STATE AID AND SERVICES OF GENERAL ECONOMIC INTEREST: CLARIFICATION OF BASIC CONCEPTS AND IDEAS

Nathalie Frisch[1]

Introduction

In a Common Market restrictions or distortions to competition must be eliminated. Whereas the competition rules contained in Articles 81 to 86 of the Treaty establishing the European Community (hereafter "ECT") are intended to apply to undertakings, according to the heading of section 1 of the rules on competition, the behaviour of undertakings is not the only way that competition can be reduced[2]. The drafters of the Treaty of Rome were well aware that the intervention of the State[3] risks distorting competition. Therefore, Articles 87 to 89 ECT were inserted to define how to treat aid granted by States to undertakings. Nevertheless, the drafters were equally aware that certain services, which are in the public interest[4], would need a special, less severe treatment concerning the prohibition of State Aid. Therefore Article 86 ECT states that undertakings performing a Service of General Economic Interest (hereafter "SGEI") is in principle subject to all the competition rules and the non-discrimination rule, as long as the application of such rules does not obstruct the attainment of the task assigned to the undertakings.

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1 LLM student at Queen Mary University of London and research student at l'Université de Paris I Panthéon-Sorbonne

2 Simonsson, I., *Privatisation and State Aid – Time for a new policy*, ECLR, 2005, 26 (8), p. 460

3 Nicolaides, P., *Markets and words: The distortive effect of government pronouncements*, ECLR, 2005, 26 (3), p.119

4 Jaspers, M. B., *Emergency Aid: An analysis of the Commission's practice with regard to Article 87 (2) (B) ECT, in particular in the light of the air transport insurance. Cases post September 11*, ECLR, 2004, 25 (9), p.546

Thus, a balance has to be struck between the submission of the SGEI to the Treaty rules[5] and the general interest[6]. This might require a less restrictive, more flexible application of these rules[7].

The ECT does not contain a definition of SGEI and the definition of the term varies in the different Member States. This can be explained by historical,[8] as well as political and economic,[9] reasons. As there is no harmonised definition at Community level, the Member States have some freedom to define what they consider to be an SGEI[10]. The Court will "intervene only in order to penalise any abuse" [11], when a Community interest is damaged. The Member States' definition is thus subject to review for manifest error. The European Court of Justice (hereafter "ECJ") and the Court of First Instance (hereafter "CFI") require the Member States to define clearly the public service mission. The Commission has generally accepted the definition given by the Member States under Article 86 ECT but there have been cases where the Commission or the Court have refused the Member State's definition and thus restricted their freedom to give a definition. For example the Court has refused to accept dock work as an SGEI[12].

Network industries[13], given the universal service obligation to which they are subject, as well as social public services, including statutory health insurance and pension schemes, are recognised as being SGEI[14]. By analysing the case law one can find other kinds of services that have been accepted as SGEI. For example, the

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5 For an example of a disallowable SGEI see T-157/01, *Busvognmaend*

6 For an example of an allowable SGEI see C-266/96 *Corsica Ferries France*

7 Robertson, A., *State Aid and reference policy after Gil Insurance*, ECLR, 2004, 25 (10), p.603

8 Mescheriakoff, A.-S., *Les développements sur la formation historique de la notion de service public*, Droit des services publics, 2e édition, PUF, Paris, 1997

9 Vogel, L., *Les nouveaux critères de définition des aides d'Etat en droit de la concurrence*, Revue concurrence consom., n°133, mai-juin, 2003, p.7

10 In its 86 (2) EC package, the Commission confirms the view that it is for the public authorities and governments at various levels in the Member States, local, regional or national, to define which public services should be delivered and by which means. The control of this definition is limited to the manifest error.

11 C-309/99, *Wouters*, AG, para 162

12 C-179/90, *Porto di Genova*, paras 27-28

13 See Glossary

14 Eg C-320/91, *Corbeau*

ECJ has accepted that the definition of SGEI can include particular waste management[15], especially if it deals with environmental problems, as well as universal mooring services[16] for safety and public security reasons. The ECJ considers that certain characteristics have to be present to constitute a public service. These characteristics are "universality, continuity, satisfaction of public-interest requirements, regulation and supervision by the public authorities[17]".

From the Court's jurisprudence a wide margin of discretion is granted to the national authorities[18]. This can be seen especially in the education and health care sectors, in social security systems[19], and in insurance schemes[20]. A company that is given the task of performing an SGEI is paid for doing so.

With the liberalisation of network industries in most of the Member States, the European Courts[21] tend to apply a stricter standard in this area, because of the growing number of Member States having managed to reconcile competition with the general interest[22]. Several Member States have proved that the privatisation of the network industries still permits these services to be offered to the consumers, and that prices charged are still acceptable to the consumers. Thus, the margins of discretion of the Member States to define an SGEI are more limited than previously concerning network industries.

As no general positive definition of SGEI exists[23] the notion tends to evolve and changes with time, and with the economic and political circumstances. The negative definition seems to be more consistent and immutable[24].

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15 C-209/98, *FFAD para* 75

16 C-266/96, *Corsica Ferries France* para 45

17 C-266/96, *Corsica Ferries France* para 60

18 Blum, F., Logue, A., *State Monopolies under EC Law*, Wiley's, 1998, p.23

19 238/82, *Duphar para* 16

20 67/96, *Albany* para 122

21 As to know the Court of First Instance and the European Court of Justice

22 Simonsson, I., Privatisation and State Aid – Time for a new policy, ECLR, 2005, 26 (8), p.460

23 Bracq, S. *Droit communautaire matériel et qualification juridique: le financement des obligations de service public au coeur de la tourmente (à propos de la décision: CJCE, 24 juillet 2003, Altmark Trans GmbH, affaire C-280/00)*, RTDE, 40 (1), janvier - mars 2004, p.33

As such SGEI are necessary in order for a society to work and as private investors may not be interested in offering such services, or at least not to the extent, or at the level of quality required, as they may not recover the costs needing to be invested, Member States are obliged to offer them directly, as has been the case for a long time in the network industries, or to oblige undertakings to provide the service. If Member States oblige undertakings to provide such a service, the concerned entity might suffer a disadvantage compared with its competitors, which would threaten to distort competition. However, if they are compensated by the State for the service provided, they might have an advantage that the competitors that are not in charge of such an SGEI do not have, because at least part of their income is guaranteed. One could also argue that the compensation for such an obligation does not constitute an advantage because it aims only to put the entity back at the normal level of competition on which it would be if it were not obliged by the State to provide a service that an entity would not offer under normal market conditions because the expected profits are not high enough.

The measures taken by States to guarantee that certain SGEI are provided to the Community at large and not to a specific industrial sector, often amount to State Aid, under the criteria. They must, therefore, be notified to the Commission, and cannot be put into effect until the latter has decided that they are compatible with the Common Market. The notification procedure permits the Commission to control the measures before they are introduced. In certain circumstances, especially when the general interest is at stake, this *ex-ante* control might be too time consuming, which makes a spontaneous intervention by the Member States impossible. The Commission[25] and the ECJ[26] are aware of these problems, as can be seen, respectively, in documents, decisions, and in the Court's case law[27]. In recent years, the attitude of the ECJ has changed regarding the approach in the area of SGEI and the compensatory approach has been accepted.

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24 For an example of a negative definition one can say that a non-market service is not to be considered as an SGEI. Such a service is by its nature excluded from the scope of Article 86 ECT. Moreover a non-commercial and non-industrial activity cannot be defined as a SGEI, but the competition rules do not apply to such an activity anyway.

25 The Member States must notify new aids they want to introduce to the Commission. The latter decides whether or not such aid is compatible with the ECT and if it can be put in place. The Commission has the sole authority for keeping under review systems of existing aid.

26 Bacon, K., *The concept of State Aid: The developing jurisprudence in the European and the UK Courts*, ECLR, 2003, 24 (2), p.54

27 Groeteke, F., Heine, K., *Institutional Rigidities and European State Aid control*, ECLR, 2004, 25 (6), p.322

Generally speaking under Article 87(1) ECT, any aid granted by a Member State or through State resources in any form whatsoever, which distorts or risks to distort competition by favouring certain undertakings or the production of certain goods, is incompatible with the Common Market, in so far as it affects trade between the Member States, and save as otherwise provided in the ECT. The purpose of this Article is to prevent Member States from granting aid to certain undertakings that would have the effect, or the potential effect, of "seriously disrupting normal competitive forces" because certain undertakings or products are granted more favourable treatment than others. The prohibition of State Aid is confirmed indirectly by Article 10 ECT[28].

The grant of State Aid may for example lead to a delay in the restructuring of operations and thus in the return of the beneficiary to competitiveness[29]. Undertakings that do not benefit from that favoured treatment have to compete with those companies that are receiving subsidies and thus risk running into difficulties, which in turn causes a loss of competitiveness. In the end, the general competitiveness of the internal market is put at risk by the granting of such aid[30].

