Volume 8 | Number 4 ESTAL 4|2009

ESTAL EUROPEAN STATE AID LAW QUARTERLY

ARTICLES

THE LEGAL PUBLISHER
lexxion
BERLIN

Material and Geographic Selectivity in State Aid – Recent Developments

A personal View

*José Luís da Cruz Vilaça**

I. Introduction

Although both the ECJ and the CFI have tried to provide a set of generally applicable criteria to define and identify State aid measures, it is still difficult to conclude for the existence of a coherent and consistent line of case-law that would permit to recognize in each concrete case what measures should be considered State aid. The notion of "specificity" or "selectivity", either *material* or *geographical*, is at the centre of the ambiguity that explains why undertakings, governments and individuals cannot rely on a clear set of guidelines in assessing the existence of State aid.

As regards the so-called "material selectivity", the recent judgments of the CFI (13.9.2006) and the ECJ (22.12.2008), as well as the Opinion of Advocate General Mengozzi (17.7.2008) in cases *British Aggregates*[1] illustrate the difficulties of such issue, in particular as its relationship with the notion of "distortion of competition" is concerned. Nevertheless, the roots of the problem must be sought throughout the traditional decision practice and jurisprudence in this respect.

As far as the notion of "geographical" or "regional selectivity" is concerned, the question was the object of important yet contradictory developments in cases *Azores*[2], the *Basque Country*[3] and *Gibraltar*[4].

II. Material Selectivity

1. The current Jurisprudence

Article 87(1) EC applies to aid "which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods".

In their jurisprudence, it is the latter aspect that the EC courts emphasise. As the CFI stated in *BAA*[5], in order to constitute State aid for the purpose of Article 87(1) EC, a measure must, in particular, be

* Professor of the Law Faculties of the Nova University and the Catholic University of Lisbon; Partner with PLMJ, A. M. Pereira & Associados, Lisbon; former President of the European Court of First Instance and former Advocate General at the European Court of Justice.

1 Case T-210/02, *British Aggregates Association (BAA) v European Commission* [2006], ECR II-2789; Case C-487/06 P, *European Commission v BAA* [2008], not yet reported.

2 Case C-88/03 *Portugal v Commission (Azores)* [2006], ECR I-7115.

3 Joined Cases C-428/06 to C-434/06 *Unión General de Trabajadores de La Rioja (UGT-Rioja)* (C-428/06), *Comunidad Autónoma de la Rioja (C-429/06) v Juntas Generales del Territorio Histórico de Vizcaya, Diputación Foral de Vizcaya, Cámara de Comercio, Industria y Navegación de Bilbao, Confederación Empresarial Vasca (Confebask) and Comunidad Autónoma de la Rioja* (C-430/06), *Comunidad Autónoma de Castilla y León* (C-433/06) *v Diputación Foral de Álava, Juntas Generales de Álava, Confederación Empresarial Vasca (Confebask) and Comunidad Autónoma de la Rioja* (C-431/06), *Comunidad Autónoma de Castilla y León* (C-432/06) *v Diputación Foral de Guipúzcoa, Juntas Generales de Guipúzcoa, Confederación Empresarial Vasca (Confebask) and Comunidad Autónoma de Castilla y León* (C-434/06) *v Diputación Foral de Vizcaya, Juntas Generales del Territorio Histórico de Vizcaya, Cámara de Comercio, Industria y Navegación de Bilbao, Confederación Empresarial Vasca (Confebask)* [2008], not yet reported.

4 Cases T-211/04 *Government of Gibraltar v Commission* and T-215/04 *United Kingdom v Commission* [2008], not yet reported. The Judgment is under appeals pending before the ECJ (Cases C-106/09 P, *Commission v Government of Gibraltar and United Kingdom* and C-107/09 P *Spain v Government of Gibraltar and United Kingdom*).

5 Para. 105.

capable of conferring a selective advantage[6], to the exclusive benefit of certain undertakings or certain sectors of activity.

As a matter of fact, the EC courts usually carry out their examination concerning the characterisation of a measure as State aid on the sole basis of the requisite of selectivity, therefore disregarding at this stage of reasoning the issue of distortion of competition.

Some statements of both courts seem to be representative of such approach.

