The commission's new SGEI package
Sauter, W.

Document version:
Publisher's PDF, also known as Version of record

Publication date:
2012

Link to publication

Citation for published version (APA):
The Commission’s new SGEI package: the rules for state aid and the compensation of services of general economic interest

By
Wolf Sauter

April 23, 2012

ISSN 1572-4042

http://ssrn.com/abstract=2044680
The Commission’s new SGEI package: the rules for state aid and the compensation of services of general economic interest

Wolf Sauter

Abstract: In December 2011 the European Commission updated its original SGEI package of 2005 in which it spelled out under which conditions public service compensation constituted aid but was compatible with the internal market. As such both versions of the Package complement the 2003 Altmark ruling of the European Court of Justice which outlined the four conditions under which compensation would not be considered to form aid in the first place. The new regime seeks to distinguish on the one hand generally compatible social services (such as healthcare and social housing) and on the other the utilities where individual exemption decisions are believed to be more frequently required. Compared to the 2005 version there is now also more emphasis on efficiency and the use of public procurement procedures and more detail on what constitutes acceptable costs and a reasonable rate of return.

Keywords: EU law, state aid, services of general economic interest, public service

JEL Classifications: K21; K23; L43; L44

* Tilburg Centre for Law and Economics (TILEC) at Tilburg University and Dutch Healthcare Authority. I am grateful to Hans Vedder and Leigh Hancher for their comments on an earlier version. The views expressed here are personal.
Introduction
The 2003 ruling of the ECJ in the Altmark Case meant a breakthrough in the treatment of services of general economic interest (SGEI) under the state aid rules. The Commission built on this basis by means of a coherent package of measures adopted in 2005 under Article 106(3) TFEU which aimed to provide a framework for SGEI that did not meet all the Altmark criteria but were eligible for an article 106(2) TFEU exemption as aid that was compatible with the internal market. This package is known as the Altmark package, or as the “Monti/Kroes package” after the Commissioners responsible. Based on the experience gained in the meantime and an extensive consultation the Commission proposed a renewed Altmark Package “Mark II” in September 2011. Following a further shorter consultation this was adopted with minor modifications on 20 December 2012 and came into force on 31 January 2012 (with exception of a de minimis Regulation that will be adopted in April 2012). In this contribution we will briefly touch on the Altmark Case and the first Altmark Package before discussing the Altmark Package Mark II and focusing on of the differences between the two as well as some points of criticism.

SGEI
First it is necessary to recap briefly the concept of SGEI. Such services can be designated by the Member States in accordance with subsidiarity, and in the absence of any limited list or definition provided at EU level. This notwithstanding in areas of EU harmonisation such as energy or electronic communications minimum sets of universal services are established at EU level that can form the basis of SGEI. A designation as SGEI is also subject to a test for manifest error. The Treaty rules for SGEI are found in Article 106(2) TFEU which provides for an exception to the Treaty rules for undertakings charged with providing SGEI in so far as these rules would obstruct the performance of the public service task involved. Article 14 TFEU (formerly Article 16 EC) and Protocol No. 26 that was added by the Lisbon Treaty also contain provisions that are relevant to SGEI, and were intended by the Member States to limit the Commission’s powers with respect to SGEI. Article 14 TFEU confers a legislative competence on the European Parliament and the Council (without prejudice to Articles 106 and 107 TFEU) that has so far not been used. The Protocol concerns the common values that are the subject of SGEI and services of general interest which (SGI), not being economic in nature, remain outside the scope of the Treaties. The more extensive secondary rules that exist for SGEI in the context of state aid are the subject of this article.

