TILBURG UNIVERSITY

TILEC

TILEC Discussion Paper

DP 2008-017

Services of general economic interest and universal service in EU law

By

Wolf Sauter

May 2008

ISSN 1572-4042

http://ssrn.com/abstract=1136105

Services of general economic interest and universal service in EU law

By

Wolf Sauter

Reprinted from
European Law Review
Issue 2, 2008

Sweet & Maxwell Limited
100 Avenue Road
Swiss Cottage
London
NW3 3PF
(Law Publishers)

THOMSON
SWEET & MAXWELL

Services of general economic interest and universal service in EU law

Wolf Sauter*

LT Competition law; EC law; Proportionality; Public interest; Public services; Single Market; State aid; Supply of services; Undertakings

Services of general economic interest (SGEI) are an EU legal category that provides an exception to the competition rules for the proportionate pursuit of legitimate public interest goals by private undertakings. While remaining the subject of intense debate at EU level, SGEI have played an important role in liberalising the network industries and are likely to play a similar role elsewhere in future. This paper covers recent developments concerning SGEI, discusses universal service obligations as the key content of SGEI and proposes a structured test for applying SGEI in a proportional manner, based on the concept of market failure.

Introduction

Over the past 10 years the topic of services of general economic interest (SGEI) has given rise to ample debate at European level. Most recently this has resulted in the adoption of a Protocol to be attached to the Reform Treaty (now also known as the Treaty of Lisbon), and a proposed amendment of the EC Treaty extending the legislative powers of the European Parliament and the Council to the sphere of SGEI. This paper discusses the concept of SGEI against the background of fundamental tension between, on the one hand, the Member States' wish to obtain a broad public service exception, and, on the other, the European Commission seeking to avoid opening a Pandora's box that could threaten the application of the market freedoms and the competition rules. At a more technical level this paper deals with the question of how SGEI and universal service obligations are interrelated and proposes a structured test for creating future SGEI with a key role for the concept of market failure. Finally, recent developments concerning SGEI in the sphere of state aid and in relation to Directive 2006/123 [2006] OJ L376/36[1] (the Services Directive) are briefly covered.[2]

* Dutch Healthcare Authority and Tilburg Centre of Law and Economics (TILEC).

[1] Directive 2006/123 on services in the internal market [2006] OJ L376/36

[2] This paper does not discuss so-called "non-economic" services of general interest. "These services, for instance traditional state prerogatives such as police, justice and statutory social security schemes are not subject to specific EU legislation, nor are they covered by the internal market and the competition rules of the Treaty." Services of General Interest, Including Social Services of General Interest: A New European Commitment COM(2007) 725 final, p.4.

The relevance of the SGEI concept

From the perspective of the competition rules European law can be characterised as essentially a binary system, classifying entities either as undertakings (i.e. carrying out economic activities bearing economic risk), or not, with important consequences in terms of the legal obligations that follow:

- as soon as services are provided by undertakings the competition rules apply in full force;
- if on the other hand the entities concerned are not undertakings but are "solidarity"-based they are excluded from the competition rules altogether.

This may occur while the actual services concerned are very similar or even identical. It leads to the central paradox that vertically integrated services provided by public authorities tend to be ignored by the Treaty, whereas introducing even a modicum of competition among undertakings providing the same services can lead to the competition rules being applied to the point where legitimate national public interests may be threatened.[3]

Of course the public interest and market freedoms are not always or necessarily in conflict because opening up services to competition frequently leads to lower prices and a greater range of choice for consumers, i.e. to net improvements in the services concerned.

However the binary system sketched above complicates efforts to introduce competition either gradually or partially. That is a problem because phasing in competition in hitherto sheltered markets is frequently not only a political necessity but also desirable from the perspective of system stability. In a liberalisation context it will often be preferable not to force a "big bang" but to provide for an adjustment period or transition mechanism, or to experiment with greater and smaller degrees of market freedom in different market segments.

