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BRINGING THE ‘MARKET ECONOMY AGENT’ PRINCIPLE TO FULL POWER

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ABSTRACT

The recent ECJ Judgment in case C-124/10 P Commission v Électricité de France (EDF) has clarified an important point in EU State aid law that bears attention: the ‘private investor’ test is not an exception, but the general test that the Commission must apply. This paper critically appraises the potential implications of such finding.

KEYWORDS


JEL CODES

H25, H57, K21, K42.

1. INTRODUCTION

In its recent Judgment of 5 June 2012 in case C-124/10 P European Commission vs Électricité de France (EDF) (hereinafter, the EDF Judgment), the European Court of Justice (in Grand Chamber) has endorsed the General Court in a significant push for an extended and antiformalistic use of the ‘market economy private investor principle’ in State aid control procedures. Further than the specific discussion of the circumstances of the aid granted by the French Republic to EDF through a preferential treatment in corporate taxation (interesting and rather sophisticated in itself), I think that the key development facilitated by the ECJ in the EDF Judgment must be found in paragraph 103 of the ruling, where it is clearly stated that:

[...]

contrary to the assertions made by the Commission and the EFTA Surveillance Authority, the private investor test is not an exception which applies only if a Member State so requests, in situations characterised by all the constituent elements of State aid incompatible with the common market, as laid down in [Article 107(1) TFEU]. [...]

where it is applicable, that test is among the factors which the Commission is required to take into account for the purposes of establishing the existence of such aid (emphasis added).

In my view, the EDF Judgment clearly requires the use of the ‘private investor’ test as the general standard for the material appraisal of State aid measures, regardless of the instruments used by

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public authorities to grant support to undertakings (be it by exercising ‘pure’ public powers, such as taxation, or otherwise) and, if properly contextualised, contributes to the development of more homogeneous substantive standards in this area of EU competition law.

In my view, the EDF Judgment must be welcome, and it would be interesting to see this antiformalistic and economic criterion extended to other areas of EU economic law—and, particularly, EU public procurement law—where the control the (disguised) granting of State aid is crying for the development of a ‘market economy private [buyer]’ test\(^3\). More generally, I think that the time is ripe for a fuller development of a ‘market economy agent’ principle that can be applied across the board in the substantive appraisal of market activities conducted by public authorities and other emanations of the State\(^4\), regardless of the ultimate nature of the powers being exercised (be them public powers in their classic definition, or other types of public prerogatives).

This paper briefly discusses the change of views by the ECJ regarding the holistic analysis of State aid schemes and measures under the ‘private investor’ test (section 2), critically appraises the need for a fuller development of the ‘market economy agent’ principle under EU economic law (section 3), and offers some conclusions regarding the implications of the EDF Judgment (section 4).

2. CHANGING VIEWS OF THE ECJ REGARDING THE HOLISTIC APPRAISAL OF STATE AID SCHEMES AND MEASURES UNDER THE ‘PRIVATE INVESTOR’ TEST: ANOTHER ANTIFORMALISTIC TURN

The case decided in the EDF Judgment arose from the failure of the Commission to appraise a tax-related measure granted by France to EDF under the ‘market economy private investor’ test. The Commission had refused to do so on the formal grounds that:

[...] the private investor principle can be applied only in the context of the pursuit of an economic activity, not in the context of the exercise of regulatory powers. A public authority cannot use as an argument any economic benefits it could derive as the owner of an enterprise in order to justify aid granted in a discretionary manner by virtue of the prerogatives it enjoys as the tax authority in relation to the same enterprise.

While a Member State may act as a shareholder in addition to exercising its powers as a public authority, it must not combine its role as a State wielding public power with that of a shareholder. Allowing Member States to use their prerogatives as public authorities for the benefit of their investments in enterprises operating in markets that are open to competition would render the Community rules on State aid completely ineffective\(^5\).

Basically, the Commission opposed the possibility to conduct a global appraisal of the conversion into capital of a tax claim by the State under the ‘market economy private investor test’ on the basis


\(^{5}\) Decision 2005/145/EC of 16 December 2003 on the State aid granted by France to EDF, paras. 96 and 97 (emphasis added).
that a private investor could never hold a tax claim against an undertaking, but only a civil or commercial claim. Therefore, the Commission contended that tax measures that (directly) imply a capital injection (because the taxes not levied are added to the net assets of the beneficiary company) cannot be analysed as a whole and, if appropriate, be declared compatible with the internal market as a single transaction. But that, rather, Member States should exact taxes from undertakings in regular form, and then inject the same amount of capital as State aid (in a double circulation of capital, rather than a set-off or compensation), if they wanted to benefit from an appraisal of such capital injections under the ‘market economy private investor’ test.

