The Market Economy Investor Principle

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The Market Economy Investor Principle or MEIP has been a cornerstone of state aid control since at least 1984 when the Commission published its communication on Government Capital Injections ([1]). It remains a key test of whether actions by public authorities represent state aid in the sense of Article 87(1) of the EC Treaty. Over the years further Commission texts, decisions and Court judgements have given the notion further precision in the various circumstances with which state aid control has been confronted. This article identifies some points which seem significant in these developments as well as other possible questions which can arise and which are arguably still open.

The Principle

The essence of the MEIP is that when a public authority invests in an enterprise on terms and in conditions which would be acceptable to a private investor operating under normal market economy conditions, the investment is not a state aid. One first point to note is that the 1984 communication does not in fact identify, of the various criteria which a measure must meet in order to qualify as state aid, which is not met by a state investment respecting the MEIP. It seems clear, however, that the criterion which is not met is that of *advantage*: the enterprise gains no particular benefit since it could have obtained the same financing in the markets ([2]). This is an important point to keep in mind in considering extensions of the MEIP to other situations, as discussed below.

The MEIP is a reasonable principle to follow, especially given that the Treaty does not allow differentiated treatment between public and private ownership. It can however be observed that whether an equity investment provides an advantage to an enterprise depends not only on the terms on which it is made but also on how the shareholding is exercised over time: state shareholders are often suspected of being less demanding of dividends, efficiency etc (even if one can debate whether it is in an enterprise's long term interest to have such a 'lax' majority shareholder). The MEIP does not address this. But for the rest of this article the basic tenet is accepted.

New or existing market economy investor?

Even accepting the principle, one question which arises concerns the situation which should be assumed of the comparator 'market economy investor' and the investor's relationship with the enterprise. In order to meet the MEIP, should an investment be acceptable to an investor with no existing stake in the enterprise? That is, should it be justified by reference only to the capital injection in question, or can the effect on a state investor's existing shareholding be taken into account?

This question is not specifically answered in the 1984 text. However, it obviously makes an important difference to the assessment. Even if there is a limit to how far any investor will 'throw good money after bad', most investors will look more favourably at a follow-up investment than at the same opportunity in an enterprise with which they have no connection. There are phrases in the 1984 communication which allude to such situations ([3]) but the point is only definitively addressed in the 1993 communication on the application of Articles 92 and 93 [now 87 and 88] of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector ([4]): 'the Commission will take account of the nature of the public authorities' holding in comparing their behaviour with the benchmark of

(1) Bulletin EC 9-1984.

(2) This is an example of the fact that the presence of advantage in a state measure is assessed by reference to what would be the case in the measure's absence, not the position relative to e.g. competitors in other Member States. A selective tax reduction does not cease to be aid simply because the general tax rate in another Member State is lower even than the reduced level.

(3) 3.3.v: 'there is State aid … where the injection of capital into companies whose capital is divided between private and public shareholders makes the public holding reach a significantly higher level than originally and the relative disengagement of private shareholders is largely due to the companies' poor profit outlook'. But this only shows that when even the follow-up investment is unattractive then the MEIP does not apply. Conversely 3.2.iii: 'Nor is state aid involved … where the public holding in a company is to be increased, provided the capital injected is proportionate to the number of shares held by the authorities and goes together with the injection of capital by a private shareholder'. This suggests that the acceptability of the injection as a follow-up investment suffices, but applies only to the specific case of a proportionate increase with another shareholder.

(4) OJ C 307, 13.11.1993, p. 3.

the **equivalent market economy investor**' (emphasis added).

This poses questions as well as answering them. What if a state owner has allowed an enterprise to develop in a way no market investor ever would? What sense in that situation can we give to the term 'equivalent market economy investor'? Is the test capable of application? The Commission has suggested that in some situations it may not be ([1]), and the Court of First Instance has found that an injection following soon after earlier provisions of state aid could not be assessed separately and found to respect the MEIP independently of the first ones ([2]). In that case the traditional criteria in the Treaty for the presence of state aid need to be assessed directly.

