Compensation for services of general economic interest: some thoughts on the Altmark ruling

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1. Introduction

With the Altmark judgement (2), the European Court of Justice has uttered the last word in a long-standing dispute: is compensation for services of general economic interest (SGEI) a State aid?

The debate — opened by the departure in the FFSA judgement (3) from the approach of Waste Oils (4) and revamped with Ferring (5) — originated from the apparent impossibility of avoiding either one of two unpleasant conclusions:

— Fair compensation for extra costs imposed by the State gives an advantage to the recipient;

— Article 86 loses any purpose in State aid, if fair compensation is no aid and over-compensation is always incompatible.

While in the previous pronouncements the arguments against one conclusion had been given more weight than those against the other, the Altmark judgement is a fine and successful attempt at squaring the circle and at striking a balance between the two views. We believe, however, that some clarifications and, possibly, a shift in emphasis in some parts, could be useful to avoid undesirable deductions from and possible misinterpretations of the judgement.

2. The Altmark judgement

In the Altmark judgement, the European Court of Justice, after reminding the requirements for existence of State aid, (6) goes on to argue that — provided the compensation for the public service obligations meets certain conditions — the recipient undertakings ‘do not enjoy a real financial advantage and the measure thus does not have the effect of putting them in a more favourable competitive position than the undertakings competing with them’. (7) In other words, public support might be arranged in a way that does not confer any advantage to the recipient, therefore failing one of the requirements of article 87(1) for qualifying as a State aid.

The conditions for such compensation to escape classification as State aid are:

— First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined.

— Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner. (8)

(1) Both authors work for the European Commission, Directorate-General for Competition. The present document only reflects their personal opinions and should not be held to represent the views of the European Commission or of the Directorate General for Competition. The authors wish to thank the many colleagues who provided them with their valuable comments and opinions. The final responsibility for the content of the paper rests solely on the authors.

(2) Judgement of the Court, case C-280/00, Altmark [2003].

(3) Judgement of the Court of First Instance, case T-106/95 Fédération française des sociétés d’assurances (FFSA), [1997] ECR II-0229. See also the Court’s judgement in Case T-46/97 SIC [2000] ECR II-2125.

(4) Judgement of the Court, Case 240/83 ADBHU [1985] ECR 531.


(6) ‘First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition’. §75 of the judgement.

(7) §87 of judgement.

(8) The ECJ adds that: ‘Payment by a Member State of compensation for the loss incurred by an undertaking without the parameters of such compensation having been established beforehand, where it turns out after the event that the operation of certain services in connection with the discharge of public service obligations was not economically viable, therefore constitutes a financial measure which falls within the concept of State aid within the meaning of Article 92(1) of the Treaty’.
— Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations.

— Fourth, where the undertaking is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs of a typical undertaking, well run and adequately provided with means.

These criteria seem to lead to the identification of three categories of cases, in which:

(1) the compensation is limited to the extra costs of an efficient operator;

(2) the compensation does not exceed the extra costs of the recipient/provider, which, however, is not an efficient operator; and

(3) the compensation exceeds the extra costs of the provider. (1)

The logical conclusion for the assessment would be a finding of:

— non-aid in the first category of cases;

— possibly, compatible aid in the second category, and

— clear-cut incompatibility in the third.

The aid element would therefore be present not only in the overcompensation of the actual costs of the public service, but also in the funding of economic inefficiency.

Within this framework, a role would be preserved for article 86, while maintaining that a provider of a public service that is compensated at the minimum possible level does not receive any economic advantage. This framework differs from what the ECJ previously implied notably in Ferring, where only the two extreme categories were foreseen: either non-aid or incompatible aid. (2)

3. Neither necessary nor sufficient conditions

The whole controversy on the SGEI is dictated by what is eminently a practical problem. If compensation for SGEI is always aid, the notification requirement of Article 88(3) EC Treaty applies, and any national judge could halt a public service whose funding mechanism had not been notified to the Commission.

