The SGEI Communication

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1. Introduction: The Communication and its role in the new SGEI package

This article is the second in a series explaining the rationale behind the new SGEI package, highlighting the most important features and novelties and introducing the new texts. The Communication[2] is a new instrument without a counterpart in the 2005 SGEI package. It is an interpretative text aiming to clarify key concepts of the notion of aid in the field of SGEI. It explains both general State aid concepts with particular relevance for SGEI and SGEI-specific concepts. Public authorities and service providers have been asking for clear explanations of the core principles for several years, and the Communication addresses these requests.

The notion of aid is difficult to clarify, because although its interpretation and application raise many questions, the concept of aid under Article 107(1) TFEU is an objective notion. This means that the Commission does not have discretion, as is the case for compatibility assessment under Article 107(3) or Article 106(2) TFEU. So it is clear from the outset that for the Communication, the Commission is bound by the Treaty and the Court's interpretation of the Treaty provisions. The Communication can only describe and interpret, to the extent possible, what the case-law has left unclear.

However, the Communication serves an important clarification purpose because it is a comprehensive horizontal document that codifies both the case-law and Commission practice. State aid rules are often applied by local authorities so easy access to the rules is extremely important. Having a single point of reference should make the application of the State aid provisions for SGEI much easier, thus making it easier to comply with the rules. Also, the Communication gives guidance on issues where the case-law leaves room for interpretation, and about which a number of questions have been raised, including the four criteria set out by the Court of Justice in its *Altmark* ruling to exclude that a compensation of SGEI costs constitutes State aid.

This article follows the structure of the Communication in order to allow for easy parallel reading with the new text. Since a detailed analysis of all aspects covered by the Communication would go far beyond the scope of this article, it focuses on the most relevant points. An important focal point is the interplay between State aid and public procurement law (section 3.4.1) because of its practical significance and because the guidance given in this field is one of the important innovations of the new SGEI package. Similarly, the sections on in-house situations (section 2.3) and on SGEI definition (section 3.2) go into more detail because these are areas where the consultations have shown a particular need for clarity and guidance.

[1] The authors would like to thank Christof Lessenich for his valuable contribution to this article. The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

[2] 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, 11.1.2012, p. 4-14).

2. Clarity on general State aid concepts

The Commission Communication provides clarity on some general State aid concepts which are particularly relevant for SGEI, as well as on SGEI-specific concepts. Amongst the former we focus on the concepts of undertaking and effect on trade (the Communication contains an additional section on State resources), before turning to the horizontal issue of in-house situations.

2.1. Undertaking and economic activity

The concept of undertaking is central to State aid law because State aid law, as competition law in general, applies only to undertakings, which have been defined by the Court as any entity engaged in an economic activity. The Communication uses the definition developed by the Court of Justice as a starting point: that an activity is economic if it consists in offering goods and services on a market (para. 11). Since it is the activity that is qualified as economic or non-economic, the characteristics of the entity carrying out the activity are of little relevance. In particular, the legal qualification under national law, or whether the entity is set up to generate profits or is non-profit, is irrelevant for the qualification (para. 9). Given technological, economic and legal developments over time as well as the differences across Member States in the way economic activities are regulated and organised, it is not possible to draw the distinction between economic and non-economic activities once and for all.

The Commission gives detailed guidance on how to delineate economic activity from non-economic activity for four areas. For the areas of social security (para. 17 *et seq.*), health care (para. 21 *et seq.*) and education (para. 26 *et seq.*), the Communication provides a (non-exhaustive) list of criteria that are relevant to make the distinction. For social security schemes, the distinction between non-economic and economic schemes can only be drawn by looking at a large number of indicators, such as whether the scheme is based on the principle of solidarity, membership is compulsory or voluntary or whether the entitlements depend on the contributions paid or are independent of them. The delineation is also based on a set of criteria in the field of education. Here, relevant questions listed in the Communication include whether the services are part of the national educational system, funded and supervised by the State, and whether the payments by parents/pupils cover only a fraction of the costs or all costs.

