

## Chapter 2

# The Impact of *Altmark*: The European Commission Case Law Responses

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**Abstract** This chapter analyses the case law of the European Commission in relation to State aid granted to companies entrusted with public service missions following the landmark ruling in *Altmark*. *Klasse* shows that the criteria laid down by the CJEU for public service compensation to be free of State aid elements have been met only on rare occasions in the case law. The author notes that this is a consequence of the difficulties the Commission has faced when applying the *Altmark* test which resulted in a very strict reading by the Commission of the *Altmark* criteria. According to his interpretation, the 2005 SGEI Package, adopted by the Commission to provide stakeholders with legal certainty on the application of the State aid rules, clarified that the room for financing public service missions without the necessity for Member States to notify the financing to the Commission is rather limited. His chapter charts the Commission's practice in relation to each of the four *Altmark* criteria. While the first three criteria are generally considered to be relatively straightforward to apply, his analysis shows that the Commission's case law has confined the Member States' room for manoeuvre in relation to each criterion. Even where the Commission acknowledges a margin of discretion on the part of the Member States, which is subject only to review for manifest errors, such as in relation to the definition of a public service mission, it has interpreted its powers widely. *Klasse* notes that the main challenging factor remains the assessment of the fourth *Altmark* criterion, according to which, in the absence of a competitive tender, a benchmarking analysis is required. Save for in exceptional circumstances, the benchmarking exercise has never been successful. He argues that it is difficult to reconcile the Commission's approach emanating from its case law with the jurisprudence of the European Courts.

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## 2.1 Introduction

This chapter analyses the case law of the European Commission law in relation to State aid in the form of compensation granted to companies entrusted with public service obligations (psos). It covers the period starting with the *Altmark* ruling in 2003,<sup>1</sup> which laid down specific criteria in order for public service compensation to be free of State aid elements, and thus be exempt from the notification requirement under Article 108(3) TFEU, and ends with recent Commission decisions on the subject.

Written shortly after the entry into force of the new EU rules on services of general economic interest (SGEI) that will be dealt with in subsequent chapters of this book, the aim of this chapter is twofold: (i) it sums up the Commission's experience with the application of the *Altmark* criteria across different sectors after 2003 and in particular since the Commission adopted its first SGEI Package in 2005; and (ii) it analyses critically the Commission's case law. It is hoped that the experiences which have emerged will help readers to better understand the concerns of Member States and general stakeholders in the reform process that has led to the adoption of the new SGEI Package.

As will be detailed in the following sections, the Commission has applied the *Altmark* criteria very strictly. As a result, scarcely any public service compensation (psc) granted by Member States have been regarded as aid-free by the Commission. There are only very few Commission decisions in which the Commission came to the conclusion that the *Altmark* test was satisfied.<sup>2</sup> Most of the cases under

<sup>1</sup> CJEU, Case C-280/00 *Altmark Trans* [2003] ECR I-7747.

<sup>2</sup> The notable exceptions include Commission, 16 December 2003, State aid N 475/2003 *Security of Supply Ireland (CADA)*; Commission, 16 November 2004, State aid N 381/2004 *Broadband Infrastructure Project Pyrénées-Atlantiques*; Commission, 3 May 2005, State aid N 382/2004 *Broadband infrastructure project Limousin (Dorsal)*; Commission, 30 September 2009, State aid N 331/2008 *Broadband Hauts de Seine*; Commission, 24 May 2007 *Energy supply Slovenia* OJ 2007 L 219/9; Commission, 15 September 2009, State aid N 206/2009 *Financing of the public transport services in district of Anhalt-Bitterfeld*; Commission, 15 September 2009, State aid N 207/2009, *Financing of the transport services in district of Wittenberg*.

scrutiny, lacked one or more of the criteria of the *Altmark* ruling as interpreted by the Commission.

This chapter is organised as follows: after recalling the main elements of the *Altmark* judgment and the Commission's 2005 SGEI Package (Sect. 2.2), this chapter critically analyses the Commission decision-making practice in relation to each of the four *Altmark* criteria (Sect. 2.3). Section 2.4 draws some conclusions as to the overall approach taken by the Commission in its case law.

## 2.2 The *Altmark* Ruling and the 2005 SGEI Package

In its well-known ruling in the *Altmark* case, the CJEU held that the discharge of pso is *not* caught by Article 107(1) TFEU where it merely compensates the provider of a public service mission for the costs that arise due to the performance of the pso.<sup>3</sup> For that to be the case, four cumulative criteria have to be met:

1. the recipient undertaking must actually have pso to discharge, and the obligations must be clearly defined;
2. the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner;
3. the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the pso, taking into account the relevant receipts and a reasonable profit; and
4. where the undertaking is not chosen pursuant to a public procurement procedure which would allow for the selection of the bidder capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs of a typical, well run and adequately equipped undertaking.

Where the conditions are satisfied, the compensation is not considered to amount to State aid. As these are cumulative criteria, where only one condition is not met, the compensation constitutes State aid and is subject to the notification requirement and standstill obligation laid down in Article 108(3) TFEU. The aid measure can still be declared compatible under Articles 107(2), (3) TFEU (or 93 TFEU and secondary legislation where applicable). This extremely controversial judgment stimulated a substantial debate amongst commentators and has led to a spate of articles.<sup>4</sup>

With a view to further clarifying the application of the State aid rules to the financing of SGEI, the Commission in November 2005 adopted a Decision and a Framework on the application of Article 106(2) TFEU to State aid in the form of

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<sup>3</sup> *Altmark Trans*, *supra* n 1, paras 89 et seq. For a detailed description of the judgment and an overview of the case law prior to *Altmark* see Klasse 2010a, p. 512, and Lübbig and Martin-Ehlers 2009, p. 66.