The Altmark case
Altmark concerned the conditions for the award of a regional transport license in Germany. In this case the Court ruled that if the undertaking concerned provided a

---


universal service in exchange for its financing there could be no case of state aid because instead of economic advantage compensation as a quid pro quo for a service provided was at stake. Such economic advantage after all is a condition for a finding that aid exist – alongside the use of state resources, selectivity and an appreciable restriction of competition and of trade between the Member States. This ruling decided the longstanding debate whether in comparable cases compatible aid was at issue or not aid but compensation in favour of the latter approach.³

In order to meet the Altmark conditions

— first, the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined;

— second, the parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner;

— third, the compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations;

— fourth, where the undertaking which is to discharge public service obligations is not chosen in a public procurement procedure, the level of compensation needed has been determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with the relevant means so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

In particular meeting the fourth condition raises difficulties in practice. In fact in most cases where appropriate public procurement procedures are followed the question is what the need for a SGEI would be in the first place. However this condition is generally seen as the most innovative because it means introducing an efficiency test.⁴ In order to provide a solution for those cases when not all four conditions are met the Commission adopted its original Altmark Package in 2005. It should be noted however that meanwhile the General Court has demonstrated in the 2008 BUPA Case that it is prepared to take a more relaxed attitude to in particular the third and the fourth Altmark conditions, which could call into question the Commission’s approach.⁵


⁴ Cf. e.g. Services of General Economic Interest, Opinion Prepared by the State Aid Group of EAGCP (Economic advisors group for competition policy), June 29, 2006. http://ec.europa.eu/dgs/competition/economist/sgei.pdf

The original Altmark Package
Where not all four Altmark conditions are met (as mentioned generally the fourth or efficiency condition is problematic) there is aid that may however yet be declared compatible with the internal market based on the SGEI exception in Article 106(2) TFEU. It is its policy with regard to the application of Article 106(2) TFEU to such aid that the Commission clarified with the adoption of its 2005 Altmark Package, which consisted of a Decision and a Framework. In parallel the Commission also updated the Transparency Directive of 1980, thereby introducing the requirement of accounting separation for SGEI.\(^6\) The Commission adopted the package using its exclusive legislative powers based on Article 106(3) TFEU, which means that the European Parliament and the Council were consulted but did not have a formal vote in the decision making process.

The Decision
The Commission Decision was in practice a block exemption that created a safe harbour for aid to undertakings below a particular threshold as well as for particular economic sectors and exempts them from the notification and standstill obligations of Article 108(3) TFEU. Provided certain conditions (that are discussed below) were met the relevant aid was considered to be compatible with the internal market on the basis of Article 106(2) TFEU.

This block exemption applied to undertakings with a turnover that was less than 100 million € for the two preceding years and with respect to a maximum compensation of 30 million €. In addition the exemption was applicable to both hospitals and undertakings in charge of social housing which were entrusted with SGEI irrespective of their turnover or the amount of compensation involved. (There were separate thresholds based on passenger numbers for air and maritime links, air- and seaports which will not be discussed further.)

In order to benefit from the exemption the undertaking concerned had to be entrusted with the operation of a SGEI by means of one or more official acts (the form of which may be determined by the Member State). These acts had to specify at least:

- the nature and the duration of the public service obligations;
- the undertaking and territory concerned;
- the nature of any exclusive or special rights assigned to the undertaking;
- the parameters for calculating, controlling and reviewing the compensation;
- the arrangements for avoiding and repaying any overcompensation.

Moreover the Decision contained detailed requirements with respect to the compensation involved, which paid particular attention to cases where the undertaking entrusted with operating an SGEI is also engaged in other economic activities. The costs to be taken into consideration involved the relevant variable costs and a proportionate contribution to fixed costs as well as a reasonable profit and any necessary infrastructural investment. In order to determine what constituted a “reasonable profit” the risk involved and the

average rate of return in the sector concerned were taken into account, or if necessary that of a comparable undertaking in another sector and/or Member State.

The Decision required accounting separation if an undertaking operating a SGEI also carried out other activities (without prejudice to the application of the Transparency Directive, see below). Finally, the Decision also included reporting obligations for the Member States on the implementation of its provisions that were intended to allow the Commission to determine whether the compensation granted was compatible although the data were delivered at an aggregate level (not by the individual undertakings concerned).