At first sight, the concept of State Aid seems to be quite clear, but the interpretation of the concept is not an easy task. Member States have tried to escape the prohibition by granting assistance that they hoped might not qualify as State Aid[31]. Consequently, the notion of State Aid has become more and more complex over the years and the recent developments in this area are far from changing this trend[32]. Today, the compensatory approach, which considers that

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28 Article 10 ECT requires Member States to abstain from measures which could jeopardise the attainment of objectives of the ECT, thus notably the establishment of a common, internal market (see Articles 2, 3 paragraph 1 (c) and 14). As a State Aid is likely to distort competition and thus to disturb the realisation of a well functioning Internal Market, Member States would violate their Community obligations. The establishment and functioning of the Internal Market would be slowed down and the free competition between undertakings reduced if State Aid was allowed and thus the achievement of the objectives of the Treaty put into danger.

29 Nicolaides, P., Kekelekis, M., *An assessment of EC State Aid Policy on rescue and restructuring of companies in difficulty*, ECLR, 2004, 25 (9), p.578

30 Biondi, A., Eeckhout, P., Flynn, J., (Ed), *The law of state aid in the European Union*, Oxford University Press, 2004

31 Pinto, C., *Tax competition and EU Law*, Eucotax Series on European Taxation, 7., Kluwer Law International, September 2003

32 For an analysis of the problems in the accession countries due to the obligation to respect the "acquis communautaire" and thus also the State Aid rules see RAPP, J., *State Aid in the accession countries – Sorting through the confusion*, ECLR, 2005, 26 (7), p.410

compensation[33] paid to a company for the realisation of an SGEI may not be considered as falling under the qualification of State Aid in certain circumstances, is accepted by the ECJ if the measure fulfils a certain number of conditions. If these conditions are not met, the measure is considered to constitute an aid and has to follow the normal procedure imposed by the ECT.

The aim of this article is to analyse the State Aid rules that apply in theory to each State Aid that is granted, to show how this application has been adapted to the specific area of SGEI and to focus more particularly on the new compensatory approach. Part I will analyse the different factors that have to be present for a measure to constitute State Aid. Part II covers the convergence of these rules and the SGEI. Finally, Part III examines the conditions set by the ECJ to determine that the measure taken by the State is compensation for a service and, thus, not State Aid. Part IV draws some conclusions.

1 State Aid – Basic ideas

1.1 Intervention of the State

The State has to intervene in one way or another in order for a measure to be potentially a State Aid. Not all measures a State takes constitute aid forbidden by the Treaty, even if they confer an advantage. An important distinction has to be drawn between general measures[34], which are not State Aid[35], and selective measures, which risk to constituting State Aid[36]. The word "State" is not limited to the central authority, but includes, all regional and local public authorities[37] and public enterprises[38].

If a Member State intends to introduce a measure that may constitute State Aid, it has to notify this project to the Commission. As long as the Commission has not specifically accepted the measure, the Member State is not allowed to introduce

33 Nicolaides, P., *Compensation for Public service obligations: The floodgates of State Aid*, ECLR, 2003, 24 (11), p.561

34 E.g. C-308/01, *Gil Insurance*

35 Robertson, A., *State Aid and reference policy after Gil Insurance*, ECLR, 2004, 25 (10), p.603

36 For a detailed analysis of this distinction see BACON, K., State Aids and General Measures (1997) 17 Yearbook of European Law 269

37 E.g. C-323/82, *Intermills*; C-5/89, *BUG-Alutechnik*

38 C-177/78, *McCarren*

it[39]. A State Aid that is introduced without notification to the Commission is automatically unlawful[40].

Once the measure is notified and all the necessary information has been given, the Commission will make a decision. Three choices are available to the Commission. First, it can consider that the measure does not constitute aid, which leaves the Member State free to introduce it. Second, the Commission could consider that the measure is a non-compatible State Aid in which case the Member State is not allowed to introduce it. Third, the Commission can consider that the measure is a State Aid, but that it is compatible with Community law and thus it can be introduced[41].

1.2 Meaning of the notion "Aid"

The explanation of what measures can constitute aid[42] can be found in the case law of the ECJ[43]. One does not find a single definition applicable to all subsequent cases, but the Court tries to cover different situations and adapts its definition according to the facts, on a case-by-case basis. The measure should improve the undertaking's financial position or reduce the costs it would normally have to bear in a similar situation[44]:

- Benefit[45]

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39 Power, V., J. G., *A proposal for State Aid reform: Beneficiaries of potential State Aid should be able to notify the European Commission of the proposed aid*, ECLR, 2005, 26 (1), p.1

40 E.g. C-367/95, *Sytraval*, para 35; Case C-295/97, Piaggio para 44; C-278/00, Greece v Commission para 30

41 Sometimes the Commission imposes some conditions on the Member States.

42 European Commission, *Competition Law in the European Communities*, Brussels 1997, Vol. II B at 5-26, available on < europa.eu.int/comm/dg04 >; A. Evans, *The EC Law of State Aid*, Kluwer 1997; M. Green, T.C. Hartley and J.A. Usher, *The Legal Foundations of the Single European Market*, Oxford University Press 1991; P.J.G. Kapteyn and P. Verloren van Themaat, *Introduction to the Law of the European Communities*, Kluwer; H. Rasmussen, *European Community Case Law*, Handelshøjskolens Forlag, at 315 et seq.

43 Article 87 ECT uses the word "aid" and gives the certain characteristics that have to be met in order for an aid not to be compatible with the Common Market, but it does not define what it means exactly by "aid".

44 Bellamy and Child, European Community Law of Competition, 5th ed., Sweet & Maxwell, 2001, p.1218

45 173/73, *Commission v Italy* [1974] para 13

- Gratuitous advantage[46]
- Unilateral and autonomous decision of a State to give resources or procure advantages to encourage attainment of economic or social objectives[47]
- Economic advantage[48]
- Subsidies and measures that mitigate the normal charges of an undertaking[49]
- Supply on preferential terms[50]
- Payment of compensation for loss without previously established parameters[51]

The form of the aid is not important and it is irrelevant whether it is a direct or an indirect aid. The ECJ has a very broad view of which measures can constitute State Aid. The following examples illustrate this variety:

- Grants, subsidies, payment of money[52]
- Loans at below-market rates of interest; interest subsidies[53]
- Guarantees for which no market fee is paid[54]
- Tax advantages[55]: tax base reductions, tax deferment, tax cancellation, tax rate reduction, tax exemptions[56], tax incentives for investments[57], tax

46 78/76, *Steinicke & Weinling,* para 22

47 61/79, *Denkavit,* para 31

48 C-39/94, *SFEI,* para 60

49 C-200/97, *Ecotrade* paras 34-35

50 67, 68 and 70/85, Van der Kooy, para 28

51 C-280/00 *Altmark* para 91

52 30-59, *Steenkolenmijnen*

53 T-204/97 and T-270/97, *EPAC*

54 T-204/97 and T-270/97, *EPAC*

concessions or exemptions that reduce the undertaking's liability towards the State[58]

- Aid financed through parafiscal charges[59]
- Reductions[60], payment facilities[61] or non-payment[62] of social security contributions
- Provision of goods and services[63] or sale of land at below-market prices by the State[64]
- Purchase of goods and services at above-market prices by the State[65] or purchases that are an actual need of the State[66]
- Capital injections, investment in the capital of an undertaking[67] can

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55 Paines, N., *When do tax measures amount to State Aid?*, Direct Tax Seminar, Monckton Chambers, www-monckton.com; Vanistendael, F., *Fiscal support measures and harmful tax competition*, ECTR, 2003/3, p.152 ; Visser, K.-J., *Commission expresses its view on the relation between State Aid and tax measures*, ECTR, 1999/4, p.224 ; Schön, W., *Taxation and State Aid Law in the European Union*, CMLR, 1999, 36, p.911; Monti, M., *How State Aid affects tax competition*, ECTR, 1999/4, p.208; HJI PANAYI, C., *State Aid and Tax: The third way?* Intertax, 2004, Volume 32, Issue 6/7, p.283; Pinto, C., *EC State Aid rules and Tax incentives: A U-Turn in Commission Policy? Part I*, ET, August 1999, p.295, and Part II, ET, September 1999, p.343

56 C-387/92, *Banco Exterior de España*; C-501/00, *Spain v Commission*; C-53/00, *Ferring*

57 70/72, *Commission v Germany*

58 C-387|92, *Banco de Credito Industrial* and T-106/95, *FFSA*

59 C-78/90 and 83/90, *Compagnie commerciale de l'Ouest*

60 173/73, *Italy v Commission*

61 C-256/97, *DMT*

62 C-276/02, *Spain v Commission*

63 67/85, 68/85 and 70/85, *Van der Kooy*

64 Case T-274/01, *Valmont*

65 T-14/96, *BAI*

66 T-14/96, *BAI*

67 C-142/87, *Belgium v Commission*

constitute a State Aid if the State does not behave like a private investor, for example if it accepts that it does not receive dividends from the undertaking in which it has invested.

- Resources available to a public undertaking[68]

- Logistical and commercial assistance by a public undertaking to its private law governed subsidiaries, which carry on an activity open to free competition, without normal consideration in return[69]

- Preferential discount rates in respect of export credits[70]

1.3 Elements of the definition of State Aid

Apart from the fact that there has been a State measure, which constitutes an aid, Article 87 ECT contains a certain number of conditions that have to be fulfilled in order for the measure to constitute a prohibited State Aid. Article 87 does not prohibit the measure if these elements are not present[71].