This argument seems extremely formalistic and, even if there could be transparency and oversight issues involved (as the Commission indicated in the appeal, but which could be remedied by less intrusive and formalistic means), it does not make economic sense to prevent the use of set-offs of taxes and capital injections if the latter are compliant with State aid law. However, it must be stressed that this position of the Commission seems in line with prior case-law of the ECJ and, in particular, with its position in Spain vs. Commission⁶, where the ECJ seemed to set a barrier against the conduct of a holistic analysis under the ‘private investor’ test where circumstances that were specific to the exercise of public powers and the discharge of public obligations were taken into account. More specifically, in that case, the ECJ found that:

In order to determine whether such measures are in the nature of State aid, it is necessary to consider whether in similar circumstances a private investor of a size comparable to that of the bodies administering the public sector might have provided capital of such an amount.

In that respect a distinction must be drawn between the obligations which the State must assume as owner of the share capital of a company and its obligations as a public authority. Since the three companies in question were constituted as limited companies, the [State], as owner of the share capital, would only have been liable for their debts up to the liquidation value of their assets. That means in the present case that the obligations arising from the cost of redundancies, payment of unemployment benefits and aid for the restructuring of the industrial infrastructure must not be taken into consideration for the purpose of applying the private investor test.

Therefore, the logic in Spain vs. Commission—ie that only circumstances replicable by a private investor of a size comparable to that of the bodies administering the public sector should be taken into account in applying the ‘private investor’ test—seemed to legitimise the formalistic approach adopted by the Commission (and the distinction between holding commercial or tax credits, which would exclude the possibility of using the latter as set-offs to pay for capital injections, since claims of the same nature would per se be unavailable to private investors). Nonetheless, the General Court dismissed the Commission’s argument by clarifying that:

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⁶ Case C-280/92 (Joined Cases C-278/92, C-279/92, and C-280/92) Spain v Commission [1994] ECR I-4103, at paras. 21 and 22. A substantially similar approach was undertaken in Case C-344/99 Germany v Commission [2003] ECR I-1139, at paras. 133 et seq. For discussion, see Sauter & Schepel (n 4) 206-207, who stressed the need to cover a gap between “what a private investor would do and what a rational public authority would do”—which I personally think that, in strictly economic terms, should be coincident.
[...] the purpose of the private investor test is to establish whether, despite the fact that the State has at its disposal means which are not available to the private investor, the private investor would, in the same circumstances, have taken a comparable investment decision. It follows that neither the nature of the claim, nor the fact that a private investor cannot hold a tax claim, is of any relevance.

It is interesting to note that Advocate General Mazák sided with the Commission, on the basis that ‘even where the measure adopted pursuant to public powers has much the same effect as one that could perhaps have been adopted by the State in its capacity as an investor, it must nevertheless be disregarded when assessing claims that the State acted as a market investor’; and, consequently, that it was right ‘to take a principled line in the contested decision, insofar as there should be a visible separation of the role of the State qua public authority from the role of the State qua shareholder’.

The ECJ, however, departed from prior case-law, dismissed the opinion of AG Mazák, and finally endorsed the antiformalistic approach proposed by the General Court in finding that:

[...] in view of the objectives underlying [Article 107(1) TFEU] and the private investor test, an economic advantage must – even where it has been granted through fiscal means – be assessed inter alia in the light of the private investor test, if, on conclusion of the global assessment that may be required, it appears that, notwithstanding the fact that the means used were instruments of State power, the Member State concerned conferred that advantage in its capacity as shareholder of the undertaking belonging to it.

It follows that [...] the obligation [...] to verify whether capital was provided by the State in circumstances which correspond to normal market conditions exists regardless of the way in which that capital was provided by the State [...].

Even if, in the EDF Judgment, the decision is in favour of the State granting aid (in less than a fully transparent manner)—and, therefore, the outcome of the private investor test does not imply a tighter scrutiny of State economic intervention—it is in my view a very interesting development of EU State aid law towards a more focused and substantive appraisal of similar situations, since it can contribute to subject to more economic criteria the granting of aid through measures falling within the core sphere of ‘public powers’—which would otherwise remain substantially shielded from

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7 EDF Judgment, at para. 37, emphasis added. To be sure, some doubt can be harboured as to whether the same approach will be taken when appraising situations in which the State has risks that would not be borne by a private investor, such as the potential liabilities disregarded in Spain vs. Commission (such as payment of unemployment benefits, or other potential liabilities in case of bail-outs or other market interventions). This is the reading advanced by Köhler (n 2) 26, who distinguishes Spain vs. Commission from EDF on the basis that, in the former case, the ECJ did not establish a set of circumstances under which the private investor test could not be applied, but simply excluded some potential liabilities from that analytical framework. I think this position is difficult to support and, in any case, is not completely aligned with economic criteria (infra §3).