The Framework
The Framework applied to those cases that fell outside the scope of the Decision but its contents were highly similar as regards the need for a formal act containing the public service obligations and the method for calculating the compensation, the costs and revenue to take into account in doing so, the concept of reasonable profit, and with regard to overcompensation. In fact the Framework was intended primarily for large undertakings that can be found in the utilities sectors such as transport, electronic communications, posts, public broadcasting, energy, water and waste disposal which could not claim the safe harbour provided by the block exemption in the Decision but that were subjected to what are the same substantive norms, albeit on a case by case basis. In this context the Framework formed a type of guidance which made the outcome of individual state aid and SGEI cases more predictable.

The Transparency Directive
Although it is broader in scope (because it applies to public undertakings more generally) the amended Transparency Directive formed a potentially significant reinforcement of the Altmark Package. This amendment imposed accounting separation for their various activities on undertakings enjoying a special or exclusive rights granted by a Member State or is entrusted with the operation of a SGEI and that carry out other activities. This was necessary in order to be able to control for overcompensation. The obligation to keep separate accounts however only applies to undertakings with a turnover of 40 million € or more and in so far as the services concerned may have an effect on trade between the Member States. In addition and paradoxically, undertakings that were charged with providing an SGEI by means of a transparent and non-discriminatory procedure are exempt from this obligation.

The review of the Altmark Package (Altmark Package Mark II)
Between the two Altmark Packages the Commission had issued two biannual reports on social services of general interest as well as two documents with answers to frequently asked questions (FAQs). After having gained about five years of experience with the original Altmark Package and after the customary extensive consultation the Commission

---

presented its proposals for the review of the Altmark Package on 15 September 2011.9 This was adopted with minor modifications on December 20th 2011.10 The Altmark Package Mark II consist of four elements: (i) a Commission Communication; (ii) a revised version of the Decision; and (iii) of the Framework; as well as (iv) a new Regulation on de minimis aid.

**The Communication**

The purpose of the Communication is to explain the main concepts that are relevant to the application of the SGEI in the state aid context. The state aid rules only apply to the relationship between public authorities and undertakings, which are defined with reference to the following quote from the Pavlov Case in 2000 as “entities engaged in an economic activity, regardless of their legal status and the way in which they are financed”.11 This means it uses a functional definition where the status of an entity under national law is not decisive. An economic activity consists of offering goods and/or services in a market: this allows a distinction to be made according to the way in which services are offered in a particular Member State at a given time. Hence the way a Member State organises an activity will co-determine whether the state aid rules apply.

The Communication also deals with the concept of the exercise of public powers (activities that intrinsically form part of the prerogatives of official authority) and with the relevant criteria for the most contested “social” sectors such as social security, healthcare and education. It is worth noting that with respect to these categories different checklists of criteria are used without reference to a hard core of common criteria in order to determine whether an activity is economic in nature of whether solidarity or public authority prevails. Hence it appears likely to make a difference which point of departure is chosen in a particular case. Next, the Communication deals with the other requirements for a finding of state aid such as advantages derived directly or directly from state intervention and an effect on trade.

Finally the Communication elaborates on the conditions applied to decide when compensation for the performance of a public service obligation constitutes just that, and not aid. This starts out from repeating the Altmark conditions and continues with the existence of a SGEI, the entrustment act, the parameters for compensation and the avoidance of overcompensation. To a large extent this repeats what we have discussed above with relation to the original Altmark package and the additional points which we will discuss below with regard to the new Decision and Framework.

More important is the emphasis placed by the Communication on the fourth Altmark condition (the efficiency condition) with regard to the use of public procurement procedures. This link between aid, SGEI and public procurement had already been

---


12 Cf. e.g. Case C-350/07, Kattner Stahlbau GmbH v Maschinenbau- und Metall- Berufsgenossenschaft [2009] ECR I-1513, para 66, where it is stated that an insurance body is not an undertaking but fulfils an exclusively social function, “where such a body operates within the framework of a scheme which applies the principle of solidarity and is subject to State supervision”.