1.3.1 Granted by a Member State or through State resources

The advantage has to be given directly or indirectly through State resources[72]. The aid has to constitute an additional charge for the State[73] or for the entities charged by the State to procure the aid, or even the entities especially created by the State for this purpose. Thus, the form of the entity[74], public or private[75], which grants

68 482/99, *Stardust*

69 C-39/94, *SFEI*

70 6 and 11-69, *Commission v France*

71 For a recent example see C-217/03, *Belgium v Commission*

72 C-379/98, *Preussen Elektra*: Where competitive advantages are granted by the State, but there is no financial burden on the State or if the burden is too remote or too indirect one does not consider the measure to be granted through State resources.

73 Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ 98 C. 384/03, 10th December 1998, para 10: A loss of revenue is to be considered as a consumption of resources

74 C-482/99, *Stardust*: The ECJ underlines in this case that various criteria must be met before a private body will be taken to be under the control of the State

75 C-156/98, *Neue Länder*: Under certain conditions there can be a State Aid even if the advantage seems to come from a private investor.

the aid, does not affect the qualification of the measure. The effect of the measure, a direct or indirect[76] charge for the State and the advantage for certain undertakings, has to be taken into account, not the statute of the entity that grants the aid. According to the Court[77], if an advantage is conferred by a State but not through State resources, this does not constitute State Aid in the sense of Article 87(1) because there is no transfer of such resources, either directly or indirectly[78].

One must distinguish between direct transfers, which are payments, and indirect transfers[79], which can consist of a State's inaction to recover a sum it normally would, for example, by exempting certain undertakings from a tax[80]: by giving a credit without requesting interest payments: or by granting a tax concession to an investor[81]. An indirect transfer can also be an allocation of resources, by an entity or a person, to certain undertakings or for the production of certain goods, if the sums provided have been given by the State to that intermediate entity[82].

1.3.2 Distortion or threat to distort competition

- *Dynamic approach*

  This condition implies that there has to be a link between the State measure and the effect, or the potential effect, on competition. Some Member States have tried to argue that in order to ensure legal certainty the Commission must base its decision on the conditions of competition existing at the date it adopts its decision. But the CFI has clearly rejected this approach[83]

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76 C-200/97, *Ecotrade*: Loss of revenue that results indirectly of employment legislation (pay lower wages) or extinguishing certain debts does not necessarily result in a reduction in state resources.

77 C-379/98, *Preussen Elektra*: The criterion of state resources is not met if burden on state resources is too indirect.

78 82/77, *van Tiggele*, paras 24-25, and C-52 - 54/97, *Viscido*, paras 12-16

79 C-72/91 and 73/91 *Sloman Neptun*: The case concerned a German scheme whereby seafarers on ships registered in Germany but who were not nationals or residents in Germany were by law excluded from various employment rights, including those regulating wages. The Commission argued that loss of German tax revenues was tax relief conferring advantage on German shipping, but the ECJ held that this scheme does not constitute State Aid.

80 Case C-156/98 *Neue Länder*, AG, para 30

81 Case C-156/98 *Neue Länder*

82 Case C-303/88, *Italie v Commission* paras 11-14

83 Cases T-132/96 and 143/96, *Freistaat Sachsen* paras 211-219

considering that the Commission is obliged to take into account the "foreseeable development of competition" and the effect of the planned aid on this development. Thus the Commission has to adopt a dynamic approach, not a static one when it carries out its assessment[84].

It would be contradictory to oblige the Commission to take a decision in a static manner and at the same time request a constant review of existing aid. In my opinion, the fact that the Commission adopts a prospective view has the effect of ensuring more legal certainty for the Member State and the undertakings to which such an aid is granted because the probability that the Commission will review the existing aid shortly after its decision is reduced.

- *Private investor Test*

The Court has also held that the State is not prevented from intervening if the conditions under which it enters into commercial transactions are the same than the ones of a private investor[85]. The private investor test appears in situations where a State invests in the capital of an undertaking or grants loans to an undertaking. If such transactions take place under normal market conditions, they are not considered to be a State Aid because such investments do not distort competition as the State behaves like any other economic actor in the private sector[86].

- *De minimis*

The Commission has issued a notice indicating under what amount[87], granted over a certain period of time, an aid does not need to be notified to it[88]. One has to be aware that if the aid is not covered by such a Commission regulation no de minimis rule in the sense commonly

84 C-301/87, *France v Commission*: Actual v potential test

85 Case 39/94, *SFEI*, para 60

86 Case C-256/97, *DMT*

87 No more than 100.000 euro over 3 years, but recent discussions highlight the intention to increase this amount to 150.000 euro.

88 The aid must not be notified if it is sure that the ceiling fixed by the notice will not be exceeded. If there are doubts whether or not the amount will be higher or lower, the measure is not covered by the de minimis rule. For an illustration see, C-156/98, *Neue Länder*

understood can be accepted[89]. This means that there is no general de minimis rule in the sense that the aid granted is relatively small or the undertaking to which it is granted is very small in size, in the area of State Aid[90]. Even a small aid, or an aid to a small undertaking can have serious effects on the competition in a certain market, if the said competition is very strong[91].

1.3.3 Favour certain undertakings or production of certain goods

An aid is prohibited only if it is selective[92]. A measure must be general[93] in nature[94] in order not to be considered as a State Aid[95]. A measure that applies to an indefinite number or an infinite number of recipients can still be selective, when the class of the beneficiaries is defined in a way that only certain undertakings are favoured[96]. Even if a measure applies generally to all public undertakings or to all private undertakings, or even a mixture of the two but is not a general measure affecting the national economy, it may be State Aid.

Equally, administrative discretion may result in a selective application of legislation[97]. The inaction of the administration can also amount to a selective measure, for example, if there is an ongoing failure to collect tax from certain undertakings[98]. But, just because a Member State has wrongly exempted some

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89 C-308/01, *Gil Insurance*

90 C-156/98, *Neue Länder*

91 C-142/87, *Tubemeuse,* para 43; C-278/92, C-279/92; C-280/92 Spain v Commission, paras 40 to 42.

92 T-55/99 *CETM*: When one looks at the criteria, it results in an advantage for certain operators in exclusion of others.

93 Bacon, K., State Aids and General Measures (1997) 17 Yearbook of European Law 269

94 Commission Notice paras 15, 16, 23- 27; Case 173/73, *Commission v Italy*; T-67/94 *Ladbroke Racing*, C-83/98 *Ladbroke Racing*; T-127/99, *Territorio Historico de Alava*; C-143/99, *Adria-Wien Pipeline*; C-308/01, *GIL Insurance*

95 Golfinopoulos, C., *Concept of selectivity criterion in State Aid definition following the Adria-Wien judgment – Measures justifies by the nature or general scheme of a system*, ECLR, 2003, 24 (10), p.543

96 C-156/98, *Neue Länder,* paras 22-23, and Advocate General ("AG") Opinion,

97 T-256/97 *DMT*; T-127/99 *Territorio Historico de Alava*

98 C-480/98 *Spain v Commission*; C-276/02 *Spain v Commission*

operators from a tax does not mean that those entities that have paid taxes should be exempted[99].

The "*Neue Länder*" case[100] illustrates the distinction between a general and a selective measure. In this case, the German tax legislation gave a tax concession to taxpayers who sold certain financial assets[101] allowing them to rollover the resulting profit when they acquired other financial assets[102]. Such a measure conferred an advantage on them, but constituted a general measure, applicable without distinction to all economic active persons[103]. This type of general measure[104] does not constitute State Aid within the meaning of the ECT. However, a new provision was introduced which broadened the tax concession. All investors could benefit from the new advantage if the purchase of the shares was connected to an "increase in capital or the setting up of new capital companies" that have "their registered office and central administration in one of the new Länder or in West Berlin and that they have no more than 250 employees at the time the shares are acquired" or are holding companies having the only object of acquiring, administering or selling shares in such companies[105]. This measure clearly drew a distinction between undertakings according to their geographical location and their size.

In its decision[106], which is upheld by the ECJ, the Commission classified the tax concession as State Aid "insofar as it favours certain undertakings in the new Länder or West Berlin"[107], because in the latter case the measure is not general but is selective and thus the provisions of the ECT are applicable.

Furthermore, this case is important because the Court accepts that an indirect advantage, which results from the renunciation by the Member State of tax revenue that it would normally have received, can constitute State Aid, if all the

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99 T-613/97 *Ufex*

100 C-156/98, *Neue Länder*

101 As to know shares in companies forming part of working capital.

102 This is a form of "roll-over relief" familiar to capital gains tax.

103 C-156/98, *Neue Länder*, para 8

104 Bacon, K., State Aids and General Measures (1997) 17 Yearbook of European Law 269

105 C-156/98, *Neue Länder*, para 9

106 Commission decision of 26th February 1997

107 C-156/98, *Neue Länder*, para 22

other criteria are fulfilled. The grant of the tax concession altered the market conditions because the beneficiary undertaking enjoyed an advantage as the public authorities accepted a loss in their revenue[108]. Even though the investor was not obliged directly by the State to invest in the companies in the new Länder or in West Berlin, they are indirectly enticed to do so in order to benefit from the tax concession.

