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The classification as “state aid” can have fortunate consequences

Most of the time, the classification as “state aid” within the meaning of Article 107 of the TFUE[1] (ex-Article 87 of the Treaty establishing the European Community) is a source of concern for companies. Fortunate consequences of such classification – notably in financial terms – are rarely noted.

Yet, fortunate consequences do exist, as attested by three judgments rendered on September 2, 2010 by the Fifth Chamber of the Versailles Court of Appeals, ruling after remand by the *Cour de Cassation* (French Supreme Court): considering that the tax on direct sales paid by pharmaceutical laboratories between 1998 and 2002 should be regarded as an illicit state aid, the Versailles Court of Appeals ordered the URSSAF (French Social Security Agency) to reimburse Bristol-Myers Squibb, GlaxoSmithKline and Boiron the sums of **12.35** M Euros, **5.75** M Euros and **11.2** M Euros respectively for the aforementioned period.

1- A look back at the creation of the tax on direct sales imposed on pharmaceutical laboratories

In France, the pharmaceutical distribution market is shared between three types of operators: pharmaceutical laboratories (that supply products directly to pharmacists via their production units), the pharmaceutical depositories and the wholesale distributors – the difference between the last two being that wholesale distributors own stock of products bought from laboratories.

In 1997-1998, the public authorities became aware that direct sales from wholesale distributors to pharmacists were steadily decreasing whereas direct sales from laboratories were on the increase.

A specific tax was therefore created and levied on pharmaceutical laboratories pursuant to Article 12 of the Law n°97- 1164 of December 19, 1997 (codified in Article L.245-6-1 of the French Social Security Code): “*A*

tax contribution based on pre-tax turnover achieved in France from sales of medicinal products to dispensing pharmacies, state-sponsored pharmacies and pharmacies belonging to mining friendly societies (…) is due by companies that offer for sale one or several medicinal products within the meaning of Article L.596 of the Public Health Code".

An action was brought before the Constitutional Council for breach of the principle of equal taxation (wholesale distributors being exempt from the tax). The Constitutional Council confirmed the legality of the tax: "*according to parliamentary preparatory works, the challenged tax was introduced not only to help finance the National Sickness Insurance Fund of Salaried Employees but also to restore the balance of competition between the various distribution channels for medicinal products, considered to be distorted by the fact that wholesale distributors are under a duty of public service which is not imposed on pharmaceutical laboratories*".

As such, the tax was considered a measure to "*rebalance competition*" in order to economically counterbalance the duty of public service imposed on wholesale distributors only[1].

This tax on direct sales remained effective from January 1, 1998 to December 2002 when it was abolished by the 2003 Social Security Finance Law.

During this period, pharmaceutical laboratories paid millions of Euros in direct sales tax (fixed at the rate of 2.50%).

Yet, as years passed by, decisions of the Court of Justice of the European Communities ("CJEC") specified the condition in which a state measure could escape the classification as state aid insofar as it compensates for the "excess costs" incurred in performing public service obligations.

And, following the judgments rendered by the CJEC (Ferring[1], Altmark[2] and Boiron judgments dated September 7, 2006), the *Cour de Cassation* reversed the decisions of the Court of Appeals that had so far dismissed the laboratories' reimbursement claims.

As such, the Versailles Court of Appeals, after remand by the *Cour de Cassation*, was to determine whether the laboratories' reimbursement claims were admissible and, if yes, fix the amount to be repaid to each laboratory respectively.

2- The reasoning applied by the Versailles Court of Appeals to establish that the tax was to be regarded as a state aid

In its three decisions, the Versailles Court of Appeals tried to establish whether the disputed tax was to be regarded as a state aid within the meaning of Article 92§1 TEC (renumbered Article 87 TCE and then Article 107 TFUE) according to which four requirements must be cumulatively met:

- The disputed tax must result from the intervention of the State or from State resources: in the case at

hand, since the tax was created by Law n°97-1164 of December 19, 1997, "*its imputability to the State is established*";

- Such intervention must be likely to affect trade between Member States: this requirement is considered met because of the size and significance of the pharmaceutical laboratories and wholesale distributors that operate on the European medical product market;
- Such intervention must confer an advantage to the recipient: the Court considered that this requirement was met since the tax gave an indirect advantage to wholesale distributors; and
- Such intervention must distort or threaten competition: "*this tax that applied to pharmaceutical laboratories but not to wholesale distributors places the latter in a more favorable financial situation, thereby distorting competition*".

