29 July 2003

European Court clarifies application of State Aid rules to State financing of public service obligations

On 24 July 2003, the Court of Justice of the European Communities ("the Court of Justice") rendered its judgment in the *Altmark* case, ending the controversy surrounding the application of the State Aid control regime to compensation granted to undertakings in consideration for public service obligations imposed on them[1].

The Court held that such compensation does not confer an advantage on the undertakings concerned, and hence does not constitute State Aid within the meaning of the EC Treaty ("EC"), provided four conditions are satisfied:

- **First, the beneficiary of the compensation has effectively been entrusted with clearly defined public service obligations;**
- **Second, the parameters for calculating the compensation must be established in advance in an objective and transparent manner;**
- **Third, the compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the revenue such obligations may generate and the fact that the beneficiary is entitled to make a reasonable profit for discharging these obligations;**
- **Fourth, either the undertaking selected to discharge the public service obligation is chosen pursuant to a public procurement procedure, or, failing this, the level of compensation is determined on the basis of an analysis of what it would cost a typical, well run undertaking to discharge these obligations, again taking into account the revenue such obligations may generate and the right for the beneficiary to make a reasonable profit.**

This judgment will enable Member States to organize public services without having to submit their financing mechanisms to prior European Commission scrutiny under the State Aid control rules. However, the Court of Justice has been careful to provide for a number of safeguards to make sure that its ruling is not used by Member States to favor certain undertakings under the guise of compensating them for the costs incurred in discharging public service obligations.

I. The mechanism of State Aid control under the EC Treaty

Article 87 (1) EC introduces a general prohibition of State Aids, while providing for a number of compulsory or discretionary exemptions to this prohibition pursuant to Article 87 (2) and (3) EC.

In order for a State measure to be caught by the prohibition, it must meet four conditions: (i) there must be a financial intervention by the State or through State resources, (ii) this

---

1 *Altmark*, case C-280/00, judgment of 24 July 2003.

intervention must confer an advantage on the beneficiary, (iii) the intervention must distort or threaten to distort competition and (iv) the intervention must be liable to affect trade between Member States[2].

State Aid can take the form of a straightforward subsidy, an interest-free or low-interest loan, a State guarantee, a tax exemption or an exemption from the obligation to pay social security or other charges, favourable prices for goods or services provided by public undertakings, etc.

Pursuant to Article 88 (3) EC, Member States are obliged to notify the Commission of their intention of granting aid, before they finally adopt this aid measure. In addition, they must respect a standstill obligation until the Commission decides whether the notified measure constitutes State Aid and, if so, whether such aid is compatible with the common market, i.e. whether it meets the conditions for one of the exemptions provided for in Article 87 (2) or (3) EC. State aid granted in violation of the notification or of the standstill obligations is deemed illegal aid. If the Commission finds that such illegal aid is furthermore incompatible with the Common Market, it will - save exceptional circumstances - order the guilty Member State to recover the aid amounts (including a commercial interest as from the moment the aid was illegally granted) from the beneficiary. In addition, the Commission is empowered to take a provisional decision ordering the offending Member State to suspend or provisionally recover the unlawfully granted aid[3].

Member States' courts are not empowered to rule upon the compatibility of a State Aid measure with the common market. They can however decide whether or not a contested measure constitutes State Aid within the meaning of Article 87 (1) EC, and, where such aid has been unlawfully granted in violation of the notification and standstill obligations, they must pronounce the illegality of the aid and take all measures to undo its effects.

Beyond the specific exemptions to the prohibition of State Aid, provided for by Article 87 (2) and (3), Article 86 (2) EC provides for a general exception to the application of the Treaty rules to undertakings entrusted with the operation of services of general economic interest where the application of such rules would obstruct the performance, in law or in fact, of the particular tasks entrusted to these undertakings, provided this exception does not affect trade between Member States in a way which would be detrimental to the interests of the European Community.

II. Compensation for public service obligations: the issue and its relevance

In the *Altmark* case, a local bus company benefited from 18 licences to operate bus passenger services in a German district, for which it received a subsidy from the public authorities. A competitor contested the licence grant, arguing among others that the beneficiary could not survive without the subsidy. The referring German Federal Administrative Court queried whether the subsidy constituted State Aid and put a question to this effect to the Court of Justice[4].

The issue before the Court was whether compensation granted by a Member State to an undertaking in consideration for the public service obligations it has been entrusted with, constitutes State Aid, and therefore must be subjected to the prior approval of the European Commission. The net result would be twofold : (i) in case of notification to the Commission, such compensation could not be granted until the Commission would have approved it; (ii) if the compensation was granted in the absence of a notification to the Commission, or in violation of

---

2 In the *Altmark* case, the Court of Justice clarified that all four of these conditions have to be met for a State measure to fall within the definition of State Aid pursuant to Article 87 (1) EC.