1.3.4 Affect trade between Member States

The analysis of the effect of the measure must be made at an intra-Community level. Where a State measure strengthens the position of an undertaking[109] competing with undertakings on the intra-Community market, such a measure is considered to have an effect on trade between Member States[110]. The relationship of competitors to favoured undertakings has to be taken into account[111].

Even if a favoured undertaking does not export products to other Member States or has no cross-border activity, a measure that grants benefits to a favoured undertaking, can still have an affect on trade between Member States[112]. Producers from other Member States, which are not granted any advantage, may see their opportunities to import their products into that Member State being reduced. A Member State is not allowed to favour its national producers, to maintain or increase their position on the domestic market, because such behaviour can seriously affect the trade between the Member States, which cannot be accepted in the Internal Market.

Member States tend to intervene in the economy in order to protect the undertakings and the investments in their country[113]. Moreover, the States have to act in the public interest and must provide, directly or indirectly[114], certain services

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108 C-156/98, *Neue Länder,* paras 26 and 27

109 62/87 and 72/87 *"Flat Glass"*: The question is whether an undertaking is strengthened and therefore could offer other products at more favourable prices.

110 730/79, *Philip Morris*, para 11

111 If a sector is quite competitive even a small aid can be distortive yet.

112 T-55/99 *CETM*: The favoured undertaking does not need to be an exporter. It may be sufficient to show that the measure maintains or increases domestic production.

113 E.g. Nicolaides, P., *Markets and words: The distortive effect of government pronouncements*, ECLR, 2005, 26 (3), p.119

114 Baistrocchi, P., *Can the award of a public contract be deemed to constitute State Aid*, (2003), ECLR, p.510

to their citizens and residents, because they are necessary for a society but would not be provided in a competitive environment as they are often not profitable. This is the case of SGEI.

The approach of the Court in this area has evolved[115] in recent years[116] as a compensatory approach has been taken[117], which considers that compensation paid to a company for the realisation of an SGEI may not be considered as falling under the qualification of State Aid in certain circumstances. In the latter case, the measure need not be notified to the Commission and can be introduced without delay. This evolution is analysed in Part III of this article.

However, it is important to highlight first in what circumstances a measure can be considered to be compatible with the Common Market, because, before the change of attitude of the ECJ[118], a measure in favour of an SGEI was in principle prohibited till the Commission considered it to be compatible[119].

1.4 Possible compatibility of an aid to an SGEI under Article 86(2)

Article 86(2) ECT brings undertakings that carry out an SGEI within the competition rules in so far as the application of those rules does not obstruct the performance of the task assigned. State action can thus be justified under the Community competition rules if it is necessary for the performance of the task of the SGEI.

In recent years, an important discussion has taken place concerning State measures that are taken in order to compensate undertakings for the costs incurred in fulfilling an obligation of an SGEI. Two different views prevail in this area:

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115 Hansen, M., Van Ysendyck, A., Zuhlke, S., *The coming age of EC State Aid law: A review of the principal developments in 2002 and 2003*, ECLR, 2004, 25 (4), p.202

116 Hakenberg, W., Erlbacher, F., *State Aid Law in the European Courts in 2001 and 2002*, ECLR, 2003, 24 (9), p.431

117 Soltesz, U., Bielesz, H., *Judicial review of State Aid decisions – Recent developments*, ECLR, 2004, 25 (3), p.133

118 Bacon, K., *The concept of State Aid: The developing jurisprudence in the European and the UK Courts*, ECLR, 2003, 24 (2), p.54

119 Case T-46/97, *SIC*: " The fact that a financial advantage is granted to an undertaking by the public authorities in order to offset the costs of public service obligations which that undertaking is claimed to have assumed has no bearing on the classification of that measure as aid within the meaning of Article 87 (1)".

- Such compensation is still considered to be aid and falls under Article 87 ECT, thus they must be notified to the Commission. The latter can consider that the circumstances are such that the aid could be justified under Article 86 ECT.

- One can also take the view the ECJ has finally accepted, that the measures taken by the State constitute a compensation which is not an advantage and which falls outside the scope of the prohibition laid down by the ECT.

Although the final result may be the same[120], the choice is important because in the former case the Member States are obliged to notify the measure to the Commission and to wait for its approval to put it into effect, whereas in the latter approach the measure can enter into force without delay. This evolving area is analysed in detail below.

2 Where Services of General Economic Interest come into play

2.1 Financing of the SGEI

2.1.1 Ways of financing SGEI

An SGEI can be financed in different ways, some of which are more likely to be compatible with the ECT rules than others. There are four means of financing, which can be used individually or which can be combined.

- The users of the service finance it by way of fees[121]

- The provider finances the public services by way of cross-subsidisation between profitable and non-profitable activities under the exclusive or special rights he enjoys

- The provider ensures the financing by carrying out commercial activities outside the scope of the SGEI that benefit from the resources necessary for the SGEI

- The provider of the SGEI receives public service compensation from the State

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120 The measure can be applied whether it is a justified aid or because it is not aid and thus is not prohibited.

121 Triantafyllou, D., *L'encadrement communautaire du financement du service public*, RTDE, 1999, p.21.

2.1.2 Compensation granted by the State to the provider of an SGEI

Financing by Member States, in some cases, of an SGEI by granting compensation to the provider has raised important questions in recent years[122]. The European Courts have been obliged to qualify the subsidies given by the Member States to providers of SGEI[123]. Such subsidies fulfil at first sight most or even all the criteria, considered to constitute State Aid prohibited by the ECT[124].

But this view is not universally accepted, and some pretend that such compensation does not constitute an advantage and thus does not threaten to distort competition, because it aims only to bring the undertaking in charge of the SGEI back to a normal level of competition with the other undertakings in the market[125]. Thus, the fact of obliging an undertaking to discharge an SGEI without giving it compensation could amount to a disadvantage for this undertaking, and thus favouring the undertakings that are not entrusted with such a particular task. This disadvantage would cause a distortion of competition because the provider of the SGEI would be in a less favourable position to its competitors and would lose market power and become less competitive than if it had not been given the task contained in the SGEI. From this point of view, the compensation granted to such an undertaking would have the effect of only putting it on an equal footing with its competitors[126].

On the other hand, one could also argue that being entrusted with the exercise of an SGEI is in itself an advantage because it allows the undertaking to be sure that this part of its business will be financed by the State or through State resources, to the amount of the supplementary costs, and thus the undertaking's risk is limited compared to its competitors.

Some comment that it is never possible to consider that a compensatory aid is not an advantage, and that it can be justified only on a case-by-case analysis by the

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122 Hansen, M., Van Ysendyck, A., Zuhlke, S., *The coming age of EC State Aid law: A review of the principal developments in 2002 and 2003*, ECLR, 2004, 25 (4), p.202

123 Hakenberg, W., Erlbacher, F., *State Aid Law in the European Courts in 2001 and 2002*, ECLR, 2003, 24 (9), p.431

124 Rizza, C., *The financial assistance granted by Member States to undertakings entrusted with the operation of a Service of General Economic Interest*, Oxford University Press, 2004

125 Kovar, R., *Droit communautaire et service public: esprit d'orthodoxie ou pensée laïcisée*, RTDE, 1996, 1re partie, p.215, 2e partie p.493

126 Cherot, J.-Y., Financement des obligations de service public et aides d'Etat, Europe, Mai 2000, chronique 5, p.4

Commission, but can never be excluded from the scope of Article 87(1). But the ECJ has accepted in its *Altmark* judgment[127] that, if certain strict conditions are met, compensation does not constitute an advantage, and thus does not fall under the prohibition of Article 87(1) because one of the general criteria is not met.

2.2 SGEI comes into play at the level of the existence of aid

2.2.1 Compensation for an SGEI, State Aid under Article 87(1)?

Initially the Commission considered that financial assistance granted by a Member State to an undertaking to offset the additional charges resulting from the exercise of an SGEI imposed on it by the State did not constitute State Aid in the sense of Article 87(1) ECT. But this analysis was not accepted by the CFI. The latter considered in several cases that "the fact that a financial advantage is granted to an undertaking by the public authorities in order to offset the cost of public service obligations assumed by that undertaking has no bearing on the classification of that measure as aid within the meaning of Article 87(1) ECT, although that aspect may be taken into account when considering whether the aid in question is compatible with the Common Market under Article 86(2) ECT"[128]. For the CFI, the fact that such Member State intervention is intended to compensate for the exercise of a public service obligation does not change the character of the measure as State Aid[129]. The CFI thus appears to consider that the four conditions set by Article 87(1) ECT are met by such compensation.

This attitude seemed to have been accepted by the ECJ, especially after it rejected the appeal in the *FFSA* judgment[130] and after it stressed in *CELF*[131], that Article 86(2) ECT does not allow derogation from Article 88(3), which would mean that even if aid is granted to the exercise of an SGEI the Member States must notify the aid and must suspend the aid until the Commission has considered the aid compatible with the Common Market[132].