9 Opinion of AG Mazák in Commission vs.EDF, at para. 96. The reasoning is developed in paras. 76 to 95.

10 In similar terms, although referred to the prior General Court Judgment, see Köhler (n 2) 24, who considers that the EDF judgement “seems to go farther than Ryanair by generally stating that the form of the measure is irrelevant to the application of the private investor test”. The reference to Ryanair (Case T-196/04) is relevant, since in that instance, the General Court had not gone that far, but had already “implicitly stated that the ‘exercise of regulatory power’ does not exclude the application of the private investor test” (Köhler, id).

11 EDF Judgment, at paras. 92 and 93, emphasis added.
economic considerations (despite the more economic approach to State aid law enforcement\(^{12}\)). The \textit{EDF Judgment} may trigger further developments, which deserve some additional discussion.

3. THE NEED FOR A MORE FULLY DEVELOPED ‘MARKET ECONOMY AGENT’ PRINCIPLE TO APPLY CONSISTENTLY ACROSS ALL AREAS OF EU ECONOMIC LAW

As already pointed out, I think that one of the major contributions of the \textit{EDF Judgment} is that it clarifies that the ‘private investor’ test is not an exception, but rather the general test that the Commission must apply in the appraisal of all and any measures that could fall within the scope of Article 107(1) TFEU, regardless of their legal nature—\textit{ie} it is a test that is common to activities developed \textit{iure imperii} and \textit{iure commercium}\(^{13}\), in order to appraise the economic rationality of any type of market intervention by the State under Article 107(1) TFEU. This should spur further change in the twofold direction of, first, harmonising the criteria applied within the area of State aid law (A); and, second, to push for further consistency of the economic criteria used to appraise the behaviour of the State as a ‘market economy agent’ across all areas of EU economic law (B).

A. FURTHER CONSISTENCY WITHIN STATE AID LAW

A possibilistic reading of paragraph 103 of the \textit{EDF Judgment} indicates that the ‘private investor’ test—or, more generally, a ‘market economy agent’—should become the homogeneous and single standard to appraise the potential existence of State aid\(^{14}\). In this regard, it is important to stress that the specific use of the term ‘investor’ in the final part of the \textit{EDF Judgment} (rather than ‘creditor’, or ‘agent’, or ‘participant’, or any other) is not relevant. In finding that the ‘private investor’ test is a mandatory requirement for all State aid appraisals conducted by the Commission, the ECJ makes reference to paragraph 78, where it had summed up the prior case-law as follows:

\begin{quote}
\textit{it is also clear from settled case-law 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.} \textit{(EDF Judgment, para. 78, emphasis added).}
\end{quote}

\(^{12}\) Similarly, see Köhler (n 2) 31.


\(^{14}\) On the economic dimensions of the ‘private investor’ test, see J Kavanagh, G Niels & S Pilsbury, ‘The market economy investor: an economic role model for assessing State aid’, in E Szyszczak (ed) \textit{Research Handbook on European State Aid Law} (Cheltenham: Edward Elgar, 2011) 90-104. It is noteworthy that the authors stress that, regardless of the subtle legal differences between the different tests developed so far, they should all follow the same economic logic. Hence, they particularly stress that the focus should be on the decision made, rather than on the process by which the decision is made. In my view, this supports the \textit{EDF Judgment} and the further developments hereby proposed, particularly having regard of the “rapid evolution of the [market economy investor principle] as an economic tool in State aid analysis” (id, 104). For further discussion, see also E Szyszczak (2011) ‘The survival of the market economy investor principle in liberalised markets’ \textit{European State Aid Law Quarterly} 1:35-40; and P Nicolaides & IE Rusu (2011) ‘Private Investor Principle: What Benchmark and Whose Money?’ \textit{European State Aid Law Quarterly} 2:237-248.

