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THE APPLICATION OF STATE AID RULES TO SERVICES OF GENERAL ECONOMIC INTEREST

On 10 June 2010 the European Commission launched a public consultation to assess the application of its 2005 Package on Services of General Economic Interest (SGEI package). The Package provides guidance as to when public funding of SGEIs is compatible with the state aid rules. The package was adopted in July 2005, following the Altmark ruling of the Court of Justice of the European Union.

The above consultation and consequently this paper, address key issues concerning:

- legal certainty and clarity in the notion of SGEI and the applicable state aid rules;
- conditions under which public service compensation amounting to state aid can be granted for the fulfilment of public service missions;
- the general approach of national authorities and the legal instruments introduced in national legislation to implement the SGEI package;
- the calculation of compensation for SGEIs; the existence of mechanisms to control over-compensation; adequacy of the thresholds;
- appropriateness of the monitoring and reporting obligations established in the package; and
- adequacy of the package to preserve a level playing field between all SGEI providers and avoid distortions of competition in the single market.

GENERAL COMMENTS

BUSINESSEUROPE believes that the provision of good public services must remain at the heart of the EU and Member States' agendas. Drastic constraints on public finances are reinforcing the need for the provision of efficient and cost-effective public services. This is coupled with other challenges coming from the environment, climate change, ageing population and energy shortages, which requires public authorities to develop innovative and timely responses, and sound strategies for the delivery of public services.

The Treaty of Lisbon emphasises the importance of Services of General Interest (SGIs) under the Protocol on Services of General Interest and distinguishes between SGEI and non-economic services. SGEI are referred to in Articles 14 and 106 TFEU and they are subject to EU legislation, in particular single market rules such as competition, state aid or public procurement laws. SGEIs are not defined in the Treaty or in secondary legislation. However, in EU practice there is broad agreement that the term refers to services of an economic nature which the Member States or the Community subject to specific public service obligations by virtue of a general interest criterion.



High quality public services are of fundamental importance for European society, the well-being of its citizens and the competitiveness of European businesses. They enhance our quality of life and greatly contribute to promoting the EU's territorial and social cohesion.

The achievement of these objectives is a priority. The EU economy must recover from a deep crisis, requiring governments to look critically at their expenditure and to ensure a return to sound public finances. Member States must commit credibly to modernising the public sector by making public spending more related to economic growth. They need to strive for better public procurement, responsible and wise management of public funds and value for money in the provision of public services.

We insist on the respect of the market as a force for innovating and modernising SGEIs. Undistorted competition and transparent application of state aid rules to SGEIs are key to avoid protectionism, reinvigorate the single market and provide better public services.

Refraining from limiting competition in markets where private operators already operate on a commercial basis would also promote competitiveness in the provision of SGEI. The way compensation for the provision of SGEIs is granted has consequences weighing on public finance and on private enterprises' ability to receive fair treatment in the delivery of these services. More open competition leads to increased efficiency, choice and innovation. This means higher-quality, lower-priced, and more cutting edge and environmentally friendly public services (the latter being particularly important in relation to the EU's ambition to become the leading green economy in the world).

The rules governing state aid in the form of public service compensation should ensure that the grant of such aid does not entail distortions in the single market and in the choice of the management modes and operators of SGEIs.

It is for public authorities to organise SGEIs and to decide in particular whether to provide such services themselves or to contract out their provision to a public or private entity. However, BUSINESSEUROPE stresses the importance of strengthened control of state aid in general and in the form of public service compensation in particular, in terms of compliance with the Treaty principles of transparency, non-discrimination, competitive neutrality and free and open competition. When providing public service compensation for SGEI provision, public authorities should in general avoid creating distortions of competition, particularly in markets where the service can already be provided by private operators on a commercial basis.

SPECIFIC COMMENTS

1. Ensure transparency

Ensuring a great level of transparency in the application of the SGEI package is critical to its effectiveness, as currently there is no clarity as to the type and amount of aid granted for the provision of SGEI by local, regional and national public authorities.

Public authorities decide to subsidise certain SGEI in the best interest of their citizens. Therefore, citizens should be informed about the various elements related to the aid, the definition of the mission, the costs associated with the SGEI provision (supplies, utilities, manpower, etc.), the revenues generated and any exclusivity rights.

The current lack of transparency and information on the conditions for the provision of these services prevents an effective control on whether distortions of competition are taking place and on the efficient use of public resources.

Furthermore, the Commission Decision of 2005 exempts from notification the compensation for the provision of public service obligations under certain conditions and specific thresholds. As a consequence, there is no information available as to the level of aid that is granted for all those cases that fall under the scope of the 2005 Decision.

