Konstantin Nitze

The scope of Article 86(2) EC Treaty between the poles of adequate provision of public services and undistorted competition

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Dedicated to all the people who contributed
to my unforgettable time in Birmingham

“Competition has been shown to be useful up to a certain point and no further, but cooperation, which is the thing we must strive for today, begins where competition leaves off.”

Franklin D. Roosevelt

Preface

This paper was drawn up and submitted as thesis in the context of an LL.M. programme in International Commercial Law at the University of Birmingham, United Kingdom.

At first, I would like to thank my lecturer and supervisor Dr Luca Rubini for a seminar structuring and mentoring which was one of the reasons why I enjoyed my academic work in Birmingham so much. Furthermore, I am especially grateful to my friend Thomas Grädler who helped me with words and deeds during the preparation phase and the whole study at the University of Birmingham.

This dissertation is dedicated to all the people who contributed to my unforgettable time in Birmingham. First of all, I would like to mention my parents who primarily rendered financial assistance. The same is true for the Konrad-Adenauer-Stiftung which supported me by a scholarship. In addition, I would be remiss not to mention all of my friends and fellow students, in particular my flatmates Burak Arikan, Davy Chan, Kasım Tuğmaner and Suhaib Al-kawaldeh.

This work reflects the legal situation as at 1st January 2009.

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List of abbreviations

AG	Advocate General
cf	confer
CFI	Court of First Instance
CMLR	Common Market Law Review
COM	European Commission documents
ECJ	European Court of Justice
ECR	European Court Reports
ed	editor
ELR	European Law Review
EPL	European Public Law
EStAL	European State Aid Law Quarterly
et seq	et sequens (and the following one)
et seqq	et sequentes (and the following ones)
EU	European Union
ibid	ibidem (in the same place)
ie	id est (that is)
OJ	Official Journal of the European Communities
p	page
para	paragraph
v	versus
SGEI	services of general economic interest
TEU	Treaty on European Union
YEL	Yearbook of European Law

A. Introduction

The provision of Article 86(2) EC Treaty[1] allows, under certain conditions, a deviation from the rules of the EC Treaty insofar as the application of these rules would obstruct the operation of services of general economic interest which have been entrusted to certain undertakings by the state. Thus, Article 86(2) is designed to strike a balance between the objectives of the Community in respect of market integration and national public service objectives. Against this background, Buendia Sierra described the meaning of Article 86(2) in the following manner:

> This provision is thus the main point of contact between two 'tectonic plates' moving in opposite directions. Regular 'seismic movement' is for this reason to be expected around Article 86(2) EC and its interpretation.[2]

In fact, from the 1980s on, the importance of Article 86(2) for litigations has steadily increased. This is primarily due to the fact that since then more and more public tasks have been outsourced to private undertakings in the course of liberalisation. In this context, the main legal problem is the very open wording of Article 86(2) which gives a huge bandwidth of possible interpretations to the European courts. Unfortunately, many questions concerning the interpretation of the provision were answered

[1] All following Articles without reference to a certain source are those of the EC Treaty.

[2] J L Buendia Sierra, 'An Analysis of Article 86(2)' in: M S Rydelski (ed), *The EC State Aid Regime – Distortive Effects of State Aid on Competition and Trade*, (London: Cameron May, 2006), p 543.

by the European Court of Justice (ECJ) or the European Commission without the formulation of general principles. This led to the development of several legal decisions on a case-by-case basis. These decisions are often unrelated to one another, overlap and have not dealt with several foreseeable issues which, because of accidents of litigation or the prudence or tactics of plaintiffs, have not been raised so far.[3]

With respect to its general scope, Article 86(2) does not only apply to competition rules but to any rules contained in the EC Treaty. The exemption can, for example, be invoked by undertakings in relation to proceedings based on Articles 81 or 82.[4] Furthermore, despite some doubts in the past,[5] it is now undisputed that Article 86(2) can also apply to state actions that infringe a Treaty rule addressed to Member States[6] or Article 86(1) in combination with provisions addressed to Member States.[7] The controversial issue of whether and under which circumstances Article 86(2) is applicable in the context of state aid will be dealt with further below.[8]

This paper addresses a critical analysis of the scope of Article 86(2) and its role between the poles of adequate provision of public services and

[3] See J Temple Lang, *European Union Law Rules on State Measures Restricting Competition*, http://www.gclc.coleurop.be/documents/288536_2.pdf, p 1 (accessed 1 January 2009).

[4] See for example Case C-393/92 *Almelo* [1994] ECR I-1477, paras 33 et seqq; Case 41/83 *British Telecommunications* [1985] ECR 873, paras 28 et seqq.

[5] See Case 72/83 *Campus Oil* [1984] ECR 2727, para 19.

[6] For instance Articles 28, 31, 43 or 49.

[7] J L Buendia Sierra (2006), p 543.

[8] See paragraph C.

undistorted competition as set out by the case law of the European courts and legislation. In a first step, the several requirements of the provision are examined. In the course of this, particular attention is paid to the definition of the term ‘services of general economic interest’ as well as to the meaning of ‘obstruction to the performance of the service’. Then, Article 86(2) is shown in its special role in the financing of services of general economic interest.

B. The requirements for the applicability of Article 86(2)

For Article 86(2) to be applicable an undertaking (I.) must be entrusted with the operation of services of general economic interest (II.) or have the character of a revenue producing monopoly (III.). Moreover, the application of certain rules of the Treaty must obstruct the performance of the particular tasks assigned to the undertaking (IV.). Finally, the derogation of the respective Treaty rule must not affect the development of trade to such an extent as would be contrary to the interests of the Community (V.).

I. The concept of 'undertaking'

The term 'undertaking' is not defined in the Treaty but has been widely construed by case law. As a general definition, the ECJ held in *Höfner and Elser v Macrotron* that 'the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity or the way in which it is financed.'[9]

In *Commission v Italy*, the ECJ provided a basic definition of 'economic activity' by describing it as 'an activity consisting in offering goods and services on a given market.'[10] Moreover, the activity must be, at least in principle, pursuable by a private undertaking in order to make profits.[11]

[9] Case C-41/90 [1991] ECR I-1979, para 21.

[10] Case C-35/96 [1998] ECR I-3851, para 36.

[11] Cases C-180-184/98 *Pavlov v Stichting Pensioenfonds Medische Specialisten* [2000] ECR I-6451, para 201.

However, it is not necessary that an actual profit was made[12] or that the entity was established for an economic purpose.[13]

The courts took a functional approach in order to define the notion of an undertaking, which means that the focus lies on the nature of the activity carried out by the entity in question. It is therefore 'a relative concept in the sense that a given entity might be regarded as an undertaking for one part of its activities while the rest fall outside the competition rules.'[14]

The concentration on the activities or functions of the entity also leads to the situation that its legal personality is irrelevant, with the consequence that natural persons, legal persons and administrative bodies of the state are potentially covered.[15]

However, the usual activities of employees,[16] trade unions[17] and agents[18] are principally excluded from the definition of 'undertaking'. Moreover, the courts have set up two categories of activities which cannot be

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[12] Case 96/82 *IAZ International Belgium SA v Commission* [1983] ECR 3369.

[13] Case 155/73 *Italy v Sacchi* [1974] ECR 409.

[14] Case C-475/99 *Ambulanz Glöckner v Landkreis Südwestpfalz* [2001] ECR I-8089, Opinion of AG Jacobs, para 72.

[15] Commission Decision No 90/456/EEC *Spanish Courier Services*, OJ 1990 L233/19; D G Goyder, *EC Competition Law* (Oxford: University Press, 4th edition, 2003), p 60.

[16] Case C-22/98 *Criminal Proceedings against Becu* [1999] ECR I-5665, para 26; Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751, Opinion of AG Jacobs, para 217.

[17] *Albany* (ibid), para 227.

[18] D G Goyder (2003), p 63.

considered to be economic.[19] First, activities concerning the essential prerogatives of the state are excluded from the competition rules. This category includes traditional *ius imperii* activities, such as the conduct of the judiciary, diplomacy, the representation of the state and foreign relations[20] and a number of public control and regulatory functions of the state, for instance granting concessions for funeral services,[21] the maintenance and improvement of air navigation safety[22] and the performance of services relating to the protection of the environment.[23] Second, certain social protection systems have not been found to be encompassed as long as they were based on the principle of solidarity.[24]

[19] See G Monti, *EC Competition Law* (Cambridge: University Press, 2007), pp 486 et seqq.

[20] J Gonzales-Orus, 'Beyond the Scope of Article 90 of the EC Treaty: Activities Excluded From the EC Competition Rules' (1999) 5 EPL 387.

[21] Case 30/87 *Corinne Bodson v Pompes Funèbres des Régions Libérées SA* [1988] ECR 2497.

[22] Case C-364/92 *SAT Fluggesellschaft mbH v Eurocontrol* [1994] ECR I-43.

[23] Case C-343/95 *Diego Cali e Figli SrL v SEPG* [1997] ECR I-1547.

[24] Cases C-159-160/91 *Poucet et Pistre v Assurances Générales de France* [1993] ECR I-637; Case C-244/94 *Fédération Française des Sociétés d'Assurance and Others v Ministère de l'Agriculture et de la Pêche* [1995] ECR I-4013; Case C-218/00 *Cisal di Batistello v INAIL* [2002] ECR-691.