<sup>4</sup> See Klasse 2010a, p. 516 for further references.

public service compensation (known as the ‘SGEI Package’ or ‘Monti-Kroes Package’).<sup>5</sup> The SGEI Decision set out thresholds for certain small-scale State funding of public service missions. Where the conditions of the Decision were met, it conferred a block exemption and a derogation from the notification requirement to the State aid measures covered by it. Its legal basis was Article 86(3) of the Treaty, now Article 106(3) TFEU.

The Commission’s SGEI Framework specifies under what conditions public service compensation can be considered compatible with the internal market under Article 106(2) TFEU for measures not covered by the SGEI Decision. The Framework made it clear that an exemption from Article 107(1) TFEU was possible on the basis of Article 106(2) TFEU, provided that the compensation was commensurate with the extra cost of providing the public service and subject to a number of conditions. The conditions of compatibility set out in the Framework by and large corresponded to the conditions of the Decision. Both measures replicated the first three criteria of the *Altmark* judgment, which did not deal with Article 106(2) but with 107(1) TFEU.

As a consequence, whenever the *Altmark* test is not satisfied, the test is to be repeated under Article 106(2) TFEU, with a slight relaxation as regards the fourth *Altmark* criterion. Where *Altmark* requires that the compensation be defined through a public tender procedure or a cost-benchmark based on the costs of a typical, well run and adequately equipped undertaking, it is sufficient under the SGEI Package that there is no overcompensation. This is established on the basis of a detailed estimate of the net-cost and a reasonable profit as specified in the Package.

The 2005 SGEI Package subsequently defined the Commission’s approach towards SGEI compensation in numerous cases. Even where the set of rules was not applicable, such as in the area of land transport,<sup>6</sup> the Commission made recourse to the Framework and applied its rules *mutatis mutandis*.<sup>7</sup> In practice, the SGEI package clarified that the room for manoeuvre that had arguably been opened by the *Altmark* judgment for financing SGEI without the necessity for the Member States to notify the financing to the Commission under Article 108(3) TFEU was rather limited. With the SGEI Package, the Commission reclaimed control over the financing of public service obligations.

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<sup>5</sup> See Klasse 2010a, p. 534 et seq. for a detailed description of the Package. The third measure in the Package was the revised Transparency Directive (Directive 2006/111/EC of 16 November 2006), see Klasse 2010c, p. 453.

<sup>6</sup> Cf. Regulation (EC) 1191/69 of the Council of 26 June 1969 on Action by Member States concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway, *OJ* 1969 L 156/1, and Regulation (EC) 1370/2007 of 23 October 2007 on public passenger transport services by rail and by road and repealing Council Regulations 1191/69 and 1107/07 *OJ* 2007 L 315/1.

<sup>7</sup> Cf. e.g. Commission, 26 November 2008, State Aid C 16/2007 *Postbus Lienz*, *OJ* 2009 L 306/26, paras 112, 113; Commission, 24 February 2010, State aid C 41/08 *Danske Statsbaner*, *OJ* 2011 L 7/1, para 352.

## 2.3 The Commission's Case Law

This part of the chapter deals with the Commission's decision-making practice in relation to each of the four *Altmark* criteria individually.

### 2.3.1 Clearly Defined PSO to Discharge

The first *Altmark* criterion is a procedural requirement. It seeks to ensure transparency and prevents Member States from establishing *ex-post* allegedly assigned public service missions. The notion of a pso, or more generally SGEI,<sup>8</sup> is not elaborated in the Treaty itself. The Commission has followed the jurisprudence of the CJEU that has emphasised that an activity is of general economic interest only if it exhibits special characteristics as compared with the general economic interest of other economic activities.<sup>9</sup> It is generally accepted by the Commission that Member States enjoy a wide margin of discretion when defining what they consider to be services of general economic interest. These definitions are only subject to control by the Commission for manifest errors or misjudgments. The main limiting factor for the Member States is the Union *acquis* in a particular sector. Where EU sector-specific rules exist on the concept of a universal service, such as in the telecoms sector or in the postal sector, these have to be taken into account and may limit the margin of discretion on the part of the Member State.

In its practice, post-*Altmark*, the criterion has not proven to be a major obstacle in the relevant cases, with the Commission generally rubber stamping the definitions provided by the Member States concerned.<sup>10</sup> There were ample examples of what services qualify as SGEI in the case law of the Courts and the Commission even prior to *Altmark*.<sup>11</sup> The Commission practice ranges from the operation of a public broadband communication network which allows for generalised access to broadband infrastructure for all of the population,<sup>12</sup> to regional passenger transport<sup>13</sup> and to universal banking services.<sup>14</sup>

<sup>8</sup> For a discussion of the development of the concept of SGEI, pso, and universal service obligations see Davies and Szyssczak 2011.

<sup>9</sup> Cf. for e.g. Commission, 25 April 2012, State aid SA.25051 *Germany—Aid to Zweckverband Tierkörperbeseitigung* (association for disposal of dead animal bodies), para 160.