3 See article 11 of Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 [now 88] of the EC Treaty, OJ [1999], No L 83, p. 1.

4 The *Altmark* case raised a number of issues relating to the treatment of public service obligations and State Aids in the transport sector, which is subject to a specific regime under the EC Treaty. These issues are not discussed in this Bulletin.

the standstill obligation, any interested party could object to the payment of such compensation before national courts.

On the other hand, should it be decided that compensation granted in consideration for the discharge of a public service obligation does not constitute a real advantage to the undertaking entrusted with such obligation and therefore does not constitute State Aid, then such compensation measures would entirely escape the discipline of the State Aid control mechanism.

Over the past years, national courts put a number of preliminary questions to the Court of Justice, illustrating the relevance of the issue the Court was asked to rule upon in *Altmark*:

- In the *Ferring* case, a pharmaceutical company argued that it should not have to pay a tax levied on direct supplies to retailers, which had been introduced in France to offset the disadvantage which wholesalers in pharmaceutical products suffered as a consequence of the public service obligations imposed upon them by the French State, while such obligations were not imposed on pharmaceutical companies' direct deliveries to retailers[5]. The pharmaceutical company argued that the scheme was constitutive of State Aid in favour of the wholesalers. Since the scheme had not been notified to the EC Commission, it argued that the French courts should refuse to apply it and hence that it should not be made to pay the tax. The French State argued that the scheme did not constitute aid since it merely offset the costs supported by the wholesalers as a result of their public service obligations.

- In the *Enirisorse* case, an Italian company challenged a port tax on the grounds that part of the proceeds of a charge went to public undertakings entrusted with dockside loading and unloading of goods at certain ports, despite the fact that it had not made use of the services of these undertakings[6]. Among the arguments put forward was that this constituted unlawful State Aid, while the Italian authorities argued that the charge was necessary to distribute the costs of the public loading and unloading services provided by the beneficiaries.

- In the *Gemo* case, a French supermarket contested a meat purchase tax imposed on supermarkets but not on small meat retailers, which was meant to finance a public service for the collection and disposal of animal carcasses and dangerous slaughterhouse waste, provided free of charge to farmers and slaughterhouses by private carcass disposal undertakings remunerated by the State under contracts awarded after public procurement procedures[7]. The contention of the supermarket was that this scheme constituted State Aid for the farmers and slaughterhouses (and the small meat retailers), which was unlawful since it had not been notified to the European Commission. It therefore asked the French courts to set aside its obligation to pay the tax. The French authorities argued that the scheme compensated the disposal operators for their public service obligations and therefore did not constitute State Aid.

In all these cases, there was an additional issue whether Article 86 (2) EC may not provide a solution to a finding that the financing scheme for public service obligations constituted unlawful State Aid. As explained above, Article 86 (2) EC contains an escape clause for undertakings entrusted with a service of general economic interest not to be subject to the Treaty rules where this would obstruct the performance of their tasks. It appears however unclear that Article 86 (2) EC could be relied upon by national courts as a reason not to set aside aid measures which would have been granted in violation of the notification and standstill obligations imposed by Article 88 (3) EC. In a previous judgment, the Court of Justice had indeed already decided that

---

5 *Ferring*, case C-53/00, [2001] ECR I-9067. judgment of 22 November 2001 – opinion of 8 May 2001.

6 *Enirisorse*, Joined Cases C-34/01 to C-38/01, pending.

7 *Gemo SA*, case C-126/01, pending.

Member States could not rely on Article 86 (2) EC to evade the notification and standstill obligations[8].

III. Divided opinions

The Court of First Instance of the European Communities has taken the view in a number of cases that measures granted in compensation for a public service obligation were constitutive of State Aid and therefore subject to the discipline of the State Aid control regime instituted by the EC Treaty, while they may be declared compatible with the common market pursuant to one of the exemptions provided for in Article 87 (2) or (3) - by the Commission, following a notification - or may be held to benefit from the exception laid down in Article 86 (2) EC[9].

Faced with the above mentioned question concerning the tax on direct sales to retailers by pharmaceutical companies in the *Ferring* case, the Sixth Chamber of the Court of Justice, adopting the opinion of Advocate General Tizzano, took the opposite view from the Court of First Instance and decided that the tax at issue would only constitute State Aid to the exempted wholesalers in pharmaceutical products, "*to the extent that the advantage in not being assessed to the tax on direct sales of medicines exceeds the additional costs that they bear in discharging the public service obligations imposed on them by national law*"[10]. The Court further held that, to the extent that the advantage enjoyed by the wholesalers would exceed the costs of the public service obligations they bear, such advantage would constitute State Aid which would not benefit from the exception of Article 86 (2) EC, since such aid would by definition not be necessary to enable the wholesalers to discharge their public obligations.