The Communication provides additional guidance with respect to a fourth area: exercise of public powers as an important field of non-economic activity (para. 16). As established by the courts, this concept captures activity that forms part of the essential functions of the State or is closely connected to those activities.The Communication lists the examples of, *inter alia*, army, police and air navigation safety and control, and explains that those activities are non-economic, unless the Member State has decided to introduce market mechanisms in the way such activities are organised.

2.2. Effect on trade between Member States

An effect on trade presupposes a market open to competition. This is why the Communication makes clear that there can only be an effect on trade if the market has been opened up to competition by EU or national legislation or *de facto* by economic development (para. 37). The Communication also gives guidance on activities with a purely local character with no effect on trade and lists cases from its past decision-making practice as reference, including the decision on a swimming pool mainly for the use of the local population[3] (para. 40).

[3] Case N 258/2000, *Leisure Pool Dorsten* (OJ C 172, 16.6.2001, p. 16).

As regards effect on trade, the interplay with another instrument from the new SGEI package needs to be highlighted. The new *de minimis* Regulation[4], expected to be adopted in spring 2012, is particularly designed to cover small local services that have no impact on trade between Member States. Since under the *de minimis* concept, the Commission can set a clear ceiling in a Regulation, the new SGEI-specific *de minimis* Regulation can provide valuable legal certainty beyond what the Communication has to say about effect on trade.

2.3. In-house situations and State aid rules for SGEI

The Communication addresses the assessment of in-house provision of public services. Given the fact that State aid law does not contain an in-house exception, there is no generally accepted definition of what "in-house situation" means, precisely. But one can refer by analogy to the in-house notion established in the case-law on public procurement[5], namely that of a separate legal entity over which the public authority exercises a control similar to the control over its own departments, and which carries out the clear majority of its activities for the public authority.

As mentioned, an important difference as regards the scope of application of EU public procurement rules and EU State aid rules is the fact that the former does not apply to in-house situations, whereas the latter does. Public procurement rules do not apply to in-house situations because they would not apply if the contracting authority were to provide the services itself. And in an in-house situation the provider is only independent from the authorities from a formal point of view, not from an economic point of view. State aid law, in contrast, applies to all economic activities, irrespective of private or public ownership of an undertaking (Article 106(1) TFEU), because it is trying to achieve a level playing field for economic activity. Since in-house situations are common in practice, it is no surprise that public authorities and others often ask for guidance on their treatment under State aid law.

The Communication makes clear that the fact that a service is provided in-house as such has no relevance for whether the activity is economic in nature or not (para. 13). Similarly, it is not as such relevant for the question of whether there is an effect on trade between Member States (para. 37). The relevant point is whether there is a market open to competition (see above section 2.2), not whether the service is provided in-house. Finally, the Communication makes clear that whether or not a service is provided by an in-house provider is not relevant for the scope of the Member State to define SGEI. (para. 13, fn. 17; see also section 3.2 below).

3. Clarity on SGEI-specific State aid concepts

3.1. The Altmark judgment: when SGEI compensation is not State aid

The Communication also provides guidance as regards SGEI-specific concepts. In its 2003 judgment in the *Altmark*[6] case, the Court of Justice set out the conditions under which compensation for public service provision falls outside Article 107(1) TFEU as it grants no

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[4] The Commission approved the content of a draft on 20 December 2011. 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).

[5] Cf. Case C-107/98, *Teckal* [1999] ECR I-8121.

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

advantage to the service provider. The Communication takes this landmark judgment as the starting point and lists the four cumulative criteria established by the Court (para. 43):

- First, existence of clearly defined obligations to carry out an SGEI;
- Second, existence of an objective and transparent compensation mechanism, set out in advance;
- Third, avoidance of overcompensation, i.e. no compensation in excess of net costs and reasonable profit;
- Fourth, choice of provider by either a public procurement procedure that allows for the provision of the service "at the least cost to the community", or by other means provided the compensation does not exceed the amount required by a typical, well-run undertaking.

The following sections address the different SGEI-specific concepts included in those four criteria and explain the guidance provided by the Communication.

