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# EC Law on State Aid and State Funding of Public Service Obligations

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# Summary

This thesis examines the question how the funding provided by public authorities to undertakings imposed with the obligation to discharge services of general economic interest as compensation for the services provided is to be treated under the EC State aid rules. The thesis in this respect both analyses the current legal framework governing such funding and evaluates different alternative solutions to the problem.

The question is whether and under what conditions the compensation granted by States to providers of services of general economic interest is to be classified as State aid under EC law. Regardless of the answer there are important consequences. If a measure falls under the State aid rules it is subject to the prohibition of State aid, however with a possibility for the measure to be exempted by the Commission under certain conditions. Further, this measure is subject to the Commission's surveillance, including the obligations of prior notification and prior authorisation. Measures, which are not defined as State aid, fall entirely outside this control system.

There are essentially two interests engaged in the question of how to treat funding of services of general economic interest under the State aid rules. On the one hand, there is the interest of the State aid rules to ensure undistorted competition. On the other hand, there is the interest of the Member States to ensure the undistorted availability of services of general economic interest.

One approach, *the State aid approach*, on how to treat financing of public service obligations under the State aid law is to regard such funding as State aid, even where the funding does not exceed mere compensation for the services provided. The main critique against this solution is that it is a too wide interpretation of the prohibition of State aid, encompassing more measures than the wording of the State aid rules seems to allow and consequently imposing unjustifiably hard procedural obligations on public service providers.

Another approach, *the compensation approach*, on how to treat financing of public service obligations is to regard mere compensations for the actual costs incurred in providing such services as falling outside the definition of State aid, thus being caught neither by the prohibition on State aid nor by the procedural requirements. This interpretation is too narrow, allowing public service providers to escape competition rules under less strict circumstances than the Treaty rules seem to allow, thus creating a risk that competition is unduly distorted.

The ECJ has recently delivered two judgments ruling on the relationship between funding of public service obligations and EC State aid law. The approach adopted by the court in these two cases, *the conditional*

*compensation approach*, regards mere compensations for public service obligations as falling outside the scope of State aid as the compensation approach. However, these rulings set out a number of conditions in addition to that the funding should only be a compensation for the actual costs incurred for providing the services. The approach assumed in these cases is a middle way; it increases protection of competition while at the same time taking into account the interest of Member States to ensure undistorted availability of services of general economic interest. This approach is, even if not entirely unproblematic, a step in the right direction.

# Abbreviations

|           |  |
|-----------|--|
| AG        | Advocate General                               |
| CFI       | Court of First Instance                        |
| COM       | Communication from the European Commission     |
| EC        | European Community                             |
| ECJ       | European Court of Justice                      |
| ECR       | European Court Reports                         |
| EC Treaty | The Treaty Establishing the European Community |
| EU        | European Union                                 |
| nyr       | not yet reported                               |
| OJ        | Official Journal of the European Communities   |
| PSO       | Public service obligation                      |
| SGEI      | Services of general economic interest          |

# 1 Introduction

## 1.1 Subject and problem

Services of general economic interest (SGEI), or public services as they are often referred to, are of a particular importance in the societies of the Member States of the EU and are given a special position in the EC Treaty. These services – most typically but not exclusively network services such as telecommunications, electricity, transport and postal services – are commercial services, which are considered to be essential to the general public. For this reason public authorities impose public service obligations (PSOs) upon certain undertakings to ensure that such services are actually provided under the conditions specified by the public authorities, for example the provision of a particular service to all citizens throughout the territory of a State at affordable prices.<sup>1</sup> Most SGEI are not economically viable and are services, which the market under normal circumstances would not provide or would not provide to the desired extent. To ensure the availability of such services public authorities grant funding to the selected public service providers as compensation for the losses suffered by these undertakings due to the obligations imposed on them.

The compensations for PSOs raise the issue of how they are to be treated under EC State aid law, which aims at preventing distortions of competition by prohibiting State measures granting advantages to certain undertakings that have a negative effect on competition. The question is whether these compensations are to be regarded as State aid and thus should be subject to the prohibition of State aid and to the Commission's surveillance. This question engages two interests. First, the interest of ensuring *undistorted competition* within the common market and, second, the interest of promoting the *availability of SGEI* to the citizens in the Member States.

The case law of the ECJ has placed the issue, whether and under what circumstances EC State aid law is applicable to the granting of State financing to undertakings imposed with PSOs, on the agenda. The case law of the EC Courts has so far been ambiguous and changing, thereby creating legal uncertainty in this area of EC law. The ECJ has recently delivered two judgments where this particular issue was ruled upon. These rulings in the *Altmark* case<sup>2</sup>, delivered on the 24 July 2003, and the *Enirisorse* case<sup>3</sup>, delivered on the 27 November 2003, have been hoped to provide a clarification on how financing of PSOs are to be viewed under the EC State aid rules. The issue has been the subject of attention not only in the EC

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<sup>1</sup> See section 3.2.2.2 for a more comprehensive definition of SGEI.

<sup>2</sup> Case C-280/00, *Altmark Trans GmbH v Nahverkehrsgesellschaft Altmark GmbH*, [2003] ECR nyr, judgment 24 July 2003. Hereinafter *Altmark*.

<sup>3</sup> Cases C-34/01 to 38/01, *Enirisorse SpA v Ministero delle Finanze*, [2003] ECR nyr, judgment 27 November 2003. Hereinafter *Enirisorse*.



Courts, but has also been debated in legal doctrine and among AGs of the ECJ, as well as at the political level in the EU. In this connection, voices have been raised for the need to increase the legal certainty in the State aid assessment of financing of PSOs.<sup>4</sup> Thus, the issue of whether and when financing of PSOs is to be treated as State aid has at least so far been uncertain and there has been a need for clarification.

## 1.2 Purpose

The relationship between the funding of PSOs and the EC State aid law was when I began writing this thesis unclear. The ECJ had just delivered the crucial judgment in the Altmark case. Another decisive decision was taken by the ECJ in the Enirisorse case during the period of writing. One of the purposes of this thesis is therefore to examine the new, current legal framework after the two most recent judgments governing the funding of PSOs with regard to the EC State aid rules. Thus, the first question to be answered is *whether, and under what conditions, the financing granted by public authorities to compensate for the PSOs imposed on certain undertakings constitutes State aid under the state of the law today.*

In addition, I will *critically analyse this current state of the law and examine whether the recent judgments offer an adequate solution to the problems concerning funding of PSOs.* First, I will examine the implications of the two new rulings. Second, I will analyse whether these judgments constitute a correct interpretation of the State aid rules. Third, I will evaluate whether the rulings offer legal certainty. Fourth, I will examine whether they provide an adequate protection from possible distortions of competition without unduly preventing the availability of SGEL.

Moreover, I will *discuss alternative solutions to solve the problem of how financing of PSOs should be treated under EC State aid law.*

## 1.3 Delimitation

The issue examined in this thesis concerns the question whether and under what conditions the granting of funding to undertakings for the performance of PSOs constitutes State aid under Article 87(1) of the EC Treaty. The thesis concerns the question whether the funding is encompassed by the State aid regulation and thus must comply with the regulatory framework designed for State aid. Consequently, this thesis does not encompass the question whether and in what situations a particular funding, which is found

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<sup>4</sup> See for example Green Paper of Services of General Interest, COM(2003), 270 final, 21 May 2003; Report to the Laeken European Council – Services of General Interest, COM(2001), 598, 17 October 2003.

to amount to State aid and thus is prohibited could be exempted from the general prohibition in Article 87(1) according to the exemptions in Articles 87(2) and 87(3) of the EC Treaty.

The thesis will not exhaustively treat procedural rules on EC State aid. Procedural aspects are mentioned solely where they may have a substantial impact on competition and the operation of PSOs as a direct consequence of whether and under what conditions financing of SGEI constitutes State aid. Remedies of unlawful aid and the burden of proof will not be discussed at all.

Furthermore, particular sector specific problems have been left aside. The reason for this limitation is the general scope of the thesis and the fundamental nature of the issue to be examined. This thesis focuses on the general question about the relationship between the State aid rules and PSOs in general.

The main focus of the thesis is the case law of the EC Courts. Subsequently, the practice of the Commission will only be mentioned to a limited extent.

## **1.4 Methodology and material**

Much of the body of law governing the funding of PSOs has evolved through the case law of the ECJ and the CFI. As has been mentioned, recent cases have modified this legal area. Hence, the thesis will have a clear emphasis on the case law of the EC Courts and these judgments will be thoroughly analysed. There will also be an examination of the relevant EC Treaty provisions. Especially the prohibition of State aid in Article 87(1) and the exception from the Treaty rules, provided in Article 86(2) of the EC Treaty, for public service providers will be dealt with as well as the important interplay between these two rules.

As a result of the recent developments in this area of the law, the EC State aid literature is not entirely updated even though written fairly recently. For this reason the role of articles, judgments and Opinions of AGs as sources of information have been more important. I have almost solely used literature and case law when examining the more general EC State aid rules and the rules on SGEI. For the parts dealing with the particular question whether the funding of public services constitutes State aid I have mainly used articles, EC Court rulings and Opinions of AGs. However, because of the evolving law governing the question, also most articles on the area, although written recently, do not cover the newly arrived judgements from the ECJ. It is especially so when it comes to the Enirisorse case where no commentaries in legal doctrine are available.

## 1.5 Disposition

Initially, in *chapter 2*, I will examine the State aid rules of the EC Treaty. Especially the definition and prohibition of State aid under Article 87(1) and the procedural rules under Article 88 will be dealt with. This is to provide a basis for the discussion of whether funding of SGEI should constitute aid and to show the difference in consequences depending on whether the financing of SGEI is considered to amount to State aid or not. In *chapter 3* I will study the specific regulation of SGEI found in the EC Treaty, especially under which circumstances Article 86(2) allows for exceptions from the rules of the Treaty for undertakings entrusted with the operation of SGEI. This chapter will also more closely explore the notion of SGEI. In *chapter 4* different solutions for reconciling the funding of PSOs and the State aid rules, that have up to this date been either used by or proposed to the EC Courts will be examined. Furthermore, this chapter will identify the main shortcomings of these solutions. I will discuss whether these ways of resolving the problem provide an adequate solution on how to treat the financial grant by public authorities to public service providers for the performance of the PSOs imposed upon them. This discussion will serve as a basis for analysing whether more recent cases from the ECJ provide a better treatment of such funding. In *chapter 5* I will examine and analyse the recent developments in the ECJ's case law. First, I will have a thorough analysis of the Altmark judgment and examine whether this judgment, as compared to the former solutions adopted by the EC Courts, provides a more adequate solution. I will then examine the most recent ruling in the Enirisorse case and compare this to the Altmark ruling. Finally, in *chapter 6*, I will have a concluding analysis and I will on the basis of this analysis suggest how the funding of SGEI should be treated under the State aid law and suggest possible improvements.

## 2 EC law on State aid

### 2.1 The general legal framework

Article 3(g) of the EC Treaty states that one of the main Community goals is the establishment of a system, which ensures undistorted competition within the common market. The rules on State aid are part of this system, aimed at ensuring that trade within the EU is not disturbed. The general EC State aid provisions are found in Articles 87 to 89 of the EC Treaty.

The substantive State aid rules of the EC Treaty are found in Article 87, which consists of three paragraphs. The first paragraph of the article provides a *prohibition of State aid* and the conditions to be fulfilled for this prohibition to come into play. Articles 87(2) and 87(3) provide exceptions from this prohibition. First, Article 87(2) states certain types of aid that are *deemed to be compatible* with the common market. Second, Article 87(3) specifies certain situations where State aid *may be regarded compatible* with the common market if the measure pursues the certain objectives set out in the paragraph.

The procedural aspects of State aid in the Treaty are regulated in Articles 88 and 89. In the area of State aid it is the role of the Commission to supervise the granting or altering of aid, as well as existing aid to ensure that the competition within the Community is not disturbed. Article 88 of the Treaty provides procedural rules on the notification, authorisation and further review of State aids by the Commission. Article 89, which will not further be discussed in this thesis, provides the possibility for the Council, under certain conditions, to adopt Regulations for the application of the State aid rules.

### 2.2 Anti-competitive effects of State aid

The State aid rules included in the EC Treaty are unquestionably vital for the establishment of a true internal market. Their purpose is to ensure the equal competition conditions for undertakings throughout the Union.<sup>5</sup>The possible negative effects of State aid on competition are numerous. Granting State aid to inefficient undertakings, which are not able to compete on their own, enables them to survive on the market at the cost of more efficient corporations. Consequently, the granting of State aid could prevent the most efficient allocation of resources and seriously distort free competition in the EU, with reduced economic welfare as a result. In addition, the granting of State aid could result in less incentive for undertakings to improve their

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<sup>5</sup> D'Sa, p. 1; Bartosch, 2003:2, p. 551.

efficiency. State aid could moreover be used to avoid necessary structural adaptation. It could instead lead to an exportation of economic problems, such as unemployment, from one State to another not granting State aid. Thereby threatening the integration of the internal market.<sup>6</sup>

In contrast, it is recognised that certain aid may have a positive effect and thus be permissible.<sup>7</sup> Furthermore, the EC Treaty itself focuses exclusively on State aid that distorts competition.<sup>8</sup> Thus, government intervention may in certain cases be acceptable. In conclusion, the State aid rules are balancing the interest of the Community to ensure undistorted competition and market integration on the one hand, and other political goals on the other.

## 2.3 The scope of Article 87(1) EC Treaty

### 2.3.1 General

Article 87(1) EC Treaty states that:

Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

The EC Treaty declares State aid, falling within this provision, to be incompatible with the common market. There is no express prohibition of State aid according to the wording of the article. Nevertheless, it is well established that Article 87(1) implies a prohibition.<sup>9</sup> However, this prohibition is neither absolute nor unconditional.<sup>10</sup>

First, the application of Article 87(1) is subject to *express exceptions* provided for in the EC Treaty. The article is, according to its wording, subject to other provisions in the Treaty and applies only to the extent that there is no other conflicting rule. Certain specific rules may apply to aid in specific sectors, which could lead to another result than the application of the general rule in Article 87(1).<sup>11</sup>

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<sup>6</sup> Ninth Survey on State Aid in the European Union, COM(2001), 403 final, 18 July 2001, para. 2; Quigley and Collins, p. 1.

<sup>7</sup> See for example the exceptions in Articles 87(2) and 87(3) EC Treaty.

<sup>8</sup> See Article 87(1) EC Treaty.

<sup>9</sup> Hancher, Ottervanger and Slot, p. 19; Quitzow, p. 139; Evans, pp. 2-3; D'Sa, p. 54.

<sup>10</sup> See for example Case 78/76, *Steinike und Weinlig v Germany*, [1977] ECR 595, para. 8.

<sup>11</sup> See for example Article 36 EC Treaty regarding specific rules for the agricultural sector and Article 73 EC Treaty regarding specific rules for the transport sector. Concerning SGEI the specific rules regulating the transport sector are of particular importance.

Article 87(1) is also, as has been mentioned, subject to exceptions from the prohibition of State aid found in the second and third paragraph of the provision, where the EC Treaty states certain circumstances under which State aid is or could be justified. The initial question whether a State funding of PSOs should constitute aid and be encompassed by the State aid regulation is distinguished from the later question whether a specific measure is permissible according to one of the exceptions provided for in the EC Treaty. Even if a measure is found to constitute aid under the first paragraph of Article 87 it could be exempted under other EC Treaty rules, such as Articles 87(2) and 87(3), and thus be allowed. Article 86(2) provides an exception from the rules of the EC Treaty under certain circumstances for undertakings entrusted with the operation of SGEI. However, the case law has been varying on the relationship between Article 87(1) and 86(2) and the answer to the question whether Article 86(2) provides an exception to Article 87(1) has differed. Subsequent chapters of this thesis will deal more specifically with the role of Article 86(2) in the field of State aid.

Second, for a State measure to qualify as State aid covered by Article 87(1) all the *conditions* in that paragraph have to be satisfied. The article provides a number of cumulative conditions.<sup>12</sup> These conditions are: (1) the measure must be granted by a Member State or through state resources, (2) the measure must confer an advantage on the recipient, (3) the measure must favour certain undertakings or the production of certain goods, (4) the measure must threaten to distort or distort competition, and (5) the measure must affect trade between Member States.<sup>13</sup> In order to be able to answer the question of whether financing of SGEI should be classified as State aid under Article 87(1) it is of essence to examine these conditions more closely.<sup>14</sup>

## **2.3.2 The concept of State aid**

### **2.3.2.1 The wide concept of State aid**

In order to determine whether a measure is subject to the regulation on State aid and to the Commission's State aid control it is necessary to examine the definition of State aid. Article 87(1) applies to "any aid [...] in any form whatsoever", fulfilling the criteria set out in the paragraph. Thus, the concept of aid is wide. There is no exhaustive definition in the EC Treaty of what constitutes aid. This has been held to be to enable a broad interpretation of the Article 87(1) to support a wide range of application and

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<sup>12</sup> Hancher, p. 365.