II. The entrustment of the operation of services of general economic interest

1. Services of general economic interest ('SGEI')

a. Definition

The term 'services of general economic interest' finds expression in the Articles 16 and 86(2) but is not expressly defined. What amounts to an SGEI is the subject of a considerable body of case law and legislation. As a starting point, it has to be emphasised that the word 'economic' does not relate to the word 'interest' but to the word 'service'.[25] This is also implied by the Commission which defined the notion as

> … market services which the Member States or the Community subject to specific public service obligations by virtue of a general interest criterion. This would tend to cover such things as transport networks, energy and communication.[26]

A similar description can be found in the White Paper with the exemption of using 'services of an economic nature' instead of 'market services'. Moreover, it clarifies that the term encompasses any economic activity subject to public service obligations.[27] Therefore, SGEI can be seen as

[25] A Jones/B Sufrin, *EC Competition Law* (Oxford: University Press, 3rd edition, 2007), p 621.

[26] Communication on Services of General Interest, OJ 2001 C17/4, Annex II.

[27] White Paper on Service on General Interest, COM (2004) 374 final, Annex 1.

services which belong to the market but which are also influenced by other, ie non-market, values.

The Commission's Green Paper points out that the existing sector specific Community legislation on SGEI 'contains a number of common elements that can be drawn on to define a useful Community concept of services of general economic interest. These elements include in particular: universal service, continuity, quality of service, affordability, as well as user and consumer protection.'[28]

The concept of 'services' in Article 86(2) has a broad meaning. In this respect, the Court, inter alia, decided that the administration of major waterways,[29] the operation of airlines,[30] the provision of electricity,[31] the provision of postal service,[32] mooring services in ports,[33] the treatment of waste,[34] the provision of emergency ambulance services[35] and the supply of telecommunication equipments[36] are encompassed by the notion. It

[28] Green Paper on Services of General Interest, COM (2003) 270 final, para 49.

[29] Case 10/71 *Ministère Public of Luxembourg v Muller* [1971] ECR 723.

[30] Case C-66/86 *Ahmed Saeed Flugreisen and Silver Line Reiseburo GmbH v Zentrale zur Bekämpfung Unlauteren Wettwerbs eV* [1989] ECR 803.

[31] Case C-157/94 *Commission of the European Communities v Kingdom of the Netherlands* [1997] ECR I-5699.

[32] Case C-320/91 *Corbeau* [1993] ECR I-2533.

[33] Case C-266/96 *Corsica Ferries France SA v Gruppo Antichi Ormeggiatori del Porto di Genoa* [1998] ECR I-3949.

[34] Case C-203/96 *Chemische Afvalstoffen Dusseldorp BV and Others* v *Minister van Volkshuisvesting, Ruimtelijke Ordening en Milieubeheer* [1998] ECR I-4075.

[35] *Ambulanz Glöckner* (see footnote 14).

[36] Case C-18/88 *RTT v GB-INNO-BM SA* [1991] ECR I-5973.

follows that not only the provision of services in the sense of Article 50 but also the provision of goods in terms of Article 23 is included.

The notion of 'economic' makes clear that the services concerned have to be of a market nature.[37]

The word 'general' shall ensure that the respective service serves the interests of society as a whole and is not limited to a special category of people.[38] Principally, SGEI should be mainly directed at private citizens although undertakings may also take advantage of them. It has been doubted whether services that are directly addressed only to undertakings can be considered to be SGEI.[39] Allowedly, it could be argued that such services are mainly in the interest of the respective undertakings and not in the general interest. However, as Buendia Sierra has set forth, it can sometimes be the best way to provide services or infrastructure to undertakings in order to create a benefit for the whole society indirectly.[40] This approach can also be found in a number of cases.[41] Moreover, the term 'general' cannot mean that every citizen or every geographic part must benefit from the service. Regional developments and actions favouring certain disadvantaged groups of people can be

[37] This issue was already explained in paragraph B.I. in the context of the notion 'undertaking'.

[38] J L Buendia Sierra, 'Article 86 - Exclusive Rights and Other Anti-Competitive State Measures' in: J Faull/A Nikpay (eds), *The EC Law of Competition* (Oxford: University Press, 2nd edition, 2007), para 6.142.

[39] Liyang Hou, 'Uncovering The Veil Of Article 86(2) EC', available at SSRN: http://ssrn.com/abstract=1025407, p 5 (accessed 1 January 2009).

[40] See J L Buendia Sierra (2006), p 551.

[41] For example *Ministère Public of Luxembourg v Muller* (footnote 29), para 11.

viewed as in the general interest. The essential point is that such actions are founded upon deliberations of general nature even though their concrete application may be addressed to certain groups.

b. Community law or national law concept?

An important issue concerning SGEI is the question whether it lies within the competence of the Community or the Member States to define what amounts to an SGEI. Formerly, the Court took the approach that SGEI is solely a Community concept.[42] However, it has been argued that the inclusion of Article 16 into the Treaty seems to alter this finding, since the provision could be interpreted as establishing shared and horizontal competences of the Community and Member States for the definition of this concept.[43] In contrast, some authors submit that Article 16 changes nothing of the case law by the Court.[44] Obviously, the biggest problem of a shared horizontal approach is that the powers of the Community and the Member States overlap where both pursue common interests with the provision of services. There is no specification in Article 16 in respect of the boundary of the Community's shared competence. Some guidance as to this issue was provided in the Commission's Green Paper on Services of General Interest which tries to concretise the respective powers of the Community and its Member States.[45] However, the following White Paper did not continue such an attempt but expected a reconstruction of

[42] Ibid, paras 14-15.

[43] See Liyang Hou, p 3.

[44] See M Ross, 'Article 16 EC and Services of General Interest: From Derogation to Obligation' (2000) 25 ELR 22.

[45] Cf footnote 28, paras 27 et seqq.

Article 16 in the European Constitution in order to give surveillance power on the operation of SGEI by Member States to the Community.[46]

In the author's view, a hierarchical surveillance model would be a better solution to the problem than a horizontal or shared approach. There are many cultural, economic and political differences among Member States, which makes it very difficult or even impracticable for the Community to establish a uniform system of SGEI appropriate for the whole Common Market. Thus, Member States need adequate discretion to perform what they traditionally view as SGEI. One good example for a wide discretion for Member States and, at the same time, a controlling function of the Community is the electronic telecommunications sector. The respective regulatory framework of 2002 allows Member States to include more universal service obligations at their will with the requirement to report these to the Commission for monitoring.[47] Another supportive argument for this solution is the fact that the concept of SGEI is a very dynamic one, capable of changing in time according to factors such as technological advances, the state of Community integration or variations in society's perception of the needs that have to be covered by the state. Hence, services which are categorised as in the general interest today can fall out of this category at a later date; on the other hand, new services can be added.[48] Member States can deal with this alteration more flexibly

[46] Cf footnote 27, p 6.

[47] Directive 2002/22/EC of the European Parliament and of the Council of March 7, 2002 on universal service and users' rights relating to electronic communications networks and services, OJ 2002 L108/51.

[48] *RTT* (footnote 36), para 16; see also Communication on Services of General Interest, OJ 1996 281/3, p 4, para 29.

than the Community could do it by finding a common solution for all members.

Nevertheless, it is apparent that the Member States' power to define what an SGEI is should not be absolute but subjected to control by the Community. A developed control already exists in certain sectors which are harmonised in respect of market access and competition, for example the electronic communications, energy, transport and postal sector. Community legislation in these areas has introduced limits on Member States' discretion to define what is meant by SGEI.[49] In addition, the ECJ already pointed out that Article 86(2) cannot be invoked when the public interest in question has been subject to Community harmonisation.[50] But even if a sector is not harmonised, the discretion of Member States is not unlimited, since it is widely accepted that the Community has the competence to prevent manifest errors.[51] So, the Community law concept of SGEI works as a maximum standard beyond which Member States cannot go. In this way, it shall be prevented that Member States abuse their freedom by artificially extending their definition of SGEI to give excessive protection to certain operators. This follows from the Court's judgments in *Port of Genoa*[52] and *BRT II*.[53]

[49] See J L Buendia Sierra (2006), p 549 with references to the sector-specific legislation.

[50] Case C-206/98 *Commission v Belgium* [2000] ECR I-3509, para 45.

[51] Case T-17/02 *Fred Olsen* [2005] ECR II-2031, para 216.

[52] Case C-179/90 [1991] ECR-I 5889, para 27.

[53] Case 127/73 [1974] ECR 318, para 23.

c. Terminological issues

Besides the term 'SGEI', other notions are often used in the same or a similar context. The notion 'services of general interest' can be reckoned as umbrella term describing both services of general economic interest (market services) which are relevant for the competition rules unless a special derogation is applicable and non-economic (non-market) services which are not subject to competition law.[54] By contrast, 'public services' is not a technical term in European law but is used by some Member States. It roughly corresponds to the concept of SGEI. The Court has even sometimes used both terms as if they were synonymous.[55]

d. The impact of Article 16

Article 16 was introduced by the Treaty of Amsterdam 1997 against the background of the huge amount of case law concerning SGEI. According to the wording of the provision, the Community and the Member States, each within their respective powers and within the scope of application of the Treaty, shall ensure that SGEI 'operate on the basis of principles and conditions which enable them to fulfil their missions.' Furthermore, a declaration accompanying Article 16 states that the provision 'shall be implemented with full respect for the jurisprudence of the Court of Justice, inter alia, as regards the principles of equality of treatment, quality and continuity of such services.' This wording has led to much speculation. Many authors have put forward plenty of interpretation proposals.

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[54] A Jones/B Sufrin, (2007), p 622.

[55] See *RTT* (footnote 36), para 22.