<sup>10</sup> Reference is also made to the case law set out in relation to the other *Altmark* criteria below.

<sup>11</sup> See the list provided by Grespan 2009, p. 1147.

<sup>12</sup> Commission, 16 November 2004, State Aid N 381/2004 *Broadband Infrastructure Project Pyrénées-Atlantiques*. The service in question did not entail the offering of a broad band service to the final consumer.

<sup>13</sup> See cases cited below.

<sup>14</sup> Commission, 6 April 2005, State aid N 244/2003 *Access to Basic Financial Services*, paras 59 et seq.; Commission, 21 October 2008, State Aid C 49/06 *Poste Italiane* OJ 2009 L 189/3.

However, in the recent decision in *Zweckverband Tierkörperbeseitigung* for instance, which concerned the financing of the disposal of dead animal carcasses and slaughterhouse waste, the Commission found that these services could not legitimately be considered as relating to an SGEI mission.<sup>15</sup> The question arose in relation to the obligation to retain spare operational capacity in case of an epidemic (for e.g. foot-and-mouth disease). Even though the Commission accepted that the services served to protect human health, it concluded that they would not be fundamentally different from other economic activities. The Commission did not stop here. In this case, it also interpreted a further criterion into the first *Altmark* requirement: it held that the first requirement would also imply assessing whether the compensation payments are indeed necessary for the provision of the SGEI. According to the Commission, even if the service in question was to constitute a service of general economic interest, the necessity of the compensation payment had to be examined, which it denied.<sup>16</sup> The Commission *inter alia* argued that elsewhere in Germany the service would be provided satisfactorily under normal market conditions.

What the Commission does here is to test whether the aid addresses a market failure, i.e. whether the services offered by existing market operators are insufficient to meet the public general interest. This clearly limits the Member States' discretion endorsed by the European Courts when defining public service missions, thereby expanding the Commission's scrutiny from a 'manifest error' test to a second-guessing of Member States' definitions. It appears questionable whether this is in line with the Courts' jurisprudence, such as, for example, the ruling of the General Court in *BUPA*. It may be argued that this is already a result of the new 2011 SGEI Package, dealt with in the subsequent chapters of this book.<sup>17</sup> However, this can also be found in previous Commission case law concerning the financing of broadband infrastructure (e.g. in the *Dorsal* case<sup>18</sup>) and of the digital terrestrial television transmission network (e.g. *DVB-T in North Rhine-Westphalia* and *DVB-T in Berlin-Brandenburg*<sup>19</sup>); in these cases, however, on the basis of more or less detailed Commission communications endorsing the principle. In the broadband sector, according to the Commission's guidelines, broadband network

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<sup>15</sup> Commission, 25 April 2012, State aid SA.25051 *Germany—Aid to Zweckverband Tierkörperbeseitigung* (association for disposal of dead animal bodies), paras 151–196.

<sup>16</sup> This was refused by the Commission. *Ibid.*, at para 180.

<sup>17</sup> Indeed, in the 2011 SGEI Communication the Commission considers it would not be appropriate to attach specific *psos* to activities provided by undertakings operating under normal market conditions, cf. *Communication on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest*, OJ 2012 C 8/4, para 48.

<sup>18</sup> Commission, 3 May 2005, State aid N 382/2004 *Broadband Infrastructure Project Limousin (Dorsal)*, paras 45 et seq.

<sup>19</sup> Commission, 23 October 2007, State aid C 34/2006 *DVB-T in North Rhine-Westphalia*; Commission, 14 July 2004, State aid C 25/2004 *DVB-T in Berlin-Brandenburg*, upheld in CJEU, Case C-544/09 P *Germany v. Commission*, n.y.r.

infrastructure cannot be considered an SGEI where a competitive broadband infrastructure providing adequate coverage and established by private funding already exists.<sup>20</sup>

Other than these examples, the Commission has only made a few general reservations as to when it would find a manifest error of assessment by a Member State. For instance, as laid down in the Commission's broadcasting Communication, activities consisting of advertising, e-commerce, the use of premium rate telephone numbers in prize games and sponsoring or merchandising cannot be considered as SGEI, and including them in the ambit of a public service remit is a manifest error of assessment.<sup>21</sup> Another example cited by the Commission is the creation and retention of jobs in an undertaking because as such, this would lack the necessary service to the public.<sup>22</sup>

Finally, the requirement under the first *Altmark* criterion that the undertaking must have a pso to discharge has been understood to mean by the Commission that the operator must be entrusted with the SGEI mission, i.e. there must be an official act having binding legal force under national law in the sense that it creates an obligation on the operator to provide the services in question. The Commission has acknowledged that the requirements of an act of entrustment are rather basic.<sup>23</sup> However, this has not precluded the Commission from applying the minimum criteria to be satisfied in the act of entrustment as laid down in 2005 SGEI Package, in particular the content and duration of the pso, the undertaking and territory concerned, and the nature of any exclusive rights assigned to the undertaking.<sup>24</sup>

### 2.3.2 Objective Parameters

The second *Altmark* criterion requires that the parameters for calculating the compensation are established in advance and in an objective and transparent manner. This excludes the possibility of changing the parameters of the calculation of the compensation *ex post*. As can be inferred from the *Altmark* judgment, with this requirement, the CJEU seeks to avoid a situation whereby the undertaking accumulates losses and is subsequently compensated for its losses, irrespective of

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<sup>20</sup> Communication from the Commission Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks, OJ 2009 C 23/7.