<sup>13</sup> Legal writing and EC case law vary on the exact number of the conditions, although the aggregate content of the conditions is the same. In my view this is merely a matter of presentation and not of substance. See Ross, p. 403; Bacon, pp. 54-55; Sinnaeve, p. 351. Furthermore, the conditions have a tendency to overlap. Bellamy and Child, p. 1218.

<sup>14</sup> See further section 2.3.3.

to protect from evasions of the prohibition of State aid.<sup>15</sup> Furthermore, Article 3(g), requiring the institution of a system ensuring that competition in the Union is not disturbed, implies that Article 87(1) should be broadly interpreted to be able to fulfil this purpose.<sup>16</sup> The EC Courts and the Commission have in fact also adopted a broad interpretation of the notion.

An aid measure can take various forms, as the wording of the article states. It is well established that the notion of aid is broader than a mere contribution of capital and includes also other types of advantages. The ECJ has on numerous occasions stated that the concept of aid includes “not only positive benefits such as subsidies themselves but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which without therefore being subsidies in the strict sense of the word, are similar in character and have the same effect.”<sup>17</sup> Examples of different forms of State aid are direct subsidies, exceptions from tax obligations, and the State selling goods at a reduced price or buying goods at overprice.<sup>18</sup> Hence, there is a wide range of measures being encompassed by the definition of State aid. It is of particular importance with regard to funding of SGEI that the concept of aid is determined independently of its form, since such funding often take various forms. Normally such funding is granted in the form of tax exemptions and subsidies. However, all these measures must satisfy the conditions of Article 87(1) to finally be defined as State aid.<sup>19</sup>

### **2.3.2.2 The effects based interpretation**

The ECJ has in various judgments regarded the purpose of Article 87(1) when defining State aid. The object of the provision has been declared to be to prevent trade between Member States from being affected by advantages, granted by public authorities, which distort or threaten to distort competition by favouring certain undertakings or products. Consequently, the Court has repeatedly concluded that the definition of what constitutes State aid is to be determined with regard to the *effects* and not with regard to the causes or aims of a particular measure.<sup>20</sup> Of importance in the classification of a measure as State aid is not the form of the measure, its legal nature nor its purpose, but its result.<sup>21</sup> Accordingly, the concept of State aid is objective

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<sup>15</sup> Evans, p. 27; Shina, p.13.

<sup>16</sup> Evans, p. 22.

<sup>17</sup> See for example Case 30/59, *De Gezamenlijke Steenkolenmijnen v ECSC High Authority in Limburg*, [1961] ECR 1, para. 19; Case C-387/92, *Banco Exterior de España SA v Ayuntamiento de Valencia*, [1994] ECR I-877, para. 13.

<sup>18</sup> Quitzow, pp. 154-155; Quigley and Collins, p. 29. See examples of common forms of State aid D'Sa, pp. 56-57; Hancher, Ottervanger and Slot, pp. 41-42.

<sup>19</sup> See sections 2.3.3.1-2.3.3.5.

<sup>20</sup> See for example Case 173/73, *Italy v Commission*, [1974] ECR 709, para. 13; Case C-310/85, *Deufil*, [1987] ECR 901, para. 8.

<sup>21</sup> Opinion of AG Ruiz-Jarabo Colomer in *Italy v Commission*, para. 22.

and the decisive question to be asked is whether the *effect* of a particular measure is to grant an advantage to the recipient undertaking.<sup>22</sup>

It is well-established case law that the general objective behind a particular law on which a measure is based and the social character of a measure cannot in itself be sufficient to exclude a measure from being defined as State aid and thus to exclude the measure from the scope of Article 87(1).<sup>23</sup> However, when a measure is objectively justified on commercial grounds the mere fact that it also has a political aim does not classify it as State aid.<sup>24</sup> Thus, when determining whether the funding of SGEI amounts to State aid one must solely regard possible effects on competition that such a measure may cause. The underlying aim behind the funding of SGEI, such as to ensure the uninterrupted availability to all citizens of a service cannot be taken into account when defining the measure as State aid.

### **2.3.3 The conditions for the applicability of Article 87(1)**

#### **2.3.3.1 The measure must be granted by a Member State or through State resources**

A condition for a measure to constitute aid, according to the wording of Article 87(1), is that it must be granted by a Member State or through State resources. ECJ case law shows that the fact that the State imposes a measure is not enough for the measure to constitute State aid. State resources must also be involved.<sup>25</sup> The ECJ has accepted tax exemptions as being State aid even though in such cases there is no actual transfer of resources.<sup>26</sup> However, these situations seem to be explained by the fact that there is an abandonment of tax revenue and thus the abandonment of State resources.<sup>27</sup>

The advantage must be granted through State resources, either directly by the State, or indirectly by a public or private body designated or established by the State.<sup>28</sup> It follows that the phrase “aid granted by Member States or through State resources” is broad and covers the financial assistance from national, regional and local authorities,<sup>29</sup> as well as other public bodies set up by the State, including public undertakings.<sup>30</sup>

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<sup>22</sup> Case T-67/94, *Ladbroke Racing v Commission*, [1994] ECR II-1, para. 52. See further section 2.3.3.2.

<sup>23</sup> Case C-310/85, *Deufil*, [1987] ECR 901, para. 8; Case C-241/94, *France v Commission*, [1996] ECR I-4551, para. 21.

<sup>24</sup> Case C-56/93, *Belgium v Commission*, [1996] ECR I-723, para. 79.

<sup>25</sup> Case C-379/98, *Preussen Elektra AG v Schleswig AG*, [2001] ECR I-2099, para. 58.

<sup>26</sup> Case C-587/92, *Banco Exterior de España SA v Ayuntamiento de Valencia*, [1994] ECR I-877, para. 14.

<sup>27</sup> Bellamy and Child, p. 1223.

<sup>28</sup> Case C-379/98, *Preussen Elektra AG v Schleswig AG*, [2001] ECR I-2099, para. 58.

<sup>29</sup> Case C-248/84, *Germany v Commission*, [1987] ECR 4013, para. 17.

<sup>30</sup> Case C-482/99, *France v Commission*, [2002] ECR I-4397, para. 38.



Usually this is not a problematic condition in the State aid assessment of funding of PSOs. Most of the financing of SGEI is made either through direct grants or through tax exemptions by public authorities, where it is relatively clear that this condition is satisfied.

### **2.3.3.2 The measure must constitute an advantage**

The key element regarding the question of whether the financing of PSOs constitutes State aid is the condition requiring that there must be an advantage conferred on the recipient undertaking for a measure to amount to aid. The controversial and core question at issue in this thesis is if the mere compensation to an undertaking for the costs of providing PSOs constitutes an advantage favouring the recipient as compared to other undertakings. In the case there is no advantage conferred the consequence is that the measure is not regarded as State aid and thus falls outside the scope of Article 87(1).

It is well established that the concept of State aid requires that the State measure must have conferred an advantage on the recipient undertaking. In the case *Ladbroke Racing* the CFI held that the concept of State aid is objective and the question to be asked when determining whether there is aid is if a measure confers an advantage on one or more undertakings.<sup>31</sup> Such an advantage is a measure that either *improves the recipient's financial position or reduces costs, which the undertaking would otherwise have to bear*.<sup>32</sup> However, a simple benefit seems insufficient. In addition, the measure must have favoured the recipient over other undertakings.<sup>33</sup> Nevertheless, the mere differential treatment of undertakings is not enough to prove an advantage in all situations.<sup>34</sup> There must also be some discriminatory element or a departure from ordinary behaviour.<sup>35</sup>

The advantage must be of at least some gratuitous nature for a measure to constitute aid.<sup>36</sup> In other words there must be some form of *unilateral benefit*. In the case of public funding of PSOs the undertaking imposed with the obligations receives a financial grant in return for the performance of the specific services. Normally there is no aid where the advantage has been received in return for full consideration. Where a payment is made in exchange for goods or services this does not normally constitute State aid. Overcompensation by the State for such goods or services may, however, amount to aid.<sup>37</sup> Thus, there is no requirement that the benefit must have been received in return for no consideration. There may be aid even in the

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<sup>31</sup> Case T-67/94, *Ladbroke Racing v Commission*, [1994] ECR II-1, para. 52. See also Case C- 83/98 P, *France v Ladbroke Racing Ltd. and Commission*, [2000], ECR I-3271, paras. 25-26.

<sup>32</sup> Case 30/59, *De Gezamenlijke Steenkolenmijnen v ECSC High Authority in Limburg*, [1961] ECR 1, para. 19. See also Bellamy and Child, pp. 1218-1219.

<sup>33</sup> Ross, p. 407. See further the selectivity criterion in section 2.3.3.3.

<sup>34</sup> See Case C-353/95 P, *Tiercé Ladbroke v Commission*, [1997] ECR I-7007, paras. 33-36.

<sup>35</sup> Ross, pp. 411-412; Quigley and Collins, pp. 20-21.

<sup>36</sup> Hancher, Ottervanger and Slot, p. 22.

<sup>37</sup> Schina, p. 15; D'Sa, pp. 66-67; Quigley and Collins, p. 29.

situation where the counter-performance of the recipient undertaking has been insufficient.<sup>38</sup> On the other hand, there are circumstances where a measure would constitute State aid even though there is full consideration.<sup>39</sup> Furthermore, the mere fact that a public authority does not maximise the consideration it receives does not make it aid if the transaction is objectively justified.<sup>40</sup> The ECJ has stated that Article 87(1) “refers to decisions of Member States by which the latter, in pursuit of their own economic or social objectives, give by unilateral and autonomous decisions, undertakings or other persons resources or procure for them advantages intended to encourage the attainment of the economic or social objectives sought.”<sup>41</sup> Thus, one must distinguish between commercially justified measures and measures which aim at attaining other social or economic objectives.<sup>42</sup> In the *Van der Kooy v Commission* case the ECJ examined whether the State measure at issue, the provision of gas at a preferential tariff, was in the context of the relevant market objectively justified by economic reasons.<sup>43</sup> Furthermore, in the *BAI* case, which concerned the purchasing of local authorities of a large amount of ferry tickets, the CFI held that since there was no need for the ferry tickets there was no normal commercial transaction.<sup>44</sup> The test that has been applied by the ECJ is to examine whether the undertaking has *received an advantage, which it would not have received under normal market conditions*.<sup>45</sup>

Often there has been emphasised *a need for a comparator* to be able to determine whether there is an advantage which the undertaking would not have received under normal market conditions and thus whether there is aid in a specific situation. The ECJ has established the market economy investor test, according to which, there is no aid when the conduct of the State is in line with the hypothetical behaviour of a rational, profit-driven investor, operating under normal market conditions.<sup>46</sup> This test has initially been used to assess whether provisions of public funds, such as equity participations in public undertakings, are State aid. However, varieties of the formula are also used in other circumstances, such as when granting loans at preferential rates and providing guarantees.<sup>47</sup>

Comparators have also been used to determine whether there is an advantage in situations where the State or a public undertaking is selling goods or services. The *SFEI* case, a case concerning the provision of commercial and logistical services by the French public postal operator, La

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<sup>38</sup> Quigley and Collins, p. 29; Hancher, Ottervanger and Slot, p. 22.

<sup>39</sup> D’Sa, p. 67.

<sup>40</sup> Quigley and Collins, p. 30.

<sup>41</sup> Case 16/79, *Amministrazione delle Finanze dello Stato v Denavit Italiana*, [1980] ECR 1205, para. 31.

<sup>42</sup> Bellamy and Child, p. 1218.

<sup>43</sup> Cases C-67, 68 and 70/85, *Van der Kooy v Commission*, [1988] ECR 219, para. 30.

<sup>44</sup> Case T-14/96, *BAI v Commission*, [1999] ECR II-123, paras. 76-79.

<sup>45</sup> See Case C-342/96, *Spain v Commission*, [1999] ECR I-2459, para. 41; Case C-39/94, *SFEI v La Poste*, [1996] ECR I-3547, para. 60.

<sup>46</sup> Sinnaeve, p. 352.

<sup>47</sup> See Ross, pp. 407-408.

Poste, to its subsidiary. La Poste is an undertaking entrusted with the operation of SGEI, constituting in offering mail distribution throughout the national territory at uniform terms and prices, i.e. the undertaking is operating a universal service network. The ECJ held that to be able to determine what constitutes a normal remuneration for the services requires an economic analysis considering all the factors, which a corporation acting under normal market conditions should have considered when fixing the remuneration.<sup>48</sup> In the Ufex case, dealing with the same factual situation and the same parties as the SFEI case, the CFI held that the fact that the subsidiary had paid La Poste a remuneration amounting to the full costs of providing the services was not sufficient to exclude aid. To determine whether there is aid the CFI held that one must at least check that the payment was comparable to that demanded by a private holding company or a group of undertakings not operating in a reserved sector, pursuing a structural policy and guided by long-term prospects.<sup>49</sup> In other words, in order to determine whether there is an advantage one should apply a private operator test to determine what constitutes normal market conditions, comparing the conduct of the undertaking in question with the conduct of a private operator. However, the Ufex case was appealed and the ECJ in the Chronopost case set aside this interpretation of the CFI. In this case the ECJ considered that La Poste was a postal operator providing SGEI and was operating a universal service network. The Court held that because of the characteristics of the service provided by La Poste the creation of a network such as created by this undertaking was not in line with a purely commercial approach and a private operator would never have created such a network. Thus, the Court ruled that in the absence of any possibility of comparing the situation of La Poste with a private undertaking, normal market conditions for the purposes of determining whether there is an economic advantage, must be assessed with reference to the objective and verifiable elements which are available. The Court found that in that case the actual cost for providing the service was such a comparator, in so far as nothing showed that it had been underestimated or fixed in an arbitrary fashion.<sup>50</sup> Thus, the Court in this case did not use the conduct of another undertaking as a comparator, but instead applied the actual cost of the undertaking as a benchmark. This case shows that having another market position, as a comparator is not suitable in all situations.

The cases referred to above deal with somewhat different situations than the situation where the State compensates a public service provider for the extra costs suffered by that undertaking due to PSOs imposed on it. The appropriateness of using a similar comparator to determine whether there is an advantage and thus State aid in the situation of State funding of PSOs has been both questioned and pleaded for.<sup>51</sup>

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<sup>48</sup> Case C-39/94, *SFEI v La Poste*, [1996] ECR I-3547, para. 61.

<sup>49</sup> Case T-613/97, *Ufex v Commission*, [2000] ECR II-4055, paras. 74-75.

<sup>50</sup> Cases C-83/01P, C-93/01P and C-94/01P, *Chronopost SA v Ufex*, [2003] ECR-nyr, judgment 3 July 2003, paras. 33-41.

<sup>51</sup> The use of a private operator in situations of funding of PSOs will be discussed further in sections 4.4.2 and 5.2.2.5.

### **2.3.3.3 The measure must favour certain undertakings**

Article 87(1) refers to aid, which favours certain undertakings or the production of certain goods. Thus, the prohibition of State aid only covers advantages, which are granted to certain undertakings, i.e. either one single undertaking, all the undertakings in a specific region or industry, or a group of undertakings sharing certain characteristics. Conversely, the prohibition does not cover advantages granted to undertakings generally.<sup>52</sup> In order to fall outside the prohibition of State aid the measures must apply to all undertakings in an objective, non-discriminatory and non-discretionary manner.<sup>53</sup> In other words the provision distinguishes between selective measures and general measures, where Article 87(1) only covers the former.

To be covered by Article 87(1) the measure must be selective and affect the balance between the beneficiary and its competitors.<sup>54</sup> Thus, there must have been a benefit granted to one undertaking or a group of undertakings when compared to other undertakings.<sup>55</sup> However, ECJ case law shows that the mere fact that there is a differential treatment does not automatically mean that there is an advantage, if the undertakings are subject to different regulatory and economic conditions. Such differential treatment could then be justified by reasons relating to the logic of the system.<sup>56</sup> Thus, albeit that a measure is general it could have different effect on undertakings because of the different economic and regulatory conditions to which they are subject.

### **2.3.3.4 The measure must distort or threaten to distort competition**

For a measure to constitute State aid it must, according to the wording of Article 87(1), distort or threaten to distort competition. Consequently, it is not necessary to prove an existing distortion of competition. It is sufficient that there is a mere threat that competition will be distorted. The competition referred to in the provision is not only actual competition, but also potential competition, such as when the aid is liable to prevent the entry of new competitors into the market.<sup>57</sup>

Originally the Commission considered that the presence of State aid automatically distorted competition.<sup>58</sup> However, the ECJ has made it clear that an actual assessment of the effect of the aid on the market conditions must be done, even though the analysis in the area of State aid is far less

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<sup>52</sup> Bellamy and Child, p. 1226; Shina, p. 31.

<sup>53</sup> Quigley and Collins, p. 50.

