

The New State Aid Rules for Services of General Economic Interest (SGEI)

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On 20 December 2011, following extensive public consultations, the European Commission adopted a new package of State aid rules for services of general economic interest (SGEI). This article offers an overview of the new SGEI package. More detailed articles on the instruments of the package, as well as an article providing a specific example of how the rules are applied will follow in the coming months.

SGEI Background

SGEI are services of an economic nature that public authorities identify as being of particular importance to citizens, but which are not supplied by market forces alone, or at least not to the extent and under the conditions requested by society. Their provision may therefore require public intervention.

Examples of SGEI range from providing large commercial services (such as postal services, energy security of supply, electronic communication services or public transport) to the entire population at affordable conditions, to a wide range of health and social services (such as care for elderly or disabled people).

SGEI are carried out in the public interest under conditions defined by the State, which imposes a **public service obligation** on the provider(s). Since SGEI provision under such conditions may not generate a (sufficient) profit for the provider, **public service compensation** might be needed to offset the additional costs stemming from the public service obligation.

Nonetheless, State intervention on a market alters the market mechanism and can be a source of distortion, unless properly targeted. Therefore, State aid control aims to ensure that public service compensation is **necessary and proportionate** to the objective pursued, so as to avoid distortions of competition and trade contrary to the interest of the EU.

Altmark judgment

In its *Altmark* judgment of 24 July 2003², the Court of Justice provided clarification as to when public service compensation does not constitute State aid owing to the absence of any advantage. According to the judgment, for a State measure to be considered aid-free, **four cumulative conditions** have to be satisfied:

- there must be an entrustment act clearly defining the public service obligation;

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² Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-7747.

- the parameters for calculating the compensation must be established in advance in an objective and transparent manner;
- the compensation cannot exceed the relevant costs and a reasonable profit (i.e. there is no overcompensation); and
- the provider is either chosen through a public procurement procedure or the level of compensation is determined based on an analysis of the costs of an average "well-run" undertaking in the sector concerned.

The *Altmark* ruling highlighted the fact that many instances of public service compensation for SGEI providers represent State aid. In order to provide legal certainty, the Commission adopted in 2005 a set of specific rules for the compatibility of such State aid with the internal market.

2005 package

The first SGEI package consisted of three legal instruments:

- a **Decision**, which provided that public service compensation, below certain amounts and fulfilling certain conditions, could be considered compatible with Article 106(2) TFEU, and therefore were exempt from the obligation to *ex ante* notification to the Commission under Article 108 TFEU;
- a Community **Framework** outlining the Commission's approach to cases falling outside the scope of the Decision and therefore subject to the notification obligation and Commission assessment; and
- an amended **Directive** on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings, setting the basic rules for separation of financial accounts between SGEI and other activities performed by the same undertaking.

Reform of the State aid rules for SGEI

The phases of the reform process and the reform objectives

The revision process was launched in 2010 with a public consultation. In March 2011, the Commission published a report³ on its outcome and on the application of the 2005 SGEI package across various sectors. The report showed that the package had made a valuable contribution to the objective of legal certainty following the *Altmark* ruling, but highlighted a very scattered application of the package and the need for further guidance and simpler rules.

A Commission Communication⁴ accompanied the report and aimed to set out the broad political **objectives** of the reform.

³ Commission Staff Working Paper SEC(2011) 397 of 23 March 2011 on The Application of EU State Aid rules on Services of General Economic Interest since 2005 and the Outcome of the Public Consultation.

⁴ COM(2011) 146 final of 23 March 2011 on the Reform of the EU State Aid rules on Services of General Economic Interest.

The Communication outlined two main objectives:

- **Clarification** of key concepts relevant for the application of State aid rules to SGEI;
- A **more diversified and proportionate approach**, by:
 - **Simplification** for small-scale public services of a local nature with a limited impact on trade between Member States and for certain social services, and
 - Greater account of **efficiency and competition considerations** in the treatment of large-scale commercial services with a clear EU-wide dimension.