In *Adria-Wien Pipeline*[7], the ECJ held that: "The only question to be determined is whether, under a particular statutory scheme, a State measure is such as to favour 'certain undertakings or the production of certain goods' within the meaning of Article [87](1) EC in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question". In *Spain v Commission*[8] similar statement was introduced by the rather strong expression: "the application of Article [87](1) EC only requires it to be determined...", thus leading to the conclusion that "[i]f so, the measure satisfies the condition of selectivity which defines State aid as laid down by that provision".

Similarly, in *Ladbroke Racing*[9] the CFI considered aid as an objective concept, "the test being whether a State measure confers an advantage on one or more particular undertakings".

A particularly clear statement in this regard can be found in *Italy v Commission*[10], Judgment of the ECJ, quoted by the CFI in *Gibraltar*[11], where the EC courts held that Article 87(1) "prohibits State aid which '[favours] certain undertakings or the production of certain goods', that is to say aid which is selective".

In short, the courts appear to take in general the view that when "selectivity" is present then distortion of competition follows as a consequence, thus triggering application of Article 87(1) EC.

Following such line of case-law, selectivity is to be considered a stand-alone requisite, which presence is not only *necessary* but also *sufficient* to conclude for the existence of State aid.

The jurisprudence and the Commission's practice have in fact paid in general little attention to the other two conditions for an aid granted by a Member State to fall under the scope of Article 87(1) EC: "distortion of competition" and "effect on intra-Community trade".

In its decisions on State aids, the Commission traditionally contented itself with rough indications about the conditions of affecting trade between Member States and distorting competition[12]. It must however be said that this approach has not always been upheld by the Court.

Indeed, in *Leeuwarder v Commission*[13], the Court of Justice criticized the Commission for not including in its decision a statement of reasons with regard to the assessment of the requirement that the aid in question affected trade between Member States and distorted or threatened to distort competition by favouring certain undertakings or the production of certain goods. After pointing out that the Commission had merely repeated the Treaty provision without any indications of fact, the Court held that even if in certain cases the very circumstances in which the aid is granted are sufficient to show that the aid is capable of affecting trade and distorting or threatening to distort competition, the Commission must at least set out those circumstances in its decision. In this respect, the Court stressed the importance of considering the

6 Such selective advantage may be the intrinsic consequence of the measure itself as it was intended to be from the outset or instead the result of its application in the complex circumstances of each case. As the CFI made it clear in Case T-55/99 *Confederación Española de Transporte de Mercancías (CETM) v Commission* [2000] ECR II-3207, para. 40, "[t]he applicant's argument that there was no prior identification [...] of the individual addressees of the measure contained therein, must be rejected. The fact that the aid is not aimed at one or more specific recipients defined in advance, but that it is subject to a series of objective criteria pursuant to which it may be granted, within the framework of a predetermined overall budget allocation, to an indefinite number of beneficiaries who are not initially individually identified, cannot suffice to call in question the selective nature of the measure and, accordingly, its classification as State aid within the meaning of Article [87](1) EC. At the very most, that circumstance means that the measure in question is not an individual aid. It does not, however, preclude that public measure from having to be regarded as a system of aid constituting a selective, and therefore specific, measure if, owing to the criteria governing its application, it procures an advantage for certain undertakings or the production of certain goods, to the exclusion of others."

7 Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, para. 41.

8 Case C-409/00 *Spain v Commission* [2003] ECR I-1487, para. 47.

9 Case T-67/94 *Ladbroke Racing v Commission* [1998] ECR II-1, para. 52.

10 Case C-172/03 *Italy v Commission* [2005] ECR I-10901, para. 94.

11 Cited above, para. 77.

12 See e.g. Commission's Decision 2002/142/EC of 18 July 2001 relative to an aid granted by Netherlands to Valmont Nederland BV, OJ L 48, 20 February 2002, p. 20, paras. 19-22.

13 Joined Cases 296-318/82 *Leeuwarder v Commission* [1985] ECR p. 809, paras. 22-24.

situation of the relevant market, the place of the undertaking receiving the aid in that market, the pattern of trade between Member States in the products in question and the undertaking's exports.