<sup>54</sup> R<sup>'</sup>Sa, p. 83.

<sup>55</sup> Hancher, p. 367; Bacon, p. 58.

<sup>56</sup> Case C-353/95 P, *Tiercé Ladbroke v Commission*, [1997] ECR 7007, paras. 33-35.

<sup>57</sup> Shina, p. 24; Quigley and Collins, p. 59.

<sup>58</sup> Eleventh Report on Competition Policy (1981), p. 176.

thorough than the market analysis required under Articles 81 and 82 of the EC Treaty.<sup>59</sup> The ECJ in the Philip Morris case held that, when determining whether there is a distortion of competition, it is necessary to examine whether the aid strengthens the position of an undertaking as compared to other undertakings competing in intra-Community trade.<sup>60</sup> The point of departure when determining whether there is a distortion of competition is the competitive position in the common market before the adoption of the State measure and whether this pre-existing competitive position has been changed by the aid.<sup>61</sup> Furthermore, the ECJ has held that the Commission must state the reasons for its finding that competition may be affected. In particular facts that must be stated have been held to be the situation of the relevant market, the position of the recipient in that market and the pattern of trade between Member States of the relevant product.<sup>62</sup>

### **2.3.3.5 The measure must affect intra-Community trade**

The final condition of Article 87(1) requires that the State measure must distort trade between the Member States of the Community. The condition of effect on trade between Member States is not entirely irrelevant with regard to the funding of SGEI, since many such services are local or regional. However, this condition is easily satisfied. The case law of the ECJ indicates that Article 87(1) applies not only, despite the wording of the article, to situations where there is an actual effect on trade, but also to situations where there is solely a potential effect on intra-Community trade.<sup>63</sup>

It is well established that when aid strengthens the position of an undertaking as compared to other undertakings competing in intra-Community trade such trade must be regarded as affected.<sup>64</sup> Where the trade in a product is only affected, or possibly affected, at a purely domestic level the criteria will not be fulfilled.<sup>65</sup> However, the fact that the aid is granted to an undertaking solely engaged in domestic activity does not exclude the application of the condition.<sup>66</sup> The ECJ has held that even when the recipient does not export its products the effect on trade requirement may be satisfied, where the recipient competes with products coming from other Member States. The aid may enable the recipient to maintain or increase its domestic production, with the result that undertakings established in other Member States have less chance of exporting their products. Such aid is

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<sup>59</sup> Hancher, Ottervanger and Slot, p. 37.

<sup>60</sup> Case 730/79, *Philip Morris Holland BV v Commission*, [1980] ECR 2671, para. 11. See however Shina questioning whether this is an absolute test or whether also other factors may be relevant. Shina, p. 28.

<sup>61</sup> Case 173/73, *Italy v Commission*, [1974] ECR 709, para. 17.

<sup>62</sup> Cases C-296/82 and 318/82, *Leeuwarder Papierwarenfabriek BV v Commission*, [1985], ECR 809, para. 24.

<sup>63</sup> See for example Case 102/87, *France v Commission*, [1988] ECR 4067, para. 19.

<sup>64</sup> Case 730/79, *Philip Morris Holland BV v Commission*, [1980] ECR 2671, para. 11.

<sup>65</sup> See Quigley and Collins, p. 61; Bellamy and Child, p. 1229.

<sup>66</sup> Hancher, Ottervanger and Slot, p. 39.

therefore likely to affect trade between Member States.<sup>67</sup> In each individual case trading conditions have to be considered.<sup>68</sup>

### 2.3.3.6 De minimis

The ECJ has not adopted a *de minimis* rule in the field of State aid.<sup>69</sup> On the contrary it has ruled that the relatively small amount of the aid or the relatively small size of the undertaking, which is the recipient of the aid, does not as such exclude the possibility that Community trade might be affected.<sup>70</sup>

However, the Commission has adopted another view. According to the Commission Notice on the *de minimis* rule for State aid a *de minimis* rule applies in certain circumstances for small amounts of aid irrespective of the size of the undertaking.<sup>71</sup> Furthermore, it follows from the Commission Regulation No 69/2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid that a *de minimis* rule may be applicable to aid under a certain amount.<sup>72</sup> However, neither the Notice nor the Regulation applies to all sectors; the transport sector is for example excluded.<sup>73</sup>

## 2.4 The Commission's supervision of State aid under Article 88 EC Treaty

The answer to the question as to whether the funding of PSOs constitutes State aid is crucial for the applicability of the State aid control under Article 88 of the EC Treaty. This is because only a measure that amounts to aid is, according to the express wording of the article, covered by this provision.<sup>74</sup>

The third paragraph of Article 88 states a *duty to notify* the Commission of any plans to grant aid or to alter already existing aid, which is not expressly exempted from such notification.<sup>75</sup> Following a notification the Commission

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<sup>67</sup> Case 102/87, *France v Commission*, [1988] ECR 4067, para. 19.

<sup>68</sup> Evans, p. 96.

<sup>69</sup> Bellamy and Child, p. 1229.

<sup>70</sup> Case C-142/87, *Re Tubemeuse: Belgium v Commission*, [1990] ECR I-959, para. 43.

<sup>71</sup> Commission Notice on the *de minimis* rule for State aid, OJ 1996 C 68/9.

<sup>72</sup> Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid, OJ 2001 L 10, 13.01.2001.

<sup>73</sup> Commission Regulation (EC) No 69/2001, Article 1(a); Commission Notice on the *de minimis* rule for State aid, para. 4.

<sup>74</sup> "Aid" is defined for the purpose of Article 88 in Article 1(a) of Council Regulation (EC) 659/1999 of 22 March 1999 laying down detailed rules for the application Article 93 of the EC Treaty OJ L 83, 27.03.1999, as any measure fulfilling all the criteria set out in Article 87(1) EC Treaty.

<sup>75</sup> See also Article 2(1) of Council Regulation (EC) 659/1999; see for example Article 2 of Commission Regulation (EC) 69/2001, which exempts certain *de minimis* aid. The applicability of Commission Regulation (EC) 69/2001 is however limited, it does i.a. not

is to conduct a review of the aid measure, to examine its compatibility with the State aid rules.<sup>76</sup> The last sentence of Article 88(3) provides that aid, which is subject to the notification requirement of the provision, shall *not be put into effect prior to the authorisation of the aid by the Commission*.<sup>77</sup> The obligation to await the Commission's authorisation is known as the standstill obligation.<sup>78</sup> This obligation applies even if the Member State regards the specific aid as compatible with the common market under one of the exceptions in Articles 87(2) and 87(3).<sup>79</sup> This prohibition of implementation of aid, derived from the last sentence of Article 88(3), applies both to aid that in fact has been notified but implemented prior to authorisation, and to aid that is put into effect without having been notified to the Commission at all.<sup>80</sup>

A breach of the last sentence of Article 88(3) has several consequences. The Commission is still required to make an assessment of the compatibility of the measure with the common market. However, pending its decision it has the power to issue an interim decision requiring the State to immediately suspend the payment of the aid and in some situations the Commission has the power to recover the amount of aid, which has already been paid.<sup>81</sup> According to the ECJ case law the prohibition to implement State aid without notification or prior to the Commission's authorisation of the aid has *direct effect*. It is within the exclusive competence of the Commission to decide whether State aid is compatible with the common market, subject to the supervision of the EC Courts.<sup>82</sup> However, due to the direct effect of the last sentence of Article 88(3) national courts may participate in the review of aid. They may decide whether or not a measure constitutes State aid within the meaning of Article 87(1) and thus must be notified.<sup>83</sup> The direct effect of the last sentence of Article 88(3) gives rights in favour of individuals that the national courts are bound to safeguard, rendering the prohibition on implementation immediately enforceable.<sup>84</sup> The ECJ has held, on the meaning of the direct effect of Article 88(3), that national courts must take all the necessary measures under national law "as regards

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apply to the transport sector, which is a sector highly relevant as regards SGEI, see Article 1 (a).

<sup>76</sup> See Articles 88(2) and 88(3) EC Treaty.

<sup>77</sup> See also Council Regulation (EC) 659/1999, Article 3.

<sup>78</sup> D'Sa, p. 377; Hancher, Ottervanger and Slot, p. 355.

<sup>79</sup> Case 171/83 R, *Commission v France*, [1983] ECR 2621, para. 12. The standstill obligation has also been held to apply to aid measures that qualify for the exception in Article 86(2) EC Treaty. See Case C-332/98, *France v Commission*, [2000] ECR I-4833, paras. 31-32.

<sup>80</sup> Case 120/73, *Gebrüder Lorenz GmbH v Germany*, [1973] ECR 1471, para. 8.

<sup>81</sup> Case C-301/87, *France v Commission*, [1990] ECR I-307, paras. 19-22.

<sup>82</sup> Case C-354/90, *Fédération Nationale du Commerce Extérieur des Produits Alimentaires v France*, [1991] ECR I-5505, para. 14. In Case C-387/92, *Banco Exterior de España SA v Ayuntamiento de Valencia*, [1994] ECR I-877, para. 17, the ECJ held that the exclusive power of the Commission also covered aid granted to undertakings entrusted with the operation of SGEI within the meaning of Article 86(2).

<sup>83</sup> Case C-354/90, *Fédération Nationale du Commerce Extérieur des Produits Alimentaires v France*, [1991] ECR I-5505, para. 10.

<sup>84</sup> Case 120/73, *Gebrüder Lorenz GmbH v Germany*, [1973] ECR 1471, para. 8.

the validity of decisions giving effect to the aid, the recovery of financial support granted in disregard of that provision and possible interim measures".<sup>85</sup> Acts putting aid into effect are invalid if they are in breach of the standstill obligation and the fact that the Commission subsequently finds the aid compatible with the common market does not retrospectively cure this unlawfulness.<sup>86</sup> Furthermore, national courts must order Member States to pay damages for the breach of the standstill obligation.<sup>87</sup> Thus, the direct effect entitles competitors of the recipient to demand the recovery of aid granted and to the general protection of the rights affected by the granted aid.<sup>88</sup>

Even in situations where the Commission has declared an aid measure compatible with the common market it still remains under the *constant review* of the Commission under Articles 88(1) and (2).<sup>89</sup>

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<sup>85</sup> Case C-354/90, *Fédération Nationale du Commerce Extérieur des Produits Alimentaires v France*, [1991] ECR I-5505, paras. 12 and 40; Case C-17/91, *Lornoy v Belgium*, [1992] ECR I-6523, para. 30.

<sup>86</sup> Case C-354/90, *Fédération Nationale du Commerce Extérieur des Produits Alimentaires v France*, [1991] ECR I-5505, paras. 12 and 16-17.

<sup>87</sup> Hancher, Ottervanger and Slot, p. 357

<sup>88</sup> D'Sa, p. 54.

<sup>89</sup> Craig and de Búrca, p. 1091; Quitzow, p. 168.



# 3 Services of general economic interest and Article 86(2) EC Treaty

## 3.1 Services of general economic interest in EC law

SGEI have been assigned a special position in the EC Treaty. To obtain a better understanding of the significance that has been placed upon services of this kind Article 16 of the EC Treaty provides a useful clarification, even if this article so far has not played an important role in neither the practice of the Commission nor the Community Courts. This provision states that, without prejudice to Articles 86 and 87, and given the place occupied by SGEI in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member States shall make sure that such services operate on the basis of principles and conditions which enables them to fulfil their missions. From this it follows that the availability of these services is regarded as being of main importance and should be encouraged. Article 86(2) implements the special treatment to be given to SGEI. This article provides an exception from the rules of the Treaty, including the rules on competition, with respect to undertakings entrusted with the operation of SGEI.

The question of the proper application of the EC State aid rules to public grants provided to undertakings entrusted with the operation of SGEI raises the issue of the interplay between State aid law and Article 86(2). This article deals explicitly with the relationship between undertakings performing SGEI and other rules of the EC Treaty. The case law defining the boundaries between the two legal regimes has been inconsistent. The question, whether Article 86(2) may provide an exception from Article 87(1), has received different answers.<sup>90</sup> It is therefore essential to examine the scope and intended function of Article 86(2). I will outline under what minimum standard this article allows a deviation from the rules of the Treaty. This is to enable an analysis in later chapters of the proper role of this article in the context of funding of PSOs and the proper analysis of the scope of the prohibition in Article 87(1).

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<sup>90</sup> See for example Case T-106/95, *FFSA v Commission*, [1997] ECR II-229. Case C-53/00, *Ferring SA v ACOSS*, [2001] ECR I-9067. See also further chapter 4.

## 3.2 The scope of Article 86(2) EC Treaty

### 3.2.1 General

Article 86(2) EC Treaty states that:

Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interest of the Community.

Article 86(2) provides a conditional exception from the competition rules of the Treaty for undertakings providing SGEI. In the ECJ case law the aim of Article 86(2) has been held to be to “reconcile the Member States’ interest in using certain undertakings [...] as an instrument of economic or fiscal policy with the Community’s interest in ensuring compliance with the rules on competition and the preservation of the unity of the common market.”<sup>91</sup> Thus, the article mitigates the competition regulation by providing exceptions from the competition rules justified by public interest objectives. Member States are given a possibility to deviate from the rules on competition in organising and realising the performance of SGEI. However, the exception from the competition rules is not unconditional but must not affect competition to a larger degree than permitted under Article 86(2). Article 86(2) defines the limits and conditions of the derogation from the competition rules of the Treaty.

### 3.2.2 Undertakings and services comprised by the exception

#### 3.2.2.1 Undertakings entrusted with the operation of services of general economic interest

Article 86(2) refers to undertakings, which have been entrusted by the public authorities with the operation of SGEI. The ECJ has ruled that the group of undertakings covered by Article 86(2) must, because of the article’s character of exception, be defined strictly.<sup>92</sup> However, both public and private undertakings, carrying out economic activities, are encompassed by the provision.<sup>93</sup>

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<sup>91</sup> Case C-202/88, *France v Commission*, [1991] ECR I-1223, para. 12.

<sup>92</sup> Case 127/73, *Belgische Radio en Televisie v SABAM (II)*, [1974] ECR 313, para. 19.

<sup>93</sup> See Case 127/73, *Belgische Radio en Televisie v SABAM (II)*, [1974] ECR 313, para. 20. See also Faull and Nikpay, p. 313; Buendia Sierra, p. 275; Craig and de Búrca, p. 1070.

A requirement for the application of Article 86(2) is that the performance of the particular service must have been entrusted to the undertaking by a public authority. The content of the obligation to provide SGEI must first have been defined by the Member State and subsequently entrusted through an express act to a specific undertaking. The obligations must also be linked to the subject matter of the SGEI in question and designed to make a direct contribution to satisfying that interest.<sup>94</sup> However, there seems not to be any requirement as to the legal form of this act.<sup>95</sup> The public authority entrusting the obligation can furthermore be a national, regional or local authority.<sup>96</sup>

### **3.2.2.2 The Community law concept of services of general economic interest**

For Article 86(2) to be applicable the services must be SGEI. This concept is not only of considerable importance for the application of Article 86(2), but also in a wider perspective in the debate of the funding of PSOs.

In Community law today there is no exhaustive definition the notion of SGEI. The term is found in different EC Treaty provisions.<sup>97</sup> However, neither the EC Treaty, nor the case law of the ECJ provides a complete answer. The Commission has interpreted the concept, and concluded that there is a broad understanding in Community practice, that the term refers to commercial services, which the public authorities subject to specific public service obligations by virtue of a general interest criterion. The Commission has further held that the concept usually, but not exclusively, refers to services provided by network industries, such as transport, postal services, communication and energy.<sup>98</sup>

The concept of SGEI is a Community law concept. The notion of *service*, in the context of SGEI, is wide and comprises not only services in a strict sense, but can also include the provision of certain goods, such as electricity and gas.<sup>99</sup> The particular service must be of an *economic* nature. This excludes activities that are solely cultural, charitable and social, however only to the extent that the undertakings performing these activities do not compete with other economic operators.<sup>100</sup> However, it seems that the general interest of the service must be non-economic and the final aim of carrying out the service should not be solely economic. An economic objective is allowed only when it is directed at guaranteeing the

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<sup>94</sup> Faull and Nikpay, p. 313. See also Case 7/82, *GVL*, [1983] ECR 483, para. 31; Case C-159/94, *French electricity and gas monopolies*, [1997] ECR I-5815, paras. 68-70; Case 66/86, *Ahmed Saeed Flugreisen*, [1989] ECR 803, para. 55.

<sup>95</sup> Faull and Nikpay, p. 1070.

<sup>96</sup> Buendia Sierra, p. 284.

<sup>97</sup> Articles 16 and 86(2) EC Treaty.

<sup>98</sup> Commission Communication on Services of General Economic Interest in Europe, COM(2000), 580 final, OJ 2001 C17, p. 20, Annex II; Green Paper on Services of General Interest, COM(2003), 270 final, 21 May 2003, para. 17.

<sup>99</sup> Quitzow, p. 104; Buendia Sierra, p. 277.