Flynn views the provision more as a protectionist measure against the growing intrusion of liberalisation and privatisation into the traditional sphere of SGEI in European law.[56] Ross argues that Article 16 can be seen as a new support for social objectives protecting the provision of certain public services from free market and competition rules.[57] In this respect, he submits that Article 16 shifts the interpretation of SGEI from a mere derogation to an obligation in Community law. In contrast, Buendia Sierra argues that Article 16 'does not modify Article 86(2) but rather reaffirms the logic behind the provision'.[58] Prosser puts forward that Article 16 is an expression of the importance of SGEI as citizenship rights which limit the scope of competition values.[59] Contrary to this opinion, Szyszczak sees the provision as part of the new European institutional design which creates ideas of SGEI through competitive markets.[60] In respect of remedies for violation of Article 16, Maresca makes the radical proposal to establish a liability for damages.[61]

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[56] L Flynn, 'Competition Policy and Public Services in EC Law After the Maastricht and Amsterdam Treaties' in D O'Keefe and P Twomey (eds), *Legal Issues of the Amsterdam Treaty* (Oxford: Hart, 1999).

[57] M Ross, (2000), p 38.

[58] J L Buendia Sierra, *Exclusive Rights and State Monopolies Under EC Law* (Oxford: University Press, 1999), p 313.

[59] T Prosser, *The Limits of Competition Law. Market and Public Services* (Oxford: University Press, 2005), p 161.

[60] E Szyszczak, 'Public Services in Competitive Markets' (2001) 20 YEL 64.

[61] See E Szyszczak, *The regulation of the state in competitive markets in the EU* (Oxford: Hart, 2007), p 220 with reference to M Maresca, 'The Access to the Services of General Interest (SGIs), Fundamental Right of European Law, and the Growing Role of Users' Rights', Paper delivered at the 10th Conference of International Consumer Law, Lima, Peru, 2-6 May 2005.

Despite this intense debate, there have been just a few judicial clues as to the interpretation of Article 16. In *GEMO*, Advocate General Jacobs refers to Article 16 and Article 36 of the Charter of Fundamental Rights of the EU in his Opinion but does not draw a clear picture of their roles.[62] An essential decision as to the question of the impact of subsequent amendments to the general part of the EC Treaty on the previous case law of the Court of Justice was made in *Echirolles*.[63] Here, the Court ruled that new provisions defining general objectives of the Treaty 'must be read in conjunction with the provisions of the Treaty designed to implement those objectives'.[64] In other words, if provisions which are directly applicable have not been amended, then the previous case law shall not be challenged. Applying this ruling to the interpretation of Article 16, it appears that the earlier decisions on Article 86(2) should still be regarded as authoritative.

By contrast, the author submits that it cannot be considered to be correct to assume that the inclusion of Article 16 in the Treaty is without any effect on the interpretation of Community objectives. Such an approach would render the whole process of including this provision totally pointless. Allowedly, Article 16 does not give the Community or the Member States new competences in respect of the definition or enforcement of policies on SGEI. However, it has, at least, a teleological value. This means that the courts will have to integrate the provision into the process of balancing different political aims when they reach a

[62] Case C-126/01 *Ministère de l'Economie, des Finances et de l'Industrie v GEMO SA* [2003] ECR I-13769.

[63] Case C-9/99 *Echirolles* [2000] ECR I-8207.

[64] Ibid, para 24.

decision. Due to the supportive wording in favour of SGEI this may result in a different outcome from time to time.

e. SGEI in the Treaty of Lisbon

Despite the fact that the Treaty of Lisbon[65] has not come into force yet and can currently not be ratified due to the rejection by Ireland, a look at the propositions concerning SGEI might illustrate the future of this issue in the European Community.

In the Treaty of Lisbon, a reference to the newly created Article 4 of the Treaty on European Union (TEU)[66] is added to the mentioned Articles at the beginning of Article 16.[67] Moreover, the following second paragraph is appended:

> The European Parliament and the Council laws, acting by means of regulations in accordance with the ordinary legislative procedure, shall establish these principles and set

[65] Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007, OJ 2007 C306/01.

[66] The contents of the new Article 4 TEU are, inter alia, the general principle that competences not conferred upon the Union in the Treaties remain with the Member States and that the Union shall respect the national identities of the Member States, inherent in their fundamental structures, political and constitutional, inclusive of regional and local self-government. Furthermore, it regulates that, pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties.

[67] According to the Treaty of Lisbon, Article 4 is newly introduced into the Treaty on European Union and Article 16 EC Treaty becomes the new Article 14 EC Treaty.

these conditions without prejudice to the competence of the Member States, in compliance with the Treaties, to provide, to commission and to fund such services.

Another novelty is the following interpretative Protocol to Article 16 (the new Article 14) that was adopted by the June 2007 European Council and added to the Reform Treaty:

Article 1

The shared values of the Union in respect of services of general economic interest within the meaning of Article 16 EC Treaty include in particular:

- the essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organizing services of general economic interest as closely as possible to the needs of the users;
- the diversity between various services of general economic interest and the differences in the needs and preferences of users that may result from different geographical, social or cultural situations;
- a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights;

> Article 2
>
> The provisions of the Treaties do not affect in any way the competence of Member States to provide, commission and organise noneconomic (sic) services of general interest.[68]

In the author's view, it is, at least, doubtful whether all these reforms make a real contribution to the clarity of the definition of SGEI and their status within the Community. Firstly, it is not clear what the consequences of the reference to the new Article 4 TEU will be. On the one hand, one could argue that the reference changes nothing, as it just reaffirms the respective powers and duties of the Member States and the Community. On the other hand, one could say that it strengthens the powers of the Member States concerning SGEI, since Article 4 TEU expressly states that the Union shall respect their national identities and their political and constitutional structures. Against this background, the author doubts whether the new reference would render the current situation any clearer.

Secondly, the Reform Treaty provides for two competing, or concurrent, legal bases for legislation on SGEI, a new one in the second paragraph of Article 14 (the former Article 16) based on co-decision between the European Parliament and the Council, and one for the Commission Directives in Article 86(3) as before. Thus, the assumption that this situation might lead to conflicts and tension is, at least, not abstruse.

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[68] Presidency Conclusions of the Brussels European Council of June 21–22, 2007, http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/94932.pdf (accessed 1 January 2009).

Thirdly, the fact that it was felt necessary to adopt the interpretative Protocol highlights the deep concerns held by the Member States that something essential on the issue of SGEI may be removed from their control. Unfortunately, the Protocol appears to add little of substance as regards SGEI themselves. Rather, it illustrates the inability of the Member States to define within the EU legal framework what they expect to be regarded as SGEI.[69]

2. Entrustment

For the applicability of Article 86(2) it is required that the operation of an SGEI has been entrusted to an undertaking. Generally, this means that the task must be assigned to one or more specific undertakings in an individualised manner[70] by a public authority of a Member State.[71] These public authorities can be of a national, regional or local nature.[72] The nature, scope and duration of the tasks imposed must be concretised by the act of entrustment.

Importantly, the public body which entrusts the SGEI in question to an undertaking must act in the exercise of its functions as a public authority.[73] In respect of the procedure, Commission Decision No 2005/842/EC provides that the entrustment shall take place 'by way of

[69] See also W Sauter, 'Services of general economic interest and universal service in EU law' (2008) 33 ELR 173.

[70] Case C-159/94 *French electricity and gas monopolies* [1997] ECR I-5815, paras 69 et seq.

[71] Cases T-204 and 270/97 *EPAC* [2000] ECR II-2267, paras 125 et seqq.

[72] Commission Decision No 82/371/EEC *Navewa-Anseau*, OJ 1982 L167/39, para 65.

[73] J L Buendia Sierra (2006), p 553.

one or more official acts, the form of which may be determined by each Member State'.[74] Once the act of entrustment took place, a unilateral withdrawal from the provision of the service at a later stage does not affect the entrustment character of the original act.[75]

Usually, the entrustment act has the form of a legal provision[76] or another public law device (for example regulation, public law contract and grant).[77] However, this issue gets more complicated when it comes to the question whether entrustment can take place by means of a simple private law contract. Obviously, in such circumstances the state does not use its prerogative powers. But this does not automatically mean that the state does not act in the function of a public authority, which is the actual prerequisite to establish an entrustment. Rather, it is doubtlessly possible and nowadays even normal that a public authority exercises its administrative powers by using private law instruments. Thus, even a private law contract should be regarded as sufficient to establish an entrustment act.

A further problematic issue occurs in a situation where a public authority merely authorises the exercise of certain activities. Similarly, there can be a situation where certain activities undertaken by private initiative find the express approval of the public authorities. In both cases, the

[74] Article 4 of Commission Decision No 2005/842/EC on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ 2005 L312/67.

[75] *Fred Olsen* (footnote 51), para 189.

[76] See for example *Ministère Public of Luxembourg v Muller* (footnote 29), para 11.

[77] *French electricity and gas monopolies* (footnote 70), para 66.

respective act of the public body cannot be considered to be sufficient to constitute an entrustment.[78] The important missing element is the underlying positive decision to consider an activity of general interest and to entrust an undertaking with it. However, it is no obstacle for an entrustment that the decisive act follows a suggestion by an operator.[79]

One important distinction is to be made between the entrustment of a certain task and the grant of aid or an exclusive right to an undertaking. Certainly, in most of the cases both things happen in a parallel manner and the exclusive right ensures that the task can be properly fulfilled. But from a legal point of view both acts are separate.

It follows from the abovementioned principles that the jurisdiction has interpreted the condition of entrustment in a functional rather than a formalistic manner.[80] A more precise set of rules as to the prerequisites of the act of entrustment are included in Commission Decision No 2005/842/EC.[81] Article 4 provides that the act must specify (a) the nature and the duration of the task and (b) the undertaking and territory concerned, which insofar is in accord with the case law. In addition, the Decision requires the specification of (c) the exclusive or special rights assigned to the undertaking, (d) the parameters for calculating, controlling and reviewing the compensation and (e) the arrangements for avoiding and repaying any overcompensation. The latter three conditions

[78] See for the authorisation Commission Decision No 81/1031, OJ 1981 L370/58, para 66; see for the approval Commission Decision No 85/77 *Uniform Eurocheques*, OJ 1985 L35/48, para 29.

