



state aid

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The Finance Hub is delivering to the government's ChangeUp programme to create voluntary and community organisations that are effective and independent because they are financially sustainable.

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This briefing provides a brief overview of the state aid regulations and aims to help practitioners in the public and third sectors develop an understanding of the subject. It is not a definitive guide. Further guidance may be obtained from regional development agencies, government offices and the DTI's State Aid Unit, which has the UK policy lead on state aid. Ultimately, however, only the European Commission and the European Courts can provide legal certainty.

State aid legislation is complicated and has been seen as potentially scary, because the ultimate sanction for non-compliance may be having to repay monies considered as constituting unfair state aid. However, there is an awareness at both European and national level that this is a difficult area, especially for third sector organisations, and there are a number of helpful publications available that try and ensure a sensible and proportionate application of the regulations.

What is state aid?

The state aid rules were put in place to protect the free market by ensuring that state resources do not distort competition or give an unfair advantage. State aid is considered to be any advantage given from state resources to an 'undertaking' (see below), where such aid may benefit particular industrial sectors or individual undertakings and affect trade in the European Union. The European Commission considers that such aid is *prima facie* illegal. However, there are circumstances in which the Commission may deem state aid to be compatible with the European Treaty. It is the Commission's role, upon application from a Member State, to assess whether an aid measure can be permitted within the state aid rules. Notifications to the Commission go through the DTI's State Aid Unit, which can advise on the best approach.

An 'undertaking' is an entity which is engaged in economic activity. Economic activity is anything a private company could potentially perform for profit. In determining whether an entity is an undertaking it is important to look at the activity, not the entity's form. Publicly owned entities, charities, charitable companies and not for profit companies, even government departments, can all be classed as undertakings if they are performing an economic activity.

How do you know if aid is present?

The following four tests must be met:

- Aid is granted by a Member State or through a state resource.
- The aid favours certain undertakings or production of certain goods.
- The aid distorts or threatens to distort competition.
- The aid affects trade between Member States.

The third sector does not have any dispensation based on organisational structure or charitable purpose, and exactly the same rules apply if third sector organisations are undertaking an economic activity.

State aid is therefore a fundamental tenet of the Treaty of Rome Article 87 (which sets out the general substantive principles for evaluating the compatibility of state aid with the concept of a 'common market') but over time the nature of the prohibition of state aid has been modified. There are a number of frameworks, guidelines and block exemptions under which aid may be granted. The Commission may also approve aid on the basis of the treaty.

Article 87(3)(c) of the treaty states that:

Aid to facilitate the development of certain economic activities or of certain economic areas can be considered to be compatible with the common market, provided that such state aid does not adversely affect trading conditions to an extent contrary to the common interest. The Commission ... will analyse whether the proposed aid is appropriate and proportionate to its targeted objectives and does not have disproportionate effects on competition and trade.

EC guidance: *State aid control and regeneration of deprived urban areas* (EC, 1 March 2006)

Case study

Brighton West Pier – United Kingdom

In 2000-01 the National Heritage Memorial Fund, a public body, agreed to finance the restoration of a pier belonging to a registered charity (Brighton West Pier Trust). The balance of the funding would be provided by a public sector partner (St Modwen). According to the grant contract between the National Heritage Memorial Fund, the Brighton West Pier Trust and St Modwen, St Modwen would also finance the pier's maintenance. In return it would receive a long lease of the restored pier (about 125 years) at a nominal rent.

The local authority (Brighton and Hove City Council) would lease two parcels of land on either side of the pier to Brighton West Pier Trust on a symbolic rent. The Trust would sublease the land to St Modwen on a symbolic rent.

The National Heritage Memorial Fund had already granted some funds to the Brighton West Pier Trust, mainly for emergency works.

Brighton West Pier – United Kingdom continued

Two series of measures were at stake:

- The grants by the National Memorial Fund to Brighton West Pier Trust and St Modwen with regard to the restoration of the pier.
- The lease of land on either side of the pier by the local authority to the Brighton West Pier Trust, and by Brighton West Pier Trust to St Modwen, on a symbolic rent.

European Commission ruling

The Commission considered that the project at issue involved no state aid in the sense of Article 87(1) of the EC treaty because the distortion of competition and intra-Community trade criteria were not met. Even if the measures at issue constituted state aid in the sense of the EC treaty, they would be compatible with the common market under Article 87(3)(d) of the treaty because they pursued a general cultural objective and did not affect trading conditions and competition to the extent that was contrary to the common interest.

www.westpier.co.uk

Possible action for third sector organisations

What avenues should third sector organisations follow to understand how state aid might impact on their activities? The easiest way is to establish whether any proposed grant, contract or other form of state support might potentially be supported within the state aid rules, which provide a legal framework for the sort of activities that may be permitted and, indeed, encouraged as part of the EU's competitiveness agenda.

Size

The European Commission is not interested in very small amounts of state aid, and the so called 'de minimis' exclusion is universal. It is currently limited to aid of €100,000 (under review) in any rolling three year period. While this seems attractive, it relies on the maintenance of three year rolling records of all support derived from a public source, and even a relatively modest annual grant from a local authority to fund a worker's post could lead to a breach of this limit. However, 'de minimis' is a clear universal rule and is therefore always worth considering.