On the other hand, as suggested by Advocate General Capotorti in his Opinion in case *Philip Morris*[14], regarding the impact on competition Article 87(1) EC may be read as establishing a simple criterion according to which the condition of distortion of competition only would not be fulfilled when no product similar or substitutable to those manufactured by the beneficiary of the aid existed in the common market. As this seldom occurs, it was held in the legal literature[15] that the condition of distortion of competition is always met and can thus in principle be presumed to be fulfilled[16].

The condition of "affecting trade between Member States" has also been subject to a wide interpretation. In the *Philip Morris* case[17], the Court admitted that "[w]hen State financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by that aid"[18]. From that statement Advocate General Jacobs in his Opinion of 1994 in cases *Spain v Commission*[19] concluded that it was "clear from the Court's case-law that the requirement of an effect on trade between Member States is easily satisfied".

I would like to express the view that this test may not always be adequate or sufficient.

2. Refining the Approach

Although in many cases the mere existence of selectivity may indeed be liable to distort or to threaten to distort competition, I believe that the wording, the objective and the context of Article 87(1) EC require a somehow more complex approach, suitable for application in the complex circumstances which characterise in general measures of selective aid.

As recalled earlier, for the purpose of application of Article 87(1) EC a State aid measure is defined by reference to any aid granted by a Member State "which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods". This provision should be read as selectivity being a constituent element of the notion of distortion of competition, which is inherent to the very notion of State aid as defined in Article 87(1) EC.

If it is so, it does not seem possible to infer simply from the fact that a measure is selective that it is to be classified as aid for the purpose of Article 87(1) EC when the measure in question, in itself and within the legal and economic context in which it is applied, is not liable to distort or to threaten to distort competition. It is by distorting or threatening to distort competition that selective measures shall be deemed to be "incompatible with the common market".

It is true that distinguished commentators[20] consider that Article 87 EC comes within a policy of "fair" or "loyal" competition, therefore inscribing itself in a context which is different from Article 81 EC.

On the other hand, the Treaty, by including the reference to "favouring certain undertakings or the production of certain goods", may allow of an interpretation according to which protection of competitors, not protection of competition as a process, is the real objective of Articles 87 and 88 EC[21].

This however is not the only possible interpretation. Firstly, rules on competition in the Treaty applying either to undertakings or to Member States should be interpreted according to the same standard. Secondly, favour to an undertaking or a production should be irrelevant when there are no

14 Case 730/79 *Philip Morris Holand* [1980] ECR p. 2671; Opinion of the Advocate General, p. 2698.

15 See Jean-François Bellis, *Les critères de la distorsion de concurrence et de l'effet sur le commerce interétatique*, in "Aides d'État", edited by Marianne Dony and Catherine Smits, IEE-ULB, Brussels, 2005, p.97-106, in particular p. 99.

16 The CFI appears to take a similar view in Case T-214/95 *Vlaams Gewest* [1998] ECR II-717, para. 46, when assessing the impact of small amounts of aid on the application of Article 87. In that Judgment, the Court held that: "Where a public authority favours an undertaking operating in a sector which is characterised by intense competition by granting it a benefit, there is a distortion of competition or a risk of such distortion. Where the benefit is limited, competition is distorted to a lesser extent, but it is still distorted. The prohibition in Article [87](1) EC applies to any aid which distorts or threatens to distort competition, irrespective of its amount, in so far as it affects trade between Member States."

17 Para. 11.

18 See also Case C-148/04 *Unicredito Italiano* [2005] ECR I-11137, para. 56.

19 Opinion delivered on 23 March 1994 in Joined Cases C-278-280/92 *Spain v Commission* [1994] ECR I-4103, para. 33.

20 See *e.g.* J.-F. Bellis, *cit.*, p.98.

21 See also J.-.F. Bellis, *cit.*, p. 98.

competitors that may be harmed and competition in the market cannot be affected.

This is consistent not only with the wording of Article 87(1) EC but also with its position in the system of the Treaty under the heading "rules on competition", applying to Member States. The slightly different way in which Articles 81(1) EC and 87(1) EC are phrased – "which have as their object or effect the prevention, restriction or distortion of competition" versus "which distorts or threatens to distort competition" – do not appear to mean anything relevant from the point of view of their respective interpretation.

A measure may therefore favour certain undertakings or certain products without being considered State aid when it does not affect the competitive position of other undertakings or products or the structure of competition on the market[22].