The ECJ therefore tries to identify situations in which there is ex-ante certitude that the public service is assured at the least cost to the community and that no advantage has been granted to the recipient. In such circumstances there would be no need for Commissions' scrutiny and the measures could be classified as non-aid.

The four conditions set in the Altmark judgement have different scope. The first pertains to the object of the payment: it must be related to well defined SGEI. The second refers to procedural aspects: calculation method must be set ex-ante. The third concerns the appropriate amount of compensation. The fourth is a mix of quantification elements (least cost or efficient provider) and procedural aspects (tender or cost analysis).

The wording of §§ 88 and 94 of the judgement suggests that the criteria established by the Court represent sufficient and necessary conditions for qualification of (non)aid. In these circumstances, (non)existence of aid would necessarily proceed not only from the object and amount of compensation, but also from procedural aspects.

3.1. The paradox of the non-tendered minimum compensation

The framing of procedural requirements as necessary conditions for non-aid could easily lead to paradox. One could imagine two cases — identical in every respect, save for the procedure followed in granting the compensation — being classified differently. The same, minimum amount granted after a thorough analysis of the costs of efficient enterprises would not be an aid, contrary to the same amount granted without such an assessment.

(1) In mathematical terms the three categories can be expressed as follows: i) $S \leq EC^* \leq EC^{R}$; ii) $EC^* \leq S \leq EC^{R}$; iii) $EC^* \leq EC^{R} \leq S$, where $S$ = subsidy, $EC^*$ = extra costs of the efficient operator and $EC^{R}$ = extra costs of the subsidy recipient.

(2) Such a problem of loss of meaning for article 86(2) EC was first highlighted by Advocate General Léger in his opinion on the Altmark case of 19 March 2002 and in the Opinion of Advocate General Jacobs of 30 April 2002 in Case C-126/01, GEMO.
Apart from this hypothetical example, there is the more realistic situation in which there are only few potential providers of a certain service. In those circumstances a tender or even a survey of typical costs would not prove very useful, but skipping those procedures leads to a finding of aid. Can we really say that in all those circumstances there is advantage for the recipient?

The mix of procedural and substantive requirements seems related to the ECJ attempt to identify under which circumstances compensation for a SGEI could legitimately escape notification (a procedural obligation), since it would be limited to the minimum necessary (a substantive requirement). However, it is doubtful that a procedural defeat necessarily implies a substantive failure.

3.2. Tenders and 'reasonable' profit

The above paradox is based on the circumstance that procedural aspects are not necessary to achieve the ‘least cost’ objective. One can also wonder whether they represent sufficient conditions.

It is an acknowledged result in economics that a tender may lead to very different results depending on how it is designed and that, at any rate, a tender does not necessarily lead to the provision of a service at the least possible cost. (1)

A typical case would be that of a SGEI provided through a network, such as water or electricity distribution. In such cases, an incumbent firm that owns the network would be greatly advantaged in a tender for the provision of the service, unless there are open access requirements to the distribution facility or the use of the network itself is also being included in the procedure. In many other circumstances, the incumbent would enjoy scale and scope economies well beyond alternative suppliers. In view of the asymmetry between providers, a tender procedure would not necessarily drive the winning offer down to the least possible cost. The incumbent, in fact, can limit its offer to just below what can be afforded by its competitors.

This observation begs the question of what is intended by the wording ‘least cost to the community’. Does it refer to the cost of the most efficient producer or to the best offer available on the market? The two are not necessarily equal and a tender procedure would only ensure the achievement of the latter.

The question is strictly linked to the issue of how to interpret the notion of ‘reasonable profit’. It is not surprising that the ability to produce at lower costs generates higher profits. Indeed, even in perfect competition the most efficient producers are capable of enjoying profits. Those could be seen as the ‘fair’ remuneration for their superior production factors. In the case of SGEI, however, the ability to produce at lower cost is often linked to the control over networks set up by the public authorities or already amortised thanks to granting of exclusive rights. Can the economic rents associated to those networks be accepted as reasonable profit?