---
emphasized by the Monti report on the internal market of 2010.\textsuperscript{13} In this context it is also relevant that even where there is no formal requirement to apply the public procurement rules the transparency case law of the Court applies, with similar substantive norms.\textsuperscript{14} The Communication spells out in detail how the procurement and transparency rules may be met in order to secure the selection of the tenderer capable of providing the services at “the least cost to the community”.

In those cases where the public procurement rules have not been applied the amount of compensation must be based on generally accepted market remuneration or, in the absence of such a standard, the amount of compensation must be based on the analysis of the costs of a typical undertaking that is well run and adequately provided with material means, taking into account a reasonable profit.

The effect on trade is now detailed as applicable “where markets have been opened to competition either by the Union of national legislation or de facto by economic development”.\textsuperscript{15} This may lead to problems especially where a decision to provide an SGEI other than through a public procurement procedure leads to market distortions such as preventing entry. In order to be classified as SGEIs services must be “addressed to citizens or be in the interest of society as a whole”.\textsuperscript{16}

In contrast to the draft of the Communication, the version adopted emphasizes the Commission will only test for a manifest error when checking whether a service can be provided by the market. The Framework specifies that this is the case unless provisions of Union law provide a stricter standard.\textsuperscript{17} Instead of stating that it would not be possible to assign an SGEI where an activity is already provided or can be provided under market conditions, the Communication now states this would not be appropriate.\textsuperscript{18} This is in line with the observation therein that “What is not a market activity today may turn into one in the future, and vice versa.”\textsuperscript{19} Read jointly with the manifest error standard already mentioned this does not add up to a clear test.

\textit{The Decision}

The proposal for a Decision contains two major changes with respect to the 2005 Decision. In the first place this concerns the scope of the exemption. The general threshold will be lowered by half from 30 to 15 million € a year. This is motivated by the increasing role in providing SGEI of multinational providers.\textsuperscript{20} At the same time what can be called the “social exception” is extended considerably. Here it is stated that at the current state of development of the internal market a “larger amount of compensation for social services does (…) not necessarily produce a greater risk of distortions of

\textsuperscript{13} A new strategy for the single market: at the service of Europe’s economy and society. Report to the President of the European Commission, José Manuel Barroso, by Mario Monti, 9 May 2010 (especially point 3.3, Social services and the single market).


\textsuperscript{15} Commission interpretative communication on the Community law applicable to contract awards not or not fully subject to the provisions of the Public Procurement Directives, OJ 2006, C179/2.

\textsuperscript{16} Ibid., para 50.

\textsuperscript{17} Framework, above note 1 para 13.

\textsuperscript{18} Communication, above note 1, para 48.

\textsuperscript{19} Ibid., para 12.

\textsuperscript{20} Decision, above note 1, recital 10.
competition.”\textsuperscript{21} Apart from hospitals and undertakings in charge of social housing the exception now covers without threshold limits the following:

(b) compensation for the provision of services of general economic interest by hospitals providing medical care, including, where applicable, emergency services (…)

(c) compensation for the provision of services of general economic interest meeting essential social needs as regards health care, childcare, access to the labour market, social housing and the care and social inclusion of vulnerable groups (…).

This exemption also applies if the undertakings concerned are involved in directly related ancillary activities.

The second main change that is proposed concerns the concept of “reasonable profit”. This takes into account the risk depending on the sector concerned, the nature of the service and the characteristics of the compensation. In this context it is accepted that the Member State promotes productive efficiency by allowing the undertaking to share in the gains – provided an equitable share goes to the benefit of the Member State and/or the users. A rate of return on capital (ROC) that does not exceed the relevant swap rate plus a premium of 100 basis points is regarded as reasonable. If the use of the ROC is not feasible its is acceptable to use other profit level indicators.\textsuperscript{22}

The obligation in the original Decision to keep separate accounts for SGEI is repeated. Also the entrustment and yearly amounts of compensation over 15 million € must be published for undertakings that engage in activities other than SGEI. The reporting obligations are retained and expanded – for instance the existence of third party complaints now has to be reported – but remain at an aggregate level (i.e. they are not specified by type of SGEI and/or undertaking).