[79] *Fred Olsen* (footnote 51), para 188.

[80] J L Buendia Sierra (2006), p 554.

[81] See footnote 74.

clearly go beyond what has been required by the Court. Their aim is to ensure the compliance with the more substantive conditions set out by case law.

III. Revenue producing monopolies

In order to be viewed as a revenue-producing monopoly in the sense of Article 86(2), an undertaking must have as its principal or sole objective the raising of revenue for the state through the provision of a particular service[82], for example the tobacco and alcohol monopolies that exist in some countries.[83] However, there is a general consensus that exclusive rights whose only objective is the generation of revenues would never be justified under Article 86(2).[84] This is due to the fact that such monopolies would normally fail to satisfy the obstruction test, since there are less restrictive and more appropriate means available to obtain such revenues, for example fiscal measures.[85]

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[82] Office of Fair Trading, *Services of general economic interest exclusion – Understanding competition law*, 2004, http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft421.pdf, p 14 (accessed 1 January 2009).

[83] See I Van Bael/J-F Bellis, *Competition Law of the European Community* (The Hague: Kluwer International, 4th edition, 2005), p 1013.

[84] J L Buendia Sierra (2007), para 6.156.

[85] See Recommendation 62/1500 *French tobacco monopoly*, OJ 1962 48; Recommendation 62/1502 *French matches monopoly*, OJ 1962 48.

IV. Obstruction to the performance of the particular task assigned to the undertaking

Once it is established that an SGEI entrusted to an undertaking is present the key element of Article 86(2) is the absence or existence of an obstruction to the performance of a general interest task, which decides about application or derogation of the relevant Treaty rules. The problematic issue is that the text, context and aim of the provision do not clearly indicate a given interpretation of the 'obstruction' element. Thus, it is unclear from the wording whether a strict or flexible construal is to be favoured. This problem directly leads to the underlying and most decisive question in respect of Article 86(2): shall the provision be interpreted in a competition-oriented way with only a few exceptions for a very limited amount of SGEI or is Article 86(2) an expression of balance between competition and SGEI as equivalent values and principles?

The first obstacle in finding an answer to this question is the ambiguity of the different linguistic versions of the 'obstruction' requirement in the Member States. The French version provides for a narrow wording indicating a strict interpretation. '*Faire échec*', which could be translated as 'make impossible', suggests that Article 86(2) applies only in very limited circumstances. On the other hand, softer language, which supports a more balanced approach, can be found in other versions of the Treaty.[86]

[86] German and Dutch: 'verhindert'; Italian: 'osti'; Spanish: 'impida'.

Taking a look at the place of Article 86(2) in the Treaty, one could argue that its position among competition rules warrants a competition-oriented approach. However, there are important arguments against this structural point of view. Paragraph 2 of Article 86 cannot be viewed as a mere exception to paragraph 1,[87] as its substance exceeds the scope of paragraph 1. The open reference to 'the rules contained in this Treaty' suggests that Article 86(2) is not simply a 'competition' provision but that, despite its position, its wide scope takes it well beyond the field of competition law.[88]

Additionally, the aim of Article 86(2) is not conclusive either. On the one hand, it could be interpreted as an expression of neutrality of the Treaty towards SGEI; on the other hand it could be seen as a very limited derogation from the Treaty rules. Furthermore, it is, at least, not completely devious to have the view that the provision gives priority to SGEI over other principles of the Treaty.

From all this follows that there is a huge spectrum of possible interpretations of the 'obstruction' element just by looking at the provision itself and its position in the Treaty. The prevailing opinion to this issue favours a competition-oriented approach due to the text and structure of the Treaty. Buendia Sierra is one of the most important representatives of this view. For him, Article 86(2) is an exception to

[87] Article 86(1) contains a prohibition of measures contrary to the rules of the Treaty in the case of public undertakings to which Member States grant special or exclusive rights.

[88] See J Baquero Cruz, 'Beyond Competition: Services of General Interest and European Community Law' in: G de Búrca (ed), *EU Law and the Welfare State In Search of Solidarity* (Oxford: University Press, 2005), p 186.

Article 86(1) and should be interpreted strictly. Therefore, 'the exception will only apply if the proportionate character of the restriction can be proved.'[89] In addition, he sets forth:

> The proportionality test contained in Article 86(2) is no different from those existing in other areas of EC law. The proportionality test is considered to be fulfilled when the following three elements are proved:
>
> (1) that a causal link exists between the measure and the objective of general interest;
> (2) that the restrictions introduced by the measure are balanced by the benefits to the general interest; and
> (3) that the objective of general interest cannot be achieved through other less restrictive means.[90]

Especially the third element is the main characteristic of the competition-oriented approach, since it gives a relative priority to competition over SGEI. However, some authors deny that such a competition-oriented approach in form of a standard proportionality test has been applied by the European courts.[91] Thus, it is necessary to take a closer look at the relevant case law in order to find out how the 'obstruction' element has been interpreted by the jurisdiction.[92]

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[89] J L Buendia Sierra (2007), para 6.161.

[90] Ibid, para 6.162.

[91] J Baquero Cruz (2005), pp 187 et seqq.

[92] The following illustration contains an investigation of the case law concerning the 'obstruction' element in the area of special or exclusive rights as set out by the ECJ. As regards the field of the financing of SGEI, this issue will be addressed in paragraph C.V.

1. The *Sacchi* case

In *Sacchi*,[93] which dealt with the Italian television monopoly, the ECJ ruled on the 'obstruction' element for the first time. It was decided that '[t]he fact that an undertaking to which a Member State grants exclusive rights has a monopoly is not as such incompatible with Article 86'. The Court went on and stated that if undertakings are treated as entrusted with the operation of SGEI by Member States, the prohibitions against discrimination and the competition rules apply to behaviour on the market, by reason of Article 86(2), 'so long as it is not shown that the said prohibitions are incompatible with the performance of their tasks.'[94]

In the author's view, a real proportionality test was not applied in *Sacchi*. This becomes clear by the fact, that the ECJ used an elementary form of proportionality in the context of the free movement of goods ('out of proportion').[95] In contrast, the Court merely employed the word 'incompatibility' in the interpretation of Article 86(2). The problem of this notion is obvious: due to its vagueness it can be interpreted in various ways. It clearly does not answer the question of the relation between competition and SGEI but rather presupposes such an answer for its interpretation. This dilemma reveals that the Court did not elaborate the concept of obstruction but just glossed over it.[96]

[93] Cf footnote 13.

[94] Ibid, paras 14 et seqq.

[95] Ibid, para 8.

[96] See also J Baquero Cruz (2005), p 187.

2. The *Ahmed Saeed* case

In *Ahmed Saeed*, where a sole right to operate on a particular air route was at issue, the wording 'incompatible' with the performance of a task in respect of the derogation of Treaty provisions was replaced by the phrase 'indispensable' for such a performance. Furthermore, the requirement of transparency was added in order to ensure that national administrative or judicial authorities are in a position to establish whether the infringements of the competition rules were in fact indispensable for the performance of an SGEI.[97] In fact, the test of indispensability seems stricter than the one of 'incompatibility'. Literally, if a restriction has to be indispensable in order to achieve an objective of general interest, it means that there must not be a less restrictive measure by which this end could also be achieved.[98] This interpretation clearly points into the direction of the third element of the standard proportionality test. However, the Court, unfortunately, did not provide further explanation on this issue and did not use the word 'proportionality' itself, which is quite illogical if it was the aim of the judges to express exactly this principle. Therefore, it is, in the author's view, difficult to draw a substantive conclusion from this judgment.

3. The *Höfner* case

Höfner concerned a legal monopoly in employment recruitment granted by the German state to the Federal Office for Employment. Nevertheless, private agencies dealing with the recruitment of business executives were

[97] Cf footnote 30, paras 55 et seqq.

[98] See J L Buendia Sierra (2007), para 6.168.

tolerated. In this case, the Court revived the 'incompatibility' test of *Sacchi* and even provided some further guidance as to the 'obstruction' element: 'the application of Article [82] of the Treaty cannot obstruct the performance of the particular task assigned to [an] agency in so far as the latter is manifestly not in a position to satisfy demand in that area of the market and in fact allows its exclusive rights to be encroached on by those companies.'[99] By some authors this decision has been interpreted as a strict and, hence, competition-oriented approach towards the recognition of derogations for SGEI.[100]

In the author's view, this point of view is doubtful. As already said, the term 'incompatibility' in itself does not give a clear indication of the grade of strictness.[101] In addition, the ruling as a whole cannot be regarded as extremely strict towards SGEI. Obviously, merely a decision of a public authority cannot lead to an exclusion of competition or free movement provisions. There must always be convincing reasons of general interest to do this. The problem of the *Höfner* case plainly is that there were no such reasons. The entity in question could not satisfy demand on the market and informally tolerated private competitors. In such a case, an opening to competition would actually help the performance of the SGEI. Such a deficient situation could only be tolerated if a priority over competition is given to public bodies providing SGEI – a situation that is clearly not characteristic for the Community. Thus, strictness towards SGEI as a reason to disapply competition provisions cannot be stated here.

[99] Cf footnote 9, para 25.

[100] See A Jones/B Sufrin (2007), p 655.

[101] Cf paragraph B.IV.1.

4. The *Corbeau* case

The *Corbeau* case[102] can be characterised as a milestone case in the row of cases concerning the interpretation of Article 86(2). In this case, Belgian law conferred a monopoly on the Belgian Post Office in respect of the collection, transporting and delivery throughout the Kingdom of various forms of correspondence. In breach of this monopoly, Mr Corbeau set up his own postal service offering special services in form of personal collection from the sender's premises and delivery before noon next day in the same area. Deliveries outside the area were made by using the ordinary post. As a consequence, Corbeau was prosecuted for infringing the Post Office's monopoly. The competent national court then referred some questions on the compatibility of the post office monopoly with EC law to the ECJ, asking, inter alia, for the compliance of the monopoly with Article 86(2).