The Commission engaged in extensive dialogue with stakeholders and prepared an impact assessment to support the reform⁵. Concrete proposals consisting of four instruments were published in September 2011 and debated at a conference in Bruges. The proposal was thus subject to a second general stakeholders' consultation and to a meeting with the Member States in October 2011. Thanks to the input and contributions of many public authorities, European and national institutions, stakeholders and practitioners, the Commission was able to adopt the new revised package of State aid rules for SGEI on 20 December 2011⁶.

A brief summary of the newly adopted package

As stated by Commission Vice-President in charge of competition policy, Joaquín Almunia, "*the new SGEI package provides Member States with a simpler, clearer and more flexible framework for supporting the delivery of high-quality public services to citizens which have become even more necessary in these crisis times.*"⁷

Clarification of key concepts in the field of State aid for SGEI is achieved through the new Communication⁸. Simplification is achieved through a new *de minimis* Regulation⁹ and through the revised Decision¹⁰. The Regulation aims to provide simplification for small, local SGEI, for which compensation below a given threshold is deemed not to constitute State aid. The Decision acts as a block exemption from notification of compensation that is State aid, but fulfils relatively simple compatibility criteria. Finally, the revised Framework¹¹ includes a more thorough check for large compensation amounts that have to be notified to and assessed by the Commission. The main changes brought by the newly adopted package are presented in the following chapter.

⁵ The report can be found on the Impact Assessment website: http://ec.europa.eu/governance/impact/index_en.htm.

⁶ Three out of four texts were adopted as final, while the new *de minimis* Regulation was adopted as a proposal, in view of its longer procedural adoption process. Its final adoption is expected in spring 2012.

⁷ Press Release IP/11/1571, 20.12.2011.

⁸ Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (OJ C 8, 11.01.2012, p. 4-14).

⁹ Draft Commission Regulation (EU) of 20.12.2011 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest (OJ C 8, 11.01.2012, p. 23-27).

¹⁰ Commission Decision of 20.12.2011 (OJ L 7, 11.01.2012, p. 3-10).

¹¹ Communication from the Commission, European Union framework for State aid in the form of public service compensation (2011) (OJ C 8, 11.01.2012, p. 15-22).

Overview of the main changes

Communication

The Communication is a new instrument, aimed at explaining basic concepts of State aid, relevant for SGEI, based on the interpretation of the Treaty by the Court of Justice and on the Commission's practice.

General State aid concepts

Besides explaining some general aspects of the definition of State aid (such as the notions of "State resources" and "effect on trade"), the Communication also explains in more detail the concept of economic activity, with reference to the relevant case-law.

The Communication clarifies that an **economic activity** is any activity consisting of offering goods and services on a market¹². However, whether a market exists depends on the organisation by the relevant authority¹³, which may differ from one Member State to the other. Furthermore, the nature of an activity might change over time depending on developments (i.e. what is not a market activity today may turn into one in the future, and vice versa). It should be noted that it is irrelevant for this assessment whether the entity is set up to generate profits or not¹⁴.

SGEI specific concepts

The first issue to clarify is **the existence of a SGEI**. The Communication explains that, first, SGEI are services that exhibit special characteristics as compared with those of other economic activities¹⁵; second, Member States have a wide margin of discretion in defining a SGEI, while the Commission only checks for manifest error¹⁶; third, a public service obligation cannot be imposed for an activity which already is or can be provided satisfactorily by the market "under conditions, such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest, as defined by the State"¹⁷; finally, a SGEI must be addressed to citizens or be in the interest of society as a whole.

In order to comply with the *Altmark* case-law, a public service assignment is needed that defines the obligations of the undertaking(s) and of the public authority. This is the **entrustment act**, which may take a variety of forms, depending on the legal framework of the Member State. In any case, it has to specify certain core features regarding the provision of the SGEI.