As shown in *BAA*, this consideration even plays a role in deciding on the admissibility of an action brought by a competitor whose market position is significantly affected by a State measure granting an advantage to some undertakings or categories of undertakings. Indeed, as Advocate General Mengozzi emphasised in his Opinion in that case[23], "the effect on the applicant's competitive position [is] the primary criterion for the purposes of assessing whether the action [is] admissible"[24]. Such assertion was upheld by the ECJ in its Judgment in this same case[25].

Moreover, as both the CFI and the Advocate General in the subsequent appeal to the ECJ pointed out[26], the purpose of the levy at issue was to transfer some of the demand for virgin aggregates to alternative products, in order to encourage the use of such products and to reduce the extraction of virgin aggregates, thus being a measure intended to have a direct effect on the structure of the market and hence on the competitive position of undertakings active on that market.

Case C-409/00 *Spain v Commission* (cited above, note (8)) provides a good example serving to elucidate this question. Indeed, when a given regime of aid covers different categories of vehicles – big tractors and lorries, small lorries and vans, buses and coaches, trailers and semi-trailers – it is clear that competition is not affected in the same way as regards all those categories. It then becomes crucial to define the relevant markets on which the aid measure may have an impact and to examine the market characteristics as a pre-condition to apply Article 87(1) EC.

In the above mentioned case, the Court did perform a perfunctory examination of the "relevant markets" at issue and distinguished aid granted to "non-professional transport companies" from "aid granted to professional transport companies". The conclusion[27] was that "those two categories of beneficiaries [...] do not belong to the same sector and do not operate in the same market".

The Court also acknowledged[28] that the contested decision contained an assessment of the effect of the aid at issue on the transport sector, namely that the aid was likely to help the beneficiaries compete with large undertakings established in Spain. It also recalled[29] that when a sector, such as the transport sector in conditions of overcapacity, is characterised by strong competition, aid of relatively little importance can affect competition and trade between Member States.

However the Court failed to consider distortion of competition as an integral part of the notion of aid for the purposes of application of Article 87(1) EC. On the contrary, it considered it necessary to establish first, that the aid at issue fell within the scope of Article 87(1) EC and second, that it distorted or threatened to distort competition, as two different steps in the analysis[30].

22 Conversely, even a general measure, which is not limited either to a particular sector or to a particular territory and is not applied to a restricted category of undertakings, "may be caught by the prohibition laid down in Article 87(1) EC if their implementation is left to the discretion of the national authorities as regards, in particular, the choice of recipients, the amount and the conditions of the financial assistance" (Mengozzi, para. 81). This is so because such general measure may threaten to distort competition between undertakings.

23 See paras. 30-50, especially para. 32.

24 As underlined by the Advocate General, "the harm of which BAA complains does not derive from the fact that its members are required to pay the AGL [a levy imposed, for environmental reasons, on virgin aggregates used in construction but of which are exempt alternative materials and aggregates exported from the UK], but from the competitive disadvantage they allegedly suffer by reason of the fact that some competing producers are exempt from the AGL" (Opinion, para. 47).

25 As the Court stressed in para. 35 of its Judgment, "irrespective of whether the aid measure in question is individual or general in nature, an applicant must, when bringing into question the soundness of the decision assessing the aid as such, demonstrate that [...] the position of the applicant on the market in question is substantially affected by the aid which is the subject of the decision in question".

26 Judgment of the CFI, paras. 55-56; Opinion of the AG, para. 65.

27 See para. 67.

28 Para. 75.

29 See paras. 76 and 77.

30 Para. 77.

In *Netherlands v Commission*[31], however, the CFI rightly pointed out that "classification as aid requires that all the [*four*] conditions set out in Article 87(1) EC are fulfilled." However, having concluded that the measure in question was not selective, within the meaning of *Adria-Wien*, the Court did not need to consider the issue of "distortion of competition"[32].

Conversely, when a measure is deemed to be selective, it may still be necessary to assess, as an integral part of the notion of aid, whether it distorts competition, including the effects on competition both on the same market and on the upstream, downstream or other related markets[33].

In brief, I propose an approach which mirrors the one followed as regards Article 81. On the one hand, Article 81(1) EC prohibits agreements, decisions by associations of undertakings and concerted practices that have as their object or effect (significantly) to prevent, restrict or distort competition, whereas Article 87(1) EC prohibits State aid that, by being selective, (significantly) distorts or threatens to distort competition.