In its ruling, the ECJ, initially, pointed out that Article 86(2) 'permits the Member States to confer on undertakings to which they entrust the operation of services of general economic interest, exclusive rights which may hinder the application of the rules of the Treaty on competition in so far as restrictions on competition, or even the exclusion of all competition, by other economic operators are necessary to ensure the performance of the particular tasks assigned to the undertakings possessed of the exclusive rights.'[103] The Court also recognised that the Belgian Post Office was entrusted with an SGEI 'consisting in the obligation to collect, carry and distribute mail on behalf of all users

[102] Cf footnote 32.

[103] Ibid, para 14.

throughout the territory of the Member State concerned, at uniform tariffs and on similar quality conditions, irrespective of the specific situations or the degree of economic profitability of each individual operation.'[104] Then, the Court went on to examine the extent to which a restriction on competition was necessary to allow the SGEI to be fulfilled under economically acceptable conditions.[105] As to that, it was stated that the performance of the public service obligation in conditions of economic equilibrium presupposed the possibility to offset less profitable sectors against the profitable ones and, thus, justified a restriction of competition from individual undertakings in respect of the economically profitable sectors.[106] Here, the Court addressed the so-called 'cherry-picking' problem. Without any restriction on competition private competitors would pick out the most profitable sectors for entering the market – a situation which would make it impossible for the Belgian Post Office to create an offset between the different sectors in order to work in circumstances of economic equilibrium.[107] 'However,' the ECJ put forward, 'the exclusion of competition is not justified as regards specific services dissociable from the service of general interest which meet special needs of economic operators and which call for certain additional services not offered by the traditional postal service, such as collection from the senders' address, greater speed or reliability of distributions or the possibility of changing the destination in the course of transit, in so far as such specific services, by their nature and the conditions in which they are offered, such as the geographical area in which they are provided, do not compromise the economic equilibrium of the service of

[104] Ibid, para 15.

[105] Ibid, para 16.

[106] Ibid, para 17.

[107] Ibid, para 18.

general economic interest performed by the holder of the exclusive right.'[108] The decision whether these criteria were met in the present case was left for the national court.[109]

Among commentators, the *Corbeau* judgment is predominantly seen as a change in the case law with a much friendlier attitude towards SGEI.[110] A corresponding statement was submitted by Advocate General Darmon in *Almelo* who set forth that the Court, instead of repeating what Member States are not allowed to do in relation to the grant of exclusive rights, specifies what they can do. He went on stating that 'the competition rules may be disapplied not only where they make it impossible for the undertaking in question to perform its public service task but also where they jeopardize its financial stability.'[111] Some authors even argued that *Corbeau* had the effect of reversing the case law by shifting priority from market to non-market values.[112]

In the author's view, there can be no question of such a volte-face. Admittedly, *Corbeau* is an important development in the case law. The ruling examines the substance of Article 86(2) more precisely than previous judgments. Equally, the judgment's wording seems to be composed more positively than before. However, this does not say that the weighting between SGEI and market considerations has been shifted.

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[108] Ibid, para 19.

[109] Ibid, para 20.

[110] See A Jones/B Sufrin (2007), pp 655 et seq; R Lane, *EC Competition Law* (Harlow : Longman, 2000), pp 238 et seq.

[111] Cf footnote 4, Opinion of AG Darmon, paras 144-146.

[112] See L M Soriano, 'How proportionate should anti-competitive state intervention be?' (2003) ELR 112.

The sole change of the formulation from prohibition to the expression of permitted behaviour does not alter anything in substance. The Court stated that all restrictions of competition or other Treaty provision have to be necessary – a term that can be interpreted in both ways restrictively and leniently. In addition, a priority shift in the case law in favour of non-market values presupposes that there was a priority for market considerations before *Corbeau*. However, as shown above, there is no explicit hint in the case law prior to *Corbeau* that competition should be prioritised. This is supported by the fact that an accurate proportionality test, which would give relative priority to competition, was never applied by the Court.

Having rejected the argument of a volte-face in the case law, it is quite arguable that *Corbeau* introduced a friendlier jurisdiction on SGEI. This becomes clear if one compares the attitudes of the Court towards the 'cherry-picking' problem before and in *Corbeau*. In the field of the free circulation of goods, the ECJ had previously firmly rejected the 'cherry-picking' argument according to which a monopoly is necessary to ensure the economic stability of the undertaking which guarantees the objective of general interest being pursued. In *Campus Oil*, it was held that a less restrictive alternative than a monopoly was available: the grant of state aid.[113] In contrast, the Court in *Corbeau* accepted the cherry-picking argument as one of the main reason for the non-application of competition rules. It even follows from the judgment that it is principally possible to create monopolies in activities which are not of general

[113] Cf footnote 5, paras 45 et seq; actually, the measure in question was even less restrictive than a monopoly (the oil product distributors were obliged to buy some of their supply from the national refinery).

economic interest if those are necessary to guarantee the economic stability of other activities which are of general economic interest.[114]

Like in the cases before, proportionality is not mentioned in *Corbeau*. Nevertheless, among commentators, the case is often seen as enshrining such a test for Article 86(2).[115] This is remarkable, since the proportionality test in its current form was already well developed by the Court at the time of the *Corbeau* decision. Moreover, Advocate General Tesauro in his Opinion brought forward many arguments for a strict application of that test.[116] Thus, the absence of any reference to proportionality in the judgment even against this background suggests that such a test was not applied by the Court. In any event, a strict form of proportionality including a 'less restrictive option' test was not adopted by the judges. An application of the latter would have led to the inapplicability of Article 86(2), since an option less restrictive to competition than cross-subsidisation in a monopoly was available: the compensation for the costs linked with the performance of the public service obligation. Having denied the usage of a strict proportionality test by the Court, it is even quite doubtful if a softer form of proportionality was applied. The ECJ solely pursued a test of necessity. However, this is not the only element in a conventional proportionality test but only one among others. In addition to the necessity of the measure in question, it is also required to examine its suitability and its appropriateness in respect

[114] This can be concluded from the statement that the exclusion of competition is not justified for specific services dissociable from the SGEI, in so far as such specific services do not compromise the economic equilibrium of the SGEI; cf footnote 108; see also J L Buendia Sierra (2007), para 6.180.

[115] See for example L M Soriano (2003), p 116.

[116] *Corbeau* (cf footnote 32), Opinion of AG Tesauro, para 14.

of the intensity of the interference between two values or principles if one wants to apply a proportionality test in any of its genuine forms.[117] Admittedly, one might argue that the inclusion of a suitability test was taken for granted by the Court without further explanation, since it is difficult to pursue a necessity test if the measure in question is not suitable. However, the situation is different for the appropriateness test, as it clearly goes beyond the requirement of necessity and, thus, is an indispensable component of each proportionality test. In this context, one might also wonder why Buendia Sierra, having enumerated correctly all requirements of a genuine proportionality test, claims that Article 86(2) includes such a test even though the Court never used all the requirements in a judgment.[118]

In comparison with *Höfner*,[119] it attracts attention that the Court's wording in the latter case was very clear and in favour of competition, whereas it was very indistinct in *Corbeau*. This conjuncture is due to the very different facts in both cases and not, as often claimed, to a change from a strict to a generous approach towards SGEI. In *Höfner*, the holder of exclusive rights could not satisfy demand and tolerated competition. Thus, it was obvious that the exclusive right in its form at that time could not be justified. In contrast, the issue of cross-subsidisation and the economic equilibrium of the SGEI rendered the decision quite difficult in *Corbeau*. Certainly, the situation, at first, sounded very advantageous for Mr Corbeau, who offered specific services for which there was demand on the market but no offer from the monopolist. However, it was very

[117] See R Alexy, 'On Balancing and Subsumption. A Structural Comparison' (2003) Ratio Juris 436 et seq.

[118] Cf footnote 90.

[119] Cf paragraph B.IV.3.

likely that his special postal service would reduce the amount of deliveries by ordinary post in the local area and, thus, affect the economic equilibrium of the Belgian Post Office.

All in all, *Corbeau* stands for a more sophisticated and cautious approach to Article 86(2). The case introduced a friendlier approach to the provision of SGEI insofar as the recognition of the formerly rejected 'cherry-picking' argument is concerned. However, in the author's view, neither a priority shift from market to non-market values nor the application of a proportionality test can be inferred from the judgment.

5. The *Almelo* case

Almelo concerned the legitimacy of exclusive purchasing and sale clauses contained in supply contracts between various electricity distribution companies and a regional distribution company in the Netherlands.[120] In effect, these clauses made the direct import of electricity from other Member States by the local companies impossible. With respect to Article 86(2), the ECJ again accepted the 'cherry-picking' argument. It was held that restrictions on competition from other economic operators must be allowed in so far as they are necessary in order to enable the undertaking entrusted with such a task of general interest to perform it.[121]

Like in the cases before, a full proportionality test was not pursued in *Almelo*. Furthermore, the question of whether or not less restrictive measures existed was hardly discussed in the judgment. This is probably

[120] Cf footnote 4.