The Communication also clarifies some aspects related to the **parameters of compensation**, which have to be established in advance in an objective and transparent manner. No specific formula is required, but how the compensation will be determined must be clear from the outset.

¹² Case 118/85 *Commission v Italy* [1987] ECR 2599; Case C-35/96 *Commission v Italy* [1998] ECR I-3851; Joined Cases C-180/98 to C-184/98 *Pavlov and Others*.

¹³ Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* [1993] ECR I-637.

¹⁴ Joined Cases 209/78 to 215/78 and 218/78 *Van Landewyck* [1980] ECR 3125; Case C-244/94 *FFSA and Others* [1995] ECR I-4013; Case C-49/07 *MOTOE* [2008] ECR I-4863.

¹⁵ Cases C-179/90 *Merci convenzionali porto di Genova* [1991] ECR I-5889; Case C-242/95 *GT-Link A/S* [1997] ECR I-4449; Case C-266/96 *Corsica Ferries France SA* [1998] ECR I-3949.

¹⁶ Case T-289/03 *BUPA and Others v Commission* [2008] ECR II-81; Case T-17/02 *Fred Olsen* [2005] ECR II-2031.

¹⁷ Case C-205/99 *Analir* [2001] ECR I-1271.

In order to **avoid overcompensation**, the amount of the public service compensation must be limited to what is necessary to cover the costs incurred in discharging the public service obligation, taking into account receipts and a reasonable profit. The reasonable profit should be taken to mean the rate of return on capital required by a typical company considering whether or not to provide the service, taking into account the risk level.

The clarification on when the **selection of the provider** by a public procurement procedure allows for the provision of the service "at the least cost to the community" is one of the major innovations of the Communication. Clarification of this interplay between State aid and public procurement law was one of the main requests by Member States and stakeholders. The Communication offers guidance on the degree to which the use of the different procedures and the different award criteria foreseen in the public procurement directives¹⁸ can ensure that the service is provided "at the least cost to the community" and therefore satisfy the first leg of the fourth *Altmark* criterion. Clarification is also provided for when the provider is not selected by a public procurement procedure and a comparison with a typical well-run undertaking is necessary.

De minimis Regulation

On 20 December 2011, the Commission published the proposal for the *de minimis* Regulation. The final adoption of this new instrument is planned for spring 2012, following a second meeting of the Advisory Committee.

At the moment, the draft proposes that public service compensation below a threshold of EUR 500.000 over three fiscal years is deemed not to constitute State aid. This threshold is higher than the one in the general *de minimis* Regulation¹⁹, based on the consideration that an SGEI provider incurs costs which are directly associated with the public service obligation that it has under the entrustment act. The aid element in the compensation is therefore presumably much lower than the amount actually granted. Based on the presumption that such aid does not have an effect on trade in the internal market, this new SGEI *de minimis* should considerably simplify compliance with State aid rules for local public authorities.

Decision

The Decision block exempts public service compensation from notification. Compared to the 2005 Decision, the main changes in the revised version concern the scope of application, the duration of the entrustment and the amount of compensation.

First, taking into account the administrative burden for providers and for authorities in the social services sector, **the scope of the exemption without any notification threshold** has been extended to services "meeting social needs as regards health and long term care, childcare, access to and reintegration into the labour market, social housing and the care and social inclusion of vulnerable groups". For the remaining SGEI, the notification threshold of the Decision has been lowered to EUR 15 million of compensation per SGEI, while the threshold for the turnover of the undertaking has been eliminated.

¹⁸ Directive 2004/18/EC of the European Parliament and the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (OJ L 134, 30.4.2004, p. 114); Directive 2004/17/EC of the European Parliament and the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors (OJ L 134, 30.4.2004, p. 1).

¹⁹ Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid (OJ L 379, 28.12.2006, p. 5-10).

The duration of the entrustment period has been limited to a maximum of 10 years, with an exception for situations where a longer period is justified by the amortisation of a significant investment.