On the other hand, if Article 81(3) EC provides a "legal exception" to the prohibition in Article 81(1) EC with respect to agreements or practices that satisfy certain conditions, Article 87(3) EC is similarly an exempting provision from the prohibition laid down in Article 87(1) EC.

To consider that a State aid falls within the scope of application of Article 87(1) EC for the simple reason that it is "selective" would be tantamount to considering that an agreement falls within Article 81(1) EC simply because it constrains "conduct" or restricts the "economic freedom" of the parties to that agreement.

This is why I am supportive of the guidelines issued by the Commission in its State aid Action Plan of 2005 favouring a more "refined economic approach" when dealing with State aids. According to the Action Plan, "State aid control comes from the need to maintain a level playing field for all undertakings active in the Single European Market" and from the concern "with those State aid measures, which provide unwarranted selective advantages to some firms, preventing or delaying the market forces from rewarding the most competitive firms, thereby decreasing overall European competitiveness"[34].

I am therefore in favour of an approach that puts competition, and not just selectivity, the consumer, and not just the competitors, in the heart of State aid policy[35].

As underlined by Ahlborn and Berg[36], the current policy under the State aid provision and the approach still prevailing in judicial review bear resemblance with the early period of legal formalism in the application of Article 81 EC.

31 Case T-233/04 *Netherlands v Commission* [2008] not yet reported, para. 63. See also case C-126/01 *Gemo* [2003] ECR I-13769, paras. 21-22. However, in *Gemo*, once again, the Court considered the measure in question to be a State aid because it was selective, without assessing whether it distorted competition in the common market. The Court limited itself to consider, in para. 42 of the Judgment, that "the fact that, in France, the costs of carcass disposal are borne neither by farmers nor by slaughterhouses necessarily has a positive impact on meat prices, thus making that product more competitive on the markets of the Member States where such costs are normally paid out of the budget of competing traders". Moreover the Court made this assessment in connection with the analysis of the condition of "affecting trade between Member States" and not in connection with the condition of "distorting competition".

32 When a measure is not selective and does not constitute State aid, distortions of competition within the common market may be tackled by other instruments: Article 94 EC, Articles 96 and 97 EC (Opinion of Advocate General Geelhoed in the *Azores* case, para. 46).

33 On the other hand, the fact that a tax measure will or could have the effect of distortion of competition within the common market is essentially sufficient for it to satisfy the selectivity criterion. Advocate General Geelhoed essentially stressed the same idea as regards regional measures, in his Opinion in the Azores case, para. 58. However, in the absence of regional selectivity, given the sufficiently autonomous powers of a concrete regional authority, the issue of (material) selectivity and distortion of competition is to be assessed within the limits of the region.

34 The Commission's approach after 2004 represented an attempt to implement a more flexible approach focused on measures which produce significant economic effects at the Community level but neither of the two draft Communications for the definition of a new framework for the assessment respectively of lesser amounts of State aid and of State aid which has limited effect on intra-Community trade has been followed by a final communication (see reference in J.-F. Bellis, *cit.*, p. 98).

35 That is why in a case like the one concerning Ryanair and Charleroi airport I would support DG COMP and its concern with the consumers' interest against DG TREN and its sensitivity to the competitors' claims.

36 C. Ahlborn and C. Berg, *Can State aid Control Learn from Antitrust? The Need for a Greater Role for Competition Analysis under the State aid Rules*, in "The Law of State aid in the EU", Biondi, Eeckout and Flynn, eds, Oxford, 2004.

Adversely, the adoption of a clear "effects-based approach" in the application of State aid rules aimed at safeguarding the competitive process in the internal market (and not simply at protecting competitors) is coherent with same approach in applying Article 81 EC after *Delimitis* and Article 82 EC as proposed in the Commission's Discussion Paper and in its Communication on "Guidance on the Commission's enforcement priorities in applying Article 82"[37].

This should not involve any kind of "carbon copy" approach since the type of competitive analysis suitable for all those fields is not necessarily the same[38]. However, I do not share the view that the interest of the consumers should not be taken into account in this context. In fact, the impact of the measure on the consumers should be considered, however complex the task may be, namely by balancing the gains for consumers in a given geographical market against the losses in other markets.