3.2. What is an SGEI?

The question of what an SGEI consists of, or rather what can be defined as an SGEI, is crucial to the application of the SGEI package. The existence of a genuine SGEI is not only part of the first *Altmark* criterion, but also is a condition for the application of Article 106(2) TFEU and a prerequisite for the application of the three other texts of the SGEI package.[7] Under the case law of the Court of Justice, SGEI have to exhibit special characteristics as compared to other economic activities (para. 45). Because of differences among the Member States, it is established that it is up to them to define what they consider a service of general economic interest, and that they have a wide margin of discretion for their definition. The Commission only checks for manifest error. The Communication provides important guidance on what the Commission considers manifest error to be, and thus increases legal certainty.

First, the Communication makes clear that only services that are not and cannot be satisfactorily provided 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" can be defined as SGEI (para. 48). Since the provision acknowledges that it is for the Member States to define the service, including all the conditions, that it considers appropriate, there is a large margin for the Member States to define what service should be provided. If exactly this service under all the conditions required by the Member State is or can be provided by the market, however, there is no reason why the public authority should provide compensation for this service. In order to illustrate this point, the Communication refers to the broadband sector, where the Broadband Guidelines[8] set out that the roll-out of a broadband infrastructure in a given territory can only be an SGEI if there is insufficient infrastructure availability. This is normally the case in rural areas as opposed to metropolitan areas already served by the market.

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7 See for example Article 2(1) of Commission Decision of 20.12.2011 (OJ L 7, 11.01.2012, p. 3-10), and para. 12 et seq. of the 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).

8 Communication from the Commission, Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks (OJ C 235, 30.9.2009, p. 7).

Second, the Communication makes clear that SGEI either have to be addressed to citizens or have to be in the interest of society as a whole. Services addressed only to businesses do not normally qualify as SGEI.

As mentioned above (section 2.3), for the SGEI definition it is irrelevant whether a service is provided in-house or not.

3.3. Entrustment act, parameters of compensation and the avoidance of overcompensation

The entrustment act assigns the public service to the provider and defines the obligations of the undertaking and of the authority (para. 51). The Communication confirms that the notion of the entrustment act is very open and leaves room for the different legal frameworks in the Member States, allowing for example regulatory or administrative acts or contracts. More specifically, it makes clear that the entrustment can be issued at the request of the service provider (para. 53). However, it also lists the necessary elements that the entrustment act needs to contain in order to provide for transparency and clarity (para. 52).

The Communication explains that the parameters of compensation have to be established in advance, but that no specific formula is required (para. 54 *et seq.*). In order to comply with the third *Altmark* criterion, the service provider cannot be overcompensated for the provision of the SGEI, i.e. the compensation cannot go beyond the costs taking into account the receipts and a reasonable profit. The Communication explains that reasonable profit means the rate of return on capital required by a typical company taking into account the risk level (para. 61). If possible, a comparison should be made to a similar type of public service contract under competitive conditions, e.g. contracts awarded under a tender.

3.4. The selection of the provider

The selection of the provider is addressed by the fourth *Altmark* criterion. As outlined above, the fourth criterion provides for two alternatives: the first requires the selection of the public service provider by a public procurement procedure; the second applies in case there is no such procedure. The two alternatives reflect different ways to ensure that the compensation is limited to the strict minimum. In other words, the fourth *Altmark* criterion allows for a compensation to escape the aid qualification only where the service is provided under conditions of economic efficiency.

3.4.1. The first alternative: The interplay between State aid and public procurement law

One of the key points where clarity was requested was when exactly public procurement procedures fulfil the first alternative of the fourth *Altmark* criterion. Beyond requests for better explanation of this State aid concept, many make the substantive point that State aid law and public procurement law should be aligned as much as possible. They have argued that compliance with public procurement rules should normally satisfy State aid rules as well.