The legal concept of SGEI offers a way out of this dilemma because proportionate restrictions on competition can be imposed to the benefit of undertakings charged with SGEI to the extent necessary to perform their public service tasks. It therefore allows legitimate national interests to be taken into account and enables a tailor-made solution for each SGEI by means of a proportional exemption based on Art.86(2) EC. The relevance of SGEI has grown apace with the scope of liberalisation in the European Union. This means in particular that it is now broadly applied in the network sectors, and, tentatively, in the social sphere.

[3] Thus *Christian Poucet v Assurances Générales de France and Caisse Mutuelle Régionale du Languedoc-Roussillon (Poucet)* (C-159/91 & C-160/91) [1993] E.C.R. I-637; *Sodemare SA v Regione Lombardia (Sodemare)* (C-70/95) [1997] E.C.R. I-3395; and *Federación Española de Empresa de Tecnología Sanitaria v Commission (FENIN)* (C-205/03) [2006] E.C.R. I-6295, where the solidarity element prevailed. The opposite occurred in, e.g., *Fédération Française des Sociétés d'Assurance v Ministère d'Agriculture et de la Pêche (FFSA)* (C-244/94) [1995] E.C.R. I-4013 and *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie (Albany)* (C-67/96) [1999] E.C.R. I-5751; *Brentjens' Handelsonderneming BV v Stichting Bedrijfspensioenfonds voor de Handel in Bouwmaterialen (Brentjens)* (C-115/97, C-116/97, C-117/97 & C-219/97) [1999] E.C.R. I-6025; and *Maatschappij Drijvende Bokken BV v Stichting Pensioenfonds voor de Vervoer–en Havenbedrijven (Drijvende Bokken)* (C-219/97) [1999] E.C.R. I-6121.

The legal basis for SGEI

SGEI find their legal basis in Arts 16 and 86(2) of the EC Treaty itself, as well as in Art.36 of the Charter on Fundamental Rights. These provisions will be discussed alongside a brief coverage of the debate on SGEI.

Article 86 EC

Article 86 of the EC Treaty—as originally introduced in the 1957 Rome Treaty at the outset of the European Economic Community—provides a special regime for revenue-producing monopolies, and for undertakings granted "special and exclusive rights" by the Member States, in respect to "the rules contained in the Treaty". The application of both the general rule and its exception are subject to Commission supervision. As such, Art.86 EC is also an elaboration of the principle of Community "good faith" set out in Art.10 EC (*effet utile*) that has led to extensive case law on market interventions by the Member States (but will not be discussed here).

Within the context of Art.86 EC, Art.86(2) of the EC Treaty provides a special rule for SGEI which reads as follows:

> "Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community."

While it is possible for the Commission to set out its own interpretation of Art.86(2) EC (as well as on the rules on special and exclusive rights in Art.86(1) EC) in greater detail by means of Commission Decisions or Directives based on Art.86(3) EC, this possibility has only rarely been used. It has served to abolish special and exclusive rights in the telecommunications sector (see further below), for the adoption of rules on financial transparency of public undertakings (dating back to 1980, which will not be discussed further)[4]; and rules on public service compensation (of 2005, 25 years later, which will be discussed below).[5] As is the case for Art.86 EC itself, such Art.86(3) EC Directives are addressed to the Member States, not to undertakings directly. However, an undertaking charged with infringing Art.82 EC for example, could invoke the applicability of Art.86(2) EC in its defence.[6]

[4] Now codified in Directive 2006/11 on the Transparency of Financial Relations between Member States and Public Undertakings as well as on Financial Transparency within certain Undertakings [2006] OJ L318/17.

[5] Community framework for State aid in the form of public service compensation [2005] OJ C297/04; and Decision on State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2005] OJ L312/67.

[6] The provisions of Art.86 EC read as follows: (1) In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Art.12 and Arts 81 to 89; (2) Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained

An important reason why the Commission is reticent to use Art.86(3) EC Directives is that the European Parliament and Council have fundamental objectives to the use of these instruments, which allow the Commission to "legislate" single-handedly. (Although it remains contested whether or not Art.86(3) EC Directives should be considered legislation, rather than an authoritative interpretation of the Treaty by the Commission.) Parliament and Council see this as lacking in democratic legitimacy, which is particularly undesirable given the general perception that a "democratic deficit" persists at EU level. The European Parliament in particular favours instruments adopted on the basis of "co-decision" instead, which give it a role equivalent to that of the Council.