III. Regional or Geographical Selectivity

As regards "geographical (or regional) selectivity", after years of hesitation and questioning, a new journey in the jurisprudence started some three or four years ago. The "*coup d'envoi*" was given by the Judgment of the ECJ in the *Azores* Case[39], which set the tone for a shift in the traditional path.

First, it stated in reply to the Commission's submission that the reference framework for the determination of a tax advantage need not necessarily be defined within the limits of the Member State concerned, so that a measure conferring an advantage in only one part of the national territory is not selective on that ground alone for the purposes of Article 87(1) EC (*Azores*, paragraph 57). When an autonomous infra-State body plays a fundamental role in the definition of the political and economic environment in which undertakings operate, it is the area in which that body exercises its powers, and not the country as a whole, that constitutes the relevant context for the assessment of whether a measure adopted by such a body favours certain undertakings in comparison with others in a comparable legal and factual situation (paragraph 58).

Next, it must be recalled that the Court did not take position with regard to the question whether such conclusion would still be valid in case of an asymmetrical devolution of powers in fiscal matters to local or regional bodies within a Member State.

However, Advocate General Geelhoed was clear in submitting[40] that when a local authority takes its decision with "true autonomy", "there is no logical or doctrinal ground for distinguishing between 'symmetrical' [...] and 'asymmetrical' devolution of tax powers", the choice being "one of constitutional policy heavily dependent on the unique historical and economic circumstances of that region".

Finally, the Court established a set of criteria that would permit to examine whether a given measure was adopted by an infra-State body in the exercise of powers *sufficiently autonomous*[41] vis-à-vis the central power.

---

37 The Court of Justice itself has pointed out in several instances that Article 87(1) does not distinguish between measures of State intervention by reference to their causes or their aims – be them environmental, economic, social or otherwise – but defines them in relation to their effects (Case C-75/97, *Belgium v Commission – Maribel bis/ter* [1999], para. 25; Case C-409/00 *Spain v Commission* [2003] ECR I-1487, para. 46). In *Maribel* (para. 51) the Court took therefore the right approach when it stated that the Belgian social security scheme for wage earners in question was a scheme of sectoral aid that improved the competitive position of the undertakings concerned, both on the Belgian market and on the export market, in relation to undertakings established in other Member States by relieving them of part of their social costs, and that consequently was liable to affect trade between Member States and to distort or to threaten to distort competition. Reference should also be made to the Judgment of the ECJ in Case *BAA*, cited above, paras. 84-92, where the Court upheld the criticism made by Advocate General Mengozzi (Opinion, paras. 98 and 102) on the first instance ruling, namely to the extent that the CFI held that "the Member States are free, in balancing the various interests involved, to set their priorities as regards the protection of the environment and, as a result, to determine which goods or services they are to decide to subject to an environmental levy" (para. 115). However, I will not enter in this article into the intricate discussion about the relevance of and the articulation between, on the one hand, the specific objectives (environmental or other) pursued by the State measure or the nature and the general scheme of the tax system in question and, on the other hand, the notion of selectivity. These, together with the discussion about the scope of Member States' jurisdiction on tax matters and the interplay between paras. (1) and (3) of Article 87 EC, were crucial issues in the *BAA* cases, but they fall outside the scope of my reflection, which concerns the relationship, with regard to the notion of State aid, between selectivity and distortion of competition.

38 In this respect, see Ahlborn and Berg, *cit.*, pp. 48-50.

39 Judgment of 6 September 2006, cited above, note 2. See J. L. da Cruz Vilaça, Regional Selectivity and State aid: the Azores Case, in "New Developments in European State aid Law 2006", European State Aid Law Quarterly, EStALI, p. 15.

40 Opinion, para. 60.

41 Or "truly autonomous", as Advocate General Geelhoed preferred to call it.

For a given measure to be regarded as having been adopted in the exercise of sufficiently autonomous powers the Court, following its Advocate General, considered that such a measure must fulfil the following conditions: *(i)* be taken by a regional or local authority with a political and administrative status separate from that of the central government (*"institutional autonomy"*); *(ii)* be adopted without the central government being able to directly intervene in the determination of its content (*"procedural autonomy"*); *(iii)* the financial consequences of the measure (in that case, a reduction of the national tax rate for undertakings in the region) must not be offset by aid or subsidies from other regions or central government (*"economic autonomy"*)[42].