Given the frequent interplay of the two sets of rules and their similar objectives, clarification and a higher degree of convergence between State aid and public procurement law has been an important objective of the reform process. However, both sets of rules pursue similar, but not identical, objectives. State aid rules try to achieve a level playing field for all economic activities, whereas public procurement law aims at equal treatment for all potential providers and at efficient spending of public money when services are procured. So the fundamental challenge is to find the right balance between convergence and alignment, and necessary safeguards for State aid assessment.

From a legal point of view, the most challenging part of the first alternative of the fourth *Altmark* criterion is the phrase "at the least cost to the community". The Communication acknowledges that this phrase means that not all public procurement procedures are sufficient to satisfy the fourth *Altmark* criterion but that it is necessary to look in more detail at the specific procedures and award criteria. The Communication provides detailed guidance for the different procedures and award criteria available under the EU public procurement rules (para. 66 *et seq.*).

The guidance can be summarized as follows: while the open procedure is sufficient and the restricted procedure is in principle sufficient to ensure compliance with the fourth *Altmark* criterion, the negotiated procedure with prior publication and competitive dialogue are only sufficient in rather exceptional cases, and the negotiated procedure without publication is not. As regards award criteria, the criterion of "lowest price" is generally sufficient. The criterion of "most economically advantageous offer" (which can include quality standards and environmental and social criteria) is sufficient provided the criteria used have a close subject matter link and allow for the offer to match the market value. The latter requirement prevents the public authority from using criteria that are too easy to fulfil so that a competition on those criteria (with little room for differences between providers) for a predefined price is inferior to a competition on price (with considerable room for differences).

Whenever the Communication refers to specific procedures and award criteria, it contains clear references to the current public procurement directives, and is thus without prejudice to future revisions of those rules.[9] This is a necessary safeguard because it is the characteristics of the different award criteria and procedures that are important, not the labelling. As an additional safeguard, the Communication contains a general clause for atypical circumstances where there is no genuine competition. A procedure where only one bid is submitted cannot be considered as sufficient to fulfil the first alternative of the fourth *Altmark* criterion (para. 68).

The approach adopted in the Communication provides for alignment with public procurement rules as far as possible and ensures appropriate State aid scrutiny for procedures that offer considerable discretion to the contracting authority and are therefore not sufficient to exclude any State aid issues from the outset. Full alignment of State aid and public procurement law is, however, not possible. Indeed, some public procurement procedures allow for conditions to be imposed that cannot always guarantee from the outset that the service will be procured at the least cost to the community[10]. By differentiating between the different procedures and award criteria, the Communication not only balances convergence and alignment of public procurement and State aid rules with appropriate safeguards, but also increases legal certainty.

3.4.2. The second alternative: The efficiency benchmark

In cases where the first alternative of the fourth *Altmark* criterion is not fulfilled, the second alternative requires that a benchmarking exercise with an efficient undertaking take place. The Communication contains details on how this comparison should be performed (para. 69 *et seq.*), which go beyond the scope of this article. We emphasize that this efficiency test is different from

[9] Cf. the proposals for the reform of the public procurement directives adopted by the Commission on 20 December 2011, in particular the Proposal for a Directive of the European Parliament and of the Council on public procurement, COM(2011) 896 final.

[10] The argument can be made that had the Court wanted to exclude the presence of aid for all public procurement procedures it would not have made the qualification that the procurement procedure had to ensure the provision of the service at the least cost to the community.

the efficiency considerations that are part of the new framework. While the latter only requires the compensation mechanism to contain efficiency incentives, the second alternative of the fourth *Altmark* criterion goes far beyond this and establishes that a measure can only qualify as aid-free if only those costs are compensated that an efficient provider would incur.

4. Conclusion

The new Commission Communication aims at providing guidance to Member States, local authorities and stakeholders on the core concepts of State aid relevant for SGEI. Within the boundaries of the current case-law, the Communication helps to determine whether compensation falls within or outside the field of State aid under the *Altmark* jurisprudence. Many of these concepts are also important when considering the compatibility rules in the new Decision and the new Framework, and the scope of application of the draft *de minimis* Regulation. These issues will be discussed in separate forthcoming articles dedicated to the SGEI reform.