Finally the Decision spells out more clearly than its predecessor that efficiency gains that do not compromise the quality of the service rendered and that are shared between the undertaking and the Member States and/or the users may be taken into account when determining what constitutes a reasonable profit.

\textit{The Framework}

The proposal for a new Framework likewise contains a number of innovations. The proposal for the new Framework had assumed that where services are already being provided, or can be provided, by undertakings in accordance with the rules of the market, and under conditions such as price and access to the service that are consistent with the public interest, they could no longer be defined as SGEI. However this has been toned down considerably. Similar to what is set out in the Communication the Framework now provides:

(…) Member States cannot attach specific public service obligations to services that are already provided or can be provided satisfactorily and under conditions, such as price, objective quality characteristics, continuity and access to the

\textsuperscript{21} Ibid., recital 11.
\textsuperscript{22} Such as accounting measures including the average return on equity (ROE), the return on capital employed (ROCE), the return on assets (ROA) or the return on sales (ROS).
service, consistent with the public interest, as defined by the State, by undertakings operating under normal market conditions. As for the question of whether a service can be provided by the market, the Commission's assessment is limited to checking whether the Member State's definition is vitiated by a manifest error, unless provisions of Union law provide a stricter standard.\(^{23}\)

In addition the new Framework requires Member States that wish to benefit from its provisions to conduct a public consultation to take the interest of users into account, i.e. to determine the nature of demand for the services concerned.

The relationship with the public procurement rules that follows from the *Altmark* Case itself is strengthened in the new Framework by a provision that aid which is granted in violation of the procurement rules is considered to be contrary to the interest of the Union within the meaning of Article 106(2) TFEU.

Like the new Decision, the new Framework too contains provisions that concern necessary costs and the reasonable profits that are included in them. In the new Framework however there is more emphasis on efficiency. On the one hand this means that where risk bearing activities are concerned the reasonable profit may reflect those, on the other hand that including efficiency incentives (or incentives to contain costs) in the compensation mechanism will now normally be required barring exceptional circumstances. It is not clear whether this emphasis on efficiency is fully covered by the *Altmark* case, while as mentioned the application of the Framework is likely to occur precisely in those cases where the conditions of the fourth Altmark condition have not been met. Whether the new Framework needs to be fully in line with Altmark on this point depends on the issue to what extent Article 106(2) TFEU itself is held to contain an efficiency requirement.

Finally the Framework states that in a number of cases compensation can generate more serious distortions in the internal market. This concerns bundling SGEI tasks that could be allocated separately, connecting SGEI with special and exclusive rights, the financing of infrastructure that is not easily replicable and those cases where the entrustment of the SGEI hinders the effective enforcement of internal market legislation. As regards the provision of an SGEI without a competitive selection procedure in a non-reserved market which results in foreclosure the Commission may intervene:

The Commission, while fully respecting the Member State's wide margin of discretion to define the SGEI, may (...) require amendments, for instance in the allocation of the aid, where it can reasonably show that it would be possible to provide the same SGEI at equivalent conditions for the users, in a less distortive manner and at lower cost for the State.\(^{24}\)

Where non-replicable infrastructure is involved an obligation to grant third party access to infrastructure on equitable terms may be imposed (such as already exists e.g. in the electronic communications and energy sectors based on sector-specific EU legislation).

*The Regulation*

Whereas the new Decision and the Framework both assume the existence of aid, which under certain conditions may be compatible with the internal market, the principle of the

---

\(^{23}\) Framework, above note 1, para 13.

\(^{24}\) Ibid., para 56.
Regulation is to create a de minimis rule with thresholds below which there is no aid. This means the conditions in Article 107(1) TFEU are not met and hence there is no obligation to notify nor to respect the standstill obligation. However the existence of an SGEI in the sense of Article 106(2) TFEU is a precondition for the application of the Regulation.