The calls for a Framework Directive[7] on SGEI adopted on the basis of co-decision that have surfaced from time to time therefore also address a situation that is unsatisfactory for the European Parliament from an institutional point of view. In the past the Commission has tried to accommodate these concerns by consulting the European Parliament informally on draft horizontal measures based on Art.86(3) EC. Meanwhile the playing field has changed because a new legal basis for SGEI legislation by the European Parliament and Council has recently been proposed, as is discussed below.

The debate on Article 86 EC

A number of landmark decisions by the ECJ in the telecommunications sector in the 1990s first sparked the debate on Art.86 EC. In these cases, brought by a number of Member States against the Commission, the Court accepted that the Commission could use Commission Directives based on Art.86(3) EC to abolish exclusive and special rights in this sector.[8] Although this tactic was successful in the telecommunications sector and its use was threatened in other sectors such as energy and the postal sector, the Commission has never replicated this feat due to the objections already mentioned above that in particular the European Parliament raised against this type of legislation.

in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community; (3) The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.

[7] The European trade union federation (ETUC) and the socialist people party block in the European Parliament (PSE) are campaigning for a Framework Directive, collecting citizens' signatures for a petition in this direction. The European Parliament, in its Resolution on the Commission communication Services of General Interest in Europe COM(2000) 580; [2002] OJ C140E/153, called for a Framework Directive. This call does not appear to have been repeated by the EP plenary. *Cf.* however the EP Committee on Employment and Social Affairs, *Report on social services of general interest in the European Union*, March 6, 2007, A6-0057/2007. The PSE has continued to champion various drafts of a Framework Directive by interest groups e.g. *http://www.socialistgroup.eu/gpes/media/documents/34604_34604_PROJET_LOI_SIEG_28_juin_2006_En.pdf* [Accessed February 12, 2008] and has criticised the Commission for not responding to these initiatives. *Cf.* PSE press release on the European Commissions' Communication on services of general interest, including social services of general interest: a new European commitment COM(2007) 724 final.

[8] *French Republic v Commission (Terminal Directive)* (C-202/88) [1991] E.C.R. I-1223; joined cases *Kingdom of Spain, Kingdom of Belgium and Italian Republic v Commission (Services Directive)* (C-271/90, C-281/90 & C-289/90) [1992] E.C.R. I-5833.

Proponents of state intervention subsequently felt strengthened by further Art.86 cases such as *Corbeau, Re* (C-320/91)[9] (where the Court found that exclusive rights and cross-subsidies between various activities could be acceptable as part of a SGEI in the context of ensuring the financial stability of a universal service system for postal services) and *Municipality of Almelo v NV Energiebedrijf Ijsselmij* (*Almelo)* (C-393/92)[10] (where a regional electricity distributor charged with universal service obligations was held to fall within the SGEI exception). They sought to broaden the scope of the public interest exception in Art.86(2) EC, respectively to limit the Commission's powers, in order to be able to continue their "strategic" interventions in "key" economic sectors without violating the EC Treaty rules and triggering Community action.

In this debate, parties fearing liberalisation and privatisation based on EU law (notably public sector unions and their political allies) campaigned to give the "*service public"* a sound basis in the EC Treaty itself. Often, France was the Member State that acted as standard-bearer for such efforts. The Commission however wished to stick as closely as possible to the existing EC Treaty provisions (i.e. Art.86(2) EC) and the case law of the Court. It appears to have been successful in neutralising dissent by drawing out a decade-long sequence of consultation exercises and generating a series of papers that might charitably be defined as "harmless".[11] The most recent instalment of these communications was provided in the context of the internal market review package of November 2007.[12]

This is not to say there have not been any changes at all: the *service public* concept was eventually written into a new Art.16 EC on SGEI of the Treaty of Amsterdam. However, this was done in a manner that involved no substantive changes to Art.86 EC, and which was characterised in the French senate as a mere "consolation prize".[13] At the same time, and equally harmlessly, the *service public* concept found its way into Art.36 of the Charter on Fundamental Rights.[14] More recently the European Parliament and the Council have been given the power to legislate on SGEI. These changes are discussed in greater detail below.