<sup>100</sup> Buendia Sierra, p. 277.

achievement of a non-economic purpose.<sup>101</sup> Finally, the service in question must be of a *general* nature, which means that the service is not only of interest to specific persons or group of persons. However, interests of municipalities, regions or groups of citizens may fall under the notion.<sup>102</sup> Moreover, the meaning of the term SGEI is evolving, depending on current needs in society and technological developments.<sup>103</sup> Thus, there are general features that characterise the notion of SGEI, however exactly which services that are able to be classify as SGEI depend on the demand of society at every given time.

Member States have a wide discretion in deciding which particular services they wish to classify as SGEI, and to impose upon a specific undertaking.<sup>104</sup> In the FFSA case the CFI held that since there are no Community rules governing the matter “the Commission is not entitled to rule on the basis of public service tasks assigned to the public operator, such as the level of costs linked to that service, or the expediency of the political choices made in this regard by the national authorities, or [the undertaking’s] economic efficiency [...]”.<sup>105</sup> Thus, confirming that the Member States have a wide discretion on how the operation of SGEI is to be fulfilled and organised and also that there is no efficiency requirement imposed upon such undertakings. On the other hand, Article 86(2) seems to be applicable only to services that comply with the Community concept of SGEI.<sup>106</sup> This is also my view and there are examples of case law pointing in this direction. In the Port of Genoa case the ECJ held that dock work was not of a general economic interest, while *not showing any special characteristics as compared with the general economic interest of other economic activity*.<sup>107</sup> Such characteristics are for example that the service is specifically important to consumers, that it is open to all consumers, and provided at uniform terms and prices.<sup>108</sup> The conclusion to be drawn is that the wide discretion of Member States in this area is not unlimited, but under the scrutiny of the EC Courts so that the services fulfil the general principles of the Community law concept. The services must show some special characteristics as compared to other economic activity.

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<sup>101</sup> Buendia Sierra, p. 278. See also Quitzow, p. 58.

<sup>102</sup> Quitzow, p. 105.

<sup>103</sup> Faull and Nikpay, p. 314; Buendia Sierra, p. 283. See also Case C-18/88, *RTT*, [1991] ECR I-5941, para. 16.

<sup>104</sup> Buenda Sierra, pp. 280-281.

<sup>105</sup> Case T-106/95, *FFSA v Commission*, [1997] ECR II-229, para. 108. See also para. 192. See however Faull and Nikpay, p. 313, note 150 for a critical view on this case.

<sup>106</sup> See Faull and Nikpay, pp. 313-314. Craig and de Búrca, pp. 1070-1071. See however Buendia Sierra, p. 280.

<sup>107</sup> Case C-179/90, *Port of Genoa*, [1991] ECR I-5889, para. 27.

<sup>108</sup> Nicolaidis, 2003:2, p. 188; see also the reasoning of AG Stix-Hackl, in Opinion in *Enirisorse*, para. 96.

### 3.2.3 The conditions for the applicability of Article 86(2)

#### 3.2.3.1 The measure must be necessary and proportionate

Article 86(2) states that the rules of the Treaty apply to undertakings entrusted with the operation of SGEI in so far as the application of these rules does not obstruct the performance of the tasks of general economic interest assigned to these undertakings. Consequently, undertakings entrusted with the operation of SGEI can be exempted from the rules of the Treaty in so far as such an exemption is *necessary* to avoid obstructing the performance of the particular general interest tasks. In other words, it must be shown that the State measure otherwise contrary to the rules on competition is *proportionate*.<sup>109</sup>

The article provides a requirement of proportionality. Consequently, a State measure must fulfil three requirements. Firstly, there must be a causal link between the State measure and the general interest objective. Secondly, there must be a balance between the negative effects of the State measure and the benefits for the general interest objective. Finally, the general interest objective cannot be achieved in a less restrictive way.<sup>110</sup> The interpretation of the proportionality test in the context of Article 86(2) is central for the scope of this exception and thus is, to a large extent, the determinative factor for what measures are to be allowed to derogate from the rules of the Treaty. It is therefore not surprising that the interpretation is one of the most controversial in EC law. It follows that there is much more to be said than there is room for in this thesis, however in the following I will try to capture the main features of this requirement.<sup>111</sup>

According to the early case law of the ECJ the proportionality requirement was defined strictly. This early practice held that the exception in Article 86(2) is only applicable if the Treaty rules are *incompatible* with the performance of the PSOs.<sup>112</sup> However, in more recent practice the Court seems to have adopted a less stringent interpretation. According to this case law it is sufficient that the exception is *necessary* in order to enable the entrusted undertaking to perform the public service tasks.<sup>113</sup> The Court has further held that it is sufficient that the application of the rules of the Treaty obstructs the performance, in law or in fact, of the special obligations incumbent upon such undertakings. In other words, the exception applies if it otherwise would not be possible for the undertaking to perform the particular PSOs. It is not necessary for the survival of the undertaking itself or its financial balance or economic viability to be threatened. The exception of Article 86(2) has been held to be applicable if the exception

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<sup>109</sup> Faull and Nikpay, p. 315; Buendia Sierra, p. 300.

<sup>110</sup> Faull and Nikpay, p. 315.

<sup>111</sup> See Buendia Sierra, pp. 303-340 for a more comprehensive examination of the case law of the EC Courts.

<sup>112</sup> Case 155/73, *Sacchi*, [1974] ECR 409, para. 15.

<sup>113</sup> Case C-393/92, *Almelo*, [1994] ECR I-1477, para. 49; Case 23/91, *Corbeau*, [1993] ECR I-2533, para. 14.

was necessary to enable the undertaking to perform the tasks under economically acceptable conditions.<sup>114</sup>

### **3.2.3.2 The measure must comply with the interest of the Community**

The exception of undertakings entrusted with the operation of SGEI from the rules of the Treaty is, according to the third sentence of Article 86(2), conditioned on that the development of trade must not be affected in a way contrary to the Community interest. The exact meaning this requirement is unclear and debated.<sup>115</sup> However, the prevailing approach seems to be that the last sentence of Article 86(2) tries to balance the interest of the Community, the elimination of distortions of competition, and the interest of Member States.<sup>116</sup> In any event the notion of interest of the Community is evolutionary.<sup>117</sup>

## **3.3 Concluding remarks**

Because of the importance of SGEI for social and territorial cohesion, these services receive a special treatment in EC law. Member States are afforded a wide discretion in organising and defining these services. Furthermore, SGEI are not under the full restraints of competition law.

However, this favourable treatment is not unconditional. Article 86(2) sets out a number of conditions:

- (1) The service must have been explicitly defined as a SGEI and explicitly entrusted by an act of a public authority to a specific undertaking.
- (2) The service in question must be a service of general economic interest as defined by the Community law concept.
- (3) The exception is necessary so to not obstruct the performance, in law or in fact of the general interest tasks. The exception must also be proportionate in order to comply with this purpose.
- (4) The exception must not affect the development of trade in a manner contrary to the interest of the Community, i.e. the elimination of distortions to competition.

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<sup>114</sup> Case C-157/94, *Commission v Netherlands*, [1997] ECR I-5850, paras. 52-53 and 59.

<sup>115</sup> See Buendia Sierra, pp. 342-344.

<sup>116</sup> Buendia Sierra, p. 343. See also Quitzow, p. 102.

<sup>117</sup> Buendia Sierra, p. 343.

# 4 How to reconcile EC State aid law with funding of services of general economic interest

## 4.1 Different solutions to the problem

The questions of the proper assessment of public funding of SGEI under the EC State aid rules and the role of the exception in Article 86(2) with regard to Article 87(1) have in the case law of the EC Courts received two different solutions. The solutions applied by the ECJ and CFI could with reference to the way of interpreting Article 87(1) be divided into two categories – the State aid approach and the compensation approach.<sup>118</sup>

The first landmark case to be ruled upon by the ECJ regarding State aid and financing of PSOs is ADBHU from 1985.<sup>119</sup> In this case the ECJ introduced the compensation approach, in essence exempting the mere compensation for the extra costs for providing SGEI from the application of Article 87(1). In 1997, thirteen years after the ECJ's judgment in ADBHU, the CFI delivered its ruling in the FFSA case.<sup>120</sup> In this case the CFI provided a clearly different reasoning and solution to the problem of funding of PSOs. The Court introduced what was later called the State aid approach, in essence defining all compensations for PSOs as State aid under Article 87(1). This ruling was upheld in the SIC case applying the same approach in 2000.<sup>121</sup> In the light of the two consistent rulings of the CFI the controversial ruling in Ferring<sup>122</sup>, delivered only one year after SIC, came as a surprise and created a large amount of uncertainty regarding how the financing of PSOs is to be treated under the State aid rules. This case returned to the compensation approach first adopted by the Court in ADBHU, without even mentioning the solution taken by the CFI in FFSA and SIC.

In the subsequent sections I will discuss these landmark cases. I will explain the meaning of the two approaches adopted by the EC Courts and discuss

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<sup>118</sup> The terms were coined by AG Jacobs in Opinion of AG Jacobs in GEMO, paras. 94-95. These terms are not used by the EC Courts, but in legal writing and by AGs, to label the two solutions adopted in the case law of the EC Courts and the different types of arguments relating to these solutions.

<sup>119</sup> Case 240/83, *Procureur de la République v ADBHU*, [1985] ECR 531. Hereinafter ADBHU.

<sup>120</sup> Case T-106/95, *FFSA v Commission*, [1997] ECR II-229. Hereinafter FFSA. Upheld on appeal in Case C-174/97 P, *FFSA v Commission*, [1998] ECR I-1303.

<sup>121</sup> Case T-46/97, *SIC v Commission*, [2000] ECR II-2125. Not appealed. Hereinafter SIC.

<sup>122</sup> Case 53/00, *Ferring SA v ACOSS*, [2001] ECR I-9067. Hereinafter Ferring.

their main implications and advantages.<sup>123</sup> Finally, in this chapter I will examine a third alternative solution, the *quid pro quo* approach, suggested by AG Jacobs in his Opinion in GEMO.<sup>124</sup>

## 4.2 The State aid approach – case law

### 4.2.1 FFSA

The FFSA case is often referred to as the case where the State aid approach as a method of assessing the funding of PSOs under the State aid rules of the Treaty was first established. The case concerned the granting of a tax advantage to the French public postal service operator La Poste, to compensate for the additional costs incurred by the undertaking due to the PSO, to provide postal services throughout the national territory, imposed on it.

Despite the fact that the additional costs exceeded the compensation received the CFI found that the measure constituted State aid within the meaning of Article 87(1). The Court held that the tax advantage had placed La Poste in a more favourable situation than other taxpayers and referred to earlier case law stating that aid covers advantages granted by public authorities, which mitigate the costs normally included in the undertaking's budget.<sup>125</sup> Thus, the Court found that La Poste had received an advantage it would not have received under normal market conditions. However, the CFI held that the State aid in question could be found to be compatible with the common market under the exception provided by Article 86(2). Hence, by relying on the exception in Article 86(2) the impact of the competition rules could be curtailed, despite the fact that the measure still constituted State aid within the meaning of Article 87(1).<sup>126</sup> In other words, Article 86(2) was understood to be an exception to the prohibition of State aid in Article 87(1). This however required that the sole purpose of the aid was to offset the additional costs incurred due to the PSOs and that the grant of the aid was necessary in order for the undertaking to be able to perform the obligations under conditions of economic equilibrium.<sup>127</sup>

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<sup>123</sup> In chapter 5 I discuss whether the recent rulings in *Altmark* and *Enirisorse* have improved these problems.

<sup>124</sup> Opinion of AG Jacobs in GEMO, paras. 117-132.

<sup>125</sup> FFSA, paras. 167-168.

<sup>126</sup> FFSA, para. 172.

<sup>127</sup> FFSA, para. 178.



## 4.2.2 SIC

SIC, another CFI ruling, confirmed the judgment in the FFSA case and applied the State aid approach. The case concerned financial grants paid by the Portuguese State to public television channels as compensation for their PSOs. The Court found that the grants constituted an advantage, since the television channels had received a financial advantage that they would not have received under normal market conditions.<sup>128</sup> This conclusion could not be altered by the fact that the grants were merely intended to compensate for additional costs due to PSOs. The Court emphasised that Article 87(1) does not distinguish between State measures by reference to their causes or aims but defines them in relation to their effects. The concept of aid is objective and the question to be asked is whether there has been an advantage conferred on one or more undertakings. The CFI held, while referring to the ruling in FFSA, that the fact that a financial advantage is granted to offset the costs of PSOs has no bearing on the classification of that measure as State aid within the meaning of Article 87(1), although that aspect may be considered when assessing whether the aid in question is compatible with the common market in accordance with Article 86(2).<sup>129</sup>

## 4.2.3 Concluding remarks

According to the State aid approach the public financing of PSOs confers an advantage on the recipient. Consequently, the financing amounts to State aid in accordance with Article 87(1), given that the other conditions set out in that article are satisfied. However, this kind of State aid may be justified under Article 86(2) if the criteria set out in that provision are met, especially that the funding is necessary and proportionate to the costs of the service. Thus, for the financing to be compatible with the common market there should be no overcompensation for the services provided. Article 86(2) functions, according to the State aid approach, as an exception to Article 87(1) in the same way as Articles 87(2) and 87(3).

Under this approach there is an advantage even when a financing measure is only intended to compensate for PSOs imposed on an undertaking. This intent could not be regarded, due to the objective nature of the notion of State aid, when considering whether a measure constitutes State aid. This could only be taken into account when considering whether the measure is compatible with the common market according to Article 86(2).

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<sup>128</sup> SIC, paras. 78-79.

<sup>129</sup> SIC, paras. 82-84.

## 4.3 The compensation approach – case law

### 4.3.1 ADBHU

The ADBHU case concerned the validity of a Community Directive, which allowed Member States to grant indemnities to undertakings, imposed with the PSO to collect and dispose waste oils, as compensation for the obligations imposed on them by the State as long as the indemnities did not exceed the actual yearly costs. The Court ruled that the indemnities at issue should be regarded as consideration for the services provided by the recipient undertakings and consequently did not constitute State aid.<sup>130</sup> Thus, as long as the compensation did not exceed the actual costs of providing the service the advantage criteria was not fulfilled and thus all the conditions for the measure to constitute State aid were not fulfilled. The Court however did not provide any elaborate explanation of its ruling. This case has been viewed as the case where the ECJ established what would later be called the compensation approach.

### 4.3.2 Ferring

The Ferring case concerned a tax exemption granted to wholesale distributors of pharmaceutical products in France, as remuneration for the PSOs imposed on them by law to keep a permanent stock of a wide range of medicines to ensure a constant supply to pharmacies in a particular geographic area. Pharmaceutical laboratories on the other hand, distributing medicines through direct sales to pharmacies and thus competing with the wholesale distributors, were not imposed with PSOs and were consequently required to pay the tax at issue. The intention of the tax exemption was to restore the balance of competition between the two distribution channels, as wholesale distributors suffered a burden due to their PSOs.<sup>131</sup> The question at issue was whether the tax exemption fell under the prohibition in Article 87(1) when it was merely intended to compensate for the burdens resulting from being entrusted with PSOs.

The Court held that, leaving aside the PSOs, the tax exemption may, in principle, amount to State aid. The tax exemption conferred an economic advantage on the wholesale distributors, through the use of State resources. Furthermore, the tax exemption improved the wholesale distributors' competitive abilities and was deemed to affect intra-Community trade.<sup>132</sup> However, the Court, examined whether the PSOs precluded the tax exemption from being State aid and while referring to its prior ruling in the ADBHU case, stated that:

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<sup>130</sup> ADBHU, para. 18.

<sup>131</sup> Ferring, para. 9.

<sup>132</sup> Ferring, paras. 18-22.

[P]rovided that the tax on direct sales imposed on pharmaceutical laboratories *corresponds to the additional costs actually incurred* by wholesale distributors in discharging their public service obligations, not assessing wholesale distributors to the tax may be regarded as *compensation* for the services they provide and hence *not State aid* within the meaning of Article [87(1)] of the Treaty. Moreover, provided there is the *necessary equivalence* between the exemption and the additional costs incurred, wholesale distributors will *not be enjoying any real advantage* for the purposes of Article [87(1)] of the Treaty because the only effect of the tax will be to put distributors and laboratories on an *equal competitive footing*.<sup>133</sup>

The ECJ concluded that the funding of PSOs constitutes State aid only if, and to the extent, that the economic advantage received exceeds the appropriate remuneration for the cost of providing the SGEI.<sup>134</sup> The ECJ thus applied the compensation approach, as first introduced in the ADBHU case.