[121] Ibid, para 49.

due to the fact that not the legislation of a Member State but independent behaviour of an undertaking entrusted with the operation of SGEI was at issue. Alternatives such as external financing through subsidies, the financing of sectors through a universal service fund or internal financing supported by exclusive rights could just be contemplated by Member States but were not available to the undertaking in question.[122]

6. *Commission v Netherlands*

In this case, the ECJ had to decide on infringement proceedings launched by the Commission for a declaration that the Netherlands had infringed Articles 28 and 31 by conferring exclusive import rights for electricity intended for public distribution.[123] In the course of this, the Court examined the application of Article 86(2). The Commission assumed that a strict proportionality test is to be applied in the context of Article 86(2) and stated that the Netherlands had 'to establish […] that there were no other measures less restrictive of trade which would also allow fulfilment of the relevant public-service obligations, such as in particular equalization of costs associated with public service obligations.'[124]

The Court started its judgment by stating that Article 86(2), as a derogation from the Treaty rules, must be interpreted strictly.[125] However, no special strictness can be located in the subsequent paragraphs. Again, a simple necessity test was applied instead of a strict proportionality test. Moreover, the ECJ pointed out that it is the aim of

[122] J L Buendia Sierra (2007), para 6.184.

[123] Case C-157/94 *Commission v Netherlands* [1997] ECR I-5699.

[124] Ibid, para 35.

[125] Ibid, para 37.

Article 86(2) to 'reconcile the Member States' interest in using certain undertakings, in particular in the public sector, as an instrument of economic or fiscal policy with the Community's interest in ensuring compliance with the rules on competition and the preservation of the unity of the common market.'[126] By using the keyword 'reconcile', the Court made clear that Article 86(2) is about finding a balance between both aims rather than giving relative priority to one of them.[127] Further, it was held that Member States 'cannot be precluded, when defining the services of general economic interest which they entrust to certain undertakings, from taking into account of objectives pertaining to their national policy or from endeavouring to attain them by means of obligations and constraints which they impose on such undertakings.'[128] Implicitly, this establishes a certain scope of discretion for the Member States to pursue non-competitive policies for general interest reasons. Likewise, a strict burden of proof, as postulated by the Commission, was not applied by the Court: 'the burden of proof cannot be so extensive as to require the Member State, when setting out in detail the reasons for which, in the event of elimination of the contested measures, the performance, under economically acceptable conditions, of the tasks of general economic interest which it has entrusted to an undertaking would, in its view, be jeopardized, to go even further and prove, positively that not other conceivable measure, which by definition would be hypothetical, could enable those tasks to be performed under the same conditions.'[129] In the authors view, this sentence clearly illustrates that a proportionality test was not utilised by the Court, since the discussion of

[126] Ibid, paras 38 et seq.

[127] J Baquero Cruz (2005), p 193.

[128] *Commission v Netherlands* (footnote 123), para 40.

[129] Ibid, para 58.

hypothetical less restrictive alternatives is an inherent part of any proportionality test.[130]

7. The *Albany* case

Albany[131] concerned a pension fund for which, at the request of the representatives of employers and employees in a particular sector of the economy, affiliation was compulsory for all undertakings in that sector. Various undertakings brought proceedings in Dutch courts challenging the compulsory affiliation regime on the grounds that they provided equivalent supplementary pension schemes themselves. It was claimed that measures less restrictive to competition were available, such as minimum requirements for pensions offered by insurance companies without making affiliation to the fund compulsory.[132]

The Court rejected this argument by stating that 'it is incumbent on each Member State to consider whether, in view of the particular features of its national pension system, laying down minimum requirements would still enable it to ensure the level of pension which it seeks to guarantee in a sector by compulsory affiliation to a pension fund.'[133] Hence, the Member States are under no obligation to choose the alternative which is least detrimental to competition. In the author's view, this clearly illustrates that a proportionality test was not applied by the Court.

[130] See also J Baquero Cruz (2005), p 194.

[131] Cf footnote 16.

[132] Ibid, para 99.

[133] Ibid, para 122.

8. Conclusive remarks

As a general conclusion, it can be stated that a proper proportionality test was not applied in any of the above-mentioned cases. This is obviously the case in respect of its strictest version which requires a less restrictive alternative test, but also its soft form in which measures should be proportionate to their aims and not go beyond what is appropriate to achieve the aim cannot be found expressly in the decisions. Admittedly, this seems to be different in the Court's ruling in *Chemische Afvalstoffen Dusseldorp*.[134] Here, the Court held that it is for the party invoking Article 86(2) to show to the satisfaction of the national court that the objective in question cannot be achieved equally well by other means. 'Article [86](2) of the Treaty can thus apply only if it is shown that, without the contested measure, the undertaking in question would be unable to carry out the task assigned to it.'[135] In fact, this decision could be used as an example of a strict competition-oriented approach taken by the Court. However, it seems to be the only one among many judgments that point to another direction. The ruling in *Albany*, which was enacted just one year later, is a good example for those judgments.[136] Another one is the Court's ruling in *Ambulanz Glöckner*[137] which was enacted three years after *Chemische Afvalstoffen Dusseldorp*. This case concerned the compatibility of a State measure granting exclusivity for non-urgent patient transport to an entity previously entrusted with exclusivity for emergency ambulance services. In the context of Article 86(2), the ECJ examined whether the cross-subsidisation of emergency transport with

[134] Cf footnote 34.

[135] Ibid, para 67.

[136] Cf paragraph C.IV.7.

[137] Cf footnote 14.

the revenue of ordinary patient transport 'helps to cover the costs of providing the emergency transport service.' However, it was not discussed whether cross-subsidisation goes beyond what is necessary to cover the costs of the non-profitable sector or if there are other possibilities less restrictive of competition. Thus, there can be no question of the application of a proportionality test in this case.

The fact that, despite all the inconsistencies illustrated above, so many commentators view the 'obstruction' as a 'proportionality' test suggests, in the author's view, that Community jurists tend to see proportionality as a flexible and rather indeterminate tool which can be applied in an infinite amount of forms.[138] In contrast, the author submits to use the label 'proportionality' only if its genuine requirements[139] are fulfilled in order to avoid ambiguities. On this understanding, the test applied by the Court is not more than one of 'objective necessity', which is situated between the test of manifest error and a soft interpretation of proportionality. In other words, the ECJ applied a suitability test with some impact of the necessity component. From all this follows, as far as competition law is concerned, that the 'obstruction' element is the place within Article 86(2) where the Community and the national courts have to find a balance between two values which principally have the same significance in Europe: the operation of SGEI and undistorted competition.

[138] See also G de Búrca, 'The Principle of Proportionality and its Application in EC Law' (1993) 13 YEL 105 et seqq.

[139] Cf the beginning of paragraph B.IV.

V. Compatibility with the Community's interests

In the second sentence of Article 86(2), it is stated that the provision can only apply if the development of trade is not affected to such an extent as would be contrary to the Community's interests. The prevailing opinion is that this is not an additional requirement but merely a clarification as to the 'obstruction' element in the previous sentence.[140] According to this approach, the whole provision of Article 86(2) has direct effect and national courts can apply the derogation without a previous decision by the Commission. Another possible interpretation is that the second sentence constitutes a separate condition and the direct effect is limited to the first sentence of Article 86(2). Then, it would be reserved for the Commission, subject to the review of the ECJ, to decide on the compatibility with the Community's interests.[141] However, the latter view is not endorsed by the Court.[142] Finally, one could think of an approach giving the second sentence a meaning distinct from sentence one and also direct applicability for the national courts. Here, the problematic issue is what the distinct meaning could be, since there is just very little guidance as to this question. The only substantial consideration is that of Advocate General Cosmas who put forward in his Opinion to *Commission v Netherlands* that for recourse to Article 86(2) to be excluded it would be necessary that trade has been affected in practice to the extent that intra-Community trade in the sector in question is practically non-existent.[143] This is consistent with the subsequent judgment of the Court, which

[140] See J L Buendia Sierra (2007), para 6.205.

[141] *Port of Genoa* (footnote 52), Opinion of AG Van Gerven, paras 26 et seqq; Case T-16/91 *Rendo* [1992] ECR II-2417.

[142] Case C-19/93P *Rendo* [1995] ECR I-3319, paras 18 et seq.

[143] Cf footnote 123, Opinion of AG Cosmas, para 126.

noted that the Commission had failed to demonstrate that as a function of the exclusive import right the development of intra-Community trade 'has been and continues to be affected.'[144]

In the author's view, the latter view should be followed for two reasons. First, it should not be imputed to the legislator that the second sentence was included in Article 86(2) without any meaning distinct from sentence one. Second, the approach is not unduly burdensome for the application of the derogation, since it requires that intra-Community trade is practically non-existent. This is important, as the main place to decide on the application of Article 86(2) should remain in the balanced sentence one. Furthermore, there is no implication for a restriction of the direct effect to sentence one, especially no provision similar to Article 88(3).

[144] Ibid, para 67.

C. The role of Article 86(2) in the financing of SGEI

Without state intervention, SGEI would principally not be profitable and, therefore, not be spontaneously provided by the market forces or, at least, not with the same characteristics. This means that the state must normally provide some support to the provider of the SGEI to increase the revenue generated by the market. This support can basically occur either in the form of exclusive or special rights or in the form of state aid.[145]

The issue of when and up to what extent the entrustment of exclusive rights is necessary for the performance of SGEI has been discussed above.[146] In respect of direct funding, the key question to consider is whether financial support granted by the state to certain undertakings in order to enable them to fulfil their public service obligations amounts to state aid within the meaning of Article 87(1) and, if so, whether it may be justified under Article 86(2).

I. Former solutions to the legal definition of the financing of SGEI

There are two main approaches to be considered when analysing financial compensation.[147] The first one views financial compensation as

[145] It has also been argued that the granting of an exclusive right may in some cases amount to the granting of aid; see Commission Decision No 2003/216/EC, OJ 2003 L88/39.

[146] Cf paragraph B.IV.