<sup>21</sup> Communication from the Commission on the application of State aid rules to public service broadcasting, OJ 2009 C 257/1.

<sup>22</sup> Commission staff working document, *Guide to the Application of the European Union Rules on State Aid, Public Procurement and the Internal Market to Services of General Economic Interest, and in Particular to Social Services of General Interest*, SEC (2010) 1545 final of 7.12.2010, p. 19.

<sup>23</sup> Ibid., p. 38.

<sup>24</sup> Cf. para 12 of the 2005 SGEI Framework.

whether these actually relate to the operation of the SGEI. The rationale is that this would mean blunting any incentives for efficient provision of the service in question.<sup>25</sup> It should be noted, though, that the requirement refers to the *ex ante* establishment of parameters and does not necessarily encompass the establishment of the amount of compensation, even though this may well be the case.

Like the first *Altmark* criterion, the second criterion has not been the subject of much controversy in the Commission's case law. Relevant cases often relate to State measures that had been in place for some time at the time of the Commission Decision and predate the *Altmark* judgment. In the *Dorsal* case concerning the public co-funding of an open broadband infrastructure in Limousin, France, the Commission clarified that, as a matter of principle, any *ex post* discretion and room for manoeuvre on the part of the authority automatically indicates that the second criterion is not fulfilled, a principle endorsed by the Commission in a number of subsequent decisions.<sup>26</sup> Again, it appears difficult to reconcile this position with the General Court's judgment in *BUPA*. According to the Court, discretion is not in itself incompatible with the existence of objective and transparent parameters within the meaning of the second *Altmark* condition.<sup>27</sup>

In the Commission's case law, the criterion was found to be satisfied for e.g. in *Postbus Lienz*, *Southern Moravia Bus Companies* and other cases concerning public service compensation for regional passenger transport in which the compensation was calculated on the basis of a price per kilometre and the total number of kilometres provided for in the contract.<sup>28</sup> Similarly, a compensation based on the number of users meets the second requirement.<sup>29</sup> In *DSB*, concerning public service contracts for passenger transport relating to a major part of the Danish rail network, the Commission accepted that multi-annual forward budgets fulfil the second requirement where these budgets are based on data and hypotheses which are reasonable and sufficiently detailed.<sup>30</sup> Also, the Commission held that in the context of public transport service contracts which provide for a transport system composed of several interdependent lines, the Member State need not necessarily determine the amount of compensation for each line taken individually.<sup>31</sup>

<sup>25</sup> Santamato 2009, para 2.572.

<sup>26</sup> Commission, 3 May 2005, State aid N 382/2004 *Broadband Infrastructure Project Limousin (Dorsal)*, para 57; Commission, 23 February 2011, State aid C 58/06 *BSM*, OJ 2011 L 210/1, para 153.

<sup>27</sup> GC, Case T-289/03 *BUPA* [2008] ECR II-81, para 214.

<sup>28</sup> Cf. e.g. Commission, 26 November 2008, State Aid C 16/2007 *Postbus Lienz* OJ 2009 L 307/26, paras 72 et seq.; Commission, 26 November 2008, State aid C 3/08 *Southern Moravia Bus Companies* OJ 2009 L 97/14, para 56. For further details on the application of the *Altmark* criteria in land transport cases, see Kekelekis 2012, p. 73. See also the chapter by Rusche and Schmidt.

<sup>29</sup> Commission, 16 May 2006, State Aid N 604/2005 *Busverkehr Landkreis Wittenberg*, para 38 et. seq.

<sup>30</sup> Commission, 24 February 2010, State aid C 41/08 *DSB*, OJ 2011 L 7/1, para 281.

<sup>31</sup> *Ibid.*, para 282.



On the other hand, in *Ustica Lines and NGI* concerning compensation for ferry services between Sicily and a number of smaller Islands, the Commission found that the second criterion was not fulfilled.<sup>32</sup> In this case, the parameters of the compensation were changed after the tender for the service. Participants in the tender had thus not been able to take the parameters into account when submitting their bids. In other cases, such as in *Poczta Polska* the Commission requested changes to the entrustment act in order to make the compensation compliant with the criterion.<sup>33</sup> In the *Zweckverband Tierkörperbeseitigung* case mentioned above, the Commission held that it was not sufficient to lay down the compensation for the reserve capacity *ex ante* in the annual business plan. It found that expected losses were not a sufficiently objective indicator of the cost of the epidemic reserve.<sup>34</sup> On a different note, however, the Commission concluded that Member States can define compensation in reference to the operating losses provided that overcompensation is excluded.<sup>35</sup>

### 2.3.3 Necessity Criterion

With the necessity criterion, the CJEU clarified that for any compensation to fall outside Article 107(1) TFEU the compensation may not only cover the costs of the public service mission but also a reasonable profit (without defining how such ‘reasonable profit’ should be determined). In the following section, the Commission’s practice when checking for overcompensation over costs and the question of what constitutes a reasonable return will be dealt with separately. It should be borne in mind that the overcompensation criterion is in principle not related to the efficiency of the provider of the service. However, as can be concluded from the fourth *Altmark* criterion, in order to exclude State aid, it is not sufficient merely to rely on a negative balance of the compensation on the one hand and all the costs associated with the public service mission plus a reasonable profit. This nexus between the third and fourth criterion will be dealt with in Sect. 2.3.4 below.