The Court further held that remuneration, which exceeds pure compensation for PSOs, cannot qualify for an exemption under Article 86(2). This exception cannot be used, since the overcompensation would not be necessary for the undertaking to carry out the particular tasks assigned to them and the proportionality test set out in the provision would thus not be satisfied.<sup>135</sup>

### 4.3.3 Concluding remarks

According to the compensation approach the public financing provided to undertakings for the performance of SGEI constitutes State aid *only if and to the extent that the economic advantage conferred on the recipient undertaking exceeds the costs for discharging the PSOs imposed on it*, given that the other conditions of Article 87(1) are fulfilled. Thus, there is no State aid if the State only compensates an undertaking for the actual costs of SGEI being discharged. The rationale behind this approach is that a mere compensation does not confer any real advantage, as it only offsets the burden imposed on the recipient. On the contrary it has the result so as to restore the balance of competition in the market. As with the State aid approach the important question is whether the remuneration exceeds the costs for the services provided and thus whether there is overcompensation. The effect of these judgments is that they exclude compensation for PSOs from the rules on State aid, because such compensation is not covered by the definition of State aid in Article 87(1). Moreover, if the funding fails

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<sup>133</sup> Ferring, para. 27. Emphasis added.

<sup>134</sup> Ferring, para. 29.

<sup>135</sup> Ferring, para. 32.

this test there is no possibility for the measure to be declared compatible with the common market.

## **4.4 The State aid approach versus the compensation approach and critique**

### **4.4.1 The effects on the Commission's surveillance**

Depending on which of the two approaches that is used when assessing funding of PSOs, the effect, with regard to the procedural rules on State aid, is different. If a mere compensation to an undertaking for providing SGEI is not regarded as constituting State aid according to Article 87(1), as under *the compensation approach*, the measure is not subject to the procedural rules governing State aid, including prior notification and authorisation of new aid as well as constant review of existing aid. On the other hand, if the funding, as under *the State aid approach*, is considered to constitute State aid it is also subject to the procedural rules in Article 88. This means that under the latter approach the same measure as would fall outside the State aid control system under the compensation approach is now subject to the notification requirement. It is further subject to the directly effective standstill obligation, which in the case of a breach renders the measure illegal with other consequences following from this. Furthermore, this measure would be under the constant review of the Commission even after an authorisation.<sup>136</sup>

A central, and in my view rightful, critique against *the compensation approach* concerns the decreased control of the Commission of financing of PSOs, resulting especially from the loss of the notification requirement and the standstill obligation.<sup>137</sup> The loss of the preventive review of the Commission would leave the State aid control less effective. In my opinion this is however mitigated by the legal consequences that follow from the breach of the standstill obligation and the fact that the last sentence of Article 88(3) has direct effect. The direct effect of the standstill obligation enables national courts to determine whether a measure, even though a State has designated it as a mere compensation, nevertheless is aid and thus should be notified, because the undertaking is in fact overcompensated. The national court can also introduce several legal consequences if a measure in fact is found to be aid that has not been notified. The possibility of initiating a complaint is available to competitors and others and has the effect of bringing not notified financing measures, which are not merely compensations, to the attention of the Commission. In addition, the

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<sup>136</sup> See further section 2.4.

<sup>137</sup> See also Opinion of AG Léger in *Altmark* 2002, paras. 91-94.

Commission can introduce infringement proceedings.<sup>138</sup> On the other hand, an *ex post* control is less effective than an *ex ante* control.<sup>139</sup>

An important argument supporting *the State aid approach* is that it preserves the Commission's surveillance role in the field of financing of PSOs, as compared to the compensation approach.<sup>140</sup> However, a main critique against this approach is in fact the procedural implications on the operation of SGEI that is a possible result of subjecting all compensations for PSOs to the notification requirement. It has been argued that the requirements of notification and prior authorisation in Article 88(3), as well as the possible consequences of breaches of these requirements, might lead to serious disruptions for the operation of SGEI. For some services it is difficult if not impossible to await prior authorisation before the measure is implemented.<sup>141</sup> It is especially troublesome that the mere compensation of such services must await prior authorisation when the measure would in any event be authorised under Article 86(2).<sup>142</sup> It has been argued that this concern is exaggerated. For example there is a possibility for Member States to notify aid schemes, which are national provisions under which without further implementing measures being required individual aid awards may be made to undertakings defined in a general manner. This requires only a single approval and not the approval of each individual case in which the scheme is applied.<sup>143</sup> Furthermore, solutions have been proposed on how to mitigate this problem. AG Léger has proposed the adoption of a block exemption, which defines the conditions under which certain categories of aid are to be regarded as compatible with the common market, exempting certain aid from the prohibition of State aid and thus the obligation to notify.<sup>144</sup> This is also a solution currently considered by the Commission.<sup>145</sup> Also AG Tizzano has proposed a compromise solution. He argues that all compensations for PSOs could be submitted to the obligation to notify, but not to the requirement of prior authorisation. He suggests that national courts could be given the possibility to declare a measure that falls under the exemption of Article 86(2) permissible. Such aid would then not be subject to the standstill obligation and the consequences following from the breach of this obligation.<sup>146</sup> As AG Tizzano himself acknowledges this solution is not in line with the exclusive competence of the Commission to rule on the compatibility of aid with the common market, and consequently requires the abandonment of this exclusive role of the Commission in monitoring aid. However, the practical problem of the State aid approach, i.e. the

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<sup>138</sup> See also Opinion of AG Stix-Hackl in *Enirisorse*, para. 160; *Nettesheim*, p. 261.

<sup>139</sup> See also *Nettesheim*, p. 261.

<sup>140</sup> *Sinnaeve*, p. 354.

<sup>141</sup> Opinion of AG Jacobs in *GEMO*, para. 115.

<sup>142</sup> *Sinnaeve*, p. 355.

<sup>143</sup> See further Opinion of AG Léger in *Altmark 2003*, paras. 62-74; *Rizza*, pp. 445-446.

See also Report to the Laeken European Council – Services of General Interest, COM(2001), 17 October 2003, para. 26.

<sup>144</sup> Opinion of AG Léger in *Altmark 2003*, paras. 70-73.

<sup>145</sup> Report to the Laeken European Council - Services of General Interest, COM(2001), 598, 17 October, 2003, para. 29.

<sup>146</sup> Opinion of AG Tizzano in *Ferring*, paras. 80-84.

unnecessary obstruction of the provision of SGEI, would undoubtedly be solved by this solution.

#### **4.4.2 Maintained equality or conferred advantage and distortion of competition?**

*The State aid approach* is often regarded as a too broad interpretation of the prohibition of State aid under the first paragraph of Article 87. According to Article 87(1) the measure must inter alia both confer an advantage on the receiving undertaking and distort or threaten to distort competition. It has been argued that these criteria are not met in the case where the funding is only offsetting the costs of the services performed. Therefore, making this approach hard to reconcile with the wording of Article 87(1).<sup>147</sup> The reasoning behind this critique could be illustrated by two arguments.

First, it could be illustrated by the argumentation of AG Tizzano in his Opinion in *Ferring* that could in fact also be said to demonstrate the rationale behind *the compensation approach*. The interpretation of the advantage criterion in Article 87(1), made under the compensation approach, starts with the assumption that the imposition of PSOs leads to additional costs on the undertaking, which it would otherwise not have to bear. These additional costs distort the balance of competition between the undertaking imposed with the PSOs and undertakings not imposed with such obligations. The mere compensation for such additional costs arising from the performance of the obligations has an economically neutral effect. It does not confer any real advantage on the recipient, but solely ensures that the undertaking is not disadvantaged in relation to its competitors due to the obligations imposed on it. Thus, the measure does not distort competition. Competition will be altered only if the compensation exceeds the additional costs of the PSOs, and only in such circumstances there will be aid involved. The imposition of the obligations and the compensation are two things of the same public measure that *cannot be separated* when determining whether the financing of PSOs constitutes State aid.<sup>148</sup> AG Léger in one of his second Opinion in *Altmark*, when arguing in favour of *the State aid approach*, opposed this net definition of aid made under the compensation approach, where there exists aid only if and to the extent the public funding exceeds the value of the commitments of the recipient undertaking. In his view the State aid rules are founded on a gross theory. According to this theory aid is not the difference between the value of the public measure and the value of the consideration provided by the recipient in return for that measure, but aid corresponds solely to the amount of the public funding. What the recipient undertaking contributes in return is only relevant when assessing whether the measure may be justified by one of the exceptions in Articles 87(2), 87(3) and 86(2). Thus, the public grant and

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<sup>147</sup> See Sinnaeve, p. 354; Opinion of AG Jacobs in *GEMO*, para. 115.

<sup>148</sup> See Opinion of AG Tizzano in *Ferring*, paras. 53 and 60-62.

what the undertaking contributes in return are to be *examined separately*.<sup>149</sup> In my view the gross theory is a too artificial construction to be used when interpreting the advantage criteria.<sup>150</sup> It seems artificial to isolate the interpretation to certain parts of a situation.

Furthermore, in the situation where the State or other public bodies purchase goods or services on the market for its own use it has been held that there is an advantage only if the payment exceeds the normal market price.<sup>151</sup> Another argument against the interpretation of the advantage criterion done under *the State aid approach* refers to this situation and concludes that the State aid assessment should not be different in the case where the State purchases services, which are to be provided to the general public directly.<sup>152</sup> It has been argued that to determine whether there has been an advantage, which the recipient undertaking would not have obtained under normal market conditions, one must examine whether the service is normally supplied in return for consideration and whether this consideration is proportionate to that service.<sup>153</sup> This argument has been met by criticism. The comparison of the State with a private operator in a market economy is inappropriate as regards funding of PSOs. First, it has been argued that the State cannot in the situation of funding of PSOs be compared to a private operator, since in such situations the State measure does not have an economic nature, but the State is solely exercising its public powers. This is so because in such cases it is hard to imagine a private operator acting with a view of making a profit.<sup>154</sup> This is arguably not an entirely accurate conclusion, since even these services must be regarded as having an economic nature and even a private operator would engage in such services if, at least in the long term, he could expect these services to become profitable. A private operator might also be interested in benefiting from the synergies his role as a public service provider would generate for other parts of his business.<sup>155</sup> Second, it has been argued that SGEI do not have a market price, as opposed to the ordinary situation when the State buys services from an undertaking.<sup>156</sup> The fact that SGEI are usually supplied in the circumstance where the market has failed to supply these services makes it hard to find a standard to assess whether the compensation is proportionate.<sup>157</sup> The discussion of whether it is appropriate to compare funding of SGEI with ordinary commercial conduct on the market will be discussed further later in this thesis.<sup>158</sup>

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<sup>149</sup> See Opinion of AG Léger in *Altmark 2003*, paras. 31-43.

<sup>150</sup> See also Sinnaeve, p. 354.

<sup>151</sup> Opinion of AG Jacobs in *GEMO*, para. 115. See also Quigley and Collins, p. 29.

<sup>152</sup> Opinion of AG Jacobs in *GEMO*, para. 115.

<sup>153</sup> Opinion of AG Stix-Hackl in *Enirisorse*, para. 153.

<sup>154</sup> Opinion of AG Léger in *Altmark 2003*, paras. 19-27.

<sup>155</sup> Bartosch, 2003:1, p. 380.

<sup>156</sup> See Bartosch, 2003:1, p. 380.

<sup>157</sup> Opinion AG Stix-Hackl in *Enirisorse*, para. 154.

<sup>158</sup> See section 5.2.2.5.

Contrary to the criticism against the State aid approach, that this approach is a too wide interpretation of the prohibition of State aid, *the compensation approach* has been criticised for being an insufficient protection not being able to ensure that an advantage, which distorts competition is not conferred. This is despite that the rationale behind the approach is that no real advantage is conferred, but that the compensation on the contrary restores a level playing field. This criticism has been raised against the compensation approach for using the actual costs of providing SGEI as the sole benchmark to determine the permissibility of the compensation. First, the approach leads to no incentive for recipients of aid to be efficient. Since there is no limit to the aid more than the actual costs, the undertaking can increase its costs and still be reimbursed. The undertaking would under these circumstances not bear the loss for its insufficiency. This gives the recipient an unfair advantage over potential competitors not receiving aid. Second, it has been argued that there is a risk for cross-subsidisation, enabling the recipient to better compete on other markets and fields which are open to competition without being more efficient. Thus, an advantage distorting free competition would be conferred to the detriment of more efficient undertakings. The compensation approach has been criticised for not requiring the recipient of aid to be efficient. However, neither Article 86(2) offers such a requirement.<sup>159</sup>

#### **4.4.3 The role of Article 86(2) and the structure of the Treaty**

One of the main critiques of the compensation approach focuses on the construction of the EC Treaty. Article 87(1) states a non-absolute prohibition of State aid. The Treaty provides a number of provisions, which are to be regarded as *lex specialis* in relation to Article 87(1). Examples of such rules are the exceptions in Articles 87(2) and 87(3). Furthermore, Article 86(2) allows undertakings performing SGEI to be exempted from the rules of the Treaty under certain limited circumstances following from that provision. *The compensation approach* has been held to undermine the structure of the Treaty and to deprive Article 86(2) of its meaning and effect in the field of State aid.

An argument raised in favour of *the State aid approach* is that Article 86(2) would lose its effect in the field of State aid if a compensation for SGEI would not be defined as State aid and thus would not be subject to examination under Article 86(2).<sup>160</sup> Under *the compensation approach* there seems to be no room for an application of Article 86(2), leaving this article without any function in the area of State aid. When the financing is only a compensation for the costs of providing the services the financing is not prohibited aid in the meaning of Article 87(1) and there is consequently no

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<sup>159</sup> See further on this point Nettesheim, pp. 262-263; Nicolaidis, 2003:1, pp. 567-568 and 570-571; Nicolaidis, 2003:2, pp. 184 and 205-207.

<sup>160</sup> Sinnaeve, p. 354.



need to assess the compatibility of the measure with the exception in Article 86(2). In the case where the funding exceeds the extra costs of providing SGEI the financing cannot escape the classification as State aid according to the compensation approach. In this situation the measure could not be justified under Article 86(2), because it would not be necessary for the performance of the PSOs and it would therefore not comply with the principle of proportionality under that article. Thus, there is a concern that Article 86(2), and the conditions it imposes, would be deprived of its effect and role within the State aid control.<sup>161</sup> However, the argument has been invoked that this provision still has importance in other areas, such as Articles 81 and 82 EC Treaty, and therefore the article's loss of importance in the field of State aid is not so serious.<sup>162</sup>

Since there is no assessment made of the compatibility of the funding with Article 86(2) under *the compensation approach*, it has been argued that there is no control of inter alia whether the services actually are “services of general economic interest”, whether they have actually been entrusted specifically to the recipient undertaking, and whether the funding affects the development of trade to an extent contrary to the interests of the Community.<sup>163</sup> Furthermore, there have been doubts as to whether the “necessary equivalence” between the funding measure and the extra costs of providing PSOs referred to in the Ferring case is comparable with the necessity requirement in Article 86(2).<sup>164</sup> Thus, there is a concern, which in my view is highly justified, that a State measure could evade the State aid prohibition under less strict circumstances than Article 86(2) would allow, while instead leaving this provision ineffective.

The loss of the effect of Article 86(2) in the field of State aid is in my view one of the central problems with the compensation approach, since this article balances the Community's interest of undistorted competition and the interest of the Member States to assure the availability of certain services and sets out the conditions under which the latter may prevail.

#### **4.4.4 The effects based interpretation**

As has been examined earlier in this thesis the concept of State aid is an objective concept. The definition of a measure as State aid must be done

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<sup>161</sup> See Opinion of AG Jacobs in GEMO, para. 116; Rizza, p. 435; Opinion of AG Léger in Altmark 2002, paras. 79-82.

<sup>162</sup> Opinion of AG Stix-Hackl in Enirisorse, para. 159. See also Bartosch, 2003:1, p. 378.

<sup>163</sup> See Opinion of AG Jacobs in GEMO, para. 116. See also Opinion of AG Léger in Altmark 2002, paras. 87-90. See also section 3.2 and the conditions that a measure under the scrutiny of Article 86(2) EC Treaty must fulfil to be exempted from the rules of the Treaty.

<sup>164</sup> Ferring, para. 27; Opinion of AG Léger in Altmark 2002, para. 89.

with reference to its effect on competition and not with reference to its purpose or aim.<sup>165</sup>

In consequence herewith, the reasoning behind *the State aid approach* is that the fact that the measure is only intended to offset the extra costs of PSOs cannot be regarded when defining a measure as State aid, since this solely constitutes the purpose of the measure. The offsetting intent could only be regarded at a later stage to determine whether the measure could be justified according to one of the exceptions provided for in the Treaty. One criticism against *the compensation approach* is that it confuses two distinct questions – on the one hand the question whether the measure should be defined as State aid, an assessment which is purely objective, and on the other hand the question whether the measure should be justified. The aim behind the measure cannot exclude it from the characterisation as aid. Thus, the compensation approach does arguably not regard the effects on competition of the measure, but its aim.<sup>166</sup> In my view this is not a valid argument. I concur with the view that the concept of State aid still preserves its objective status even when regarding whether the measure was merely meant as a compensation for PSOs. Such an analysis in fact considers the economic situation of the recipient with regard to its competitors not imposed with PSOs.<sup>167</sup>

## **4.5 The *quid pro quo* approach – the middle way**

As a response to the problems inherent in both the State aid approach and the compensation approach, as discussed above, AG Jacobs in his Opinion in GEMO<sup>168</sup> proposed an alternative solution – *the quid pro quo* approach. It is a middle way or a compromise in the sense that it is a combination of the solutions adopted in the case law.

