Redrawing the market economy operator test: EU State aid law post-Frucona

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The Court of Justice of the European Union (CJEU) has handed down a landmark ruling in the field of State aid.[1] The case resolves a number of fundamental and long-existing questions concerning the application of the market economy operator test.[2] What does the Commission's obligation to conduct a diligent and impartial investigation encompass? What is the requisite legal standard for discharging its burden of proof in that regard? Is the Commission's obligation to examine "all relevant information available" limited to documents on its administrative file, or does it include additional information that the Commission should have sought to obtain? Does the subjective state of mind of the Member State concerned affect the scope of that obligation? *Frucona* has succinctly answered these questions in a ruling that marks the first time that the Court defined the extent of the Commission's duties of investigation when carrying out the private creditor test. In doing so, the Court has formulated what we will refer to below as the "*Frucona* test".

The case is also noteworthy as it is indicative of an emerging pattern in EU State aid law, whereby Member States seek to rely on EU State aid rules to advance their case in commercial disputes against the beneficiaries of alleged State aid. The case exemplifies the inherent risks that such cases entail for the beneficiaries and the deficiencies of the current legal framework in this regard. Against this backdrop, the arguments put forward by the Commission in *Frucona* had the potential to undermine significantly the legal position of beneficiaries in State aid investigations. The CJEU rejected the Commission's arguments, in a remarkable ruling that in effect strengthens the position of beneficiaries of aid. The key takeaways of the Court's ruling can be summarised as follows:

- The private creditor test is not an exception that applies solely if put forward by a Member State. Rather, it is the Commission's duty to examine whether the test is applicable and if so, to carry out the relevant assessment in order to establish the existence of aid. These obligations are an integral part of the Commission's duty to conduct an impartial and diligent investigation.
- The starting point for determining whether the test is applicable is the economic nature of the measure, not the subjective state of mind of the Member State. The Commission's assessment therefore should not be limited to the course of conduct that the State actually considered, but must cover all the options that a rational and fully informed private creditor would have contemplated.
- It is well-established case law that, when carrying out the private creditor test, the Commission must assess all the relevant information that is available at the time of the decision. Critically for this and many other cases, the Court has now clarified that "available" does not only mean information on the administrative file, as the Commission argued, but also encompasses information that could have been obtained upon request to the Member State.

The judgment is of particular practical significance. Notably, it highlights that failure by the Commission to obtain information that could not be ignored by a normally prudent and diligent private creditor in a situation as close as possible to that of the public creditor is a manifest error of assessment that can lead to the annulment of a decision.

Background to the case

The case originated in 2004 when Frucona Kosice (Frucona), a Slovak producer of spirits and alcoholic beverages, found itself in financial difficulty, having accumulated tax debt of approximately €21.4 million. Following an application by Frucona to the Slovak regional court for a debt arrangement, its creditors, including the local tax office, agreed to write off 65 per cent of its debt. The Slovak regional court approved the tax arrangement and Frucona paid the remaining 35 per cent of its total tax debt, effectively ending the tax arrangement procedure. Subsequently, the central tax administration, sought to undo the arrangement in legal proceedings before the Slovak courts, including before the Slovak Supreme Court, which ultimately ruled in favour of the regional tax administration (and Frucona).

[1] Judgment of 20 September 2017 in *European Commission v Frucona Košice* (C-300/16 P) EU:C:2017:706.
[2] The test applies in various forms, depending on whether the State acts as investor, creditor, vendor, guarantor, purchaser or lender in each case. In *Frucona*, the Polish State acted as a creditor, therefore the judgment (and this article) uses the term private creditor test.

In 2006, following a complaint lodged by the Slovak State, the Commission opened a formal State aid investigation, which concluded that the tax arrangement, whereby Frucona was granted a debt write-off, was incompatible with the internal market.

In its decision, the Commission noted that the tax office was in a strong position as a creditor with a secured claim and could have satisfied that claim from the sale of secured assets through a bankruptcy procedure. Consequently, in order to determine whether or not the State had behaved like a private creditor in accepting the tax write-off, the Commission considered it necessary to compare the settlement procedure that was followed with the alternatives available to the State at the time, namely a bankruptcy and a tax execution procedure. The Commission took the view that both the bankruptcy and the tax execution procedures were more advantageous than the settlement procedure that had been pursued. Accordingly, by agreeing to the debt write-off, the State had conferred an advantage on Frucona, which the company would not have been able to obtain in open market conditions and which therefore amounted to unauthorised State aid.