#### 2.3.3.1 Avoiding Overcompensation

In order to establish whether the compensation does not exceed the extra costs related to the public service mission, the Commission in its case law has relied on an *ex post* assessment/verification of the actual costs effectively borne by the

<sup>32</sup> Commission, 24 April 2007, State aid N 265/06 *Ustica Lines and NGI*, para 39. This case is mentioned by Santamato 2009, at para 2.573.

<sup>33</sup> Commission, 15 December 2009, State aid C 21/05 *Poczta Polska* OJ 2010 L 347/29.

<sup>34</sup> Commission, 25 April 2012, State aid SA.25051 *Germany—Aid to Zweckverband Tierkörperbeseitigung* (association for disposal of dead animal bodies), para 200.

<sup>35</sup> Commission staff working document, *supra* n 22, p. 48.

SGEI. The Commission practice appears to be based on the premise that a full review of the actual costs by the public authorities as provided for in Article 6 of the 2005 SGEI Decision and para 20 of the 2005 SGEI Framework is the only means capable of proving that no overcompensation has occurred.<sup>36</sup> In the absence of *ex post* checks of the actual cost, it has excluded overcompensation where the public service mission was assigned to the undertaking requesting the lowest level of compensation on the basis of genuinely competitive tendering. Conversely, as will be discussed in more detail below, a tender procedure is not in itself sufficient to exclude overcompensation.

For instance, in *Busverkehr Wittenberg*, the Commission concluded that the lump-sum payment to a local passenger transport undertaking which had been selected on the basis of a competitive tender (on the basis of the lowest compensation) did not meet the third *Altmark* criterion.<sup>37</sup> The Commission criticised the fact that the amount of compensation to be paid had not been made dependent on the revenues earned from the service. The Commission took note of the fact that the contract provided for an incentive for the transport undertaking to win more passengers. At the same time, the undertaking also had to carry the risk that fewer passengers would use the service than expected. While the Commission accepted that, from an economic point of view, chances and risks under the contract were in balance (i.e. it was equally likely that the undertaking would generate less revenues from the contract than making more profit than expected), it came to the conclusion that under such a contract, overcompensation could not be ruled out as there was not sufficient correlation between the costs incurred and the compensation paid by the State.<sup>38</sup> Hence, the Commission held that the compensation to be paid would amount to State aid which, however, could be declared compatible with the common market on the basis of Article 107 (3) (c) TFEU.<sup>39</sup>

### 2.3.3.2 Reasonable Profit Benchmark

As mentioned before, there is little guidance from the Courts on how a reasonable profit should be determined. The Commission's case law on the subject is very case specific. The Commission has avoided any clear cut general statements as to what level of profit it would consider appropriate in light of the business risks, or absence of risks associated with the service. Rather, it appears that the Commission has been inclined to accept 'reasonable' proposals brought forward

<sup>36</sup> See, e.g. Commission, 15 December 2009, State aid C 21/05 *Poczta Polska*, OJ 2010 L 347/29. Commission, 29 October 2010, State aid N 178/2010 *Spain—Preferential dispatch of indigenous coal plants*.

<sup>37</sup> Commission, 16 May 2006, State Aid N 604/2005 *Busverkehr Landkreis Wittenberg*.

<sup>38</sup> Commission, *ibid.*, para 60 (non-fulfilment of the third *Altmark* criterion). Cf. also the subsequent decision, which cleared the measure as State aid free: Commission, 15 September 2009, State Aid N 207/2009 *Busverkehr Landkreis Wittenberg*.

<sup>39</sup> *Ibid.*, paras 78 et seq.

by the Member States. As a consequence, the few case-specific profit benchmarks publicised in the case law do not necessarily reflect the maximum profit the Commission would have accepted had the Member State set the benchmark at a higher level. The Commission has applied both capital-based (such as ROCE) as well as sales-based (such as EBITDA) profitability indicators, even though the 2005 SGEI Decision and Framework show a preference for assessing the profit on the basis of the return on own capital employed in the provision of the SGEI in question.

For instance, in the French broadband infrastructure case, *Pyrénées-Atlantiques* the Commission came to the conclusion that a ROCE of approx. 11 % was reasonable for the sector.<sup>40</sup> In *Southern Moravia Bus Companies*, the Commission considered a margin of close to 8 % as reasonable for the passenger transport in question,<sup>41</sup> while in the case of public passenger transport service compensation in *Anhalt-Bitterfeld*, the Commission held that the proposed margin cap of 5 % (turnover margin) over the costs of providing the service would allow for a reasonable margin.<sup>42</sup> In *DSB*, the Commission accepted that the reasonable profit would vary between 6 and 12 % (return on equity), with an annual cap set at 10 % over 3 years, to take account of efficiency gains and/or the improvement in the quality of the rail passenger services to be provided by DSB.<sup>43</sup> For the Spanish electricity sector, the Commission cleared a pre-tax rate of return of 7.86 %, corresponding to a post-tax rate of return of 5.5 %, as this was lower than the weighted average capital cost of the Spanish electricity sector as observed in the years preceding the decision.<sup>44</sup> Where available, as for instance in *DSB*, the Commission makes recourse to economic studies available to it in order to assess whether the level of profit is reasonable.