[147] See A Biondi, 'Justifying State Aid: The Financing of Services of General Economic Interest' in: T Tridimas/P Nebbia (eds), European Union Law for the Twenty-First-Century – Rethinking the New Legal Order (Volume 2, Oxford and Portland Oregon: Hart Publishing, 2004), pp 262 et seq.

a state aid under Article 87(1) and then examines whether this compensation could be justified by Article 86(2) (so-called 'state aid approach'). This approach has been adopted by the Court of First Instance (CFI)[148] and in the two Opinions of Advocate General Léger in the *Altmark* case.[149] According to the second approach, the financial compensation for the provision of the SGEI would not be qualified as a state aid within the meaning of Article 87(1) because it would not confer any advantage to the undertaking (so-called 'compensation approach'). This view was originally supported by the decision of the ECJ in *ADBHU*,[150] the Commission's decision-making practice and subsequently in the Court's judgment in *Ferring*.[151] It was also held in *Ferring* that if the compensation exceeds the additional costs incurred by the provision of the SGEI, it is to be qualified as state aid without any possibility of justification under Article 86(2).[152]

II. The *Altmark* decision

In this case,[153] which concerned the status and legitimacy of subsidies granted by German public authorities to Altmark Trans for the operation of a passenger bus service, the Court had the opportunity to decide

[148] See Cases T-106/95 *FFSA and Others/Commission* [1997] ECR II-229; Case T-46/97 *SIC - Sociedade Independente de Comunicação/Commission* [2000] ECR II-2125.

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

[150] Case 240/83 *ADBHU* [1985] ECR 531.

[151] Case C-53/00 *Ferring* [2001] ECR I-9067.

[152] Ibid, para 33.

[153] Cf footnote 149.

between or reconcile the two approaches on the financing of SGEI. In its trend-setting ruling, the Court opted for the compensation approach, citing *ADBHU* and *Ferring*, but also established four conditions to be satisfied for the measure not to constitute state aid:

(1) the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined;
(2) the parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner;
(3) 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;
(4) where there is no public tendering system to choose the public service provider the level of compensation must be determined by an analysis of the costs a typical undertaking, well run and adequately provided for to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and the reasonable profit for discharging the obligations.[154]

Unfortunately, the judgment did not provide further guidance on the possibilities of justification of a measure constituting state aid according

[154] See ibid, para 95.

to Article 87(1) and the four conditions. Particularly, it was not stated how Article 86(2) might apply.

III. Regulatory approach

Given the unclarity in respect of Article 86(2) left by the *Altmark* decision, the EC Commission adopted a package of measures using a Decision and a Framework drawn up as part of the so-called State Aid Action Plan.[155] Where the *Altmark* conditions are not met and the general criteria for the applicability of Article 87(1) are satisfied, either the Commission Decision No 2005/842/EC[156] or the Framework[157] applies.

Under the Commission Decision, public service compensation that constitutes state aid within the meaning of Article 87(1) is permitted (ie it is justified by Article 86(2) and does not need to be notified to the Commission) if it is less than EUR 30 million per year paid to undertakings with an annual turnover of less than EUR 100 million or is paid to hospitals, social housing undertakings, certain small air or maritime undertakings or certain small airports or ports carrying out an SGEI.[158] There must always be an official act, such as a statutory rule, specifying the undertaking's exact public service obligation, the parameters of calculating, controlling and reviewing the public service

[155] See http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm (accessed 1 January 2009)

[156] Cf footnote 74.

[157] Commission Framework for state aid in the form of public service compensation, OJ 2005 C297/4.

[158] Article 2(1) of the Decision.

obligation and the arrangements for avoiding over-compensation.[159] Furthermore, there are certain criteria concerning the 'obstruction' element within Article 86(2) which will be discussed in the next section.[160]

A public service compensation which does not fulfil the *Altmark* criteria or the Commission Decision must be notified to the Commission in the usual way. Then, the Framework regulates when Article 86(2) is applicable. The prerequisites of the Framework are identical to the Decision, with the exception of the notification requirement. The fact that, despite this analogy, two separate legal instruments are used is probably due to the Commission's wish to get the opportunity to scrutinise larger amounts of state aid and perhaps impose conditions on the grant of the aid.[161] In cases where the public service compensation does not fall under the conditions of *Altmark*, the Decision or the Framework, the remaining state aid rules may still be applicable.

IV. *BUPA v Commission* – a reinterpretation of *Altmark*?

Even though the *Altmark* judgment is a milestone case in respect of the legal categorisation of compensation for the performance of SGEI and is referred to in the above mentioned legislative measures of the Commission, the Court of First Instance, in its very recent judgment in *BUPA v Commission*,[162] seems to move away from a literal and strict interpretation of the four *Altmark* conditions under which a compensation

[159] Article 4 of the Decision.

[160] See C.IV.

[161] E Szyszczak (2007), p 236.

[162] Case T-289/03 [2008] EStAL 326.

for public service obligations is not considered to be state aid. The case concerned a system of risk equalisation in the health care sector in Ireland by which private health insurers were legally forced to contract with all applicants for a private health insurance and to charge all customers the same price for the same level of cover, regardless of age, gender and the state of health. Furthermore, they had to pay a levy to a public body when they had a risk profile below the average market risk profile. Subsequently, the public body granted this money as compensation for insurers with a risk profile higher than average.

With respect to the second *Altmark* condition, which requires that the parameters of the basis on which compensation is calculated must be established in advance in a transparent and objective manner, the Court held that some discretion by the Minister of Health in deciding on whether or not to activate the risk equalisation system did not compromise the compliance with it.[163] Even though this is obviously not a very strict interpretation of the second *Altmark* condition, it is arguable that it merely recognised that certain kind of adjustment in the calculation of costs might be necessary and also desirable.[164] Thus, one has to be cautious in viewing this reasoning as a clear departure from *Altmark*.

Examining the third *Altmark* condition, which states that the compensation must not exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, the Court found that the special legal requirements for the health insurers required a kind of compensation. Moreover, it was held that the compensation

[163] Ibid, para 220.

[164] A Biondi, 'BUPA v. Commission' (2008) EStAL 405.

system, which was not directly linked with the actual costs associated with compliance of the special legal obligations but only with the risk profile of each insurer, did not constitute an infringement of the *Altmark* criteria. The Court justified this approach by stating that the present case concerned a general regulatory welfare system which was substantially different from the more easily identifiable costs for the operation of bus services in *Altmark*. This implies that such general compensatory systems, provided that their SGEI mission is clearly established and they apply equally to all operators, do principally not fall within the scope of state aid provisions.[165] As a consequence and against the background of the facts, the Court also rendered the fourth *Altmark* requirement redundant, since no tendering procedure could be established and no efficient undertaking model was detected and compared.

In the author's view, this judgment changes the third and fourth *Altmark* condition substantially and reveals the difficulties of applying *Altmark* to risk equalisation schemes in the health care sector. These schemes often ensure equal access to health care – a core value of the European policy. Thus, there is a political interest not to hamper the performance of risk equalisation schemes by EC law. Admittedly, one could argue that the *Altmark* test should be applied strictly, since the result could be subsequently corrected by Article 86(2). However, the author is of the opinion that the treatment of risk equalisation schemes is more a substantial question of the current European law, as similar problems concerning the direct cost compensation would also arise in the context of this provision. This becomes clear by taking a look at the requirements of the 'obstruction' element within Article 86(2).

[165] Ibid.

V. The 'obstruction' element

The 'obstruction' element within Article 86(2) must be examined separately for the area of state aid. This is due to the fact that this area is regulated by special secondary legislation which is not applicable in the context of special or exclusive rights. However, this is not the case for the other requirements of Article 86(2), which have already been illustrated above.[166]

Article 5 of Commission Decision No 2005/842/EC[167] includes a detailed illustration of the methods to calculate compensation which is necessary to satisfy the public service obligation in question, ie otherwise the fulfilment of the task in question would be obstructed. Only if the granted state aid is determined according to these principles, it can be justified by Article 86(2). Thus, the following analysis is oriented to the standards of Article 5 of the Decision.

1. The principle of cost coverage

Principally, the costs that may be compensated under Article 86(2) are the actual net costs incurred by the undertaking. The efficiency of the undertaking is not relevant under Article 86(2).[168] Thus, even if the actual costs are higher than those of other more efficient undertakings, they can nevertheless be regarded as compatible. This interpretation seems to take into account the current realities in the public service provider sectors,

[166] See paragraph B.

[167] Cf footnote 74.

[168] J L Buendia Sierra (2006), p 556.

since public services are often still provided by former public monopolies which are, in terms of costs, not always the most efficient ones. However, this approach is debatable. One could argue that compensation is really necessary only where it is calculated by using the level of costs that are predominant on the market. This reasoning is in line with the fourth condition of the *Altmark* judgment which has to be fulfilled to exclude the aid in question from the state aid rules.[169] Nonetheless, it is submitted that this condition cannot be imposed in the context of Article 86(2). Firstly, the *Altmark* judgment merely sets out conditions under which the funding of public service providers is not considered to be state aid in the sense of Article 87(1). This cannot be equated with the applicability of Article 86(2), since this provision can undoubtedly still apply if the measure in question amounts to state aid according to the *Altmark* conditions. Secondly, the 'efficiency gap' is clearly included in the wording of Article 5 of the Decision, as it refers to 'the costs incurred by the undertaking' instead of any other benchmark. This suggests that the Commission was aware of this issue when drafting the Decision. However, the efficiency gap can only be accepted up to a certain level of inefficiency. In this respect, *Ambulanz Glöckner* may be interpreted as showing that Article 86(2) cannot be used for the justification of compensation for costs of highly inefficient operators.[170]

2. The role of public tenders

It is arguable that the efficiency gap in Article 86(2) could be closed by using public tendering as a market mechanism instead of directly and

[169] Cf footnote 154.