In his first opinion in the *Altmark* case, Advocate General Léger severely criticized the judgment in *Ferring* and suggested that the Court of Justice should reverse it[11]. Advocate General Léger opined that the Court in *Ferring* had confused the question of characterising a measure as State Aid and the question of justification for a measure once it has been characterized as State Aid. He felt that the judgment deprived Article 86 (2) EC of its effect, while the conditions for application for this article were stricter than the conditions set by the Court in *Ferring* for the definition of State Aid. In other words, measures which in the past would have been considered as State Aid and which would not have met the conditions to benefit from Article 86 (2) EC would now escape all scrutiny. Advocate General Léger also feared that the *Ferring* test would effectively remove State measures to finance public services from the Commission's control of State Aids. He thus proposed that the Court should rule that subsidies granted to offset the costs of a public service obligation were liable to constitute State Aid.

In an opinion given a few months later, Advocate General Jacobs for his part adopted a compromise position, suggesting that a distinction should be made between State measures showing a direct and manifest link between the financing granted and the public service obligations imposed, where these obligations are clearly defined, and measures "*where it is not clear from the outset that the State funding is intended as a* quid pro quo *for clearly defined general interest obligations*"[12]. The Advocate General conceded that his proposed distinction might not always be easy to draw. In his view, however, this solution may give to Member States "*an incentive to grant compensation for the provision of general interest services on the basis of unequivocal and transparent arrangements, and perhaps even on the basis of public service contracts awarded after open, transparent and non-discriminatory public procurement procedures*"[13].

---

8 *France v. Commission*, case C-332/98, [2000] ECR I-4833.

9 *FFSA*, case T-106/95, [1997] ECR II-229 ; *SIC*, case T-46/97, [2000] ECR II-2125.

10 *Ferring*, see above.

11 Opinion of Advocate General Léger of 19 March 2002 in *Altmark*¸ case C-280/00.

12 See opinion of Advocate General Jacobs in *Gemo SA*, case C-126/01, § 120.

13 *ibidem*, § 129.

In yet another case, Advocate General Stix-Hackl concurred with the opinion of Advocate General Jacobs[14].

IV. The Court's judgment in Altmark

In view of these divergent opinions, the *Altmark* case was entrusted to the full Court of Justice and it was decided to re-open the procedure to afford all parties to comment on *Ferring* and the ensuing discussions in the different opinions of the Court's own Advocates General. In the event, six Member States intervened and split on whether the Court should confirm the *Ferring* solution or whether it should adopt the compromise solution advocated by Advocate General Jacobs[15].

In its judgment of 24 July, the full Court has adopted a solution clearly inspired by Advocate General Jacobs' opinion. The Court did first of all confirm *Ferring* in holding that a State measure to finance public obligations is not State Aid within the meaning of Article 87 (1) EC where it "*must be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations, so that those undertakings do not enjoy a real financial advantage and the measure thus does not have the effect of putting them in a more favourable competitive position than the undertakings competing with them*" (§ 87).

However, the Court showed sensitiveness to the arguments which had been put to it that, without more, the *Ferring* formula may make it tempting for Member States to unduly advantage some undertakings, since it enabled them to refrain from notifying their intended measures of financial support to the Commission, while not having to worry about the consequences in national court.

Thus, the Court has subjected the *Ferring* solution to a number of relatively stringent conditions meant to ensure that it would only be applied in the most clear-cut cases:

> (1) the public service obligations being compensated must be clearly defined in national law;
>
> (2) the compensation for such obligations must be based on parameters which have been determined in advance, in an objective and transparent manner;
>
> (3) the compensation cannot exceed the costs of the public service obligations, but the Court does however concede that these "costs" may include "*a reasonable profit*" (§ 92); and finally
>
> (4) the Court encourages Member States to select the public service providers through a public procurement procedure, in the absence of which the compensation shall have to be determined based not on the actual costs of the undertaking entrusted with the public service obligations, but on the costs of a "*typical undertaking, well run and adequately provided with the means* [of performing the services]", which can presumably be taken to refer to a normally efficient and economically viable company. Again, the Court allows for the fact that the service provider is entitled to "*a reasonable profit*" (§ 93).