[9] *Corbeau, Re* (C-320/91) [1993] E.C.R. I-2533.

[10] *Municipality of Almelo v NV Energiebedrijf Ijsselmij* (*Almelo)* (C-393/92) [1994] E.C.R. I-1477.

[11] *cf.* the barrage of communications from the Commission: Services of general interest in Europe [1996] OJ C281/3; Services of general interest in Europe [2001] OJ C17/4; Report to the Laeken European Council—Services of general interest COM(2001)598 final; Green Paper on services of general interest COM(2003) 270 final; White Paper on services of general interest COM(2004) 374 final; White Paper on services of general interest COM(2004) 374 final; Implementing the Community Lisbon programme: Social services of general interest of the European Union COM(2006) 177 final.

[12] Services of general interest, including social services of general interest: a new European commitment COM(2007) 725 final and the accompanying Commission Staff working documents, published in the context of a single market for 21st century Europe COM(2007) 724 final.

[13] Hubert Haenel, *Rapport d'information fait au nom de la delegation pout l'Union européenne sur les services d'intérêt general en Europe*, No.82 (November 2000), p.20, cited in 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 : OUP, 2005), pp.169 *et seq*., p.177.

[14] "The Union recognises and respects access to services of general economic interest as provided for in national laws and practices, in accordance with the Treaty establishing the European Community, in order to promote the social and territorial cohesion of the Union."

Article 16 EC

Thirty years after Art.86 EC was introduced in the EEC Treaty, a new Art.16 EC on SGEI was introduced by the Treaty of Amsterdam in 1997. This ambiguous text reads:

> "Without prejudice to Articles 73, 86 and 87, and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting territorial and social cohesion, the Community and the Member States, each within their respective powers and within the scope of application of this Treaty, shall take care that such services operate on the basis of principles and conditions that enable them to fulfil their missions."

On the one hand the core legal elements of the concept of SGEI are confirmed ("without prejudice to"), while on the other hand they are connected to a diffuse set of objectives as if to balance these against the market freedoms. Moreover a declaration attached to the Amsterdam Treaty underlined the need to interpret this provision in the light of the existing case law on Art.86(2) EC.

The ambiguity of Art.16 EC may further increase due to the Reform Treaty,[15] which in its version of October 2007 adds a reference to Art.4 TEU[16] in the abovementioned text of Art.16 EC (now 14), and also adds the following second paragraph:

> "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 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."

In future, we will therefore have two competing, or concurrent, legal bases for legislation on SGEI, a new one in Art.14 EC based on co-decision between the European Parliament and the Council, and one for Commission Directives in Art.86(3) EC as before. At the same time, the Commission so far appears still to see little reason for proposing a Framework Directive: its position is that sufficient clarification has been provided by the interpretative Protocol discussed immediately below.[17] Given the Commission's

[15] Draft Treaty amending the Treaty on European Union and the Treaty establishing the European Community. Documents approved at the Intergovernmental Conference of October 18, 2007 in Lisbon, at *http://consilium.europa.eu* [Accessed February 12, 2008]. On Art.16 EC, at length, see Ross, "Promoting solidarity: from public services to a European model of competition", [2007] 44 C.M.L.R. 1057.

[16] Art.4 (now 3) TEU reads as follows: "1. In accordance with Article 5, competences not conferred upon the Union in the Treaties remain with the Member States. 2. The Union shall respect the equality of Member States before the Treaties as well as their national identities, inherent in their fundamental structures, political and constitutional, inclusive of regional and local self-government. It shall respect their essential State functions, including ensuring the territorial integrity of the State, maintaining law and order and safeguarding national security. In particular, national security remains the sole responsibility of each Member State. 3. 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. The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives."