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127 C-280/00, *Altmark*

128 T-106/95, *FFSA*, and T-46/97, *SIC*

129 Rizza, C., *The financial assistance granted by Member States to undertakings entrusted with the operation of a Service of General Economic Interest*, Oxford University Press, 2004

130 T-106/95, *FFSA*

131 C-332/98, *CELF*

132 AG Jacobs has dubbed the "State Aid approach" in its Opinion in *GEMO*, C-126/01

2.2.2 Commission decision and framework on Article 86(2)

The Commission has accepted this view in its Article 86(2) package[133] in which it has tried to clarify certain concepts. The Article 86(2) EC package is applicable only to measures that are considered to constitute State Aid and which, because of their special elements, could be justified[134]. The package has the positive effect of assuring more legal certainty to the Member States and to the undertakings to which State Aid is granted. The conditions set down by the Commission and its discretionary power in certain circumstances will help to guarantee the financing of public service obligations without unnecessary distortion of competition.

The package will furthermore reduce the administrative burden for the Member States, who will not have to notify all the State Aid measures taken. This will probably reduce the number of notifications going to the Commission, and the Commission will be able to concentrate its resources on State Aid providing the greater risk to distortion of competition between the Member States.

Moreover, the package tries to make sure that there is no over-compensation and that obligations on the Member States and the recipient undertakings are such that it is easier to discover the cases where over-compensation has taken place.

- Decision[135]

  The "Commission decision on the application of Article 86 ECT to State Aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEI"[136] applies only to public service compensation that constitutes State Aid if it falls into one of the following categories:

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133 The 86(2) EC package contains various documents, which each have another function and which address different circumstances. One can distinguish the Commission decision, the Community Framework and the Commission Directive amending the Transparency Directive 80/723/EEC.

134 The package only applies on economic entities, thus does not apply to public services supplied by non-economic entities, such as contributions-based compulsory social security organisations. An economic activity can be even non profit making.

135 Decision based on Article 86(3) ECT

136 Commission decision of 28 November 2005 on the "application of Article 86(2) ECT to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest" (notified under document number C(2005) 2673) (2005/842/EC), OJ 29.11.2005

- *Significance criterion:* If the compensation granted to an undertaking discharging an SGEI is less than 30 million Euros per year and if the beneficiaries have an annual turnover of less than 100 million Euros, including all their activities, for the two financial years preceding the year of the assignment of the SGEI, it is deemed to be compatible with the Common Market. This will cover mainly the small-scale public services, such as for example home-care services, local radio stations and local public childcare facilities.

- *Air and sea transport:* Air and sea transport have different thresholds because of their specificity. Compensation for air and sea transport to islands as well as airports and ports below thresholds defined in passenger volumes is deemed to be compatible with the Common Market and does not need to be notified to the Commission.

- *Hospitals and social housing*: The Commission decision does not impose a cap in the area of hospitals and social housing in order to deem compensation granted to the SGEI carried out by these services to be compatible with the Common Market. Attention has to be paid to the fact that not all activities carried out by these services necessarily constitute an SGEI. The compensation is deemed to be compatible only if the four other conditions are satisfied.

Most of the activities covered are active only locally and there is little risk of serious distortions of competition within the Single Market.

- Framework

The Community framework for State Aid in the form of public service compensation[137] covers everything that is not covered by the decision or by the *Altmark* criteria and everything that is above the thresholds set down in the decision. Even if State Aid is covered by the framework it is not automatically deemed compatible with the Common Market. As the Commission has explained in its decision, if the thresholds are not surpassed, the amount of the compensation granted to an undertaking whose turnover is limited does not affect the development of trade and competition to an extent that would be contrary to the interests of the

137 Community framework for State aid in the form of public service compensation (2005/C 297/04), OJ 29.11.2005

Community. If the threshold is surpassed, there is a risk that the effect on trade and competition is contrary to the interests of the Community. In this case, the measure must comply with the obligation set down in the ECT, notably it must be notified to the Commission. The framework sets the criteria[138] the Commission will apply to determine whether the aid is compatible or not. The Commission has a discretionary power to decide whether or not the aid in question is to be considered State Aid compatible with the Common Market.

The framework is applicable to larger scale public service compensation. Generally the activity to which such compensation is granted is larger than local. Furthermore, there is a larger risk that the compensation may be used by companies on other markets open to competition, which would be another factor that has to be taken into account when deciding whether or not the State Aid is compatible with the Common Market.

2.2.3 Under certain conditions compensation for SGEI is not State Aid

If the situation seemed to be, more or less, clear after the *FFSA* and the *CELF* judgments, the Court made a U-turn in November 2001[139], by taking a decision that has caused a lot of reaction. In its *Ferring* judgment[140], the ECJ stated the non-assessment of a provider of a public service obligation to a tax is considered to be compensation for the services provided[141], "and hence not State Aid" within the meaning of Article 87 ECT, if the amount of the exemption and the additional costs occurred are equivalent[142]. The Court insisted on the fact that in its view the providers do not enjoy a "real advantage" in the sense of Article 87(1) ECT, because the compensation only puts the undertakings in this market on an "equal competitive footing"[143].

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138 These criteria are a mere formulation of the way the Commission has always applied Article 86 (2) ECT.

139 Merola, M., Medina, C., *De l'arrêt Ferring à l'arrêt Altmark: Continuité ou revirement dans l'approche du financement des services publics*, CDE, 2003, p.639

140 C-53/00, *Ferring*, para 27

141 Bacon, K., *The concept of State Aid: The developing jurisprudence in the European and the UK Courts*, ECLR, 2003, 24 (2), p. 54

142 Bartosch, A., *The relationship between public procurement and State Aid surveillance: The toughest standard applies?*, CMLR, 2002, p.551

143 Case 53/00, *Ferring*, para 27

In this sense, as long as the compensation does not exceed the additional costs incurred by discharging a public service obligation, there is no advantage for the recipient of the measure, and thus the measure does not fall within the scope of Article 87(1) ECT. This judgment has been largely criticised by scholars[144], mostly because it widens the discretionary power for the Member States to grant subsidies or indirect help without having to notify the Commission, thus without prior approval from them.

Probably, at least partly, because of the severe criticism, the ECJ has limited the effect of the *Ferring* judgment[145] in its later *Altmark*[146] judgment, in which it sets out the conditions for compensation to meet in order to be excluded from the scope of Article 87(1), and thus not to constitute State Aid[147].

In short, the four conditions[148] imposed by the Court are the following:

- The recipient has a public service obligation to discharge, which is clearly defined
- The parameters for the calculation of the compensation are fixed in advance in an objective and transparent manner
- The compensation does not exceed what is necessary to cover the costs incurred to discharge the obligations
- The undertaking is chosen pursuant to a public tender or the level of compensation is determined by reference to the costs that a well-run undertaking would have for the same obligation.

These criteria tend to establish an objective determination of the compensation for the discharging of a public service obligation. If the four conditions are met, the

144 See especially Nicolaides, P., *Distortive Effects of compensatory aid measures: a note on the economics of the Ferring judgment*, ECLR, 2002, 23 (6), p.313

145 Nicolaides, P., *Compensation for Public service obligations: The floodgates of State Aid*, ECLR, 2003, 24 (11), p.561

146 C-280/00, *Altmark*

147 Bracq, S. *Droit communautaire matériel et qualification juridique: le financement des obligations de service public au coeur de la tourmente (à propos de la décision: CJCE, 24 juillet 2003, Altmark Trans GmbH, affaire C-280/00)*, RTDE, 40 (1), janvier - mars 2004, p.33

148 Hansen, M., Zuhlke, S., Van Ysendyck, A., *Altmark Trans: European Court of Justice outlines conditions for public service compensation*, www.practicallaw.com/A32061

public service compensation does not constitute State Aid and Articles 87 and 88 do not apply. In this case it has to be considered that no State Aid exists. It is an objective analysis; the Commission has no discretion as to whether or not the measure constitutes State Aid.[149]

The conditions laid down to consider whether compensation is State Aid will be analysed in further detail in Part III.

2.3 SGEI comes into play at the level of compatibility of aid with the internal market

2.3.1 Application of 86 (2) to public service compensation

If the four conditions set by the ECJ in its *Altmark* judgment[150] are not fulfilled, but the general criteria for the application of Article 87(1) ECT are met, public service compensation constitutes State Aid and is subject to Articles 73, 86, 87 and 88 ECT. In this case, the aid has to be notified to the Commission and comes within the standstill obligation of Article 88(3) ECT.

Some authors[151] suggest that the Court implicitly considers that, if the four conditions are not met and the measure is considered to be State Aid, such State Aid "would be deemed operating aid[152]" and would thus probably not meet the conditions to be approved under Article 86(2) ECT and should be recovered.