V. Consequences of the judgment

The *Altmark* solution is illustrative of the way the Court of Justice is able to enact quasi-regulatory requirements, which Member States will have to take into account if they want to avail themselves of the favourable regime heralded by the *Ferring* judgment. While the Court

---

14 Opinion of Advocate General Stix-Hackl in *Enirisorse*, Joined Cases C-34/01 to C-38/01.

15 In a second opinion in the *Altmark* case, given on 14 January 2003, Advocate General Léger persisted in his first opinion that the Court of Justice should simply reverse *Ferring*.

maintains the *Ferring* solution, it surrounds it with significant constraints on the ability of Member States to organize the provision of public services as they see fit. In particular, with the fourth condition attached to its judgment, the Court is clearly pushing Member States towards a policy of systematic attribution of public services contracts through open bid procedures. This requirement appears justified from a legal point of view since it can be argued that State financing that would reward providers of public services for their inefficiency would constitute an advantage and hence State Aid to these providers. A public bid procedure is the best way to make sure that public services will be discharged in the most efficient manner.

While these constraints may perhaps create an important burden, in particular for local authorities, the transparency and efficiency thus promoted by the Court can only be positive for the provision of public services.

The *Altmark* judgment has brought significant clarification to the treatment of the financing of public services in the European Union. There are however still important issues that will require further clarification in the case-law in order for their scope to be clearly defined, such as what constitutes *reasonable profit*. This notion has proved to be quite elusive indeed in other areas of EC law, such as the issue of what constitutes abusively high pricing under Article 82 EC or the regulation of interconnection and access issues in the telecommunications field.

Also unresolved is the question of the role Article 86 (2) may play for all cases of State financing of public services that will not benefit from the *Altmark* rule. Indeed, while Article 86 (2) EC does not enable State Aid to public services providers to escape from the notification and standstill obligations, it may be argued that for a national court to draw all consequences from the illegality of such Aid granted in violation of these obligations may in certain circumstances at least hamper the provision of public services. Could the beneficiary rely upon Article 86 (2) EC in such circumstances to set aside the obligation of national courts to take all measures to undo the effects of illegal aid? In view of the divergent views which were expressed by the Advocates General on the proper scope and consequences of Article 86 (2) EC in the field of State Aids, it is to be regretted that the Court of Justice did not seize the opportunity to also address this issue in its *Altmark* judgment.

This last issue is important as significant areas of State intervention in favour of public services will not benefit from the *Altmark* judgment. This will be the case for instance of general exemptions from income and other taxes, which by their nature do not reflect exactly the costs of provision of public services. Another frequent type of State intervention in support of public services, the *a posteriori* compensation of losses incurred, will also be considered State Aid and will have to be notified to the Commission for approval (which approval could then be granted under the specific exceptions of Article 87 (2) or (3) or, arguably, under Article 86 (2) EC), or run the risk of national litigation where the beneficiary will have to argue that the measures in question are saved by Article 86 (2) EC. In any event, it seems clear from the *Ferring* judgment, as the Court of Justice did not come back upon this in *Altmark*, that Article 86 (2) EC may not be relied upon to save State financing which would overcompensate a provider for discharging its public services obligations. State financing which would exceed the costs of provision of these obligations and a reasonable profit for the service provider will indeed be considered unnecessary to allow the public service provider to perform its tasks.

* * *

This Bulletin has been prepared by Frédéric Louis and Anne Vallery. If you have any questions about the *Altmark* judgment or any other EU law matter, please do not hesitate to contact them or any of the lawyers listed below.

WCP ANTITRUST AND COMPETITION GROUP

In Brussels: ***+32 (2) 285.49.00***

Claus-Dieter Ehlermann	**Christian Duvernoy**	**Antonio Capobianco**	**Jan Heithecker**
John Ratliff	**Yves Van Gerven**	**Pablo Charro**	**Lorelien Hoet**
Charles Stark	**Sven Voelcker**	**Axel Desmedt**	**Anne Vallery**
Paul Von Hehn	**Frédéric Louis**	**Flavia Distefano**	**Naboth van den Broek**
Marco Bronckers	**Eric Mahr**	**Martin Goyette**	**Deirdre Waters**
Thomas Mueller	**Natalie McNelis**	**Axel Gutermuth**	

In Berlin: ***+49 (30) 20.22.64.00***

Karlheinz Quack	**Rainer Velte**	**Stefan Ohlhoff**	**Andreas Zuber**
Ulrich Quack	**Markus Hutschneider**	**Hartmut Schneider**	
Natalie Luebben	**Joerg Karenfort**	**Ruediger Schuett**	

In Washington, DC: ***+1 (202) 663.6000***

William Kolasky	**Ali Stoeppelwerth**	**Nicole Berry**	**David Olsky**
Douglas Melamed	**Leon Greenfield**	**Aaron Brinkman**	**Jeffrey Rogers**
Robert Bell	**Jeffrey Ayer**	**Richard Elliott**	**Jeffrey Schomig**
Veronica Kayne	**Janet Ridge**	**James Frost**	
John Rounsaville	**Yaa Apori**	**Jacqueline Haberer**	
James Lowe	**Laura Batenic**	**Ron Katwan**	

All attorneys can be reached via email by first name.last name@wilmer.com