Without questioning the rationale of the Decision, BUSINESSEUROPE believes that the Commission should include and enforce reporting obligations for Member States in this regard. As mentioned above, this information should also be made known to the public and to operators active in the provision of SGEI.

2. Evaluate the application of the fourth Altmark criterion

• *Current legal setting*

The Altmark judgment established four cumulative conditions under which public service compensation does not constitute State aid:

- The recipient undertaking must actually have clearly defined public service obligations to discharge.
- The parameters for the calculation of the compensation at stake must be established in advance in an objective and transparent manner.
- The compensation cannot exceed what is necessary to cover the costs incurred in the discharge of public service obligations and a reasonable profit.
- Where the undertaking is not chosen through public tender selecting the least costly applicant, the compensation level must be established on the basis of an analysis of the costs which a well run and adequately equipped undertaking would have incurred.

A measure that complies with all the criteria set out by the Court of Justice in the Altmark judgment does not constitute state aid and is automatically compatible with the single market. If the measure does not fulfill all the Altmark criteria, the Commission still considers it compatible if it complies with the criteria set out in the Decision or the Framework that compose the 2005 SGEI package. These criteria correspond to the first three Altmark criteria. In other words, in particular under the Framework, the Commission carries out an assessment and considers compatible each measure that complies with at least the first three Altmark criteria.

As mentioned above, the fourth criterion set by the European Court of Justice in the Altmark judgment allows *two alternative options*:

- *Altmark 4(1)*: either the service provider has been selected following a public tender selecting the least costly applicant (transparent and objective criterion); or
- *Altmark 4(2)*: its cost for providing the service must be established on the basis of an analysis of the costs which a well run and adequately equipped undertaking would have incurred (subjective criterion, requiring case-by-case assessment).

In other words, the Court established that, in the case where the undertaking is not chosen through public tender, the level of compensation must not exceed the cost of a well-run typical company.



The SGEI package does not include the fourth Altmark criterion among the conditions used by the Commission to assess whether compensation to companies for the provision of public service obligations is considered compatible with the single market. When the Framework was adopted in 2005, in practice it established that the fourth criterion set by the ECJ was not a necessary condition for compatibility, based on the “stage of development of the common market” in 2005 (para 8) and if “it is necessary to the operation of the services of general economic interest” and does not affect trade to an extent contrary to the interests of the Community (para 8).

- ***Application of Altmark 4(1)***

If the fourth Altmark criterion is respected, the measure will not constitute state aid, therefore public authorities will not need to notify the measure and the Commission will not carry out an assessment of its compatibility. We recommend that the Commission clarifies that if an SGEI provider is selected following a transparent, non discriminatory and competitive public tender (Altmark 4.1) – and the other three Altmark criteria are complied with – the compensation provided will not be state aid and, therefore, it will not need to be referred to the Commission (also reducing administrative burden).

As the Framework expires in 2011, BUSINESSEUROPE believes that it is timely to re-evaluate closely whether the Commission should still authorise or not aid measures in those cases where state aid is not necessary to ensure the operation of the SGEI because such provision can be guaranteed under normal market conditions by making good use of public procurement. The Framework should specify that SGEIs that are subject to open tender need not be notified.

- ***Application of Altmark 4(2)***

The lack of application of an efficiency analysis to the compensation granted has a negative impact on trade between Member States and can create distortions of competition. Allowing state aid for SGEI that is not based on a reasonable cost of supply does not incentivise public authorities to use tenders, thereby decreasing opportunities for potentially more competitive providers across the EU to deliver high quality SGEIs at the best price.

In addition, the Altmark 4(2) reference to the costs of a well-run company (efficiency analysis) is not sufficiently precise and this makes it in practice irrelevant in its current form. The Commission should consider introducing other, more effective instruments to test efficiency for SGEI provision.

The need of a subsidy may be the result of two parameters: costs that are too high or revenues that are too low. Questioning the compensation’s magnitude by introducing an efficiency approach would have the merit of encouraging public authorities to give greater consideration to optimising cost effectiveness in the provision of SGEI.

Market testing is a means of assessing optimal cost effectiveness. We believe the Commission should amend the Framework to give more favourable consideration to contracts that have been awarded based on proper market testing. This would also promote further use of public tenders or – in cases when it is not economically efficient – would at least ensure that there are realistic possibilities to evaluate whether the compensation granted to the chosen SGEI provider does not amount to state aid.