### 2.3.4 The Fourth *Altmark* Criterion

#### 2.3.4.1 Competitive Tendering

It follows from the first limb of the fourth *Altmark* criterion that the CJEU believes that assignment of a public service mission by way of a tender procedure is the preferable solution with a view to establishing compensation in conformity with

<sup>40</sup> Commission, 16 November 2004, State Aid N 381/2004 *Broadband Infrastructure Project Pyrénées-Atlantiques*, paras 76 et seq., para 82.

<sup>41</sup> Commission, 26 November 2008, State aid C 3/08 *Southern Moravia Bus Companies*, OJ 2009 L 97/14, para 71.

<sup>42</sup> Commission, 15 September 2009, State aid N 206/2009 *Financing of the public transport services in district of Anhalt-Bitterfeld*, para 46.

<sup>43</sup> Commission, 24 February 2010, State aid C 41/08 *DSB* OJ 2011 L 7/1, paras 357, 359.

<sup>44</sup> Commission, 29 October 2010, State aid N 178/2010 *Spain—Preferential dispatch of indigenous coal plants*, para 145.

Article 107(1) TFEU. Where the service provider is chosen by virtue of a public tender procedure, there is a presumption that the transaction will necessitate the least cost for the State. This is clearly in line with the Commission's policy which has relied on competitive tendering in other State aid contexts, such as in the context of the private investor principle in relation to the privatisation of State-owned undertakings.<sup>45</sup> According to the Commission, where a tender procedure fulfils certain minimum criteria, it can be assumed that the compensation corresponds to the market price and does not include elements of excess compensation. For that to be the case, the Commission checks whether the relevant market is an effectively contestable market, whether the procedure has resulted in genuinely competitive tendering, and whether the SGEI is assigned to the undertaking requesting the lowest level of compensation. The latter requirement is reflected also in the fourth *Altmark* criterion (selection of the tenderer capable of providing the services 'at the least cost'). Where one of the elements of genuine competitive tendering is missing, the criterion will not be met. For instance, in *Southern Moravia Bus Companies*, the Commission concluded that it would not be sufficient to approach the known carriers already active in the region (in this case: 41) as this procedure ran counter to the possibility that carriers from other Member States could be taken into account.

In the aftermath of *Altmark*, the question arose whether 'qualitative' tenders would be acceptable, i.e. where the undertaking is selected on the basis of the most advantageous bid, or, in other words, where the highest quality of service for the lowest level of compensation is sought. The *Altmark* jurisprudence appears to suggest that while it is for the Member States to define the SGEI and the level of quality of the service, the authority has to award the SGEI to the undertaking requesting the lowest level of compensation in order for this compensation to be State aid free. Hence, the Member State has to choose the operator that fulfils the criteria set by the authority, irrespective of whether these criteria actually request a high or low level of quality of service (employment, or investments etc.).<sup>46</sup> This was confirmed by the Commission in its *CADA (Security of supply Ireland)* decision.<sup>47</sup> The decision concerned compensation payments to electricity network operators that invest in electricity reserve generation capacity in order to ensure the security of energy supplies in Ireland, including peak periods. The network generators that were granted the compensation were chosen by way of a competitive tender procedure equally open to Irish and foreign undertakings. The main criterion within the procurement decision was the amount of compensation requested by the undertaking, hence the procedure resulted in a 'lowest-price' tender. Here, the Commission concluded that this procedure complied with the

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<sup>45</sup> See, for e.g., Commission staff working document, Guidance Paper on State aid-compliant financing, restructuring and privatisation of State-owned enterprises, SWD (2012) 14 final of 10 February 2012.

<sup>46</sup> See also *Santamato* 2009, para 2.578.

<sup>47</sup> Commission, 16 December 2003, State aid N 475/2003 *Security of supply Ireland (CADA)*.

fourth criterion and that the compensation payments granted would not constitute State aid. The Commission emphasised that in order to verify whether the procurement procedure would actually allow for the selection of the tenderer capable of providing those services at the least cost to the community it would need to undertake a ‘material analysis’ going beyond the mere consideration of the applicable public procurement rules.<sup>48</sup>

As a consequence, a competitive tender procedure, even when open, transparent and non-discriminatory, does not in itself provide a safe harbour from the State aid rules.<sup>49</sup> A material analysis may come to the conclusion that the tender does not suffice to meet the fourth criterion (first limb), or even where it does, the resulting compensation cannot *per se* be considered necessary (within the meaning of the third criterion). Examples of both scenarios can be found in the Commission’s practice. In the *Busverkehr Wittenberg* case (mentioned above), the Commission came to the conclusion that the payments to finance public transport in the district of Wittenberg constituted State aid despite the fact that the service provider had been chosen by a public procurement procedure. In this case, the Commission found that the system adopted by the authority, namely aid commensurate with the number of passengers carried, while complying with the fourth *Altmark* criterion, could not exclude overcompensation and therefore did not meet the third *Altmark* criterion.<sup>50</sup> In the *Dorsal* case concerning public funding for a broadband network, the fact that the authorities undertook a public procurement procedure did not suffice as the service provider was not selected on the basis of the least cost, but on the most favourable conditions.<sup>51</sup>

It has been questioned whether a tender procedure always provides for the best results when assigning a SGEI. In many instances, such as in the case of the postal sector, the incumbent may be the only company which is suitable to provide the service universally. In complex cases, where it is particularly difficult to define the quality of service, it may be more efficient to negotiate appropriate quality standards directly with interested parties rather than the authority setting the standards itself and making the bidders compete purely on the price.<sup>52</sup>

### 2.3.4.2 Efficient Undertaking Comparator

Even though procurement is the main rule under *Altmark*, the CJEU has been reluctant to pose an obligation on the Member States to perform tenders every time. Instead, in *Altmark*, the CJEU created an alternative test based on efficiency

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<sup>48</sup> Commission, *ibid.*, para 57.