Evidence for the MEIP to be met

The best possible evidence for the MEIP to be met is generally that the terms of the investment not only *would be* acceptable to a market economy investor, but that there *is actually* such an investor making the same investment on the same terms ([3]). (The identity of conditions — including of timing — is of course crucial.) This has however led some public authorities and economic operators to regard such 'concomitance' as the key test and objective in order to comply with state aid rules, because they can thereby claim that there is no state aid present. In cases where the state, other investors or the beneficiary have other relationships outside the terms of the investment, there is at least room for doubt whether such concomitance in the mere investment terms suffices. These questions are discussed below.

Where there are other investors, identifying which are market economy investors can itself be a problem. Most EU economies have a range of economic operators, from the purely private and profit-seeking through co-operative and mutual organisations, some of which have non-commercial objectives, to state-owned but commercial ventures and the organs of the state. Determining at what point the definition of market economy investor ceases to apply is not always simple.

The presence of other investors provides at the least a benchmark for the Commission to make its assessment. There is a risk, however, that this provides an incentive to Member States not to involve outside investors for fear that any difference in terms will be identified as evidence of the presence of State aid: if there is no benchmark, it is harder for the Commission to show that the state's intervention does not meet the MEIP and there may be a temptation to give the benefit of the doubt. Given that, as a general rule, state interventions alongside private capital are likely to be less distortive than those made without such co-investors, there is a danger of creating perverse incentives.

Concomitance

The search for a construction which appears to assure concomitance, in order to obtain a no-aid finding, seems to have become a key preoccupation of certain authorities, enterprises and their advisers. Some constructions have been devised which the Commission's existing texts (1984 and 1993) simply do not envisage. Two in particular are as follows.

Side-agreement between the state and other investors

The Commission has instructed one case where although the state and a private investor were providing capital on equal terms and in the same proportions as their shareholdings, there was a separate agreement in existence that the state would cede its entire holding to the investor, for a price already determined. The state and the investor therefore had very different longer-term perspectives in respect of the business. The new injection would allow the state to preserve the sale agreement it had made; the investor, on the other hand, obtained an injection of capital into the business it had agreed to buy. In practice the bankruptcy of the business concerned intervened before a Commission decision. The presence of aid in such a situation is therefore still an open question.

Investment by the state in the subsidiary of an enterprise

In another scenario a state authority invests in the subsidiary of a company on equal terms with the parent. The subsidiary creates a new facility

([1]) Decision of 7 May 2002 on the sale price of SBW to RAG (not yet published) : 'Given the inherent unprofitability and large potential liabilities of the black sector, whose survival is dependent entirely on state aid, it seems questionable whether a market economy investor would have allowed assets with a significant positive value to be unprotected in this way. The market economy investor principle is therefore not capable of straightforward application.'

([2]) Case T-11/95 (Enichem). European Court reports 1998 Page II-03235.

([3]) See for example http://europa.eu.int/comm/secretariat_general/sgb/state_aids/industrie.htm, case N 705/99.

providing semi-finished products to the parent at cost price. The state's prospects of dividends is therefore poor. This is also true of the parent, but then it benefits from the industrial output of the subsidiary and makes its profits from the finished goods. Can this be construed as no aid? The Commission has opened the investigation procedure in such a case, expressing doubts over the Member State's claim that no aid is present. The outcome will follow during 2002 ([1]).

Extensions of the MEIP

Market Economy Lender Principle

The first and most obvious extension of the MEIP is from the provision of investment capital to that of loan finance: a loan contains no aid if it is provided on terms which a commercial lender would accept. The Commission has developed reference interest rates for this purpose. Indeed, given that lenders generally have less control over enterprises than providers of equity finance, some of the observations on the MEIP in the preceding paragraphs do not apply. So a 'market economy lender principle' seems a sensible extension to the MEIP.

Market Economy Creditor Principle

A more radical extension to the principle was provided by the Court's *Tubacex* judgement ([2]) of 1999. Effectively this created a 'market economy creditor principle'. The Court determined that the test of aid, when the state decided whether or not to waive or reschedule debts, was whether a market creditor would have acted in the same way.