Frucona sought to annul the Commission's decision first before the General Court and, after the General Court upheld the Commission decision, subsequently before the CJEU. On appeal, the CJEU ruled in favour of Frucona, finding that the Commission had committed a manifest error of assessment by omitting to take into account the duration of the bankruptcy proceedings when carrying out the private creditor test. Following the Court's judgment, and in order to remedy the shortcomings identified by the CJEU, the Commission adopted a new decision in 2013 that was in substance similar to the first one.

Following a second action for annulment brought by Frucona, the General Court upheld Frucona's arguments and annulled the Commission's second decision. The Commission appealed the judgment to the CJEU, essentially arguing that the General Court had disregarded the conditions of applicability of the private creditor test, as well as the limits of the Commission's obligation to conduct a diligent and impartial investigation.

Legal background—the private creditor test

The private creditor test is a tool that the Commission uses to assess the existence of an economic advantage, as one of the constituent elements of the definition of State aid in art.107 TFEU. According to art.107(1) TFEU, aid granted through State resources is incompatible with the internal market if it confers an economic advantage upon its recipient. If, however, the recipient could have obtained the same economic benefit under normal market conditions, then the impugned measure is not regarded as an advantage and cannot be caught by art.107(1) TFEU.[3]

The assessment of whether or not a measure has been granted under normal market conditions should be made by applying, in principle, the private creditor test.[4] The application of the test entails an examination of whether or not the Member State acted as a rational private creditor seeking to recover sums owed to it by a debtor in financial difficulties. Put differently, the private creditor test needs to be applied to determine whether the State's conduct could have been adopted by a private creditor in similar circumstances that was seeking to limit losses.

In accordance with the Court's settled case law, when applying the private creditor test

> "the Commission must carry out an overall assessment, taking into account all relevant evidence in the case enabling it to determine whether the recipient company would manifestly not have obtained comparable facilities from a private creditor".[5]

Key arguments and findings on appeal

The right of the recipient to invoke the private creditor test and burden of proof

The Commission argued that the private creditor test may not be usefully relied upon by the recipient of aid when appealing a finding of aid, because the test concerns the subjective state of mind of the Member State and only the Member State has all the relevant evidence upon which it based its decision to adopt the measure in question. In the alternative, if the recipient is allowed to invoke the test, the Commission argued that it must

> "establish unequivocally and on the basis of objective and verifiable evidence that the measure implemented falls to be ascribed to that Member State acting as a private creditor".[6]

The CJEU rejected the Commission's arguments, holding that the private creditor test is not an exception that can only be raised as an argument by the Member State concerned. Rather, it is the duty of the Commission to examine whether the conditions for the applicability of the test are met in each case, irrespective of any arguments raised to that effect. The Court reiterated its settled case law according to which, where applicable, the test is among the factors that the Commission must take into account in order to establish the existence of aid.[7]

Accordingly, the Court continued,

[3] *European Commission v Electricité de France (EDF)* (C-124/10 P) EU:C:2012:318 at [78] and case law cited.
[4] *European Commission v Buczek Automotive sp z oo* (C-405/11 P) EU:C:2013:186 at [32].
[5] *Spain v Commission of the European Communities* (C-342/96) EU:C:1999:210 at [46].
[6] Paragraph [13] of the judgment.
[7] *Buczek Automotive* EU:C:2013:186 at [32], *Spain v Commission* EU:C:1999:210 at [46]; *Déménagements-Manutention Transport SA (DMT), Re* (C-256/97) EU:C:1999:332 at [24]; *Commission v EDF* EU:C:2012:318 at [78], [103].

> "nothing prevents the recipient of the aid from invoking the applicability of the test and if it does invoke it, it is for the Commission to determine if the test is applicable and if so to assess its application".[8]

Indeed, as Advocate General (AG) Wahl observed, the ability of the recipient to rely on the private creditor test follows from the rationale of the administrative procedure, which is aimed at ensuring that the Commission possesses all the relevant information to perform an objective assessment as required under art.107(1) TFEU. Precluding the beneficiary from putting forward arguments and evidence during the administrative procedure, including by invoking the private creditor test, would run counter to the aim of that procedure. "That is so despite the fact that, strictly speaking, only the Member State is a party to that procedure".[9]

Moreover, AG Wahl pointed out in his opinion that the burden of proof rests on the Commission to establish that the impugned measure constitutes State aid and that

> "under no circumstances can it be for the recipient of the alleged aid to show unequivocally and on the basis of objective and verifiable evidence that the test is applicable."[10]

The AG's analysis by reference to the burden of proof highlights precisely what the flaw in the Commission's plea is and underscores the significance of the Court's ruling in this regard: had the Court accepted the Commission's argument, it would have effectively shifted the burden of proof to the recipient. The recipient would be required to disprove the existence of aid, while the Commission's decision would benefit from a presumption of lawfulness. Not only would this run counter to existing case law, it would also put the recipient in the impossible position of having to disprove the Commission's analysis without having been a party to its investigation. In cases where there is an underlying commercial dispute between the recipient and the State meaning that the recipient may have no access to the State's evidence, this argument would have effectively swung the balance to the State.