The Commission however considers that if the criteria established in the *Altmark* judgment are not satisfied, the measure constitutes State Aid and thus falls under Article 87 ECT, with all the obligations contained therein and that in so far as the compensation does not exceed the net additional costs of the service, it is justified under Article 86(2) ECT. The Commission considers that in certain cases State Aid in the form of public service compensation is necessary for undertakings entrusted with an SGEI to fulfil their mission, and can under certain conditions be justified under Article 86(2) ECT. The Commission seems to intend to set down in

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149 Nicolaides, P., *The new frontier in State Aid control: An economic assessment of measures that compensate enterprises*, Intereconomics, 2002, p.190

150 Bracq, S. *Droit communautaire matériel et qualification juridique: le financement des obligations de service public au coeur de la tourmente (à propos de la décision: CJCE, 24 juillet 2003, Altmark Trans GmbH, affaire C-280/00)*, RTDE, 40 (1), janvier - mars 2004, p.33

151 Hansen, M., Van Ysendyck, A., Zuhlke, S., *The coming age of EC State Aid law: A review of the principal developments in 2002 and 2003*, ECLR, 2004, 25 (4), p.202

152 See Glossary

a decision addressed to Member States the conditions under which certain types of compensation are compatible with Article 86(2) ECT and do not need to respect the administrative procedure set down in Article 88(3) ECT[153]. One can distinguish two types of potential compatible compensatory aid. The compensatory aid can be substantial, which could significantly distort competition, or can be smaller in amount, and thus potentially less distortive, if the remaining conditions are met by the Member States. The Commission has adopted by decision a kind of "de minimis" rule for compensatory aid, which includes the conditions required by Article 86(2) ECT as well as the Commission's pre-*Ferring* requirement that the compensation can cover, at most, the exact amount of extra-costs incurred. The Commission considers that small amounts of compensatory aid granted to providers entrusted with a particular task clearly set out in a public instrument, ensuring a degree of transparency in financial relations between the State and the undertakings, whose turnover is limited and which comply with the conditions that the amount of compensation is proportionate to the costs incurred in discharging the public service and the development of trade is not affected to an extent contrary to the interests of the Community, and do not substantially affect the development of trade and competition and, therefore, do not need to be notified to the Commission.

The conditions for such an automatic consideration of compatibility should be analysed very precisely. The fact that an aid is only small in amount does not necessarily imply that it does not cause any distortion of competition. Even a small amount of aid can have a significant impact on competition and must thus be monitored in its proper context. Probably this is the reason why the Commission

153 The conditions which have to be satisfied are the following:

- Granted in order to ensure the provision of SGEI
- Beneficiary specifically entrusted by the Member State with the operation of a particular SGEI
- Obligations incumbent on the undertakings and on the State clearly set out in a formal act of the competent public authorities within the Member State concerned.
- Compensation does not exceed what is necessary to cover the costs incurred in discharging the public service obligations, account being taken of the relevant receipts and a reasonable profit
- Where over-compensation does not exceed 10 % of the amount of annual compensation, it can be carried forward to the next period and be deducted from the amount of compensation payable for the next year. In the area of social housing the revenue may vary seriously from one year to another (risk of insolvency of leaseholders). Where an undertaking only operates SGEI over-compensation can be carried forward up to 20% of the amount of the annual compensation.

If all these conditions are fulfilled and if the thresholds laid down in the decision are respected, the Commission considers that the development of trade is not affected to such an extent as would be contrary to the interests of the Community, and thus the compensation should be deemed to constitute State aid compatible with Article 86(2) ECT and therefore no prior notification will be required.

has not extended the possibility of the automatic compatibility to every compensatory measure that is proportionate to the additional costs incurred in discharging the public service obligation, but only to undertakings that fulfil the additional conditions[154].

2.3.2 Application of Article 86(2) to exclusive or special rights

One must remember that public service compensation is not the only possibility Member States have to "remunerate" providers of an SGEI. A Member State can confer special or exclusive rights on such a provider in order to make up for the costs that have to be borne in order to fulfil its public service obligations. At present, the ECJ does not appear to include in the definition of compensation the grant of special or exclusive rights and thus, in the compensation approach. Granting a special or exclusive right appears to fulfil the general criteria to constitute State Aid and thus the only possibility for accepting them would be to consider them as being justified under Article 86(2) ECT.

In the future, it seems possible that the grant of a special or exclusive right will be analysed in the same way as the financial compensation. One could argue that if the grant of an amount of money or the exemption to pay a certain amount of money to the State is considered not to be an advantage in the sense of Article 87(1) ECT, the grant of a special or exclusive right could be considered in a similar way if some conditions are met – for example if it is limited in time, if the market concerned it necessary if the parameters of the right are clearly determined, etc. Of course the conditions are not easy to define, and the concepts used may be difficult to apply, especially in an economic analysis, but probably they are not more difficult to define than the conditions applicable in the actual compensation approach.

2.3.3. Conditions of Article 86(2) ECT

The Commission considers that some conditions have to be met in order for an aid to be able to be authorised:

- Member States must define the service
- Member States must entrust a company with the service
- Member States must ensure proportionality and avoid over-compensation

154 Merola, M., Medina, C., *De l'arrêt Ferring à l'arrêt Altmark: Continuité ou revirement dans l'approche du financement des services publics*, CDE, 2003, p.639

The Commission has the discretion to consider whether or not these conditions are met and thus whether or not it authorises the aid. In the former case, when the conditions necessary to consider that compensation is not State Aid are met, the Commission has no discretionary power; the measure is simply not within the scope of the relevant Articles[155].

One has to be aware that these conditions, which have to be met to allow the Commission to consider that an aid can be justified, are very close to the ones established by the ECJ in *Altmark*. The conditions in *Altmark*[156] are difficult to apply. They have to be interpreted in a very strict manner. When the Commission analyses whether an aid can be declared compatible with the internal market, the discretionary power it exercises allows it to take a less strict view on a certain aid. It is thus able to take into consideration exceptional circumstances, special needs, more flexible concepts, if it considers that in a particular case the aid is necessary for the exercise of the SGEI, although strictly speaking the criteria are not met.

However, if a Member State wants to be discharged from its obligation to notify a measure it intends to introduce to the Commission, the *Altmark* criteria have to be fulfilled, without any possible derogation. It is therefore important to analyse in detail what form a measure can take in order not to be considered to constitute a State Aid.

155 For a clarification of the approach in the area of SGEI of the Commission see the amendment of Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings adopted on 28th November 2005.

156 The beneficiary of the compensation must be entrusted with a clearly defined public service mission. The parameters for calculating the compensation payments must be established in advance in an objective and transparent manner. Compensation must not exceed the cost incurred in the discharge of the public service minus the revenues earned by providing the service. And the beneficiary is chosen in a public tender or else the compensation must not exceed the costs of a well-run undertaking that is adequately equipped with the means to provide the public service. These conditions will be analysed in detail in Part III.

3 Compensation is not State Aid if ....

3.1 Conditions set out by the ECJ

For the compensation[157] not to be considered to constitute State Aid four conditions have to be met, as set out in the *Altmark* judgment. These different conditions[158] are far from being clear beyond doubt[159].

3.1.1 Entrustment with a clearly defined public service obligation to discharge

The beneficiary of the compensation must be entrusted with a clearly defined public service mission.

- *Entrusted*

  The decision to distort competition in pursuit of a public interest objective should not be taken by an undertaking without official authorisation. The State authorities seem to be most competent to define what should be considered as constituting a public interest objective. The State has a democratic legitimacy undertakings do not have, whether they are public or private. The State represents the collectivity, its different interests, its various aspects, and it is situated at the most appropriate level to evaluate the different interests, to reconcile them and to determine the interests that are needed at a level allowing to consider whether they are worth developing the exercise of an SGEI.

  Community law does not oblige the State to make the legislator pass a law to entrust an undertaking with an SGEI[160]. The public service obligation must be set out in a public instrument. The form of the instrument may vary according to the legal systems of the Member States concerned. It can be a law, a regulation, or another instrument used in the Member States as

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157 Merola, M., Medina, C., *De l'arrêt Ferring à l'arrêt Altmark: Continuité ou revirement dans l'approche du financement des services publics*, CDE, 2003, p.639

158 Hansen, M., Zuhlke, S., Van Ysendyck, A., *Altmark Trans: European Court of Justice outlines conditions for public service compensation*, www.practicallaw.com/A32061

159 Bracq, S. *Droit communautaire matériel et qualification juridique: le financement des obligations de service public au coeur de la tourmente (à propos de la décision: CJCE, 24 juillet 2003, Altmark Trans GmbH, affaire C-280/00)*, RTDE, 40 (1), janvier - mars 2004, p.33

160 C-393/92, *Almelo*, para 47

long as it includes all the information necessary to identify precisely the special task.

- *Clearly defined*

  In the instrument chosen by the Member States to entrust a particular task to an undertaking, the service entrusted to it must be clearly defined. It is not sufficient to highlight that the undertaking has a particular task. Instead, what the task consists of must be precisely described: the services that have to be provided and the obligations placed upon it. For example whether:

  - a particular infrastructure has to be built and/or managed
  - it is a universal obligation
  - the tariffs have to be the same for everyone
  - there should be cross-subsidies
  - the undertaking also carries out a business which is not an SGEI
  - part of the profits made in this area must be used to set off part of the supplementary costs of the SGEI.

  The chosen instrument must define the precise framework in which the SGEI has to be carried out, with all the conditions and obligations, in order to constitute an accurate working basis to calculate the additional charges of the particular task for which the State grants financial help.