<sup>49</sup> Cf. also Rusche and Schmidt 2011, p. 257.

<sup>50</sup> Commission, 16 May 2006, State aid N 604/2005 *Busverkehr Landkreis Wittenberg*.

<sup>51</sup> Commission, 3 May 2005, State aid N 382/2004 *Broadband infrastructure project Limousin (Dorsal)*, paras 66 et seq.

<sup>52</sup> See Opinion by the State Aid Group of EAGCP, Services of general economic interest, 29 June 2006, p. 7.

of the provider of the service and the least cost for the community. However, the *Altmark* judgment does not specify what constitutes a typical, well-run undertaking. The concept has been criticised for being virtually impossible to accomplish in practice because of a lack of comparable undertakings that could be used as benchmarks.<sup>53</sup>

The Commission's practice has not shed much light on the practical application of the criterion, either. For instance, in the *Dorsal* case, the condition was found to be met as the compensation was based on a comparative report analysis of the needs of the project and the offers of the candidates.<sup>54</sup> In the case of the postal bonds distributed by the Italian post in *Poste Italiane*, the Commission came to the conclusion that the criterion would be met.<sup>55</sup> The Commission undertook a 'highly complex economic assessment', and came to the conclusion that the remuneration for the distribution of the postal bonds was in line with the respective remuneration for the distribution of comparable financial products on the markets. The Commission found that the benchmark of market remuneration was an appropriate estimate of the level of costs, taking into account receipts and a reasonable profit that a typical efficiently run undertaking within the same sector would incur.

By contrast, in *Postbus Lienz* the Commission came to the conclusion that Austria had not been able to demonstrate that the cost of Postbus in discharging the pso corresponded to the cost of a typical well-run undertaking.<sup>56</sup> In this case, the Commission considered it appropriate to distinguish between the different aspects of the second limb of the fourth criterion. These are: (i) the cost of a typical undertaking and (ii) the cost of a well-run undertaking that is (iii) adequately provided with means of transport. Since the compensation in this case was based on standard parameters determined on average costs in the sector, the Commission found that Postbus constituted a typical undertaking. However, it held that these costs would not necessarily reflect an efficient undertaking and that Austria had failed to demonstrate that Postbus was such an efficient undertaking. However, the Commission indicated that Austria could have fulfilled the test by providing a cost-benchmark based on the average cost of undertakings that had been awarded

<sup>53</sup> See EAGCP Opinion, *ibid.*, p. 7; Braun and Kühling 2008, p. 475.

<sup>54</sup> Commission, 3 May 2005, State aid N 382/2004 *Broadband infrastructure project Limousin (Dorsal)*, paras 66 et seq. In two cases concerning broadband services in Scotland and the East Midlands which appeared similar at the outset, the Commission held that the financing of these services amounted to State aid. The aid elements were declared compatible under Article 107(3) lit. c TFEU. The main difference to the French cases was that the compensation was not limited to the offset of the cost for the network operation, but also included the actual broadband services to end-customers. Commission, 16 November 2004, State Aid N 307/2004 *Broadband Project Scotland*; Commission, 16 November 2004, State Aid N 199/2004 *Broadband Project East Midlands*; cf. also Commission, 2 July 2008, State Aid N 250/2008 *Broadband Project South Tyrol*; see for a detailed overview of the cases concerning public funding of broadband networks Nicolaidès and Kleis 2007, p. 627 et seq.

<sup>55</sup> Commission, 21 October 2008, State aid C 49/06 *Poste Italiane—Remuneration for distributing postal savings certificates* OJ 2009 L 189/3.

<sup>56</sup> Commission, 26 November 2008, State aid C 16/2007 *Postbus Lienz*.

contracts in the sector in previous years.<sup>57</sup> This position has been endorsed in other decisions. According to the Commission, statistical data based on the actual cost in a sector cannot be considered sufficient proof that an average of these costs represents the costs of an efficient undertaking, and hence does not suffice to meet the fourth criterion.<sup>58</sup> The benchmark for the Commission is the would-be price, had the public service been assigned by way of a competitive tender.<sup>59</sup>

In *DSB*, the Commission held that the public funding would not meet the fourth *Altmark* criterion, even though the Commission did not contest that DSB's financial requirements had been established on the basis of an in-depth economic analysis and steps to enhance the efficiency and productivity of the undertaking had been laid down in the forward business plan.<sup>60</sup> The Commission argued that the difficulties of drawing comparisons with the financial performances of national or European rail operators would not enable it to conclude that the compensation would indeed meet the efficiency standard. Furthermore, it pointed to the fact that a subsidiary of DSB had applied services at reduced costs when compared to those of DSB. This was seen as an indication by the Commission that DSB would have prospects of achieving similar productivity gains.