The relevance of the Member State's subjective state of mind

The Commission claimed that, although the private creditor test was applicable to assess the bankruptcy procedure as an alternative to the concluded tax arrangement, the test should not apply to the tax execution procedure, since the Slovak State had not considered it as an alternative course of action when it agreed to the tax arrangement. This, according to the Commission, follows from the fact that the private creditor test relates to the subjective state of mind of the State and is not aimed at "reconstructing of its own motion the behaviour of the ideal, rational and fully informed hypothetical private creditor".[11] Accordingly, the Commission is not required to examine courses of action that the Member State did not contemplate when making its decision.

In line with the AG's opinion, the CJEU noted that the question of whether the private creditor test is applicable must be determined on the basis of objective criteria concerning the capacity in which the State has acted. Specifically, the starting point is the economic nature of the measure, and not how the Member State thought it was acting, or which alternative courses of action were considered before acting. Moreover, the private creditor test is aimed at determining whether the recipient could have obtained comparable facilities to those obtained through State resources from a private creditor in normal market conditions. It follows that, where the test is applicable (i.e. where the State acted in an economic capacity in granting the impugned measure), the assessment that the Commission is required to undertake cannot be limited to reviewing the options that the public authority actually considered, but *must necessarily cover all the options that a private creditor would have reasonably envisaged in such a situation*.[12]

The AG's analysis on this point is remarkable for its clarity and conciseness. It is also particularly instructive as it describes the analytical framework and reveals the fallacy of the Commission's argument. Crucially, AG Wahl drew a distinction between two distinct analytical steps, namely the "applicability" and the "application" of the private creditor test.

The AG observed that the subjective state of mind of the State is relevant to the question of whether or not the State has acted in an economic capacity, that question being a pre-condition for the applicability of the private creditor test. Therefore, the subjective state of mind of the State becomes relevant and may be taken into account only when there are doubts as to whether the State acted in economic capacity in adopting the measure in question. Conversely, once it is established that the State acted in an economic capacity, its subjective state of mind is then irrelevant when actually applying the private creditor test, which requires an objective assessment.

The AG noted that the Commission's argument regarding the relevance of the subjective state appears to stem from an erroneous interpretation of the *Commission v EDF*[13] case. In that case the Court had stated that, in assessing whether the private operator test is applicable, the objective of the measure and therefore the State's intent may be relevant. The AG clarified that in that case there were doubts as to whether the State had acted in an economic capacity and the Court's statement merely explained how to determine that capacity, therefore

[8] Paragraph [26] of the judgment.
[9] Paragraph 73 of the opinion.
[10] Paragraph 76 of the opinion.
[11] Paragraph [15] of the judgment.
[12] Paragraph [29] of the judgment.
[13] *Commission v EDF* EU:C:2012:318 at [30] of the judgment.

> "instead of alleviating the investigative burden on the Commission, the judgment in *Commission v EDF* adds a preliminary step to the assessment of whether an advantage exists".[14]

In the *Frucona* decision, the Commission conflated the two analytical steps of "applicability" and "application".

The scope of the Commission's obligation to examine "all relevant information available"

The Commission claimed that its duties of investigation when applying the private creditor test do not entail an obligation to obtain additional information with a view to substantiating its conclusions. On the contrary, the Commission is obliged to carry out its assessment exclusively by reference to the information and evidence in the administrative file. By failing to limit the Commission's obligation to the evidence available to it on the administrative file, the General Court created a new requirement, imposing on the Commission an excessive burden of proof of having to seek all "imaginable" information. Such a requirement, the Commission contended, goes beyond the principles established by case law and would make it impossible for the Commission to discharge its investigation duties, in particular given the absence of guidance by the General Court as to how to reach that evidentiary threshold.

The Court observed that this plea concerned the extent of the Commission's investigation obligations when carrying out a private creditor test assessment. To this end, it first reiterated its well-established case law, according to which the Commission must carry out an overall assessment, taking into account all relevant evidence available to it with a view to determining whether the recipient company would have obtained comparable facilities from a private creditor.[15] It noted in that regard that "relevant" information includes any information pertaining to factors that a normally prudent and diligent private creditor in a situation as close as possible to that of the State could not have ignored.