[17] Services of general interest, including social services of general interest: a new European commitment COM(2007) 725 final. Curiously, the staff working document that explicitly sets out to examine the need for

monopoly on the legislative initiative this means that for the time being the European Parliament and Council remain blocked.

Another result of the recent negotiations that were aimed to salvage the main elements of the failed Draft Constitutional Treaty is the following interpretative Protocol to Art.16 EC (now 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."[18]

Somewhat cynically, the Commission has embraced this Protocol as finally delivering the clarification that had long been sought during long years of consultation, consequently making a Framework Directive on SGEI superfluous.[19] Although the fact that it was felt necessary to adopt this Protocol again highlights the deep concerns held by the Member States that something essential may slip from their control on this issue, in reality the Protocol appears to add little of substance as regards SGEI themselves. If anything it illustrates an inability on the part of the Member States to conceptualise within the EU legal framework what it is they want from SGEI. Taking a more positive view however, it may be that in future the values of, "a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of universal rights" will be fleshed out further as basic principles of SGEI in relation to universal service.[20] The

a Framework Directive neglects even mentioning this possibility in the remainder of the text: Commission staff working document: Progress since the 2004 White Paper on services of general interest SEC(2007) 1515.

[18] Presidency Conclusions of the Brussels European Council of June 21–22, 2007, at *http://consilium.europa.eu* [Accessed February 12, 2008]. The provision on "non-economic services of general interest" in Art.2 of the Protocol, absurd as it may be (are the provisions on equal treatment of men and women in the workplace and the working times directive no longer to apply to public librarians?), need not detain us here.

[19] Services of general interest, including social services of general interest: a new European commitment COM(2007) 725 final and the accompanying Commission Staff working documents.

[20] *cf.* Services of general interest, including social services of general interest: a new European commitment COM(2007) 725 final, pp.9–11.

concept of access to SGEI is also recognised in the EU Charter on Fundamental Rights (see below).

Article 36 Charter on Fundamental Rights

As mentioned, the concept of SGEI found its way into Art.36 of the Charter on Fundamental Rights (proclaimed in December 2000) under the heading of solidarity, as follows:

> "The Union recognizes and respects access to services of general economic interest as provided for in national laws and practices, in accordance with the Treaty establishing the European Community, in order to promote the social and territorial cohesion of the Union."

This reference to access in the context of social and economic cohesion can be seen as relevant to the ubiquitous accessibility aspect of universal service. Again the emphasis is therefore on universal service.

Outcome of the debate

The outcome of the debate can be summarised as follows: as before Art.86(2) EC remains key. Jointly, the new Art.14 EC, Protocol and Art.36 of the Charter on Fundamental Rights add a new legal basis for legislation concerning SGEI, as well as some core notions that can be linked to universal service. Substantively however these provisions add little to Art.86(2) EC or to the case law of the Court on this provision.

From the Commission's perspective the entire public debate on SGEI can be seen as a holding exercise intended to diffuse political tension on this topic, which in the final analysis has not had much of an impact on the scope or meaning of SGEI. If anything in the course of this process the concept of SGEI has become more accepted as the maximum that can apparently be achieved by way of an albeit limited public service exception to the competition rules. A benefit of this outcome is that the European Union has not been saddled with a far-reaching *service public* clause that could have crippled future liberalisation efforts, e.g. in network sectors or the social sphere. The drawback of this limited outcome is that certain basic elements like definitions, the purpose of SGEI, and the nature of the proportionality test to be applied remain hazy.[21]

These issues will be dealt with below, followed by a short discussion of two areas where there have been recent developments concerning SGEI at the level of secondary legislation, respectively regarding state aid and the Services Directive.

Defining SGEI and universal service

Why there is no definition of SGEI

There is no definition of SGEI. One way of looking at this is that it makes sense to leave open the definition of SGEI because the EC Treaty gives the Member States

[21] A criticism also found in the European Parliament Resolution on the Commission White paper on services of general interest, September 27, 2006, A6-0275/2006, Point 12. The EP in this document did not insist on a Framework Directive however.

a wide freedom to define missions of general economic interest and to establish the organisational principles of the services intended to accomplish them. The plausibility of this reading is strengthened by the fact that successive (proposed) amendments of the EC Treaty have not come up with a definition.

