid. But, where the services or products provided by the asset transfer beneficiary could be traded internationally – even if there was no intention of doing so – then the fifth test criterion would be met.

So, many supported community asset transfers may in fact not be subject to the State Aid Rules, either through one or more of these five criteria not being met, or else due to there being no "economic undertakings" taking place. However, where economic activity benefitting from the transferred asset will likely have an impact on local competition, AND involve services or products that could be traded beyond local / regional/ national markets, then the State Aid Rules may well be invoked, and assistance may only be awarded through either the De Minimis provision or Approved Schemes routes as set out above.

If it appears that State Aid will be involved, and no pre-approved scheme is appropriate, it is important that **groups establish for themselves the scale of any awards of De Minimis funding they have received over the previous 3 fiscal years**, to ensure that the rolling ceiling for De Minimis is not exceeded. This may require checking all previous offers of public sector assistance as these should state awards were being made under the De Minimis rule if this was the case. If De Minimis is not mentioned in the offer of assistance, then you might assume the assistance was either not deemed State Aid, or else was awarded though an approved scheme.

Because the scope to receive State Aid through the De Minimis provision is limited to €200,000 over a rolling 3 year period, this entitlement should be considered (and protected) as an asset in its own right. Groups should therefore scrutinise all assistance offered under the label of "De Minimis State Aid", and strongly resist the "State Aid" label on support they are clear should not in fact be considered as State Aid.

D Importance of Correct Procedures

Where assistance is identified as being subject to, and permitted by, the EC State Aid Rules, it is important that **the awarding body** follows the appropriate procedures and notification/reporting relevant to the particular exception being used. If State Aid is awarded incorrectly, and the Commission is made aware of this, then the EC may cause the aid payment to be halted or a repayment to be made by the recipient of the aid (plus interest). The Commission may also take infringement procedures against the member state, and there is also the possibility of aggrieved competitors taking legal action for damages.

As mentioned at the outset, given these potentially severe penalties and the lack of a universal understanding of State Aid across the public sector referred to earlier, there is a risk public bodies may "play safe", and categorise assistance towards community asset transfers as "De Minimis State Aid" under circumstances where it could reasonably be argued State Aid is not in fact involved.

E Further Information

Scottish Government State Aid Unit:
- Website for information: http://www.stateaidscotland.gov.uk
- Staff for guidance: stateaid@scotland.gsi.gov.uk or 0300 244 1152.

UK Government State Aid Guide (2011):
http://www.bis.gov.uk/assets/biscore/business-law/docs/s/11-1040-state-aid-guide.pdf

UK Government Guidance Note "Taking Account of State Aid Issues in Policy Making - A Risk-Based Approach" (2004) : http://www.bis.gov.uk/files/file32879.pdf