\(^{15}\) \textit{EDF Judgment}, at para. 78 (references to prior case-law omitted, and emphasis added).
Therefore, we see how the ECJ uses ‘private investor test’ as a short term for ‘transaction under normal market conditions’ or, drafted differently, for a ‘market economy agent’ test—without further distinction. This seems to run contrary to the Opinion of AG Mazák in EDF, where he had clearly read the (pre)existing case-law as mandating a formal separation of tests, depending on the role adopted by the State in the granting of State aid (ie, distinguishing between the State as ‘creditor’ and as ‘investor’; and potentially, as a buyer, provider, etc). AG Mazák specifically said:

I consider it important not to treat in the same way two notions which are quite different. A distinction should be made between the private creditor (in a market economy) principle and the private investor (in a market economy) principle (the MEIP). Indeed [...] it is not possible to compare the position of a private investor with the position of a private creditor. Whereas an investor seeks to generate a profit by making representations to undertakings, a creditor seeks to obtain payment of sums owed to it by a debtor in financial difficulties. 16

Following such a formalistic approach would require the application of (at least two) sets of different tests and criteria to transactions that imply a change from creditor to investor (such as a set-off of debt against capital), or viceversa (such as the sale of shares owned by the State to the undertaking, for instance as part of a plan to reduce the outstanding volume of issued capital, if the purchase of its own shares was not paid in cash by the undertaking). Moreover, given the fact that, under a formalistic prism, it may not be the same to be a ‘financial’ creditor (ie one that just lends money), a ‘commercial’ creditor (which extends credit as a result of a commercial transaction, by allowing for a deferred payment of any outstanding invoices) or an ‘involuntary’ creditor (eg due to harm inflicted by tort, or by the existence of pure legal credits, not necessarily derived from taxation), the scope for subdivision and multiplication of tests within the family of the ‘private ...’ seems potentially very broad (if not almost endless). Further, such a formalistic approach could also determine the use of different methodologies to calculate the expected market returns for a given investment depending on whether it was in ‘pure’ debt, in hybrid finance, or in ‘pure’ capital (whereas the valuation method could be uniform, as long as it allowed room to take into account the different risks implied in lending money or buying shares, or in any financial transaction that falls in between regarding the balance between investment, property and repayment rights and obligations).

16 Cfr. Opinion of AG Mazák in Commission vs.EDF, at para. 87. Along the same lines, the General Court seems to have recently differentiated between the ‘private investor’ and the ‘private creditor’ test in Case T-1/08 Buczek Automotive sp. z o.o. v European Commission [2011] ECR nr [appeal pending before the ECJ as case C-405/11 P Commission v Buczek Automotive and Poland]. However, it does not seem that the General Court has made any specific effort to distinguish between both tests, since its analysis is mainly restricted to the appraisal of the behaviour of the State as a ‘creditor’, without further theoretical elaboration. Hence, the drafting ‘private investor’ and ‘private creditor’ test seems fully interchangeable in the existing case-law; or, as argued by B Slocok (2002) ‘The Market Economy Investor Principle’ Competition Policy Newsletter 2:23-26, the market creditor, market guarantor and any other specifications of the principle are not more than ‘extensions’ of the basic ‘private investor’ principle as initially named in the case-law. Similarly, see Köhler (n 2) 21-22, with further references to German commentators. Cfr. U Soltesz (2011) ‘General Court Tightens Judicial Review when Commission Applies «Private Creditor Test» – Case T-1/08, Buczek Automotive’ Journal of European Competition Law & Practice 2(6):556-557. See also M Muñoz de Juan & JM Panero Rivas (2012) ‘Locus standi and the Private Creditor Test after the Judgment of the General Court on Buczek Automotive v Commission’ European State Aid Law Quarterly 1:273-281.
In my view, hence, the exponential formalism that derives from the opinion of AG Mazák and similar legal positions—whereby public activities would need to be appraised under specific economic criteria depending on the very specific and formalistic circumstances that would distinguish the economic behaviour of an ‘investor’ and a ‘creditor’, and which define watertight compartments depending on the specific role of the State—imposes a serious restriction in the development of EU competition law, and jeopardises the consistency of several branches of EU economic law in wider terms (if, in fact, does not create pure and simple inconsistencies; on this, see more infra §3.B)\(^\text{17}\).

The development of excessively specific and formalistic tests creates a significant risk of disconnection between law and market reality and, what is more, reduces legal certainty and the economic soundness of the case-law. On the contrary, it is potentially more effective to develop a general, flexible test that requires the State to behave as a ‘market economy agent’ would have done—given the actual role and (often hybrid) circumstances, which can be hard to conceptualise under narrow categories [as when private agents have dual conditions (eg of shareholders and creditors) or can opt between different economic instruments (such as to invest directly or through derivatives, or to either lend money or buy a stake in a company)]\(^\text{18}\).