Having determined that the tax set forth under former Article L.245-6-1 of the French Social Security Code had the objective characteristics of a state aid within the meaning of the TFUE, the Versailles Court of Appeals – referring to the aforementioned decisions of the CJEC (and notably to the Altmark decision) – attempted to find out whether such tax could be viewed as a "*compensation for public service obligations*" and, as such, escape the classification as a state aid.

The Versailles Court of Appeals examined the following requirements:

- First, wholesale distributors have effectively been entrusted with public service obligations and such obligations have been clearly defined;
  This requirement is met: Article R.5115-13 of the French Public Health Code imposed on wholesale distributors clearly defined public service obligations.

- Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner;
  In this respect, the Versailles Court of Appeals held that "*during the entire exchange between the government, members of Parliament and the rapporteurs of the successive bills, there has not been any discussion to define the scope of the new tax in relation to the costs incurred by wholesale distributors in discharging their public service obligations, whereas the contemplated tax was precisely aimed at compensating such costs that pharmaceutical laboratories did not have to bear*".
  As such, it appears that the parameters used to calculate the compensation had not been fixed and that the tax in question was even partly abolished, "*because it was impossible for both the government and the members of Parliament to have economic estimations justifying the compensation of the additional costs incurred by wholesale distributors in discharging their public service obligations*".

- Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations; and

- Fourth, the level of compensation needed must be determined on the basis of an analysis of the costs that an average company would have incurred in performing such obligations, taking into account the relevant income and reasonable profits derived from such performance discharge.
  Regarding the third and fourth requirements, the Versailles Court of Appeals examined two studies (one

from Eurostaf and one from a chartered accountant) and considered that it had not been established that the wholesale distributors incurred additional costs justifying a compensation.

Having assessed the situation successively through these two analysis "filters", the Versailles Court of Appeals held that the tax imposed on pharmaceutical laboratories "*must be regarded as a state aid in favor of wholesale distributors insofar as the advantage in not being subject to the tax on direct sales of medicinal products necessarily exceeded the additional costs that they potentially had to bear in discharging the public service obligations imposed on them over numerous years (and long before the creation of the disputed tax) and that remain in effect to date despite a small change in the national legislation even though the disputed tax was abolished in 2003".*

Therefore, the tax on direct sales could not at any time be regarded as a justified compensation for the public service obligations discharged (before and after this tax) by wholesale distributors. This is sufficient to classify this tax as a state aid causing a distortion of competition to the detriment of pharmaceutical laboratories, said tax being, in addition, illegal since it had not been notified to the competition authorities in accordance with Article 92§1 (Article 107 TFUE).

Consequently, the sanction to be imposed was logically the reimbursement of the sums paid (plus interest at the legal rate) by the pharmaceutical laboratories during the years where this tax – that, in retrospect, had become illegal – was in effect.

Considering the amounts to be reimbursed by the URSSAF (**29.3** M Euros!), it is more than likely that an appeal against these three decisions will be lodged before the *Cour de Cassation*…

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[1] Treaty on the Functioning of the European Union: new title of the Treaty establishing the European Community since the entry into force of the Treaty of Lisbon on December 1, 2009.

[2] Pursuant to Article R.5124-59 of the French Public Health Code, wholesale distributors must, within their distribution territory, (i) keep in stock a range of medicines comprising at least nine-tenths of all forms of medicines actually sold in France, (ii) be able to satisfy at all times the needs of their regular customers for a period of at least two weeks, to deliver any medicine in their stock within 24 hours of receipt of the relevant order and deliver any medicine sold in France to any pharmacy requesting it.

[3] CJEC Ferring (November 22, 2001) : "*Article 92 of the EC Treaty (now, after amendment, Article 87 EC) is to be interpreted as meaning that, because it is charged only on direct sales of medicines by pharmaceutical laboratories, a measure such as the tax introduced by Article 12 of Law No 97-1164 of 19 December 1997 on social security funding for 1998 amounts to State aid to wholesale distributors only to the extent that the advantage in not being assessed to the tax on direct sales of medicines exceeds the additional costs that they bear in discharging the public service obligations imposed on them by national law.*"

[4] CJEC, Altmark, C-280/00 (July 24, 2003) : *" (…) public subsidies intended to enable the operation of urban, suburban or regional scheduled transport services are not caught by that provision where such subsidies are to be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations. For the purpose of applying that criterion, it is for the national court to ascertain that the following conditions are satisfied:*

- *first, the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined;*
- *second, the parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner;*
- *third, the compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations;*
- *fourth, where the undertaking which is to discharge public service obligations is not chosen in a public procurement procedure, the level of compensation needed has been determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations."*