The answer to this question must be negative, but this implies that even in cases where a SGEI is attributed through a tender, the third Altmark criterion (no overcompensation) might not be met and that the compensation is an incompatible aid that should have been notified. This is consistent with the wording of the judgement — ‘selection of the tenderer capable of providing those services at the least cost to the community’ — providing that the concept of least cost to the community is interpreted restrictively. Even so, however, the Commission would be put in a very difficult position if it had the burden of proving that the tender procedure was not capable of avoiding overcompensation.

4. Absence of advantage: the paradox of the tendered factory

The Altmark judgement is based on one fundamental principle: when the public service is assured at the least possible cost — including a reasonable profit margin — no advantage is being granted to the recipient. In such cases there is no State aid.

Now let’s, for a moment, avert the discussion from SGEIs and imagine a situation in which a regional authority tenders out the production of a certain good in its territory. The region faces some competitive disadvantages so that a subsidy is needed to attract, for instance, the necessary investments. The subsidy could take the form of a factory or of a piece of equipment or land rented at below market price. The tendering procedure might ensure that the subsidy is the minimum necessary to attract a producer. Therefore, it can be reasonably argued that the winner of the tender does not enjoy a financial advantage and is put in

exactly the same competitive position as producers located in more favoured regions. Is this an aid?

The first reaction to this question would be to say that the measure is clearly aid, actually a regional aid, i.e. aid for the development of a region. Regional aid is typically subject to strict rules as it distorts the investment allocation of firms across the EU and trade between Member States. (1)

Indeed, the Altmark criteria are not relevant here since the good in question is not a service of general economic interest. However, if the principle is accepted that a mere compensation for disadvantages — that does not put recipients in a more favourable competitive position than competitors — is not an aid, why the reasoning should be valid for services of general economic interest and wrong in other circumstances? Once an absence of advantage is ascertained, the State measure no longer meets one of the basic conditions in Article 87(1) and, regardless of its aims and purpose, should not qualify as aid. (2)

In fact, we can think of three different types of goods or services which could be 'procured' by the State through a tender procedure, e.g.: the service to the public administration, a public service to the citizens or an economic activity to a less developed region. The three situations are obviously very different, but they have one element in common: the tender procedure is supposed to neutralise the advantage for the recipient. If the advantage to the recipient is a condition sine qua non for presence of aid the emergence of a paradox cannot be prevented.

5. Possible clarifications

Are the paradoxes avoidable? Could some adjustments be envisaged or clarifications provided, to avoid possible misinterpretations of the judgement? We believe so.

The difficulties arise from the circumstance that it is possible to have overcompensation in the presence of a tender and fair compensation in the absence of tender. This is not to say that reference to tenders or to well run undertakings is without merits. On the contrary, it is very important because it clarifies that there is aid whenever compensation goes beyond the costs of an efficient provider, not simply beyond the costs of the recipient. (3) It would probably have been better, however, to clarify this concept and present the 'ideal tender' as the benchmark for assessment, without raising the procedural requirements to the rank of constituent parts of the notion of aid.

A second comment is referred to the issue of 'advantage' and to the notion of services of general economic interest.

Qualifying State intervention as non-aid simply on the basis of absence of advantage for the individual operator, would neglect the possibility that there might be an advantage for certain productions. When the State procures stationary for its administration it behaves like a normal consumer and does not favour any production; but when it alters the allocation of resources in the market, by acting as a public authority (4), it may favour certain sectors or productions. (5) This would be justified in the case of services of general economic interest, less so to stimulate economic activity in general, possibly to the detriment of productions in other Member States.

In fact, in the case of SGEI, the non-aid nature of the intervention is due to the nature of the aided activity as much as to the absence of advantage for the individual recipient. The reasoning presents some analogies with the funding of non-economic activities. When the State finances the universal health system or public education it is not deemed to favour certain productions, but rather carrying out a typical duty of the public authority. In that

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(1) In fact it would not be possible to argue that the region is acting as a market economy investor to the extent it could sell the same good or service at a higher price had it decided to impose no condition on the use of such good or service. See for instance Commission Communication on State aid elements in sales of land and buildings by public authorities (97/C 209/03), OJ C 209, 10.7.1997. See also the Commission Guidelines on National Regional Aid, OJ C 74/9, 10.3.1998.