- *Public service mission*

  The mission carried out by the undertaking, and which is set down in the chosen instrument, must constitute a public service mission, a particular task, an SGEI. The fact that there is no general Community definition of the SGEI, implies that Member States are free to determine what they consider to constitute such an SGEI at their national level. The control of the Community is limited to a control of manifest error on the part of the Member State. The Member States' power to define this notion is therefore, mainly discretionary. But in certain cases the definition used by the Member State has been refused, for example by the ECJ, which has

handed down in a judgment that dock work is not an SGEI[161]. The consideration of what can be accepted as constituting an SGEI or a public service mission varies with the time, and with the economic and political circumstances in a country. When an area that constituted an SGEI in the past[162] becomes an area where private undertakings are ready to offer the service on a competitive market[163], the need to provide a specific service qualified to be an SGEI might lose its importance. This has been the case in many of the network areas, which have been considered for a long time to constitute an SGEI by nature, but which, quite recently, have been liberalised. Today, it is much more difficult for Member States to see their definition of a network industry as an SGEI accepted, especially where other Member States have managed to open up the same sector to competition.

3.1.2 Parameters for the calculation of the compensation

The parameters for calculating compensation payments must be established in advance in an objective and transparent manner. Under the *Ferring* judgment one could have considered that the State was free to calculate the amount of the compensation at the end of the financial year, after the service has been provided. But in *Altmark*, the ECJ required the Member States to fix parameters for the calculation in advance, before the service is carried out[164]. This is in line with the obligation to define the mission clearly. The Court obliges the Member States to set down all the necessary information in a transparent manner, in order to avoid distortion of competition by limiting the compensation to the strict minimum. It is logical in relation to the other criteria, the public tender or the "well-run undertaking" criteria, as well as the prohibition of over-compensation, that the undertakings which apply for the grant of the SGEI are aware of the parameters related to their compensation, and thus what they have to include in their own calculations when they make an offer to the State. In order to assure that the SGEI is effectively discharged all the costs and revenues will have to be taken into consideration by the undertaking, to be sure it is able to meet the obligations. To

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161 C-179/90, *Porto di Genova*, paras 27-28

162 The need for an SGEI in the past may be due to several reasons:
- Private investors were not interested in an area because they did not consider it economically interesting
- A large investment would have to have been made

163 This interest can notably be due to the fact that the public interest in such an area is present or starts to show up

164 Merola, M., Medina, C., *De l'arrêt Ferring à l'arrêt Altmark: Continuité ou revirement dans l'approche du financement des services publics*, CDE, 2003, p.639

be effectively discharged an SGEI must be available to all concerned, at a certain quality and respect the necessary security requirements.

The specified parameters must detail what has to be included in the calculation to determine the amount of compensation which is necessary. Some Member States will require the undertaking to finance the service partly by cross-subsidisation between profitable and non-profitable activities, if special or exclusive rights are enjoyed, others request the consumers to participate financially, by paying a fee, still others require the provider to ensure the financing by carrying out commercial activities outside the scope of the SGEI that benefit from the resources necessary for the SGEI.

This condition may help the competitors or potential competitors of the undertaking carrying out the SGEI to verify whether or not the amount of the compensation has been correctly calculated and may also help the Commission or the European Courts to do the necessary verification if an action is brought before them contending that the requirements to fall outside the scope of Article 87(1) ECT are not met.

3.1.3 Compensation must cover only the cost of the obligation

The compensation can include all costs, all variable costs, a portion of the fixed costs, and a return on capital.

Compensation must not exceed the cost incurred in the discharge of the public service minus the revenues earned by providing the service. The maximum amount of the compensation is the effective supplementary cost of the SGEI. No over-compensation is allowed. Up to this point, the calculation of the compensation still seems to be an objective concept. The parameters of how to calculate the compensation are set out in advance, the mission is clearly defined, and the revenues earned can be found in the undertaking's accounts.

What makes the concept less objective is the ECJ's consideration that the compensation may, however, include a reasonable profit. What is a reasonable profit? Is it the average profit that undertakings in this area make? If there is no comparable undertaking in this area, is it the average profit an undertaking in another Member State makes in this area? Is it necessary to exclude from the calculation poorly managed undertakings that do not make any profit? It appears that one has to take into account whether the concerned undertaking bears a risk or not, and according to the level of the risk, the amount of reasonable profit will vary. It is also necessary to take into account whether the undertaking enjoys exclusive or special rights. Some of the elements that have to be taken into account are easily detected because they are the same as the ones an undertaking that is not

entrusted with a public service obligation would consider in order to fix its prices and thus its profits. But this does not provide all the necessary information to determine the reasonable profit in this specific area.

The concept of a reasonable profit varies from one Member State to another, sometimes even from one region to another. As the ECJ does not give any indication of the parameters that have to be taken into account to calculate a reasonable profit, it appears to be left to the Member States to define what a reasonable profit is. This definition would then only be subject to a control of manifest error, as can be found in the notion of SGEI.

3.1.4 Public tender or "well-run undertaking" reference

The beneficiary is chosen in a public tender or else the compensation must not exceed the costs of a well-run undertaking that is adequately equipped with the means to provide the public service.

If the beneficiary is chosen in a public tender one can estimate that the costs of the public service obligation are correctly calculated if the procedure recognises all the obligations. The undertakings that want to discharge the public service obligation have to make a detailed analysis of what they think it will cost. They have an interest in not exaggerating the price they are charging because in general the price is the most important factor to choose the beneficiary, even though other considerations can sometimes come into play, for instance, environmental elements. If the State decides to choose the undertaking by a tender procedure, it has to define in advance clearly what service will be provided to enable all potential candidates to tender. This way of granting the service is objective and transparent, and has the effect of defining from the beginning the costs of discharging the public service obligation.

Interestingly, the Member States also have the possibility to grant the exercise of a public service and the compensation for the extra-costs in a less objective way. If an undertaking is not chosen by public tender, the compensation, to avoid being considered as State Aid, must not exceed the costs of a "well-run undertaking that is adequately equipped with the means to provide the public service". This explanation gives rise to an important number of questions. What is a well-run undertaking? How do you evaluate it? Do you have to compare with an average undertaking in the same sector? And if there is no comparable undertaking, is it possible to compare it with an undertaking in another Member State? And when is an undertaking well-run? When it makes a reasonable profit? What if it makes less profit because it places more emphasis on social security factors, pensions, and environmental factors that are important for the public interest? From a purely economic sense "well-run" will probably have another meaning than in a social,

environmental or political meaning. Should "well-run" be defined in a special sense because it appears in the special area of SGEI, and thus be interpreted as well-run in a general public interest? Or "well-run" in the general economic interest?

This second criterion seems to give a large amount of discretion to the Member States to define this notion. But here again, as there is no general Community definition for well-run undertaking, and the Member States have some discretionary power to define it; the Community instances will limit themselves to control of manifest errors. But, as the criteria are to be interpreted quite strictly, it could well be that the Commission or one of the European Courts would consider the Member State's decision that the amount of compensation fixed is one that a well-run undertaking would have needed to cover the costs for the SGEI to be a manifest error, and thus one of the conditions to avoid the prohibition of Article 87(1) will not be met.

3.2 Practical example: T-274/01, *Valmont*

In the *Valmont* case, a municipality sold land to an undertaking, on which a car park had been constructed that was used continuously by the undertaking that had bought the land and by other undertakings. This arrangement, which had the aim of ensuring the public use of the car park, a benefit that was granted free of charge, had been fixed by a pre-existing gentlemen's agreement between the municipality and the undertaking. Thus the lack of public infrastructure for the parking of trailers was palliated, and the parking of trailers on the streets of the municipality was avoided. By virtue of the municipality's power under the municipal development plan, it was able to enforce the gentlemen's agreement strictly and thus, ensured a long-term and continued use of the land as a car park. The application of the arrangement was thus ensured by a legislative provision and the undertaking could not unilaterally terminate the agreement. The benefits resulting from the agreement were in the interests of the concerned undertakings as well as in the public interest.

The municipality had contributed to the construction of the car park by financing part of it. The Commission indicated that such a contribution constitutes State Aid under Article 87(1) ECT.

The *Valmont* case[165] is an interesting case for three reasons. First, it is an application by the CFI of the theory set down by the ECJ in its *Altmark*

165 Idot, L., Aide d'État et vente de terrain à des conditions préférentielles, Europe, 2004, Novembre Comm. nº 367, p.21

judgment[166]. Second, the CFI gives some indication as to how the Commission must take into consideration the compensation approach in its decisions. Third, there is an application of the compensation approach when there is a sale of land from a local authority to a private undertaking and the subsequent construction and use of a car park on part of that land. Moreover, it is interesting to note that the funds were paid by the provincial authority to the municipal authority, and that the State Aid involved arose from the fact that the municipality could sell the land below its real commercial value.

The Court considered that the outcome of the gentlemen's agreement between the undertaking and the municipality was to make the undertaking bear "a burden in the public interest"[167].