Delivering public services

Normal contracts awarded under the EU procurement rules are not aid. However, if a contract is awarded to a charity without it going out to tender, this will be contrary both to the procurement and the state aid rules.

'Services of general economic interest', as defined by EU legislation, do not constitute state aid provided that the service to be delivered is clearly defined, the level of remuneration is established in a clear and transparent manner (for example against a business plan) and is reasonable (it can include a profit), and can be demonstrated as adequate for the specified task. What constitutes a service of general economic interest is a changing field: the BBC is a quoted example. The DTI's State Aid Unit Advice can advise on where this block exemption can be used.

Activities that may be supported under the state aid rules

State aid relating to the promotion of culture may be permitted. Other areas that may be supported include employment, environmental protection, research and development, regional development, undertakings in deprived urban areas, aid to small and medium-sized enterprises (SMEs) and training.

The provision of social housing, improvements to the physical environment and renovation of brownfield sites are all activities deemed to be general investments for the public good and therefore do not involve state aid.

From the social perspective of a regeneration strategy, efforts to promote education, to support families, to provide leisure and to fight crime are not likely to constitute state aid. Either no aid is given to undertakings or there is no effect on competition or trade between member states.

EC guidance: *State aid control and regeneration of deprived urban areas* (EC, 1 March 2006)

Specific rulings have been issued in relation to credit union development, based on Scottish case studies, and the provision of managed workspace, based on Welsh case studies.

Regional government offices and the DTI's State Aid Unit will provide guidance on the established precedents, but the Commission remains the ultimate arbiter.

Local service delivery

In 2001 the UK government sought clarification from the EU concerning the state aid scheme 'Partnership support for regeneration 5: community/voluntary (neighbourhood) regeneration'. The scheme permits the acquisition and development of land and buildings, project management, and support for start up staffing. Schemes must ensure that any assets are used for the original purpose for a minimum of five years (see the briefing 'Publicly funded assets', included in this pack). While some specific activities are mentioned, much of the work of local community organisations can be included in this exemption. The guidance refers to 'local' as being up to a regional level. While this ruling is extremely useful, care should be taken, as some activities which seem to be local are considered, at least potentially, to be the subject of intra-country trade.

Case study

Partnership support for regeneration 5: community/voluntary (neighbourhood) regeneration

The scheme arose because it is often difficult for local communities to access capital and funding. It is designed to offer support to local communities by enabling them to participate more effectively in local regeneration.

In the majority of cases the types of activity eligible for support are:

- provision or conversion of buildings for community use by local non profit making groups
- training, for example job interview techniques or information technology skills
- teaching English to immigrant communities
- provision of crèches.

Exclusively non profit bodies that work only in the voluntary and community sector can apply for assistance. These organisations will be small and local, and operate in areas such as education and youth work.

No profit distributing commercial company can be a beneficiary of the scheme. Any party owned or associated with any undertakings that are subject to intra-Community trade cannot be eligible for support.

The scheme includes the following forms of support:

- Support for the acquisition of land or buildings by the applicant, provided that the acquisition is at or below market value.
- Support for the development or refurbishment of buildings, including professional fees.
- Project management services.
- Support for start up staffing to ensure project viability for up to three years.
- Support for irrecoverable VAT incurred by the applicant on any of the above expenditures.
- Support for interest or similar financing costs. All works will be contracted in accordance with the rules for public procurement. The full cost of the assistance granted, or the market value of the asset, will be repayable if the initial investment supported by the scheme is not maintained for its original purposes for at least five years.

European Commission ruling

The Commission noted that, although the immediate beneficiaries of the scheme might be undertakings within the meaning of Article 87(1) of the EC treaty, they are small, voluntary and community bodies organising activities which will be purely for local interest, ie not of an international nature. As the scheme specifically excludes the possibility that the financial assistance benefiting this kind of undertaking may affect trade between Member States, it does not involve any aid in the meaning of Article 87(1) of the EC treaty.

www.erdf.odpm.gov.uk/Repository/PDFs/CommunityRegeneration

Regeneration measures that involve compatible state aid

Many undertakings deemed economic can still attract state support within limits, especially in assisted areas. Extra support is possible where the undertaking is by an SME.

The level of permissible state aid varies according to the designation of the assisted areas; Objective 1 and Objective 2 areas will be familiar to most practitioners. The precise maps and levels of aid permissible are available from regional government offices. The new designations for the UK after the end of the current 2000-2006 structural funding programmes are still under negotiation.

Conclusion

State aid regulation is fundamental to ensuring a level playing field across the EU.

Over the years a number of Commission frameworks, guidelines and exemptions have been adopted, which provide guidance about how 'undertakings' may receive support from state resources.

The UK government has supported a balanced risk-based approach to the application of state aid regulations. Recent rulings and elaborations in relation to local non profit groups and urban regeneration provide useful guidance. While each case still needs to be judged on its independent merits there are many pathways through the state aid regulations for third sector organisations.

Specialist support is available through regional government offices and the DTI's State Aid Unit. Many regions also have specialist third sector advisory organisations for European funding.

Further information

www.dti.gov.uk/ccp/stateaid/

www.erdf.odpm.gov.uk/StateAidHomePage/

europa.eu.int/comm/competition/state_aid/others/

For an accessible guide to the EC's guidance on state aid and urban regeneration see

www.europa.eu.int/comm/competition/state_aid/others/vademecum.pdf