[170] Cf footnote 14, para 62.

individually attributing the SGEI to a specific undertaking, which usually is a former monopolist. Theoretically, this would force the tendering undertakings to reduce their costs, which would result in a lower compensation to be paid. However, this solution is just seemingly simple and may be misleading, since certain requirements have to be fulfilled to have a functioning tendering procedure. Inter alia, transparent criteria for choosing the most efficient operator must be defined ex ante objectively and transparently. Nevertheless, in practice, many public procurement procedures take place in a negotiated way leaving the respective authorities a wide degree of discretion. Furthermore, the functioning of a tendering procedure presupposes a market with several undertakings competing for the contract in question. This is not always the case in the field of public service obligations. Thus, tendering may be helpful under certain conditions but does not always lead to a reduction of the efficiency gap.

However, even if the general conditions for the application of tendering are fulfilled, it is doubtful if Article 86(2) requires SGEI to be entrusted by way of a competitive procedure.[171] The Commission did not include such a requirement in Article 5 of Decision No 2005/842/EC[172] even though it was asked by the European Parliament to do so. The Commission's behaviour is probably due to the actual situation in the market, as many existing SGEI have been entrusted without competitive procedure, especially in the sectors of broadcasting, electricity, telecommunication and postal services.

[171] See *Fred Olsen* (footnote 51), para 239.

[172] Cf footnote 74.

Nevertheless, there seems to be one argument in favour of a tendering requirement in Article 86(2). The Court's recent case law indicates that Articles 43 and 49 (rules on establishment and services) constitute a general requirement of equal treatment when it comes to the attribution of public service concessions to third parties by public authorities.[173] Such a requirement practically leads the obligation to use open and competitive procedures to comply with Articles 43 and 49. This legal situation becomes crucial in the context of Article 86(2) when envisioning that, according to certain case law, the Commission cannot declare a state aid to be compatible with the common market if it is indissociably linked with an infringement of a fundamental rule of Community law.[174] Thus, it could be argued that the selection of the provider of the public service is indissociably linked with the funding of these services by the state, in which case no compensation could be authorised if the provider was not chosen through a competitive procedure.

In the author's view, this line of reasoning is, at least in the context of Article 86(2), not persuasive. The analysis of an SGEI under Article 86(2) takes a functional perspective, ie the important issue is the level of financing and not the identity of the provider. In contrast, Articles 43 and 49 are predominantly concerned with the provider's identity and shall ensure that European undertakings have equal access to the market within the whole Community. Thus, the links between both issues cannot be regarded as indissociable.[175] In conclusion, a tendering procedure is not a

[173] See Case C-458/03 *Parking Brixen* [2005] ECR I-8612, para 61.

[174] Case 74/76 *Iannelli* [1977] ECR 557, paras 9-14.

[175] See also J L Buendia Sierra (2006), p 561.

requirement for the applicability of Article 86(2). However, this does not preclude that the presence of such a procedure might, in some cases, be regarded as an additional indication for the necessity of the compensation in question.

3. Revenues

Usually, SGEI are not exclusively financed by state aid. Even though they are not profitable, they normally produce some revenue, for example through fees paid by customers. This revenue must be considered when calculating the net cost of the SGEI, which is the only cost that can be compensated under Article 86(2). Likewise, any other payments made indirectly by the state must be included in the calculation. In this respect, one could think of payments made directly by customers or other undertakings in fulfilment of a legal obligation, for example license fees in the broadcasting sector. The state aid character of such payments is, at least, debatable. However, this does not change the fact that, in any case, they have to be taken into consideration when calculation the compensation.[176]

4. Cost allocation

One of the most significant problems in calculating the net cost occurs when the undertaking in question provides an SGEI and, at the same time, operates a purely commercial activity. In this case, it is very likely that both activities have common costs due to the collective usage of

[176] See Commission Decision No 2004/339/EC on the measures implemented by Italy for RAI SpA, OJ 2004 L119/1, para 123.

facilities and resources. Then, the crucial issue is how these common costs shall be allocated to each of the activities.[177] There are three possible answers to this question.

Firstly, it is possible to argue that the common costs should be wholly attributed to the commercial activities, since, for the sake of fair competition, the SGEI operator should be able to cover the stand alone cost of the commercial activity like all other competitors.[178] This means that synergetic effects based on the SGEI network could never be used to offer cheaper prices for other commercial activities.

Secondly, the common costs could be wholly attributed to SGEI activities, since it makes economic sense to offer cheaper prices due to synergies, provided that the commercial activities are priced above the incremental cost. In this case, one could argue that no real cross-subsidization between activities takes place.[179]

Thirdly, one could think of a calculation where common costs are allocated between both SGEI and commercial activities in a way that reflects the real situation in the company most. This approach was taken by the ECJ in *Chronopost* where it was held that both activities must make a contribution to cover common costs in a reasonable and proportional way.[180] Article 5(2)(c) of Commission Decision No

[177] See on this issue L Hancher/J L Buendia Sierra, 'Cross-subsidization and EC Law' (1998) CMLR 901.

[178] Case T-613/97 *Ufex e.a. v Commission* [2000] ECR II-4055.

[179] Commission Decision No 98/356/EC concerning State aid granted by France to SFMI-Chronopost, OJ 1998 L164/37.

[180] Cases C-83, 93 and 94/01P *Chronopost* [2003] ECR I-6993, para 40.

2005/842/EC endorses this approach by setting the standard of a proportionate contribution to fixed costs common to both SGEI and other activities. Both the Court and the Commission seem to leave a wide degree of discretion to undertakings in choosing the concrete way of partition. In order to ensure a reasonable cost allocation, Article 5(5) of Commission Decision No 2005/842/EC provides that undertakings have to keep analytical accounts.

In the author's view, only the third approach can be regarded as correct in order deal with common costs. On the one hand, it would be very unfair to other competitors if an undertaking was entitled to attribute all common costs to the SGEI, since this would be an artificial device to relocate actually accruing costs. On the other hand, one cannot disregard that the SGEI take part in the creation of the common costs. In other words, it cannot be demanded of the undertaking to partially cover costs of the SGEI by its other commercial activities. However, such a cost-splitting can only be used if it is possible to differentiate conceptually between costs incurred in running the SGEI and those caused by other commercial activities.[181]

5. Temporal link

Usually, compensation is paid soon after the incurrence of the costs, ie either in the same financial year or in the following one. Sometimes compensation is even paid in advance. Nevertheless, it is crucial that the

[181] This might be difficult, for example, in the public broadcasting sector, see Communication from the Commission on the application of State aid rules to public service broadcasting, OJ 2001 C320/04, paras 53 et seqq.

time span between the incurrence of the costs and compensation is as short as possible in order to ensure that the causal link between both transactions is real. The Commission has, however, been rather generous in this respect.[182]

6. Reasonable profit

Article 86(2) allows the inclusion of a reasonable profit for the undertaking carrying out the SGEI in the calculation of the net cost to be compensated. The case law does not provide clear guidance as to the definition of what amounts to a reasonable profit. However, Article 5(4) of Commission Decision No 2005/842/EC includes some useful indications. According to this provision, reasonable profit means 'a rate of return on own capital that takes account of the risk, or absence of risk, incurred by the undertaking by virtue of the intervention by the Member State, particularly if the latter grants exclusive or special rights. This rate shall not normally exceed the average rate for the sector concerned in recent years.' In cases without the possibility of comparing this rate within a particular sector, comparisons with other sectors or similar sectors in other Member States can serve as guidance.

[182] See J L Buendia Sierra (2006), p 566.

D. Conclusion

All in all, the role of Article 86(2) between the poles of adequate provision of public services and undistorted competition is complex and, due to the relevant case law and legislation, not always straightforward. However, the various proposals in this paper aim to improve this situation.

In the interpretation of the requirements of Article 86(2), the notion 'SGEI' still leads to problems, in particular as to the competence of determining what amounts to an SGEI. In this respect, the author favours a hierarchical surveillance model with a wide discretion for the Member States and a controlling function for the Community. Furthermore the author submits that Article 16 supports the appreciation of SGEI within the Community and has, at least, a teleological impact. In contrast, it is doubtful whether the reforms on this issue in the Treaty of Lisbon can be regarded as improvement towards more clarity.

The 'obstruction' element within Article 86(2) has probably led to the largest debate in the context of Article 86(2), since it is the core element to strike a balance between market and non-market values. A preference for one of those values cannot be found in the case law. In this respect, it is submitted that a genuine proportionality test has not been applied by the Court. Instead, a test of 'objective necessity', which is situated between the test of manifest error and a soft interpretation of proportionality, has been used. In other words, the Court's examination can be referred to as a suitability test with some impact of the necessity component. Admittedly, this approach has led to some legal uncertainty in this area. However, in the author's view, a genuine proportionality test

should not be applied in the context of Article 86(2), since this would create a relative priority for other Treaty rules over the provision of SGEI. Against the background of the importance of SGEI as a European value, this cannot be regarded as correct. Instead, the jurisdiction should apply an appropriateness test which considers SGEI to be at the same level as other important values, such as undistorted competition.

Moreover, it is submitted that the second sentence of Article 86(2), which refers to the interests of the Community, should be given a meaning distinct from sentence one and also direct applicability for the national courts.

In the field of the financing of SGEI, Article 86(2) can be applicable if a measure is regarded to be a state aid according to the four *Altmark* conditions. Even though the Court of First Instance in *BUPA v Commission* seems to have altered some of those conditions substantially, the *Altmark* judgment should still be regarded as authoritative until the ECJ has had the opportunity to pass a ruling on this issue. The conditions under which Article 86(2) grants exemption in the state aid field are set out in a Decision and a Framework issued by the Commission.[183] According to them, compensation can only be justified if it covers the net costs of the performance of the SGEI in question. In order to determine the actual net costs, revenues and a reasonable profit should be taken into consideration. In the case of common costs in respect of SGEI and other commercial activities, a cost allocation shall be carried out in a reasonable and proportional way if it is practically possible.

[183] See paragraph C.III.

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