The approach proposed by AG Jacobs divides all cases of financing of PSOs into two categories. The compensation approach should be used in cases where there is a direct and manifest link between the financing measure and clearly defined PSOs imposed on the undertaking. These are, in other words, cases where the financing is clearly intended as a *quid pro quo* for clearly defined PSOs. An example is, according to AG Jacobs, public service contracts awarded after a public procurement procedure, since such contracts identify the duties of the undertaking and the amount to be paid.

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<sup>165</sup> See section 2.3.2.2.

<sup>166</sup> See Opinion of AG Léger in *Altmark* 2002, paras. 76-78. See also Nicolaidis, 2003:1, p. 561.

<sup>167</sup> See Bartosch, 2003:1, p. 378. See also Opinion of AG Stix-Hackl in *Enirisorse*, para. 158.

<sup>168</sup> Case C-126/01, *Ministre de l'économie, des finances et de l'industrie v GEMO SA*, [2003] ECR nyr, judgment 20 November 2003. The Court, however, never discussed the financing of PSOs in its decision.

Conversely, the other category of cases includes situations when it is not clear from the outset that the State funding is intended to be a *quid pro quo*, thus when there are no clearly defined PSOs or the link between the funding and the duties is not direct or manifest. Those cases are to be analysed according to the State aid approach. An example, according to AG Jacobs, is tax exemptions for public banks.<sup>169</sup>

This approach has been met by both positive and negative comments.<sup>170</sup> As AG Jacobs himself recognises, the distinction between the two categories might in practice not always be possible to make.<sup>171</sup> Thus, the large problem with this approach is the legal uncertainty.<sup>172</sup> However, the *quid pro quo* approach clearly shows that AG Jacobs has tried to find a practical solution that alleviates the problems of the two approaches adopted by the EC Courts. First, it narrows the range of measures that are able to escape classification as State aid under the compensation approach. Second, it limits the too strict State aid approach to not be used in situations where it is clear that the funding is a mere *quid pro quo* for the services provided. By doing this the *quid pro quo* approach compromises between the two solutions and tries to avoid the problems of the strict application of the earlier approaches. It is an appealing approach in the way that it aims at removing the measures from the State aid rules that from the outset clearly do not confer an advantage on the recipient undertaking, and leaves the compatibility of the more unclear cases to be examined further, with a possibility of an exception by Article 86(2).

## 4.6 Concluding remarks

It can be concluded from the previous sections that both the compensation approach as well as the State aid approach suffer from clear deficiencies. The earlier solutions given to the problem of the proper assessment of funding of PSOs seem to be either too broad or too narrow.

On the one hand, *the State aid approach* provides a too broad interpretation of the concept of State aid, particularly with regard to the advantage criterion. First, the approach encompasses more measures than the wording of the prohibition in Article 87(1) seems to have been designed to cover. Second, the approach gives rise to far-going procedural obligations, which in some circumstances seem hard to justify. Thus, the State aid approach suffers from shortcomings relating to both legitimacy and efficiency. However, the State aid approach at first sight provides a solution, which is easy to apply and which provides legal certainty. This approach further

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<sup>169</sup> Opinion of AG Jacobs in GEMO, paras. 117-120. See also a similar view of AG Stix-Hackl in Opinion of AG Stix-Hackl in Enirisorse, paras. 153-161.

<sup>170</sup> See Bacon, p. 57; Nicolaidis, 2002, p. 194 ; Sinnaeve, p. 357; Opinion of AG Léger in Altmark 2003; paras. 79-92; Rizza, pp. 442-443.

<sup>171</sup> Opinion of AG Jacobs in GEMO, para. 129.

<sup>172</sup> See also Opinion of AG Léger in Altmark 2003, paras. 85-89.

gives meaning to the exception in Article 86(2) and secures that a funding measure is not allowed under less strict circumstances than is admitted by that provision. In addition, it provides a broad protection of competition and thus effectively protects from evasions of the prohibition of State aid. The obvious problem with such a strict approach is nevertheless that every intervention by a public authority to secure the availability of SGEI is classified as State aid. Such a solution is not justifiable and proportionate in the light of the Community interest to ensure the availability of SGEI within the Union.

On the other hand, *the compensation approach* offers a too narrow protection of the prohibition of State aid and thus a too narrow protection of competition. A number of objections may be raised against this approach as it has been developed in ADBHU and Ferring. First, this approach leaves Article 86(2) without any meaning within the field of State aid. It is regrettable to interpret one article as to deprive another of a substantial part of its meaning. At the same time the compensation approach seems to set a lower standard for funding measures to escape the State aid prohibition than seems to be set by Article 86(2). The function of Article 86(2) is in fact to balance the interest to ensure that competition is not unduly distorted and the interest to ensure the availability of SGEI. The provision entails a compromise between these two interests. The lowest benchmark in my view under which funding measures should be able to escape the prohibition in Article 87(1) is the one set out in Article 86(2). Second, by not imposing another requirement to be fulfilled for funding of PSOs to escape the State aid rules than that the compensation may not exceed the extra costs of providing the services is clearly insufficient. Under these circumstances it cannot be excluded with sufficient certainty that a measure that is allowed to escape classification as State aid under the assumption that it does not confer an advantage in reality in fact does so. Thus, there is a risk that competition is distorted. However, in my view the interpretation of the advantage criterion done under this approach, i.e. that mere compensations do not confer any advantage, is in principle the correct interpretation. One must, in my view, regard not only the public grant but also the consideration contributed by the recipient undertaking in return. In addition, by using this approach one furthers the interest of the availability of SGEI, not unnecessarily burdening these service providers with procedural obligations.

*The quid pro quo approach* is in my view a very interesting alternative to the two other approaches. It is an appealing solution in that it offers a middle way trying to solve the problems of the other two approaches. However, it suffers from a shortcoming in that it creates a large amount of legal uncertainty in its attempt to be flexible so to be able to adapt to a wide range of situations.

From the abovementioned follows that there is a clear need for a different solution, providing legal certainty and reconciling the wish to ensure that competition is not unduly distorted and the wish to ensure uninterrupted

availability of SGEL. In the following chapter I will examine the recent case law of the ECJ to evaluate whether these interests have been met.

# 5 Recent developments in the case law

## 5.1 General

In the following sections I will analyse the recent ECJ rulings in the Altmark case and the Enirisorse case, delivered on 24 July 2003 and 27 November 2003 respectively. The uncertainty on how financing of PSOs were to be treated under the State aid rules following the Ferring ruling made these cases particularly important in clarifying the proper legal framework to govern this area of the law. It is necessary to analyse the scope of these judgments to be able to determine how funding of SGEI should be assessed under State aid law today. Furthermore, I will examine to what extent the ECJ considered the critique of the earlier rulings of the EC Courts, in order to evaluate whether the two cases offer an improvement with respect to earlier case law and whether they mitigate the problems inherent in the earlier state of the law. I will discuss whether the legal framework governing funding of PSOs has been clarified and to what extent uncertainty still remains. The question to be answered is whether the judgments in Altmark and Enirisorse offer an adequate solution to the issue of how to reconcile financing of PSOs and EC State aid law.

## 5.2 Altmark

### 5.2.1 The judgment

After the confusion following on the controversial judgment in Ferring the important ruling in the Altmark case, with the ECJ sitting in plenary formation, was hoped to clarify the situation. The case concerned the granting of subsidies intended to compensate an undertaking for a deficit suffered due to its PSO to operate local public transport services.

The Court commenced by stating that all the conditions in Article 87(1) have to be fulfilled for a measure to be defined as State aid.<sup>173</sup> Initially the ECJ answered the question from the national court whether the local and small-scale nature of the SGEI excluded these services from being subject to the EC State aid rules.<sup>174</sup> The Court confirmed that the fact that a subsidy is granted to an undertaking providing only local or regional services within the State of origin does not exclude the possibility that intra-Community

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<sup>173</sup> Altmark, para. 74.

<sup>174</sup> Altmark, para. 67.

trade is affected.<sup>175</sup> This statement is important, as many SGEI are merely local or regional. Further, the Court held that there is no *de minimis* rule to exclude a measure of small scope, unless covered by an express Community rule to that effect. Thus, the scale of the activity, the amount of the aid or the local character of the recipient does not exclude the fulfilment of this condition.<sup>176</sup>

However, the central issue in the case was whether the subsidies intended to compensate for PSOs imposed on the recipient undertaking constituted an economic advantage within the meaning of Article 87(1). In this regard the ECJ in its judgment emphasised that one of the conditions that must be fulfilled to consider a State measure as State aid under Article 87(1) is the prerequisite that the measure must confer an advantage on the recipient undertaking. The Court continued and declared that measures that are likely to directly or indirectly favour certain undertakings are regarded as State aid. The same applies to measures that confer an economic advantage, which the recipient would not have received under normal market conditions.<sup>177</sup> Following these more general statements the Court, while referring to its rulings in ADBHU and Ferring, concluded that:

[W]here a State measure must be regarded as *compensation* for the services provided by the recipient undertaking in order to discharge public service obligations, so that those undertakings do *not enjoy a real financial advantage* and the measure thus does not have the effect of putting them in a more favourable position than the undertakings competing with them, such a measure is not caught by Article [87(1)] of the Treaty.<sup>178</sup>

The Court therefore, without any further discussion and without mentioning FFSA and SIC, confirmed its earlier rulings in ADBHU and Ferring that a mere compensation not exceeding the additional costs of performing PSOs does not amount to an advantage and consequently not to State aid. However, the ECJ in addition identified a number of cumulative conditions that must be fulfilled for a payment to constitute a mere compensation allowing it not to be defined as State aid.<sup>179</sup> These conditions are:

- (1) The recipient undertaking must actually have PSOs to discharge, and the obligations must be clearly defined.<sup>180</sup>
- (2) The parameters, on the basis of which the compensation is calculated, must have been established beforehand in an objective and transparent manner.<sup>181</sup>

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<sup>175</sup> Altmark, para. 77.

<sup>176</sup> Altmark, paras. 80-82. See also Commission Regulation No 69/2001.

<sup>177</sup> Altmark, paras. 75 and 83.

<sup>178</sup> Altmark, para. 87. Emphasis added.

<sup>179</sup> Altmark, paras. 88 and 94.

<sup>180</sup> Altmark, paras. 89 and 95.

<sup>181</sup> Altmark, paras. 90 and 95.

- (3) The compensation must not exceed what is necessary to cover all or part of the costs incurred in discharging the PSOs, taking into account the relevant receipts and a reasonable profit for discharging those obligations.<sup>182</sup>
- (4) Where the undertaking which is to discharge PSOs is not chosen in a public procurement procedure the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary PSOs, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.<sup>183</sup>

All these conditions have to be fulfilled for a funding of PSOs to constitute a sole compensation, excluding an advantage and thus excluding State aid. Conversely, if one or more of the conditions are not satisfied there will be an advantage and thus State aid if the other conditions of Article 87(1) are met.<sup>184</sup>

## **5.2.2 Analysis and commentary**

### **5.2.2.1 The State aid assessment**

The ECJ in *Altmark* confirmed the rulings in *Ferring* and *ADBHU* in the respect that where there is a mere compensation for PSOs the recipient does not receive an advantage and therefore the compensation does not constitute State aid within the meaning of Article 87(1). As regards the case of a mere compensation the Court adopted the view, without any elaboration on its conclusion, that there is no real advantage conferred on the recipient undertaking. Consequently, the judgment indirectly rejected the interpretation of the advantage criterion in *FFSA* and *SIC*. The effect is that the financing of PSOs that merely compensates the recipient for such obligations fall outside the State aid regulation. However, the Court did not entirely follow the classical compensation approach as adopted in *Ferring* and *ADBHU*. Instead by adding a number of conditions that must be fulfilled for a measure to escape classification as State aid the Court applied what could be called the conditional compensation approach<sup>185</sup>.

### **5.2.2.2 The first condition: entrustment of clearly defined PSOs**

The first condition set out in the *Altmark* ruling that must be fulfilled for a funding measure to escape classification as State aid is that the beneficiary undertaking is actually required to discharge clearly defined PSOs. One

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<sup>182</sup> *Altmark*, paras. 92 and 95.

<sup>183</sup> *Altmark*, paras. 93 and 95.

<sup>184</sup> See *Altmark*, paras. 94-95.

<sup>185</sup> The term is used by Sinnaeve, p. 356.



cannot avoid noticing that this condition corresponds to Article 86(2) in this respect. This article requires that the PSOs in question are clearly defined and actually entrusted to specific undertakings to permit a measure to be encompassed by the exception from the competition rules set out in that provision. By adding this first condition in Altmark there is a similar benchmark, in this respect, for a measure to escape classification as State aid and consequently be excluded from the prohibition in Article 87(1), as for a measure to be exempted from the Treaty rules in accordance with Article 86(2). Hence, the Altmark ruling to some extent meets the concern of the critique of the classical compensation approach that this approach provides a weaker protection of undistorted competition than Article 86(2).<sup>186</sup>

However, the condition is limited. The Court has solely imposed a formal requirement, to clearly define the content of the PSOs in question, instead of a substantial one.<sup>187</sup> The condition does not limit the wide discretion of Member States in designating specific services as SGEI to be subjected to obligations of a public interest.<sup>188</sup> This condition does not expressly place the legitimacy of the public interest obligation under the scrutiny of the Community institutions and national courts.<sup>189</sup> On the other hand, also Article 86(2) allows Member States to have a wide discretion in this respect.<sup>190</sup> One must also recognise that there is a difficulty with absolute and strict definitions of what should be a valid public interest obligation. There would be implications of the inflexibility of such a concept not fitting all the various situations existing in different Member States and not being suited to meet future developments in society. However, to avoid abuses there must be an enforceable, however flexible, standard that must be met.<sup>191</sup>

The condition is vital as a formal requirement to ensure transparency and to prevent that States, for the sole purpose to avoid the prohibition of State aid in Article 87(1), defines *ex post* allegedly imposed PSOs where such never existed.<sup>192</sup> It is also necessary to be able to conduct an adequate examination of whether the compensation is excessive or not to clearly know what is being compensated for and to be able to determine the costs of these obligations.<sup>193</sup> This condition is also in line with the *quid pro quo* approach stating that a compensation approach is only possible to use when the PSOs have been clearly defined, otherwise it is not possible to ascertain that there is only a mere compensation.<sup>194</sup> Furthermore, the condition provides an increased protection from distortions of competition and from the rules on

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<sup>186</sup> See section 4.4.3.

<sup>187</sup> See also Sinnaeve, p. 357; Travers, p. 390.

<sup>188</sup> See also Travers, p. 390.

<sup>189</sup> See however Enirisorse in section 5.3.

<sup>190</sup> See section 3.2.2.2.

<sup>191</sup> See also Buendia Sierra, pp. 381-382.

<sup>192</sup> See also Sinnaeve, p. 357.

<sup>193</sup> See also Opinion of AG Stix-Hackl, para. 155.

<sup>194</sup> Opinion of AG Jacobs in GEMO, paras. 118-119.

compensation for PSOs being abused, since it clearly limits the flexibility of States in providing funding of PSOs. It is thus an important step in limiting the scope and increasing the control of measures escaping the classification and prohibition of State aid.

### **5.2.2.3 The second condition: pre-established compensation**

The judgment in *Altmark* imposes a condition, requiring the prior establishment in an objective and transparent manner of the terms on which the compensation is calculated, to prevent an economic advantage from being conferred on the recipient undertaking to the detriment of its competitors.<sup>195</sup> It has been argued that this condition imposes an even stricter standard than provided by Article 86(2), since this article only provides an examination of whether the exemption is necessary for the performance of the public service task on an *ex post facto* basis and this condition requires Member States to conduct an *ex ante* control that there will be no overcompensation.<sup>196</sup>

One criticism against this condition is that it seems to assume that objective, transparent and pre-established compensation terms ensure that later payments will remain purely compensatory. However, it has been argued that the compensation terms themselves could lead to a potentially excessive compensation even though they are established in advance in an objective and transparent manner.<sup>197</sup>

Even though it may be uncertain as to the exact extent to which this condition is capable of preventing advantages from being granted and protecting competition it is nevertheless, in my view, an improvement of the protection of competition in the field of funding of PSOs. The classical compensation approach has been criticised for that it does not force operators of PSOs to be efficient. This approach does in fact permit compensations to inefficient undertakings to be excluded from the prohibition of State aid.<sup>198</sup> Under the classical compensation approach undertakings can let their costs increase in the knowledge that the State will nevertheless be able to compensate them. This gives these undertakings an advantage over their competitors or potential competitors, and could consequently distort competition. Therefore, the second condition set out in *Altmark* strengthens competition by forcing the recipient to assume at least part of the risk of its operations and not as before pass all its commercial risk to the State.<sup>199</sup> Thus, the compensation is limited to the pre-established level and lessens the flexibility of public authorities by preventing them from *ex ante* covering deficits.