Finally, **the amount of compensation** must not exceed the net costs, including a reasonable profit. The **reasonable profit** is to be determined as the rate of return on capital that would be required by an undertaking considering whether or not to provide the service, taking into account the degree of risk. A profit below the relevant swap rate (the swap rate is taken as an indication of the return of risk-free investment) plus a liquidity premium of 100 basis points is considered to be reasonable in any event. The change of indicator for the reasonable profit reflects the evolution from an accounting approach to an economic approach and corresponds to the practice of the public authorities when deciding on the budget to allocate to a SGEI. However, where the use of the rate of return on capital is not feasible, other profit indicators are allowed.

Framework

The Framework sets the rules for the compatibility check of public service compensation for large commercial SGEI that do not fall under the scope of the Decision, and thus have to be notified to and assessed by the Commission.

The **transparency** requirements are reinforced on three levels under the revised Framework. The undertaking has to comply, where applicable, with the Transparency Directive; proper consideration has to be given to the public service needs by means of a public consultation or a similar instrument; and the Member State must publish on the internet or by other appropriate means certain information with regard to aid falling within the scope of the Framework.

In order to ensure coherence between State aid and public procurement law, the revised Framework introduces the requirement of **compliance with public procurement rules**, which means that for aid to be declared compatible, the public authority which entrusted the provision of the SGEI must have complied with the relevant rules in the area of public procurement, including the Public Procurement Directives, but also the principles of transparency, equal treatment and non-discrimination stemming from the Treaty.

Another requirement is that of **absence of discrimination**, which means that compensation for several providers entrusted with the same SGEI has to be calculated in the same way.

A novelty in the revised Framework is that calculation of the compensation should be done on the basis of **the net avoided cost methodology**, which has also been used under the Telecommunication and Postal Directives. Under this methodology, the cost of the SGEI is calculated as the difference between the net costs of the undertaking operating the SGEI and the net costs of the same undertaking but without the SGEI entrustment. This methodology provides a better estimate of the economic burden of the public service obligation, as it takes account of the decisions which would be made in the absence of such an obligation. Thus it facilitates fixing the amount of the compensation at a level which ensures the best allocation of resources. However, there is a possibility for Member States to use the cost allocation methodology where it is not feasible or appropriate to use the net avoided cost methodology.

Regarding the **reasonable profit**, the same concepts as under the Decision apply.

Another new element in the revised Framework is the requirement for Member States to introduce **efficiency incentives** in the compensation scheme, unless they can justify that this is not feasible or appropriate. Member States have great flexibility in designing such incentives. However, when improvements in efficiency are achieved, the related gains can be partly retained by the undertaking as an "additional reasonable profit". Efficiency gains should be achieved without prejudice to the quality of the service.

For cases where the development of trade is affected to an extent contrary to the interests of the Union, the Commission may impose **additional requirements** (see section 2.9 of the Framework). The situations envisaged in the Framework concern: excessive duration of the entrustment; bundling of tasks; market foreclosure without competitive selection procedure; public service obligation connected with special or exclusive rights, providing immaterial advantages; financing of a non-replicable infrastructure to which competitors would not have fair and non-discriminatory access; and entrustment hindering the effective implementation or enforcement of EU law, aimed at safeguarding the proper functioning of the internal market.

Conclusions

The new Communication is an important clarification tool, which provides public authorities with a useful summary of the main State aid concepts relevant for SGEI and clarifies the relation with public procurement rules. Moreover, the new package provides for a more targeted approach towards aid measures for SGEI. On the one hand, rules are much simpler for services that are small and of a local nature and therefore do not have a significant effect on trade or impact of competition in the internal market, as well as for social services. On the other hand, more emphasis is now placed on larger SGEI that are likely to have a significant impact on the internal market, and thus require a more in-depth assessment of their compatibility according to stricter conditions.