

Preserving Competition and Choice in Contracting

Mark Johnson examines some topical issues in preserving the fairness of contracting procedures.

In previous articles we have looked at the need for commissioners to ensure a level playing field when awarding service contracts. Commissioners must comply with various rules which are designed to promote competition. There are the Procurement Regulations, which are derived from EU Directives. We will examine some topical aspects of these in Part 2 of this article. Here we examine the rules on state aid.

State aid is essentially an unfair subsidy which is given to an enterprise (whether profit-distributing or not) from state resources, and which materially distorts competition. State aid is regulated by Article 87 of the EC Treaty, and is policed by the European Commission in Brussels. The prevention of unfair subsidies to certain market players, at the expense of others, is just one plank of their policy to promote competition and a level playing field across the European single market.

In the UK context, the DBERR (formerly DTI) monitors this area of activity and often helps in advising on the impact of the rules and obtaining clearances from the EU Commission. Article 87 declares that State aid is incompatible with the common market and must be notified to the Commission for prior assessment and possible approval. Funding is classed as state aid if four criteria are satisfied:

- *It is a subsidy*
- *It is granted by a State or from State resources (e.g. a special fund set up by the state)*
- *It is selectively applied and therefore distorts or threatens to distort competition by favouring certain enterprises, and*
- *It affects trade between EU Member States.*

If state aid is granted unlawfully (i.e. without an authorisation from the Commission or an exemption), the recipient can be ordered by the Commission to repay it. Also any third party who believes their commercial interests have been prejudiced by an unlawful subsidy may be able to bring an action for damages in the UK courts. Consequently, the parties to an arrangement which may constitute state aid often seek clearance from the Commission in advance.

Aid can take many forms besides an obvious cash payment. It could be a direct subsidy or grant, the transfer of IP rights without charge, or providing loans, guarantees or other support on "soft terms" i.e. on terms that are not at arm's length. It can also apply to ongoing payments for services, to the extent that these are not on market terms, or over compensate the service provider (a so-called 'sweetheart deal'). The Commission is more relaxed about these benefits if they are awarded following an open and transparent competitive process for a contract or transfer of a service.

State aid rules are likely to be particularly relevant in situations where an in-house service is to be transferred out into a new social enterprise or private undertaking. Often the new enterprise may receive a dowry, preferred supplier terms, or sometimes even a guarantee of its debts (e.g. a special deal on pension liabilities). Where a service or market is highly contestable, it is possible that actual or potential corporate

competitors may be affected and could cry foul. State aid is also relevant where new start-ups are applying for financial support from Government-backed funds, such as the Department of Health's Social Enterprise Fund and Futurebuilders.

UK civil servants have traditionally adopted a very cautious approach to state aid rules. This perhaps because the EU Commission has sought to apply the rules even to relatively small local projects, such as Brighton Pier and a swimming pool in Westphalia, where the effect on inter-state trade was at best theoretical. Some sponsoring departments may be reticent to notify and seek clearance from Brussels because they fear wider scrutiny of their funding programmes may cause difficulties.

However, recipients of aid and commissioners have some reason to be optimistic about this issue. Firstly, as from January last, the Commission has exempted small subsidies from the obligation to notify them in advance for clearance. Under the new Regulation, aid of up to €200,000 (approx £135,000), granted over any period of three years will not be considered as state aid. Loan guarantees are also exempted to the extent that the guaranteed part of the loan does not exceed €1.5 million (£1m). Secondly, the Directorate has signalled its intention in the consultation draft State Aid Action Plan to focus enforcement action in future only on markets where there is a genuine effect on a competitive market across intra-European boundaries.

State aid is a complex area of law and policy on which specialist advice will be required. However, all the signs are that a common sense approach will apply to crucial health and social infrastructure and services.

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