Importantly, the Court went on to clarify that the information "available" to the Commission is not limited to the evidence on the case file, but extends to information that "could have been obtained, upon request by the Commission, during the administrative procedure".[16] In particular, where it appears that the evidence on the file does not support the Commission's conclusions, its investigatory duties entail an obligation to obtain additional evidence in order to substantiate its conclusions to the requisite legal standard. Not to do so would amount to a manifest error of assessment, insofar as the Commission would ignore information that a normally prudent private creditor would have taken into account.

The Court then turned to the specific facts of the case and observed that the Commission had determined the value of Frucona's assets in the event of liquidation by way of inference from the evidence on the administrative file, without undertaking any methodological or economic analysis and without requesting additional information with a view to verifying the accuracy of its inferences. Moreover, the Commission had omitted to take into account the anticipated duration and costs of a tax execution procedure in comparing the alternative courses of action the State could have taken. All this, the Court noted, was information that a normally prudent and diligent private creditor would not have ignored.

By failing to obtain information from the State on these matters, the Commission based its findings of aid on unsubstantiated inferences and incomplete information. The General Court was therefore correct in concluding that the Commission had failed to take into consideration "all relevant information", as required by the case law.

This, the CJEU noted, is in line with the duties of the European Courts in undertaking complex economic assessments in the context of judicial review, such as applying the private creditor test. To this end, the EU Courts must establish not only whether the evidence relied on is factually accurate, reliable and consistent, but also whether that evidence contains all the relevant information that should be taken into account to assess such a complex situation.

Implications

The *Frucona* ruling is particularly important for the protection that it could offer to beneficiaries of alleged State aid. It confirms that the Commission must perform an objective assessment, by considering all the information that a private creditor would have reasonably contemplated in a situation similar to that of the State, rather than limit itself to a verification of the information put forward by the State. The Court emphasised that the Commission is not allowed to rely on unsubstantiated inferences in circumstances where it could have obtained the relevant information through a request to the State. Accordingly, where it appears that the private creditor test could be applicable, the Commission is under a duty to ask the Member State concerned to provide it with all relevant information enabling it to determine whether the conditions governing the applicability and the application of that test are fulfilled. Conversely, if the Commission omits to make that assessment, it would be in breach of its obligation to conduct an impartial and diligent investigation.

The ruling also strengthens the position of beneficiaries of alleged aid from a procedural standpoint. By confirming that the beneficiary is entitled to invoke the private creditor test, the judgment makes it possible for the beneficiary to put forward arguments and evidence

[14] Paragraph 77 of the opinion.
[15] Paragraph [59] of the judgment and case law cited.
[16] Paragraph [71] of the judgment.

that the Member State itself had not raised. This is a very important procedural guarantee of fairness of process and proper administration.

Not being addressees of the Commission's initial decision to open a case, State aid recipients do not enjoy the usual guarantees that defendants in administrative proceedings benefit from. Accordingly, their ability to compel the Commission to take into account arguments and evidence, which the Member State did not put forward and which could alter the final outcome of the assessment, has so far been questionable as a matter of law; as this case showed, the Commission did not consider this part of its administrative duty to exercise due diligence.

This lacuna could be particularly problematic when there is an underlying commercial dispute between the State and the beneficiary. Indeed, it is increasingly common for Member States to use State aid proceedings as a last resort recourse, after having exhausted arbitration and/or national proceedings. Such situations entail an inherent risk that the State will not put forward information that would run counter to the findings of aid, as the State has a vested interest in the Commission making a finding of unlawful State aid. In such cases the Commission's duty to carry out a truly impartial and diligent investigation becomes all the more important. The Court's ruling is therefore notable in that it guarantees procedural fairness for the beneficiaries of alleged State aid, specifically their right to be heard.

Significantly, the judgment also marks the first time that the CJEU has clarified that "available" information upon which the Commission should base its assessment includes information that could have been obtained upon request to the Member State during the administrative procedure. This has particularly important implications from both a practical and an academic perspective. From a practical perspective, the ruling signals that failure to obtain information that a normally prudent and diligent private creditor in a situation as close as possible to that of the public creditor could not ignore is a manifest error of assessment that can lead to the annulment of a decision. In addition, it suggests that any doubts as to the robustness of the Commission's conclusions by reference to the evidence underpinning its finding of aid must be regarded as a failure on the part of the Commission to demonstrate the existence of aid.

From an academic standpoint, the ruling represents further development of the Court's jurisprudence on the private creditor test assessment. By clarifying the extent of the Commission's obligations when applying the private creditor test and the relevant evidentiary threshold for a diligent and impartial assessment, the Court has formulated what will be known as the "*Frucona* test".