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<sup>195</sup> *Altmark*, para. 91.

<sup>196</sup> Bartosch, 2003:1, p. 385.

<sup>197</sup> Travers, p. 391.

<sup>198</sup> See section 4.4.2.

<sup>199</sup> Nicolaidis, 2003:1, p. 573.

The Court in its ruling held that the payment by a State of compensation for the loss incurred by an undertaking providing PSOs, without prior established compensation terms, where it turns out after the event that the operation of certain services in connection with the discharge of PSOs was not economically viable, is State aid.<sup>200</sup> According to this statement the condition seems to be met as long as the terms of compensation are established in advance even if the performance of the SGEI never have been likely to have been economically viable in the first place.<sup>201</sup>

The Court offers no guidance on how this requirement is to be interpreted and how a national court is to determine whether the condition is fulfilled.<sup>202</sup> Consequently, the implementation of this vague condition is not entirely unproblematic or certain.<sup>203</sup>

#### **5.2.2.4 The third condition: the proportionality of the aid**

The third criterion set out in *Altmark* states that the compensation may not exceed what is necessary to cover the costs of providing the services and a reasonable profit. The Court declared that this condition ensures that no economic advantage is conferred on the recipient, which would strengthen the beneficiary's competitive position and thus distort or threaten to distort competition.<sup>204</sup>

This condition is not an entirely new innovation of the Court in *Altmark*. Firstly, it resembles the criterion in Article 86(2) that a measure to be exempted from the rules of the Treaty must meet a proportionality test.<sup>205</sup> Secondly, it is in practice a confirmation of the statement in *Ferring and ADBHU* that the undertaking must not be overcompensated for the costs of providing the service. However, in *Altmark* the Court seems to take it one step further than both Article 86(2) and the prior cases by permitting that the compensation may also include profit.<sup>206</sup> Thus, it seems to be less strict in this respect than both the State aid approach and the classical compensation approach in *ADBHU* and *Ferring*.<sup>207</sup>

In connection with the Court's recognition of a profit component in the permissible compensation a number of difficulties arise. An important

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<sup>200</sup> *Altmark*, para. 91.

<sup>201</sup> Travers, p. 391.

<sup>202</sup> See however Enirisorse in section 5.3.

<sup>203</sup> See also Sinnaeve, p. 357.

<sup>204</sup> *Altmark*, para. 92.

<sup>205</sup> See also Bartosch, 2003:1, p. 385.

<sup>206</sup> See Travers, pp. 389-391; Sinnaeve, p. 357. This is in line with the view of AG Lenz in Opinion of AG Lenz in *ADBHU*, p. 356.

<sup>207</sup> See Bartosch, 2003:1, p. 385. See also for another opinion Nicolaidis, 2003:2, p. 192, who argues that there is a possibility that Article 86(2) allows for a profit to be included in the compensation. Even if this is the case, in my view, the *Altmark* criterion differs in the sense that it expressly states the permissibility of a profit component as opposed to Article 86(2).

problem is that the Court does not mention how “a reasonable profit” is to be determined, thereby creating a not entirely irrelevant uncertainty. The border between a normal profit and an excessive profit might in certain cases be hard to identify.<sup>208</sup> There is also a significant risk of abuses created by the profit component and the uncertainty surrounding its interpretation. The profit component could be used by public authorities to justify higher levels of compensation than they otherwise would have been able to give, consequently strengthening the competitiveness of the recipient.<sup>209</sup>

This criterion aims at preventing distortions of competition by adding a limit to the amount that may be granted to an undertaking imposed with PSOs without falling under Article 87(1). However, as a result of the vagueness of the condition and as a result of allowing compensation for a reasonable profit there is a risk that an advantage is conferred on the recipient undertaking and that competition is distorted, despite the opposite aim of this criterion. However, the fourth criterion provided in *Altmark* may be a solution to this problem.

#### **5.2.2.5 The fourth condition: public procurement procedures or private operator test**

In the fourth and last condition the Court provides two possible alternatives to determine the level of compensation, so as not to allow any overcompensation. Firstly, the provider of the SGEI and the compensation could be determined pursuant to a public procurement procedure. Secondly, the compensation could be established on the basis of a comparison of the costs including a reasonable profit, which a typical, well-run undertaking that is adequately provided with the means to perform the services in question would have had providing the same PSOs.<sup>210</sup> Both these alternatives alleviate much of the problems of the classical compensation approach, as established in *Ferring* and *ADBHU*. The classical compensation approach has been criticised for setting a too low benchmark for determining whether there is overcompensation, by merely regarding the actual costs of the recipient undertaking. Furthermore, the classical compensation approach has been criticised for allowing funding of PSOs to escape classification as State aid even where the recipient is inefficient.<sup>211</sup> These two new alternative ways to determine the proper compensation undeniably sets a higher standard than *Ferring* and *ADBHU*, forcing the recipient undertaking to actually be efficient.

The public tendering of compensation contracts as a method to determine the appropriate funding of SGEI ascertains, in my view, to a large extent that competition is upheld. A **public procurement procedure** is a useful tool to establish whether the compensation reflects normal market

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<sup>208</sup> See Travers, pp. 390-391; Sinnavee, p. 357.

<sup>209</sup> Travers, p. 391.

<sup>210</sup> *Altmark*, paras. 93 and 95.

<sup>211</sup> See section 4.4.2.

conditions, since the price resulting from such a procedure normally must be regarded as a normal market price.<sup>212</sup> As a consequence, there would be no overcompensation involved in the remuneration paid.<sup>213</sup> This is also in line with the view often adopted by the Commission to regard public procurement procedures as excluding overcompensation and ensuring that normal market conditions are upheld and that there is thus no State aid.<sup>214</sup> An open, transparent and non-discriminatory tender procedure is, in my view, the way to determine the appropriate compensation that most resembles that of a normal market. Only in such a situation the undertaking would not receive the funding without having to compete for it. Such tender procedure allows for undertakings to actually compete with each other, on price and efficiency, in order to receive the funding. It opens up the market and allows for new undertakings to enter. It is furthermore, an explicit assurance that the efficiency of the undertaking chosen is considered and that the public authorities in fact consider all the alternatives on the market.<sup>215</sup> Furthermore, public procurement procedures would have the effect of reducing the compensation paid, by introducing competition in the supply of services.<sup>216</sup> Further, by using public procurement procedures the compensation is, at the outset, determined at the minimum possible level. This means that an undertaking has to stay efficient, since the possible losses it would suffer would not be compensated.<sup>217</sup>

Even though public procurement procedures normally exclude State aid, there is still a possibility that despite such procedures aid still exists.<sup>218</sup> An example that could be mentioned is a recent CFI case, *P & O European Ferries*, concerning a public authority purchasing services from an undertaking. In this case the CFI found that since the public authority did not have the need for these services the transaction, despite the public procurement procedure, did not constitute a normal market procedure.<sup>219</sup>

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<sup>212</sup> See also Bartosch, 2003:2, p. 562.

<sup>213</sup> See however for another view Travers, p. 391.

<sup>214</sup> See for example Community Guidelines on Maritime Transport, OJ 1997 C 205, para. 9; Commission Communication on Services of General Interest in Europe, COM(2000), 580 final, OJ 2001 C17, para. 26.

<sup>215</sup> It is unclear whether even in cases where the EC public procurement directives do not directly apply the Member States when selecting a service provider have to ensure that there has been advertising sufficient to enable competition and that the selection must be non-discriminatory. The Commission seems to have adopted the view that such is the case as regards the selection of a public service provider. See Green Paper on Services of General Economic Interest, COM(2003) 270 Final, 21 May 2003, para. 81. Case C-324/98, *Telaustria*, [2000] ECR I-10745, para. 62, could be regarded as indirectly supporting this view. However, the ECJ has not clearly confirmed that the selection of a public service provider must follow these principles and there are also doubts about such a requirement. See Sinnavee, p. 359.

<sup>216</sup> Nicolaidis, 2002, p. 195.

<sup>217</sup> Nicolaidis, 2003:1, pp. 568 and 571.

<sup>218</sup> Bartosch, 2003:1, p. 385; Travers, p. 391. See also other critique Nicolaidis, 2002, p. 195.

<sup>219</sup> Cases T-116/01 and T-118/01, *P&O European Ferries SA v Commission*, [2003] ECR II-nyr, judgment 5 August 2003, para. 117. For further examples where aid still exists despite public procurement procedures, see Bartosch, 2003:2, pp. 554-555.

For a public procurement procedure to have the effect to preserve competition and prevent that an advantage is not conferred there are a number of conditions to be met. Such procedures must be sufficiently competitive and sufficiently advertised so that all interested undertakings may participate.<sup>220</sup>

Regarding the second alternative to calculate the proper compensation the Court in essence introduces some form of **private operator test**. The amount of aid to be granted is limited by the cost efficiency of the recipient undertaking compared to its competitors. Thus, this alternative is in fact an efficiency requirement. It is not enough to refer to the actual additional costs incurred by the recipient undertaking, but the undertaking must also perform the PSOs in an economically efficient manner.<sup>221</sup> By this condition the amount of the compensation that could be paid by a State without being classified as State aid has been limited.<sup>222</sup> Hence, this alternative to calculate the appropriate compensation seems to impose a stricter test than both the test offered by the classical compensation approach for a measure to escape classification as State aid, and the test under Article 86(2) under which a measure can be found to be compatible with the common market. The classical compensation approach merely regards the actual costs of the recipient and under Article 86(2) the test is solely whether the operation of the services would be obstructed.<sup>223</sup>

This second alternative is not entirely unproblematic. Due to the special characteristics of SGEI it may in some circumstances be inappropriate to compare the undertaking imposed with such obligations with another hypothetical undertaking. Often it is not possible to make this comparison, since the public service provider is regularly in a situation different from other undertakings, due to the PSOs imposed on it. For this reason such a comparable undertaking will not exist in reality. Other undertakings will often not operate on the market under the same conditions.<sup>224</sup> When using a market economy test there must be sufficient guidance to be able to apply the test in a manner so that it does not become an arbitrary second-guessing of market behaviour.<sup>225</sup> Such a test is even more problematic considering the fact that the reason for the funding in the first place often is that the private market has failed to provide a service of that kind.<sup>226</sup> In conclusion, in my opinion a private operator test could be an effective tool to rule out overcompensations. However this test is not appropriate to use in all circumstances. In many of the markets where undertakings imposed with PSOs operate there are no competitors; this is often so in network industries aiming at providing a universal service throughout a territory of the State. In

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<sup>220</sup> See to this effect Cases T-116/01 and T-118/01, *P&O European Ferries SA v Commission*, [2003] ECR II-nyr, judgment 5 August 2003, para. 118.

<sup>221</sup> See Nicolaidis, 2003:1, p. 573; Sinnaeve, p. 357.

<sup>222</sup> See also Nicolaidis, 2003:1, p. 573.

<sup>223</sup> See also Bartosch, 2003:1, p. 385.

<sup>224</sup> See also Sinnaeve, p. 358. See also Hancher, p. 371.

<sup>225</sup> See Ross, p. 408.

<sup>226</sup> See Ross, p. 411.

such cases the comparison would be arbitrary and the only certain reference point available would be the actual costs of the service. The Chronopost ruling could serve as an illustration of this problem.

The recent ECJ ruling in Chronopost, delivered on 3 July 2003 only three weeks earlier than Altmark, shows the problem of using a comparison with another hypothetical undertaking.<sup>227</sup> In this case the ECJ ruled on the concept of State aid and the meaning of the criterion of a private operator acting under normal market conditions. However, even if the situation in that case was somewhat different from the situation under discussion in this thesis the general principles provided by the Court in that judgment most likely has relevance even in this situation. The Court in the Chronopost case found that a comparison with another undertaking on the market was not possible because of the specific SGEI, a universal service network, performed by the public service provider. The Court found that the costs actually incurred in operating these services should be regarded when determining whether there has been overcompensation and thus State aid. It is disputed whether the fourth condition of Altmark is compatible with the ruling in Chronopost. It has been argued that there is no conflict between the two judgments. Altmark sets out the general framework under which compensation for PSOs may escape the prohibition of State aid. The Chronopost ruling shows the limitations that this general framework has in cases where there is no comparable private operator, with whom the costs of the recipient could be compared.<sup>228</sup> However, also doubts have been raised whether and how these two rulings can be reconciled.<sup>229</sup> Thus, in this respect the Altmark judgment leaves uncertainty. The ECJ itself did not provide any clarification on how the judgments should be read together.

There are also other problems with the private operator test provided in Altmark. The vague wording of this condition gives room for much interpretation and raises several questions. For example what is a typical undertaking, which is well run, and what happens when the costs of the undertaking vary from one year to another?<sup>230</sup>

Furthermore, criticism has been raised against the introduction of an efficiency criterion, arguing that such a requirement is not compatible with the principle that it is above all the responsibility of the Member States to define the way in which SGEI can be best fulfilled and that the Community institutions are not entitled to rule on the economic efficiency of the undertakings selected.<sup>231</sup> On the other hand, a main critique against

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<sup>227</sup> Cases C-83/01 P, C-93/01 P and C-94/01 P, *Chronopost SA v Ufex*, [2003] ECR nyr, judgment 3 July 2003; see also section 2.3.3.2.

<sup>228</sup> Bartosch, 2003:1, pp. 384-385. The factual situations in Altmark and Chronopost differed. In Chronopost there was no competitors providing the same service. However, in Altmark there was in fact a competitor who was interested in and capable of operating the particular services.

<sup>229</sup> Travers, p. 392, Sinnaeve, p. 358.

<sup>230</sup> Nicolaidis, 2003:1, pp. 573-574.

<sup>231</sup> Sinnaeve, p. 358. See also FFSA, para. 108, and section 3.2.2.2.

especially the classical compensation approach is that it does not distinguish between efficient and inefficient undertakings when approving compensation for PSOs. Thus, the Court by introducing an efficiency criterion in fact complies with this latter argumentation.

#### **5.2.2.6 Concluding remarks**

The ruling in *Altmark* is clearly a middle way. It lands in the middle of the too broad State aid approach and the too narrow classical compensation approach. On the one hand, it adopts a compensation approach, in that it considers the mere compensation for the performance of PSOs as not constituting an advantage and thus as falling outside the scope of Article 87(1). On the other hand, it sets out four criteria, which narrow the range of financing measures that are exempted from the State aid rules. Thus, despite that the judgment assumes a form of compensation approach *Altmark*, in my view, to some extent mitigates a number of the problems of the classical compensation approach and increases the protection of competition.

The *Altmark* conditions clearly show significant resemblance with the conditions set out in Article 86(2) for a State measure to benefit from the exception from the competition rules provided by that provision. Hence, setting similar standards for public funding to escape classification as State aid and thus to escape the application of the prohibition in Article 87(1), as for Article 86(2) to apply. In this regard the *Altmark* ruling has the effect of lessening the concern that the funding of SGEI could escape the prohibition of State aid under less strict circumstances than Article 86(2) would allow. Even more, the second and the fourth criteria seem to set out an even stricter standard than Article 86(2).<sup>232</sup>

However, the criticism that the classical compensation approach renders Article 86(2) inefficient, since this provision under that approach could never be applied directly in the area of State aid, seems not to be fully complied with. Even though the Court in *Altmark* incorporates the conditions of Article 86(2) in the State aid assessment the Court never directly applied this provision. Furthermore, it is highly uncertain whether the *Altmark* approach leaves any room for an application of Article 86(2) with regard to State funding of PSOs. Unfortunately the *Altmark* ruling leaves the question unanswered. Since, the *Altmark* conditions correspond to the Article 86(2) criteria it seems unlikely that Article 86(2) could be used as an exception if a measure did not fulfil the *Altmark* requirements. However, one could argue that at least when the fourth condition is not fulfilled such a possibility exists, since this *Altmark* condition sets a stricter standard than Article 86(2). The fourth condition would then be defining compensation for the purposes of Article 87(1) and a less strict definition would apply for the Article 86(2) assessment, which would justify

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<sup>232</sup> See section 4.4.3.



compensations as long as the remuneration would not exceed the actual costs of the PSOs. On the other hand, one could argue that not fulfilling this condition would mean that there has been an overcompensation which could not be justified under Article 86(2).<sup>233</sup> Nevertheless, since the Court in *Altmark* did not discuss the possibility of Article 86(2) being applicable, it most likely did confirm the Ferring exclusion of the provision in the field of financing of PSOs.<sup>234</sup> In my view, despite that the Court to some extent provided conditions for the exclusion of Article 87(1) that correspond to conditions set out in Article 86(2), the total exclusion of this provision, rendering this article inefficient in the field of State aid, is unfortunate. It is unlucky to interpret one article of a Treaty as to render another without significance.