This is plausible but also innovative. In the case of investing and lending, the state can choose whether or not to provide funds: the strongest argument that there is no state aid is that the enterprise could find the finance elsewhere. But an enterprise at a given moment does not choose its creditors: they are who they are. It will not always be the case that it has other creditors whose waiving or rescheduling of debts would give the same assistance to its liquidity situation. Thus the argument that there is no advantage depends on a hypothesis: if the enterprise had had the same level of debts towards private (market) creditors, then they would have behaved in the same way and therefore the company derives no particular benefit.

Inevitably the same issues arise as for the MEIP. What if no private creditor would have allowed such debts to build up? What about the situation where the Government has subordinated its debt to that of other creditors ([3])? Two judgements of the Court are significant here: Magefesa ([4]) found that 'the undertakings in question were able for several years to continue trading without complying with their tax and social security obligations……In those circumstances, the Commission was justified in deciding that, in the particular circumstances of the case, the non-payment of taxes and social security contributions … constituted illegal aid'. Thus in certain circumstances the allowing of such debts to build up can itself constitute an aid, even before any consideration by the state of whether to waive or reschedule them. And an often-overlooked sentence of *Tubacex* states that 'On the assumption that, as the Commission acknowledges, the fact that the sums advanced by Fogasa to pay the wages of Tubacex's employees **are not State aid** has been established…' (emphasis added). In other words *Tubacex* seems to suggest that a waiving or rescheduling can avoid constituting state aid only if the original granting of the loan or credit was not itself aid.

Market Economy Guarantor Principle?

In its notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees ([5]) the Commission allows that certain guarantees do not constitute state aid, notably if the guarantee is adequately remunerated. Does this constitute a generalised 'MEGP'? I would argue not – at least to the extent that it cannot be assumed that just because a state acts as a private institution would in terms of receiving an adequate premium for the grant of the guarantee, the beneficiary thereby receives no advantage. At least for large and very large (and even unlimited) amounts, the guarantee of the state is worth more than that of anyone else. Applying the reasoning of the preceding paragraph, it should also be said that granting a loan or a further guarantee to prevent an

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([1]) Carsid. OJ C 95 of 19.04.2002, p. 2.

([2]) Case C-342/96. European Court reports 1999, page I-02459.

([3]) In many jurisdictions, certain forms of debt to the state have priority over other creditors. *Tubacex* would seem to suggest that the decision not to exercise that priority but to waive or reschedule debts on the same basis as the generality of creditors does not constitute an aid.

([4]) Case C-480/98. European Court reports 2000 Page I-08717.

([5]) OJ C 71 of 11.03.2000.

earlier guarantee from being called – thereby apparently saving the state money, and being therefore the rational economic course for the state to take – is nonetheless aid unless the earlier guarantee was itself non-aid. This issue has arisen in respect of a financial institution in the Community.

Conclusion

The MEIP is a useful tool in state aid control. However no text can be exhaustive, and the existing Commission texts which explain the principle do not cover every eventuality. In applying the MEIP, and indeed in any future revision of the 1984 and 1993 texts, three related points stand out from the above analysis.

The first is that the MEIP is a construction and is not something mentioned directly in the Treaty. It is a test of what the Treaty means by 'favour' in Article 87(1). To avoid errors in using the MEIP it can be useful to trace the concept back to its roots.

Second, it is ultimately the effect on the enterprise which is important not the behaviour of the state *per se*. Discussion of the MEIP in some cases tends to dwell on whether the state was or was not taking the most financial advantageous course for itself in the circumstances, or was or was not acting in concomitance with another investor. While in most cases this gives the right result, there are others where this is at least questionable.

Third, one of the situations where it is hardest to apply the MEIP is where the beneficiary is already in an 'aid environment'. If an enterprise has already received aid then further provision of capital which depends for its remuneration on that aid cannot necessarily rely on the MEIP to lift it out of the definition in Article 87(1).