In contrast to the new Decision and Framework which find their legal basis in Article 106(3) TFEU, the legal basis for this de minimis Regulation for SGEI is Regulation (EC) 994/98 which enables the Commission to set a threshold for measures that do not meet all the criteria of Article 107(1) TFEU.\(^{25}\) This means the SGEI Regulation is a lex specialis with regard to the general de minimis Regulation for state aid that has the same legal basis and determines that aid may not amount to more than 200,000 € per undertaking over a three year period.\(^{26}\)

The Regulation applies a de minimis regime to aid that amounts to less than 500,000 € over any period of three fiscal years. There is a long list of exceptions such as aid for fisheries and aquaculture, the coal industry, road transport and aid granted to undertakings in difficulty that will not be examined further here. In addition there are monitoring obligations. Finally the Regulation has retroactive effect.

**Commentary**

*Social SGEI versus utilities*

In broad strokes the Altmark Package Mark II is mainly a revamped version of the original Altmark Package. It is noteworthy that the Commission in its Altmark Package Mark II has attempted to create a clear division between on the one hand social SGEI (sometimes confusingly called social services of general interest while it is their economic nature that makes them SGEI) under the new Decision and on the other hand the large providers of SGEI such as are seen in transport, electronic Communications, posts, energy, water and waste management under the new Framework. This is understandable as a device that enables the Commission to concentrate its limited resources on the most serious cases. The new focus on (or leniency toward) social services dates back not only to the Lisbon Agenda,\(^{27}\) but certainly also originates with the Services Directive, which could only be adopted in 2006 after healthcare, various social services and SGEI had been excluded from its scope.\(^{28}\)

In this context it is also worth noting that the General Court in its 2008 BUPA Case adopted a very pliant approach to especially the third and the fourth Altmark conditions.\(^{29}\) It may be justified that the complex world of risk equalisation schemes where insurers have to collude at one level in order to compete more effectively on another is not judged by standards originally devised to meet the possibly more straightforward needs of local transport concessions. However this does raise questions regarding the limits of the

---


\(^{29}\) Case T-289/03, above note 4.
conditions set in the Altmark Case which after all form the foundations of both the original Altmark Package as well as the Altmark Package Mark II now under discussion.

**Enforcement**

The means for private enforcement of the state aid rules concerning SGEI appear to be limited. The Altmark conditions themselves can be applied by national courts in order to determine whether state aid is involved or not. Likewise the national courts can test to see whether the conditions of the block exemption Decision have been met. At the same time, although the reporting obligations are set at an aggregate level the obligation to keep separate accounting data under the Decision will lead to much more relevant information being accessible for individual cases. However once it is clear that not all relevant conditions are met the process stalls and intervention by the Commission becomes necessary in order to determine whether a case of exemptable aid is involved. A complaint to the Commission – which has now made its strategic priorities in the utilities sectors abundantly clear – will then be the only remedy, with generally a limited chance of success.

In addition the formal emphasis on the entrustment act and the long list of items that have to be covered there stands in stark contrast to the Commission’s actual practice of deriving de nature and scope of the public service concerned from the context of laws and regulations at national level – never mind the parameters for compensation and the instruments for recovering overcompensation. See, for instance, the BUPA case. Or should we expect a different approach for healthcare and the social services covered by the new Decision?

**Conclusion**

Article 14 TFEU and Protocol No. 26 to the Treaties created the impression that the Commission would become less interventionist in its application of Article 106(2) TFEU. However with the Altmark Package Mark II the Commission is now continuing its tightening of controls on economically significant utility services while imposing a more relaxed regime on the politically sensitive sectors of social services and healthcare. The requirements for acceptable costs and reasonable profits are tightened and there is a concerted effort to impose efficiency incentives. There is also a recurring tandem between the state aid rules for SGEI and the public procurement rules – an area where further developments may well be expected. On balance this appears to be an advance in the sense of creating more room for market-based solutions. The weak point of the Altmark Package Mark II is likely to be enforcement. Too much rides on the Commission services. This has always been the case for state aid and in the present context concerns in particular the services that will be covered by the new Decision. Against this background more active judicial review – even if limited to verification of the Altmark criteria as well as the requirements set for the block exemption – would be a welcome development.