Applying these criteria to the case under appeal, the Court considered that the Azores region could not be considered sufficiently autonomous since the reduction in tax revenue for the region was offset by the existence of financial transfers from the central government, in light of the principles of national solidarity and of correction of inequalities.

On this point, the Court disregarded the fact that such financial transfers to the constitutionally autonomous regions of Azores and Madeira are made according to a pre-established formula set out in the framework law on the finances of the autonomous regions. It also did not consider the arguments drawn by the Portuguese Republic from the *Pape*, *Van Calster* and *Pearle* case-law[43] and from the fact that there is no link or any kind of correlation between such transfers and infra-structural investments, on one hand, and the tax reductions in the region, on the other hand, the former being the expression of the global economic, financial and budgetary policies of the State.

On the contrary, the Court considered[44] that "the two aspects of the fiscal policy of the regional government, namely the decision to reduce the regional tax burden [...] and the fulfilment of its task of correcting inequalities derived from insularity, [were] inextricably linked and [depended], from the financial point of view, on budgetary transfers managed by central government".

The Judgment on the *Azores case* deserves reflection and some criticism. Indeed, it is doubtful whether the concept of "sufficient autonomy" can be deemed a useful tool to ascertain in every case the "selectivity" of a regional tax measure. This was shown two years later by the Court's Judgment in the *Basque* cases[45].

First of all, the concepts used to appraise the nature as State aid of a given regional tax measure are ambiguous enough to have given rise to such contradictory understandings as those expressed in the Basque cases by UGT-Rioja, on one hand, and by Confebask, on the other hand. Whereas the former claimed that there was "absolutely no doubt that the tax measures at issue in the main proceedings constitute State aid", Confebask claimed for its part that "since the Judgment in *Portugal v Commission* is very clear [...] there can be no doubt that the tax measures at issue in the main proceedings do not constitute State aid"[46].

Secondly, the Court, confronted with the Commission's contention that the assessment whether the regional body played a fundamental role in the definition of the political and economic environment in which undertakings operate constituted a precondition for the operation of the three criteria set out in paragraph 67 of the *Azores* Judgment, had to clarify the meaning of this Judgment. It clearly stated (as had been done by Advocate General Kokott in her Opinion) that no such precondition is laid down in that Judgment.

Thirdly, as regards procedural autonomy, the Court[47], implicitly diverging from the opinion of Advocate General Geelhoed in the *Azores* case, considered that "an infra-State body's obligation to take into consideration the State interest in order to respect the limits of the areas of competence which are accorded to it does not, generally, constitute an element calling into question the procedural autonomy of that body where it adopts a decision within those limits".

Finally, regarding economic and financial autonomy, the Court, in the *Basque* Judgment[48] and

42 See para. 67 of the Judgment. The expressions between round brackets have been used by Advocate General Geelhoed in his Opinion.

43 On this line of case-law please refer to my article *How far should National Courts go in Drawing all the Necessary Inferences from the last Sentence of Article 88(3) EC?* in "New Developments in European State aid Law 2005", *European State aid Law Quarterly*, EStALI, p. 45.

44 Para. 76 of the Judgment.

45 Cited above, note 3.

46 See paras. 37 and 38 of the Judgment.

47 Para. 108 of the Judgment.

48 Para. 135.

apparently contradicting its findings in the *Azores* case, found that "the mere fact that it appears from a general examination of the financial relations between the central State and its infra-State bodies that there are financial transfers between the former and the latter, cannot, in itself, suffice to demonstrate that those bodies do not assume the financial consequences of the tax measures which they adopt and, accordingly, that they do not enjoy financial autonomy, since such transfers may take place for reasons unconnected with the tax measures".

It is worth mentioning in this respect that in the case of the Basque autonomous territories financial transfers are also foreseen from the regions to the State budget or to other autonomous territories through a compensation fund, according to a principle of national solidarity. It would be odd to think that this factor should play any role in deciding on the existence of "sufficient autonomy", since the criterion for assessment cannot depend on the region in question being more or less rich than the average of the country.