Furthermore, the classical compensation approach has been much criticised for undermining the Commission's surveillance in the field of State aid, by exempting compensations for public service costs from the notification and standstill requirements. An effect of the *Altmark* conditions is that it is harder for compensatory measures to escape these procedural obligations. Consequently, a narrower range of measures will be able to fall outside the State aid control system in Article 88. On the other hand, the *Altmark* judgment does not go so far as to submit all compensation measures under this obligation, as the State aid approach, but allows some measures to still escape the classification as aid and thus the procedural requirements. Therefore, the *Altmark* ruling has to some extent mitigated the problem of a decreased supervising role of the Commission without making the procedural requirements unjustifiably far-reaching for the providers of SGEI. The ruling is a compromise between the State aid approach and its strict interpretation of the advantage criterion resulting in a wide control by the Commission and far-reaching procedural burdens upon public service providers, and the classical compensation approach resulting in a wide range of measures escaping such control. The judgment reconciles the interest of an effective prohibition of State aid aiming at preventing distortions of competition and the interest of the availability of SGEI. However, there is an implication following from permitting the compensation for PSOs to escape classification as State aid and thus not submitting such compensation to the notification requirement. A measure that has been assumed by a Member State to constitute a mere compensation could be challenged by competitors due to the direct effect of Article 88(3). In such case there is a risk that the measure is found not to fulfil the *Altmark* conditions and therefore constitutes State aid. Furthermore, the Commission could determine that the measure constitutes prohibited State aid. The legal consequences of the breach of the standstill obligation could be hard on the public service provider in question. This risk is even more important since there still remains large legal uncertainty on how to assess funding of PSOs

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<sup>233</sup> Sinnaeve, pp. 358-359.

<sup>234</sup> See also Travers, p. 392.

after Altmark and thus the assessment done by the State and by the Commission could differ.<sup>235</sup>

The main problem with the classical compensation approach, as adopted in Ferring and ADBHU, is that it only requires that the compensation does not exceed the actual costs of performing the PSOs imposed on the recipient. Altmark, by providing its conditions, sets out some additional limitations of the possibility to escape classification as State aid. Thus, the Altmark ruling has limited many of the risks of the Ferring ruling. The ruling in Altmark therefore provides a better protection of competition than Ferring and ADBHU. Furthermore, it lessens the flexibility of the Member States in designating a payment to an undertaking as a compensation for PSOs and thus protects from evasions of the State aid rules. In addition, the conditions in Altmark increase the transparency in the field of public funding of PSOs, i.a. by requiring pre-established compensation terms and clearly defined PSOs. This is in my view of large importance. In such cases it is easier to establish whether the alleged compensation actually was a mere compensation.

In conclusion, the first three conditions are, in my view, not especially problematic. Even if there are some uncertainties regarding the interpretation and application of these conditions they are a step in the right direction increasing the protection of undistorted competition. The fourth condition in Altmark also leads to a better protection of competition. However, this condition is not as unproblematic as the first three. On the one hand, I very much advocate the usage of a public procurement procedure as a condition to rule out advantages, which the recipient would not have obtained in the normal course of business. A public procurement procedure has a number of positive consequences, since it introduces competition in the determination of a proper compensation. However, it is not always suitable to use a private operator test, because of the difficulty to use such a test.

Despite that the judgment in Altmark mitigates a number of the problems of the State aid approach and the classical compensation approach it has not solved all the problems that arise in the context of funding of PSOs. Unfortunately, the judgment does not provide the legal certainty it was hoped to do. On the contrary, it raised even more questions, especially with regard to how the particular conditions are to be applied and implemented.

### **5.3 Enirisorse**

The judgment in the Enirisorse case is the most recent ruling dealing with funding of PSOs. This judgment is important as a clarification of the judgment in Altmark, which left several questions unanswered. The ruling

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<sup>235</sup> See also Travers, p. 392; Sinnaeve, p. 360.

in Enirisorse also answers the question whether the ECJ has maintained its point of view in Altmark and whether this case provides the final test for assessing compensations for PSOs under Article 87(1) also outside the transport sector. The case dealt with an Italian law establishing port charges in respect of loading and unloading of goods in certain Italian ports. A proportion of the proceeds of the charge paid to the State should later be allocated to undertakings entrusted with PSOs in the ports, including the loading and unloading of goods, as compensation for the extra costs of providing SGEI. The question arose whether this allocation constituted State aid within the meaning of Article 87(1).

To determine whether the funding of the PSOs at issue constituted State aid the ECJ discussed the conditions for the definition of State aid set out in Article 87(1). There being no doubt that the requirement that the aid must be granted through State resources was fulfilled, since the financing came out of the State budget, the Court continued to discuss the affect on trade criteria. In this respect the ECJ, as in Altmark, found that there was no *de minimis* requirement to be satisfied according to this condition.<sup>236</sup> The Court then continued to discuss the conditions that there must be an advantage favouring the recipient, which distorts or threatens to distort competition. Also in this respect the ECJ came to the same conclusion as in Altmark. The Court adopted the conditional compensation approach established in this case. It confirmed that in the situation of a mere compensation for PSOs there is no real advantage for the recipient and such a compensation does therefore not put the recipient in a more favourable position as compared to its competitors. Consequently, there is no State aid in such cases. However, certain conditions have to be satisfied for the financing measure to escape classification as State aid.<sup>237</sup>

First, the Court discussed the condition that the recipient must actually have clearly defined PSOs to discharge. This is exactly the same as the first condition in Altmark. However, in this respect the ruling in Enirisorse took it one step further by using the case law under Article 86(2) to define whether the services in question actually were of a general economic nature.<sup>238</sup> Thus, it is clear that even under the Article 87(1) assessment the services must be SGEI as defined by the case law under Article 86(2). Even if the discretion of Member States is wide in designating specific services as SGEI under this article it is not unlimited and it is subject to the control of the Community institutions.

Second, the Court discussed the second Altmark condition that the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid conferring an economic advantage which may favour the recipient undertaking over competing undertakings. Even regarding this condition the

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<sup>236</sup> Enirisorse, paras. 26-28.

<sup>237</sup> Enirisorse, para. 31. See also Altmark, paras. 87-88.

<sup>238</sup> Enirisorse, paras. 32-33.

Court provided some clarity as compared to *Altmark*. The Court held that it was not clear from the facts of the case that this condition was satisfied, since the information at hand, in particular did not show of what exactly the supposed public service consisted. Furthermore, it was not clear whether the public service concerned only loading and unloading or also other services. Moreover, there were no details available on the cost of those services or on the assessment of the compensation.<sup>239</sup>

Third, the Court discussed the third *Altmark* criteria requiring that the compensation cannot exceed what is necessary to cover the costs incurred, including a reasonable profit, for discharging the PSOs. The Court held that the amount paid to the recipient did not reflect the costs actually incurred due to the discharging of the loading and unloading obligations, since the amount paid was linked to the volume of goods transported by all users and shipped in the port. Thus, the amount paid varied depending on the activity in the port and not on the service provided.<sup>240</sup>

The Court concluded by stating that:

[...] if a measure concerning the allocation by a Member State of a significant proportion of charges, such as port charges, to a public undertaking is not linked to clearly defined public services duties and/or if other conditions, such as those laid down in *Altmark Trans* and set out [in this judgment], are not complied with, that measure must be classified as State aid within the meaning of Article [87(1)] of the Treaty in so far as it affects trade between Member States.<sup>241</sup>

Contrary to the *Altmark* ruling the ECJ in *Enirisorse* did not discuss the fourth criterion in *Altmark*, requiring a private operator test or the public tendering of compensation contracts. However, the Court arguably indirectly mentions this condition by referring to the conditions set out in *Altmark*. However, one could argue that the reference is only to the conditions also referred to in *Enirisorse* thus not to the fourth *Altmark* criterion. This raises several questions. Is this condition still available or is it only a condition used in the field of transport? The Court in *Altmark* when discussing the conditions referred generally to the first three conditions in its judgment, but with regard to the last condition it referred to transport services.<sup>242</sup> Did this imply that particularly the fourth criterion was limited to the transport sector? Or perhaps the Court found it incompatible with the *Chronopost* ruling to set out a market economy test in this case as compared to the factual situation in *Altmark*. Nevertheless, the Court could have provided a clearer answer whether this fourth condition still is a necessary condition to be fulfilled also outside the transport sector and exactly which criteria are necessary to be satisfied for a measure not to be classified as

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<sup>239</sup> *Enirisorse*, paras. 35-37.

<sup>240</sup> *Enirisorse*, paras. 38-39.

<sup>241</sup> *Enirisorse*, para. 40.

<sup>242</sup> *Altmark*, paras. 89-94. See however Travers, p. 390.

State aid. In this respect the ruling in Enirisorse creates additional uncertainty.

Furthermore, the Court did not mention the possibility that a State measure not fulfilling the criteria and thus constituting State aid could be found to be compatible with the common market according to Article 86(2). The silence of the Court in this respect strengthens the probability that no such possibility exists.

In conclusion, even though the ruling in Enirisorse to some extent clarifies Altmark, there still remains some degree of uncertainty. However, it is clear that a conditional compensation approach is the state of the law as it stands today.

## 6 Conclusions and the future regulation of the funding of public service obligations

As has been shown in this thesis there are several different possible interpretations of the concept of State aid with regard to funding of PSOs. The proper legal framework to govern the relationship between State aid law and funding of PSOs has been disputed and different solutions have been suggested.

*The State aid approach* provides a broad interpretation of the concept of State aid with regard to funding of PSOs. This approach interprets the advantage criterion so as to encompass also a mere compensation for the extra costs suffered by a public service provider due to the PSOs imposed on it. Such compensations are therefore to be regarded as State aid under this approach. Such State aid may however be justified by the Commission under Article 86(2). This wide interpretation clearly provides a broad protection of competition and protects from evasions of the law by merely defining a measure as funding of PSOs. As has been discussed in this thesis the notion of State aid is to be interpreted broadly in order to fulfil the purpose of the prohibition in Article 87(1), i.e. to protect competition. However, in my view the interpretation of Article 87(1) made under the State aid approach is too broad and it is not reconcilable with the provision itself. First, it is artificial to find an advantage and a distortion of competition in the situation where there is solely a pure compensation for services provided. Second, even the Treaty itself recognises that not all State measures, but only such that grant an advantage and distort competition, are prohibited. This definition of compensations of PSOs further leads to far-reaching procedural obligations, which seem unjustifiable in the case of a mere compensation for PSOs. Such a strict approach is further hard to reconcile with the interest that the provision of SGEI should not be unduly distorted. The positive aspect of this approach is however that Article 86(2) has an effect in the field of State aid. However, this fact cannot in itself be decisive. For these reasons in my view the State aid approach is not a preferable solution to the problem.

*The compensation approach*, as established in Ferring and ADBHU, has in my view the correct analysis of the advantage criterion in Article 87(1) with regard to the finding that there is no advantage conferred by mere compensations. It is most logical to regard the compensation for a performed duty as not conferring any real advantage. However, the benchmark for determining whether there is a mere compensation under the classical compensation approach is clearly insufficient. This approach only requires that there should not be a compensation exceeding the actual costs incurred in discharging the PSOs. This is a too narrow interpretation of

Article 87(1) in that this benchmark is insufficient to rule out that no advantage has been conferred. Furthermore, this approach not only deprives Article 86(2) of its meaning in the field of State aid, but moreover seems to accept a lower standard under which measures may escape classification as State aid than for measures to be exempted from the Treaty rules according to that article. In my view the requirements in Article 86(2) should constitute the minimum standard under which funding of PSOs may escape the prohibition of State aid, since this provision balances the interest of protection of competition and the interest of the availability of SGEI. The compensation approach offers a too weak protection of competition. However, it provides a flexible framework by not imposing all compensations of PSOs to the procedural rules of Article 88. Thus, the approach could be argued to promote, at least in the short run, the operation of SGEI. Nevertheless, the classical compensation approach is too narrow and can thus not be accepted as an adequate solution to the problem.

*The quid pro quo approach* combines both the interest of undistorted availability of SGEI and the interest of undistorted competition in one solution. Furthermore, it gives meaning to Article 86(2) in the field of State aid. However, there is a significant uncertainty regarding how the solution is to be applied in practice. The *quid pro quo* approach seems to provide even more legal uncertainty than the Altmark and Enirisorse rulings. Moreover, this solution does not provide an improvement neither for the protection of competition nor for the availability of SGEI as compared to the Altmark/Enirisorse solution.

The judgments in *Altmark* and *Enirisorse* confirm the interpretation under the classical compensation approach that a mere compensation for PSOs does not confer an advantage on the recipient and does thus not constitute State aid. This is as expressed earlier, in my view, the correct interpretation of Article 87(1). However, by providing additional conditions that have to be satisfied, thus applying a conditional compensation approach, these judgments are a clear improvement as compared to Ferring and ADBHU. In my view, the first three criteria in Altmark increase the protection of competition and are in all a positive contribution to the State aid assessment. These conditions are further fairly unproblematic. It is more questionable whether a private operator test, as introduced in the fourth Altmark condition, is suitable in all situations of public service financing, because of the special characteristics of SGEI. However, in my view, a sufficiently advertised and open public procurement procedure is an appropriate tool to exclude overcompensation. Such procedure best ensures that normal market conditions are upheld. In any event, all the Altmark conditions offer an increased protection of competition. The benchmark in Altmark to determine whether there is a mere compensation is far more satisfactory than the benchmark provided by Ferring and ADBHU. The benchmark in Altmark provides at least a standard comparable to that set out in Article 86(2), even if regrettably Article 86(2) seems not to be directly available. Furthermore, the Altmark conditions provide increased transparency. Furthermore, the Altmark judgment preserves the interest of uninterrupted

availability of SGEI, by not unnecessarily burdening public service providers with the procedural obligations under State aid law. Even though the Altmark ruling and the Enirisorse ruling have, as has been seen in the thesis, resolved a number of the problems existing in this area of the law prior to these rulings, they themselves create some new problems and uncertainty. There is considerable uncertainty regarding in particular the interpretation and application of the conditions. Furthermore, even if Article 86(2) most likely is not a possible exception if a measure does not comply with the conditions set out in these judgments, however this has not been directly confirmed. Furthermore, the Enirisorse ruling possibly provided uncertainty with regard to the exact conditions that have to be fulfilled for a measure not to be classified as State aid, in particular by not directly discussing the fourth Altmark condition. Lastly, in the case that the fourth condition of Altmark should be regarded as applicable the ECJ has not clarified the relationship between the private operator test contained in that condition and the Chronopost ruling. In my view a conditional compensation approach, like the one in Altmark and Enirisorse, even if not a perfect solution, is definitely a step in the right direction to solve the problem how to treat PSOs under the EC State aid rules, taking into account both the protection of competition and the availability of SGEI.

Following from the conclusion above, a main problem with the current legal framework governing the funding of PSOs is the lack of legal certainty. Many questions, especially on the interpretation and application of the conditions, are still unanswered. This uncertainty is not acceptable in such an important area of the law. Thus, further measures must be adopted to clarify in which situations the prohibition of State aid comes into play. Future case law will hopefully interpret the Altmark and Enirisorse solution further and hopefully provide more legal certainty. There is definitely a need for an express answer to the question whether a measure not fulfilling the conditions of these cases could nevertheless be regarded as compatible with the common market according to Article 86(2). Also the Commission could increase the legal certainty. The Commission could do so through a soft law, such as a communication, guideline or a framework.<sup>243</sup> In such a soft law the Commission should state its interpretation of the new developments in the field of funding of PSOs. It should in such a soft law also state whether and under what conditions it regards Article 86(2) as being an available exception under the current legal framework. Furthermore, the Commission has considered the possibility of adopting a block exemption for funding of PSOs.<sup>244</sup> This would definitely provide legal certainty, since such a block exemption would set out the exact conditions under which funding measures could escape the prohibition of State aid and the notification requirement. However, this condition seems only to be

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<sup>243</sup> See Report to the Laeken European Council – Services of General Interest, COM(2001), 598, 17 October 2003, para. 28, where the Commission announces that it intends to adopt a Community framework.

<sup>244</sup> See Report to the Laeken European Council – Services of General Interest, COM(2001), 598, 17 October 2003, para. 29.



available if the Court would have adopted the State aid approach, because only then there is a need for exempting compensations from the prohibition. Under the Altmark/Enirisorse solution and the classical compensation approach the compensations for PSOs are not covered by the prohibition from the outset.<sup>245</sup>

It will undoubtedly be interesting to see how the Commission in its practice and the EC Courts in future case law will interpret these judgments.

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<sup>245</sup> See also Bartosch 2003:1, p. 385.

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