Therefore, in appraising whether State aid exists because there is an economic advantage that the beneficiary undertaking would not have obtained under market conditions, no specific attention should be paid to the instruments used or the specific role played by the State, but only to the actual economic structure and effects of the measure—which should be compared against the benchmark of what an arm’s length ‘market economy agent’ would have done under (economically) comparable circumstances. I.e. the relevant test should be based on the economic soundness or the ultimate rationality of the decision on the basis of economic and budgetary considerations (since public authorities must aim to maximize value for money and efficiency across all areas of public management\(^\text{19}\), particularly in times of economic crisis, where prioritisation of public interventions and minimisation of expenditure and debt have become top goals). The development of such streamlined, flexible and more general test fits nicely within the priorities set by the Commission in the State Aid Modernisation Communication\(^\text{20}\)—and, consequently, should receive particular attention in the current wave of revision of EU State aid law in order to actually achieve “a clearer and more coherent architecture of State aid control”.

\(^{17}\) For an interesting criticism of a capricious development of the ‘private investor principle’, but for different reasons, see M Parish (2003) ‘On the private investor principle’ European Law Review 28:70-89—who advocated the suppression of the principle on the basis that it was politically charged and had become unnecessary in view of the predictability of State aid case-law. In my opinion, the criticism can be realigned in an exercise of filling the principle with economic soundness, rather than suppressing it altogether.

\(^{18}\) Similarly, see Köhler (n 2) 31, where he indicates that “when the aim of the private investor test is to determine whether a private investor would have taken the same measure in an economic sense (with regard to the funds and the risks at stake) it is only necessary to compare the economic effects of the measure but not the way how the result can be achieved”.

\(^{19}\) Cfr. Sauter & Schepel (n 4) 206-207, who hint at the development of a ‘rational public authority’ test.

\(^{20}\) Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions—EU State Aid Modernisation (SAM), of 8 May 2012, COM(2012) 209 final.
B. FURTHER CONSISTENCY ACROSS ALL AREAS OF EU ECONOMIC LAW

Moreover, the (re)design of a ‘market economy agent’ test would allow for approximation and consolidation of the case-law oriented towards the appraisal of public interventions in the economy more generally. For instance, it would build a bridge between State aid and public procurement rules, where the actual appraisal of the economic conditions under which a public contract is awarded is likely to require more intense scrutiny if the 2011 proposal for a revision of the current EU public procurement Directives is finally approved—and which will be particularly relevant in the area of financing of services of general economic interest (SGEI) [Article 106 TFEU], where the development of an effective ‘market economy agent’ test could be particularly beneficial.

Such a ‘market economy agent’ test should aim to determine whether the public authority (or any other emanation of the State) has clearly identified the public good or the need in the public interest to be satisfied or covered, has taken due consideration of the economic effects of the measure (be it an investment, a financial facility, a purchase, the granting of a special or exclusive right, etc), has conducted a cost-benefit analysis in accordance with economically sound and generally accepted methodology and based on reasonable estimates and plausible assumptions, and has not incurred excessive risks or made excessive financial commitments that would render the decision so economically unbalanced as to make it irrational or exclusively defensible on political grounds completely detached from economic considerations and basic principles of proper public management. To be sure, such a test can be hard to apply in every specific set of circumstances and some guidance through new, creative and innovative case-law would be much needed. However, the current trend of developing excessively narrow tests, disconnected across the several areas of EU economic law, and potentially inconsistent between them has generated a type of box-ticking public policy that may not serve other purposes that avoiding scrutiny (by the European Commission) and that may not be rendering best value for money to tax payers.

4. CONCLUSION

In the end, my opinion is that the EDF Judgment and the antiformalistic push it can give to the development of a more substantive appraisal of State aid (and other types of public market intervention or interaction) are but a clear signal that, across several areas of EU economic law, there is a need for a broader and more flexible test that relies on the proper exercise of discretion by public bodies (and other emanations of the State), in virtue of which they would have to justify that they made a decision in the absence of conflicts of interest, with as full information as available and as refined economic analysis as feasible, and that they pursued a legitimate public interest (as determined in accordance with EU law and, obviously, in compliance with the requirements of the general principles of the Treaty and the pillars of the internal market). The analogy that comes to mind is that of the ‘business judgment rule’ in the appraisal of private sector managers’ decisions. If a similar ‘economically sound judgement rule’ could be developed in EU economic law on the basis of the several bits and pieces that we can group under the umbrella of a ‘market economy agent’ principle, then that development would power a true wave of legal change and improvement.