Differences in the kind of judicial relief sought in each case may provide an explanation for such apparent double standard in the judicial review of tax measures lying within the scope of competence of regional autonomous bodies. Indeed, whereas the *Azores* case related to a direct action for annulment of a Commission's decision, the *Basque* case concerned a reference for preliminary ruling originating in a national court. In the latter case, the Court finally considered that it was for the national court to determine whether the criteria of autonomy laid down in paragraph 67 of the *Azores* Judgment were satisfied.

However, it does not seem appropriate to make the answer to such fundamental questions depending on the form of process that was followed in each circumstance. Moreover, as is apparent from the *Basque* Judgment, the national courts will inevitably be granted such a wide margin of discretion that may run counter the principles of equality and legal security.

Three months after the *Basque* ruling, the CFI delivered its judgment in the *Gibraltar* cases[49]. The judgment, concerning a reform of corporate tax adopted by the Government of Gibraltar, is of great importance in several respects.

First of all, the CFI held that "the determination of the reference framework has a particular importance in the case of tax measures, since the very existence of an advantage may be established only when compared with 'normal' taxation", the 'normal' tax rate being "the rate in force in the geographical area constituting the reference framework"[50].

Having concluded that the reference framework corresponded, in that case, exclusively to the geographical limits of the territory of Gibraltar, the CFI held that "no comparison can be made between the tax regime applicable to companies established in Gibraltar and that applicable to companies established in the United Kingdom for the purpose of establishing a selective advantage favouring the former"[51].

It follows from this assessment that there is no selectivity when the measure in question applies without distinction to all the companies in similar circumstances within the region.

Secondly, with regard to the condition of "financial autonomy", the CFI, "interpreting" the use of the verb "offset" in the *Azores* Judgment, considered that it meant that "a causal link must exist between the tax measure at issue adopted by the infra-State body and the financial support from other regions of the central government of the Member State concerned". The Court rightly pointed out that the "interpretation proposed by the Commission"[52] would make the third condition set out in the Judgment on the tax regime in the Azores a dead letter, since it would be very difficult to conceive of an intra-State body which does not receive any financial support, in whatever form, from central government[53].

49 Judgment of 18 December 2008, cited above, note 4.

50 Para. 80.

51 Para. 115.

52 According to which the condition of "financial autonomy" implies that no assistance is even potentially available to the infra-State body to offset the effects of the body's decisions about its tax measures (*Gibraltar*, para. 102).

53 *Gibraltar* para. 106.

Thirdly and concerning the abovementioned condition, the CFI made clear that, in its view and as it had been submitted by the Portuguese Republic in the *Azores* case, the burden of proving the causal link lies upon the Commission[54].

Furthermore, with regard to material selectivity, the CFI clarified to the Commission's attention the road map to follow in order for it to classify a tax measure as selective[55].

Finally, it is worth noting that the CFI found it necessary to underline[56] that with regard to the determination of the tax system, "as Community law currently stands, direct taxation falls within the competence of the Member States. Thus, it is solely the latter, and infra-State bodies which have sufficient autonomy [...] in relation to central government, that have competence to devise systems of corporate taxation which they consider the best suited to the needs of their economies. Furthermore, [...] application of the Community rules on State aid is without prejudice to the power of the Member States to decide on their economic policy and, therefore, on the tax system – and the common or 'normal' regime under it – which they consider the most appropriate and, in particular, to spread the tax burden as they see fit across the different factors of production and economic sectors".

It is my view that this approach strikes an adequate balance between the requirements of State aid rules and the powers retained by Member States.

From the evolution of the case-law described above, it is therefore possible to conclude that obscurity as regards the notion of selectivity is progressively dissipating; however it remains to be seen how the jurisprudence in this regard will consolidate.

54 Paras. 112-113: "...in the absence of evidence to the contrary adduced by the Commission, it must be found that none of the abovementioned financing serves to offset any financial consequences that the tax reform would entail for Gibraltar". "Since therefore there is nothing that can cast doubt on the applicant's assertions that Gibraltar does not receive any financial support from the United Kingdom that offsets the financial consequences of the tax reform, it must be held that the third condition set out in the judgment on the tax regime in the Azores is met in the present instance."

55 Paras. 141-145.

56 Para. 146.