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BRIEFING NOTE
Privatization and state subsidy regimes

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Executive Summary:

This paper examines the application of **state aid** rules in the specific context of **privatizations**. It explores how to determine whether a privatization constitutes unlawful aid, with a focus on the **market economy investor principle**. The paper also details the crucial aspects to consider before and during the privatization process to ensure **legal compliance** and avoid potential risks for both the buyer and the seller, emphasizing the importance of an **open and transparent** process.

Keywords:
State aid
Subsidy regimes
Privatizations context
MEVP Principle
Previous investments
Privatization

Introduction:
This analysis paper examines the main themes and important ideas raised in the chapter excerpt concerning state aid issues in the context of privatizations. The chapter focuses on the specific requirements for privatizations to be considered compliant with state aid rules and on selected issues that may arise when applying these rules. The main objective is to inform about the options available, primarily for buyers, in order to achieve maximum legal certainty.

1. Economic and Public Policy Justifications for State Aid in Privatizations:

Privatization may be justified to limit state debt and transfer investment risks to private actors potentially better qualified to assess and manage them.

International institutions such as the IMF, OECD, and the World Bank regularly encourage privatization, particularly for potentially competitive government activities, but also for natural monopolies that can be adequately regulated.

State aid disciplines play an important role in the efficiency of privatised activities, notably to avoid unequal competitive conditions arising from soft budget constraints for state-owned enterprises.

2. The Market Economy Investor Principle (MEIP) / Market Economy Seller Principle (MEVP):

To assess whether a privatisation involves state aid, the market economy seller principle (MEVP) is applied, which is a variation of the general market economy investor principle (MEIP).

The MEVP compares the State's behavior to that of a private seller seeking to obtain the best possible price under normal market conditions. According to the Communication on the Notion of Aid, the MEVP assesses whether a private seller could have obtained the same or a higher price: "According to the Communication on the Notion of Aid, the MEVP is used to assess whether a private seller, under normal market conditions, could have obtained the same or a better price."

If the state is not seeking to maximize the proceeds of the sale or minimize losses, it may be considered to be providing assistance to the buyer or the privatized company.

The existence of a dysfunctional market or market failures is "irrelevant to the presence of aid and can only be considered during the later compatibility assessment." Similarly, positive externalities of the sale do not influence the presence of aid, but may be relevant to the compatibility assessment.

The State's behavior is judged in relation to that of a prudent investor seeking to limit investment risk as much as possible on a case-by-case basis, and no longer solely by reference to global or sectoral policies.

Long-term strategic considerations are recognised, but need to be detailed by the Member State.

When applying the MEVP, only the obligations and benefits linked to the role of the State as an economic operator are taken into account, and not its prerogatives as a public authority.

3. Taking into Account Previous State Investments:

Previous government investments in a company (equity investments, loans, guarantees) must be taken into account when assessing the MEVP. "If the government holds shares in a company, it will have a greater incentive to make new investments to keep the company going, as it would lose not only the return on any additional investment, but also the previous investments."

Taking into account previous investments that have included State aid is complex. The Court of Justice has issued seemingly contradictory judgments on this point (Commission v FIH and Commission v Netherlands). However, it is noted that restructuring aid is generally accompanied by economic compensation for the State as an investor.

4. Consideration of Broader Political Concerns in the MEVP:

The Court rejected a broad interpretation of the MEVP that would include public policy considerations such as effects on employment or tax revenue. "The Court explicitly stated that a distinction must be made between the obligations that the State must assume as the owner of a company's share capital and its obligations as a public authority."

5. Possible Preparatory Measures Before Privatization:

Preparatory measures (restructuring, debt cancellation, capital increases) may include elements of State aid and must then comply with the applicable rules (guidelines on rescue and restructuring aid).

In the context of preparatory measures, the MEIP is often applied in the form of the market economy creditor principle (MECP).

Preparatory restructuring measures are consistent with the MECP if the creditor (the State) is better off with the measure than it would be without it.

Capital increases for subsidiaries may not constitute State aid if they are necessary for the sale of the subsidiary and if the sale would not otherwise be possible, in accordance with commercial logic (MEVP).

Compensation for "legacy costs" (e.g., pension costs in liberalized sectors) is often considered state aid by the Commission, although some measures may be compatible with the internal market. The Commission carries out a "before-and-after" comparison to assess whether the company benefits from the measure.

6. Organization of the Privatization Process:

The privatization process must be open, transparent, non-discriminatory, and unconditional to comply with the MEVP. "A sale through an open, transparent, and non-discriminatory tender is considered by the Commission to be the best way to ensure that the sale price is consistent with the market."

The sale must be advertised sufficiently to attract as many potential buyers as possible.

Relevant information must be made available to all potential bidders in a non-selective manner.

Reasonable time limits must be allowed for the submission of bids.

The sale must generally be made to the highest bidder. Accepting a lower offer constitutes unlawful assistance, except in exceptional cases where other aspects of the offer are more economically attractive.

Conditions imposed on buyers that are not customary in comparable transactions between private parties and that may reduce the sale price may constitute state aid. Conditions that restrict the buyer's entrepreneurial freedom are generally unacceptable.

The Commission has a "deterrence" approach to the imposition of conditions, seeking to prevent state-owned companies from being sold below their intrinsic value by threatening recovery.

7. Potential State Aid Risks for the Buyer and the Seller:

An order to recover unlawful state aid granted to the company prior to privatization may be extended to the buyer of the assets if "economic continuity" is established. The Commission assesses various factors to determine this continuity.

Even in the absence of economic continuity, State aid may be considered if assets are sold at a price below their market value.

Buyers often attempt to include warranty or withdrawal clauses in sales contracts to protect themselves against risks related to prior State aid. The Commission generally considers such clauses unacceptable because they could circumvent recovery. However, mechanisms to restore the buyer to its original position in the event of a State aid issue could be acceptable.

The seller may also face state aid risks, particularly if the purchase price of a public company by another public entity is higher than the market price.

8. Means of Establishing Sufficient Legal Certainty:

Resolving pre-privatization state aid issues is crucial to maximizing legal certainty.

The sale process must be structured to avoid any state aid.

Notification to the European Commission is the surest way to obtain confirmation of compliance with State aid rules.

Informal contacts with the Commission are possible, but their legal scope is limited.

Conclusion and Perspectives:

Privatization will remain an important instrument of economic policy in EU Member States. Case law has clarified many aspects of the application of state aid rules to privatizations. However, complexities remain, particularly regarding the consideration of prior aid and the balance between economic objectives and public policy considerations. Compliance with state aid rules is essential to ensure the long-term viability of privatized companies and avoid future litigation. The advent of the Foreign Subsidies Regulation could introduce a new dimension to the assessment of privatizations involving acquirers who have received significant financial contributions from third countries.

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