(2) The argument that in the two cases the origin of the disadvantage is different — State obligation vs external factors — is not convincing: the obligation to produce in a disadvantaged region would not be very different from the obligation to open a post office in a remote area.

(3) The reference to a tender also clarifies that all sorts of advantages — direct and indirect — linked to the entrustment of the public service must be taken into account in determining the amount of compensation. Indeed, bidders form their offers on that basis.

(4) The different roles of normal economic actor or of public authority are typically detected by checking the compliance with the Market Economy Investor Principle (MEIP), i.e. whether a private operator would have carried out the same transaction on the same terms under similar circumstances.

(5) A few examples would be that of a form of transport that is favoured over alternative means, or televised information over newsprint, or clean energy over non-renewable one.
case the recipients are not considered to be ‘undertakings’, which is sufficient to qualify the intervention as outside the scope of Article 87. When making possible the provision of SGEIs, the State is similarly performing a typical task of the public authority. The only difference is that it chooses to entrust the task to undertakings. This requires the State to avoid granting advantages to the individual recipients of compensation, but the activities remain, so to say, protected from a possible claim of sectoral aid.

Perhaps the Court could clarify that the absence of advantage for individual recipient is sufficient to exclude aid, only in view of the fact that sectoral advantage must be ruled out in the particular case of services of general economic interest. This, however, should be coupled with greater guidance as to which type of services can be defined as services of general economic interest. In the current situation, Member States enjoy a large discretion on this issue and there is a concrete risk that the notion of SGEI is extended with the purpose of subtracting certain types of subsidies from the standard rules on State aid. The qualification as service of general economic interest should be confined to services that meet general needs of the population, that are not adequately provided by the market in the absence of State funding and where the entrustment of a specific task to individual operators is the only practicable solution or has clear advantages over the alternatives (e.g. general regulation).

It should be noted that the fulfilment of the Altmark criteria deprives the Commission of the possibility to effectively apply the common interest criterion of Article 86(2). Accordingly, the circumstance that there might be less distortive ways of achieving the public interest task, than a financial transfer to individual operators — through e.g. regulation (laws on media concentration etc) or open access public infrastructures — can only be tackled by questioning the definition of the public service. (1) If it is maintained that the Commission role is limited to control for manifest error, the Altmark judgement would imply lowering the standard for compatibility with the common market.

6. Conclusion

The Altmark judgement conclusively establishes the principle that a compensation that does not exceed what is necessary to cover the minimum possible costs incurred in the discharge of public service obligations is not a State aid. This is a welcome clarification as well as an appreciated introduction of the idea that compensation for inefficiency is an aid, although possibly compatible.

The judgement, however, goes beyond the setting of this principle and links some procedural requirements (ex-ante fixation of parameters, tender procedure, analysis of the costs of a typical undertaking) to the notion of aid. While this has the beneficial effect of preserving ex-ante Commission control in cases where the compensation is not entirely transparent, it has the consequence of labelling as aid all compensations not meeting those requirements, independently of whether they provide an advantage to the recipient or not. On the other hand, these procedural requirements — possibly refined to ensure the achievement of the desired outcome — should continue to provide guidance on the assessment of cases.

Finally, further developments on the definition of SGEI would be desirable. The absence of advantage to the individual recipient should be considered sufficient to exclude State aid only in connection to services of general economic interest. The latter should be confined to services that meet general needs of the population that are not adequately provided by the market and where those needs cannot be reasonably served in less distortive ways.

(1) In case of recourse to cost analysis rather than to a tender, there might also be distortions originated by the application in different Member States of different definitions of SGEIs and different criteria for compensation. On this topic cf. An example of the application of State aid rules in the utility sector in Italy, Competition Policy Newsletter, N. 3, October 2002, p. 17.