3. Levels of thresholds

Private operators of SGEI are normally selected through a competitive process (fourth Altmark criterion). Therefore any compensation received for the service they operate would not be state aid and the package would not apply. Consequently, the turnover and subsidy thresholds would mostly apply in practice to publicly-owned entities.

Those thresholds are already very high and allow Member States not to notify most of their SGEI operations, assuming that those operations comply with the Decision's conditions. We therefore recommend that any current review of the package should not raise the thresholds further to avoid additional risks of competition distortions.

As the validity of the Framework comes to an end in 2011, we believe the Commission might consider changing the thresholds only if new rules would take due consideration of the fourth Altmark criterion and ensure sufficient transparency.

4. Target all economic entities likely to benefit from compensation

All types of entities, and not only private companies strictly defined, may supply SGEIs and thus benefit from compensations granted by public authorities: such entities may be associations, local authorities and their groupings (and in particular all public entities ensuring cooperation between local authorities).

According to the Treaty, it is irrelevant whether SGEIs are provided by private or public undertakings. It is therefore necessary to ensure that the provisions of the package are effectively applied to all operators no matter their nature. However, as stated before private SGEI operators are normally selected through tenders, therefore the compensation received would normally not be state aid and the package would not apply. Consequently, the SGEI package in practice applies mostly to publicly-owned entities.

In this context, BUSINESSEUROPE strongly welcomes the submission of the European Commission to the OECD on competitive neutrality in 2009¹. In this paper, the Commission defines competitive neutrality as a competition authority's policy to remove any unfair competitive advantages or disadvantages that public undertakings involved in commercial activities may experience over their privately-owned competitors, simply as a result of government ownership or involvement.

Implementing competitive neutrality measures allows privately-owned businesses and government-owned businesses to compete on an equal footing. We underline that the consequent increase in competition for the provision of SGEI would lead to greater efficiencies, better quality and lower prices, leading to an increase in consumer welfare.

As already mentioned, and as recognised in the Commission OECD submission, greater efficiencies in the public sector also mean a more effective use of taxpayers' resources. In essence, competitive neutrality involves the application to public enterprises of the incentives and regulations faced by private businesses.

In its above-mentioned paper the Commission underlines that the principle of competitive neutrality between public and private enterprises is recognised in the Treaty and that the Commission has operational tools to implement this principle. We therefore encourage the

¹ European Commission contribution to the OECD Competition Committee discussion on corporate governance and the principle of competitive neutrality for state-owned enterprises, 28 September 2009.

Commission to make full use of these operational tools by ensuring that the principles set by the Court of Justice are fully applied to public-owned entities.

5. Impose the obligation to give notice of compensations in “social sectors”

Hospital and social housing services have a very important social function. However, large-scale aid granted to hospitals and to social housing may possibly have distortive effects on competition. In addition, these are areas where private operators are likely to trade and where the private sector can provide services more efficiently.

BUSINESSEUROPE believes that public authorities, before taking a decision on the way to provide these services, should test the market every time it is economically sensible to do so. This would ensure that efficient options that can be provided by the market are duly considered when deciding on the provision of hospital and social housing services.

Likewise, when Member States grant compensation for these services, they should have an obligation to make their decision publicly available and inform the Commission to ensure further transparency and limit possible distortive effects.

6. Strengthen the transparency of the terms of the compensation

In general, BUSINESSEUROPE opposes any definition of the notion of reasonable profits, because private operators would typically be selected under a competitive process, making the question of “reasonable profit” irrelevant. In fact, this seems to refer only to in-house provision. In addition, this notion is specific to each enterprise, sector and each economic philosophy or culture. However, in case this concept is retained, we would still raise concerns related to the practical measurement of reasonable profits. Some often used accounting standards refer to parameters (e.g. return on equity or return on capital) which are unsuitable for comparison because they differ significantly among countries and among operators. More suitable measures for comparison should reflect the profitability of the SGEI provision and be independent from parameters that can largely differ within the EU. In addition, also the risk elements should be taken into account.

Furthermore, it is highly advisable to broaden the notion of compensation to any type of aid, including cash, physical or human resources, favourable tax regimes, aid based on a legal provision or on the beneficiary’s status.

Finally, a problem experienced in various sectors is that overcompensation for SGEIs often leads to cross-subsidising of commercial activities operated by public entities. In case of overcompensation fair and equal competition must be restored as quickly as possible. If a SGEI provider is overcompensated, it might use the economic advantage to crowd out private competitors. We believe that the distortive effects of overcompensation cannot be remedied just by, for example, using dividends as claw-back mechanism. Claw-back mechanisms should take into account economic benefits in any form, including access to excess (free) funding by the SGEI provider.

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