The CFI then pointed[168] out the fact that, for the ECJ, compensation to an undertaking that discharges an SGEI, which does not give a real advantage to such an undertaking, does not constitute State Aid if certain conditions are met, namely, those established in *Altmark*[169].

In the present case, the landowning undertaking bore a burden to discharge a public interest under an agreement concluded with a municipal authority. The Commission has considered that a portion of the financing granted by the authority for the construction of the concerned party benefits the landowning undertaking.

The CFI concluded that the Commission could not "automatically" consider that the financing "necessarily" benefited the undertaking. The Commission has an obligation to analyse the information that is available to it and to examine whether or not the financing could be regarded as a compensation for the discharge of an SGEI. The Commission is therefore obliged to verify in each case whether the *Altmark* criteria are met to determine whether the measure constitutes State Aid or compensation for a public service obligation. The Commission cannot simply consider that the financing benefited the undertaking, but it is obliged to examine in each case whether the criteria fall outside the scope of Article 87(1) ECT because a measure meets all of the four conditions required by *Altmark*.

> "*The decision shows that the Commission merely considered that that portion of the financing benefited Valmont, and does not show at all that*

166 Soltesz, U., *European State Aid law*, www.practicallaw.com/7-201-5322

167 T-274/01, *Valmont*, para 124, Emphasis added by the author

168 T-274/01, *Valmont*, para 129

169 C-280/00, *Altmark*, paras 89-95

> *the Commission examined the question as to whether it could be regarded as being* ***compensation for the burden borne by Valmont***"[170].

The CFI rejected the argument of the Commission that the conditions set by *Altmark* were not satisfied as an excuse for not having established its considerations in its decisions[171]. Thus the Court requires the Commission to indicate clearly in its decision whether the measure in question can be treated as State Aid, after examining in detail whether the *Altmark* conditions are satisfied, if the recipient is discharging an SGEI. The Commission has to classify the measure as State Aid in its decision.

The Court also points out that it is the mission of the Commission to carry out such an examination and that the Community Courts cannot replace the Commission in this area by carrying out this analysis, and moreover could not substitute its conclusions for those of the Commission. The burden of analysing whether a measure constitutes State Aid is on the Commission and the Courts cannot replace the Commission in this mission, and thus a decision of the Commission, taken without a detailed examination of the situation at issue, must be annulled by the Court, even though if the Commission had carried out the analysis it would have come to the conclusion that the measure constituted State Aid, and would have taken the same decision.

3.3 Difficulty of satisfying the *Altmark* criteria

The criteria set out in *Altmark* are very strict and require the Member States to calculate strictly, before paying any compensation, what the measure is intended to compensate for and how the costs of the public service obligation will be calculated. Spontaneous assistance is therefore not possible even if it would compensate for a public service obligation. Furthermore, it is difficult to ensure in advance that the definition of certain terms will be accepted by the Commission if someone complains about the payment. For example, take the definition of public service obligation, as the accepted definition can change according to the economic circumstances. Moreover, as there is no clear definition of "reasonable profit" and of "economic advantage", it is difficult to determine what an adequate compensation, acceptable under the criteria, would be.

The main difficulty in satisfying the *Altmark* criteria is the last condition set by the ECJ, regarding the public tender or the well-run enterprise that has the required means to meet the requirements of the public service. In practice, tenders are not widely used, particularly for small SGEI in municipalities. Thus, all the payments

170 T-274/01, *Valmont* para 134

171 T-274/01, *Valmont* paras 135-136

granted can be considered as constituting compensation which is not State Aid only if the authorities concerned, which have not used a tender, are obliged to perform a complex economic analysis to determine what is a well-run undertaking, an analysis which, as has been seen above, is very difficult to achieve as it is not clear what factors have to be taken into account.

The ECJ has managed to limit the effects of its *Ferring* judgment the "floodgates of State Aid"[172] which the compensation for public service obligations could have opened by setting these four *Altmark* criteria. As these criteria are very difficult to satisfy it seems that the Commission has considered that Article 86(2) ECT still has significance. If it would be easy to escape the scope of Article 87(1) ECT if compensation is paid for the exercise of an SGEI, the justification under 86(2) ECT would probably have lost all its importance.

Nevertheless, even if the criteria seem to be quite difficult to fulfil, one of the main criticisms one can make on this jurisprudence is that it will have the effect of shifting the control of such measures from an *ex-ante* control by the Commission to an *ex-post* control of the national courts[173]. The domestic courts will therefore be obliged to decide whether or not a State Aid exists. If they consider that the measure is of a compensatory nature, fulfilling the four criteria, they will accept the fact that the State has not notified it to the Commission. If the measure should have been notified by the State because the criteria set by the ECJ are not fulfilled, the measure in any event is unlawful. Not only is it unlawful because it has not been notified, but if the criteria are not fulfilled, the criteria which the Commission considers in order to determine whether or not an aid will be compatible with the Common Market will not be fulfilled either. Thus, the only person who would be interested in seeing the measure being notified in order to have a legal certainty is the beneficiary[174], because the State will often be much more interested in keeping certain information away from the Commission[175]

3.4 The need of a communication on Article 87(1) ECT

Due to the new developments in the area of SGEI, Article 87(1) ECT needs clarification in order to provide more legal certainty for the Member States as well

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172 Nicolaides, P., *Compensation for Public service obligations: The floodgates of State Aid*, 2003, ECLR, p.561

173 Merola, M., Medina, C., *De l'arrêt Ferring à l'arrêt Altmark: Continuité ou revirement dans l'approche du financement des services publics*, CDE, 2003, p.639

174 Power, V., J. G., *A proposal for State Aid reform: Beneficiaries of potential State Aid should be able to notify the European Commission of the proposed aid*, ECLR, 2005, 26 (1), p.1

175 See AG Opinion in C-126/01, *Gemo SA*

as for the recipient undertakings. But it appears that the Commission does not want to take the responsibility for delineating the necessary definitions. It is aware that the definition of the concepts contained in the criteria set in *Altmark* is a very difficult task, which implies that it has to take into account the economic, political and social environment of the different Member States if it wants to give a useful definition that is valid throughout the European Community. But even though the burden lying on the Commission is a heavy one, the latter must accept its responsibilities and give guidelines to the national and the Community Courts in order to ensure a more uniform application of the criteria. Otherwise a serious risk of distortion of competition in the Common Market could arise, which would jeopardise the Community's objectives. One must hope that in the near future the Commission will decide to issue a Communication on the application of Article 87(1) ECT, as it has done for Article 86(2) ECT.

4 Conclusion

The previous chapters have shown that the area of State Aid is evolving. The areas of anti-trust[176] and merger control[177] have been reviewed in recent years and it appears that the State Aid area is next on the agenda[178]. This change is partly due to the fact that in recent years there is an increased awareness that tax obstacles might jeopardise the objectives of the Common Market. Once the more obvious obstacles to the Common Market have been eliminated, like for example customs' duties and overt discrimination based on nationality, the indirect barriers, as for example tax exemptions and tax obstacles in general become more prominent[179].

The main task of the Community institutions in the State Aid area in the coming years will be to update Community policy in the light of recent developments in

176 Agreements that restrict competition are prohibited (Article 81 ECT) and firms in a dominant position may not abuse of that position (Article 82 ECT). The Council adopted a new Regulation implementing Articles 81 and 82 ECT. This regulation replaces Regulation 17/62 and came into force on 1 May 2004. Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 ECT.

177 Commission Regulation (EC) No 802/2004 of 7 April 2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings.

178 See the 1997 Tax package, where it is clearly stated that one of the priorities in the 2005-2009 agenda will be the combat against harmful tax competition. One of the possible obstacles to competition in the internal market is the potential influence measures taken by the State can have.

179 See Communication from the Commission – 1996/1997 *Tax Policy – toward an EU without tax obstacles* where this point was highlighted

the case-law and the economic and political context. Although Member States seem to have accepted that State subsidies are less acceptable than before, SGEI remain a very sensitive domain and the Member States are not ready to give up their competences. Public service obligations cannot be completely excluded from the control of the Community institutions because of the risk of serious distortion of competition in the Common Market, not only in this area, but also indirectly in non-public service domains; the Member States try to keep a certain freedom, which is understandable as the Member States differ in their views in this area because of their varying historical, political and economic context.

The reaction of the ECJ on the problems in the area of State Aid and SGEI has not brought an end to the debate, because even if Member States now have the possibility of taking measures that do not amount to State Aid under the ECT, spontaneous interventions are still impossible, as the criteria that have to be fulfilled are such that the compensation must be precisely calculated, which will take some time. Thus, the fact that there is no need to notify the measure to the Commission does not remedy the concern of the Member States to have more power to introduce measures without an important procedural burden.

In the present situation, the best way to reconcile the different interests in question is to establish clear criteria that give legal certainty to all concerned. As long as important concepts remain vague, those trying to interpret them do so in the way most suitable to meet their own ends. For this reason this paper has tried to give an overview of the different concepts that exist today, to highlight the precise meaning of the concepts which have been defined, and to point out the concepts which are still not clear in the actual legal and judicial context and which will need to be clarified by the Community institutions in order to guarantee the legal certainty necessary for the further development and functioning of the Common Market.