In *Energy Supply Slovenia*, the Commission deviated from the strict reading of the fourth *Altmark* criterion.<sup>61</sup> In its decision concerning the public support of certain power generators in Slovenia, the Commission held that the compensation payments in favour of the power plant Trbovlje were in line with the *Altmark* criteria and State aid free. Similar to the Irish scheme discussed above, the purpose of the public funding was to ensure national supply security. The compensation was affected by favourable feeding-in tariffs that were above market price for a particular percentage of the energy generated in the power plant. The Commission decision extensively deals with the fulfilment of the fourth *Altmark* criterion, questioning whether choosing the Trbovlje power plant, in the absence of a public procurement procedure, indeed guaranteed provision of the service at the least cost to the community. It appeared that, according to a literal reading of the second alternative of the fourth *Altmark* criterion, the criterion would not have been met. However, the Commission answered the question in the affirmative. It argued that there were no other power plants which had the capacity to fulfil the obligation. Furthermore, the power plant had been modernised and restructured, and there was no indication of bad management or obvious inefficiency. More significantly, the Commission found that the compensation did not include any profit element.<sup>62</sup> In fact, the Commission limited its analysis to the confirmation that by assigning the

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<sup>57</sup> Commission, *ibid.*, para 86.

<sup>58</sup> Commission, 26 November 2008, State aid C 3/08 *Southern Moravia Bus Companies* OJ 2009 L 97/14, paras 82, 83.

<sup>59</sup> *Ibid.*, at para 83.

<sup>60</sup> Commission, 24 February 2011, State aid C 41/08 *DSB*, OJ 2011 L 7/1, paras 284 et seq.

<sup>61</sup> Commission, 24 May 2007 *Energy supply Slovenia*, OJ 2007 L 219/9, paras 111 et seq.

<sup>62</sup> *Ibid.*

task to the Trbovlje power plant Slovenia opted for the solution which would incur the least cost for the State.

Other than on the rare occasions mentioned above, the Commission has not accepted that a given service provider is a typical undertaking, well run and adequately equipped.

## 2.4 Conclusions

The analysis of the Commission's case law shows that the Commission has interpreted the *Altmark* test in a strict manner. As a consequence of the Commission's approach, the *Altmark* criteria are regularly considered *not* to be met. The Commission's point of view is comprehensible: while *Altmark* allows for a self-assessment by Member States of public service compensation, the assessment of whether compensation that qualifies as State aid meets the requirements for compatibility under Article 106(2) TFEU or other Treaty provision is a matter for exclusive competence of the Commission. In its practice, the Commission has had the tendency to find that the state-financing of public service missions does not comply with the *Altmark* criteria, thereby bringing it within the ambit of Article 107(1) TFEU, and then, subsequently, declaring it compatible with the common market on the basis of Article 106(2) or Article 107(3) TFEU. Hence, by its strict interpretation of the *Altmark* requirements, the Commission has seized control over Member States' spending in the context of what they consider to be a public service remit.

The main challenge has been the fourth *Altmark* criterion. In essence, the Commission's practice appears to be based on the premise that it can only be met in its first alternative, i.e. if the provider is chosen on the basis of a competitive tender. However, even in those cases where the choice of undertaking to be entrusted and the amount of compensation are affected by way of a procurement procedure perfectly in line with competition and public procurement rules, the compensation may fail the Commission's necessity test (or the 'least cost' criterion). The consequence of the *Altmark* test as interpreted by the Commission in these cases is that public service contracts that include incentives for the operator to increase its efforts, seek improvements in quality, attract more customers and retain additional revenues, require notification. The Commission thus has compelled the parties to agree on a more or less fixed margin that is not allowed to increase depending on the economic success of the service in question.

Where the Member States want to invoke the second alternative of the fourth criterion (typical, well-run undertaking comparator), the situation is even less clear. Absent additional guidance of what constitutes such an undertaking, the practical application of the test by the Commission has lacked foreseeability as to the results. As a consequence, there has been a considerable degree of legal uncertainty involved in the self-assessment of the Member States of whether the *Altmark* test would be fulfilled when assigning the SGEI. A sector benchmark is



often not feasible and may well be considered meaningless where the market concerned does not afford suitable benchmarks for such an assessment. First, there may be no specific and objective references, for instance, where there are no private undertakings active in the sector. Second, differences in the public service task between the different Member States may not allow for cross-border comparisons. As a consequence, the benchmark may need to be based on a hypothetical (i.e. non-existent, fictitious) undertaking, making any finding on part of the Member State (or the Commission) in itself likely to be contestable.

It remains to be seen if, and to what extent, the Commission's approach can be reconciled with the more flexible stance taken by the General Court in *BUPA*.<sup>63</sup> Meanwhile, under the current practice of the Commission, the main problem for Member States and providers of public services is that in the absence of a Commission decision declaring compensation compatible with the common market, no legal certainty exists. Competitors may intervene and invoke these cases in national court proceedings. National courts may then stop further payments and/or order reimbursement, because they find a breach of the standstill obligation under Article 108(3) EC where the *Altmark* criteria are deemed not to be fulfilled. It is obvious that in such cases, the prospect of a subsequent approval of the payments by the Commission after months or years of a pending notification and (possible in-depth) investigation does not bring about sufficient relief.

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<sup>63</sup> GC, T-289/03 *BUPA v. Commission* [2008] *ECR* II-81.

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