Another plausible reason why there is no list of SGEI, or of services that are not, is that the concept of SGEI is a dynamic one. Perceptions of what such services comprise, or what they do not, vary between time and place.[22] Thus, according to the Commission's Green Paper on services of general interest[23]:

> "The range of services that can be provided on a given market is subject to technological, economic and societal change and has evolved over time. (. . .) Given that the distinction is not static in time, (. . .) it would neither be feasible nor desirable to provide a definitive a priori list of all services of general interest that are to be considered non-economic."

Because the concept of SGEI is a fluid one, providing a list of such services merely serves by way of example. Nevertheless there are several descriptions of key elements of SGEI that are useful. For example, the Green Paper listed the following as common elements of a Community concept of SGEI, " . . . in particular: universal service, continuity, quality of service, affordability, as well as user and consumer protection".[24] According to the White Paper SGEI mean the following:

> "[I]n Community practice there is broad agreement that the term refers to *services of an economic nature* which the Member States or the Community *subject to specific public service obligations* by virtue of a general interest criterion (emphasis added)."[25]

Here the link between SGEI and specific public service obligations stands out. Territorial coverage obligations are also mentioned frequently in this context. It should be noted however that all of these factors are also frequently mentioned in relation to universal service, raising the question of what the relationship between universal service and SGEI is.[26] This will be discussed in greater detail below.

The Member States' freedom to designate SGEI is almost absolute up until the moment that pre-emption occurs, i.e. the point where the relevant services are defined by Community legislation, based either on Art.95 EC harmonisation measures or on Art.86(3) EC Commission Decisions or Directives, or both. The Community element

[22] Of course it is possible to provide a list of sectors where the Court or the Commission have accepted the existence of a service of general economic interest in past cases. These include river port operations; establishing and operating a public telecommunications network; water distribution; the operation of television services; electricity distribution; the operation of particular transport lines; employment recruitment; basic postal services; maintaining a postal service network in rural areas; regional policy; port services; waste management; ambulance services; and basic health insurance. However this does not mean that these services should be regarded as services of general economic interest in all Member States, at all times. Buendia Sierra, "Chapter 6: Article 86" in J. Faull and A. Nikpay (eds), *The EU law on competition,* 2nd edn (Oxford: OUP, 2007), pp.629–630.

[23] Green paper on services of general interest COM(2003) 270 final, p.14.

[24] Green Paper, p.15.

[25] White Paper, p.7.

[26] *cf. Corsica Ferries France SA v Gruppo Antichi Ormeggiatori del porto di Genova Coop Arl (Corsica Ferries France)* (C-266/96) [1998] E.C.R. I-3949; [1998] 5 C.M.L.R. 402, [44]–[47], which suggests universal service obligations are coextensive with services of general economic interest.

is only introduced at the level of the proportionality test of the measures concerned. Hence, pre-emption and proportionality are two important categories that will likewise be discussed further below.

The definition of universal service

The second important concept that requires further discussion is universal service. In the course of the debate on SGEI, universal service has been defined as follows:

> "[T]o guarantee access for everyone, whatever the economic, social or geographic situation, to a service of a specified quality at an affordable price."[27]

Slightly different descriptions are:

> "The concept of a universal service refers to a set of general interest requirements ensuring that certain services are made available at a specified quality to all consumers and users throughout the territory of a Member State, independently of geographical location, and in the light of specific national conditions, at an affordable price."[28]

And:

> "In a liberalized market environment a universal services obligation guarantees that everybody has access to the service at an affordable price and that the service quality is maintained and, where necessary improved."[29]

Ubiquitous access and uniformity are thus important features of universal service. At the same time however, continuity, quality of service, affordability and user and consumer protection are sometimes mentioned alongside universal service as objectives of public policy in their own right.[30] Likewise the common elements of SGEI cited above include: "universal service, continuity, quality of service, affordability, as well as user and consumer protection".[31] Again, universal service is juxtaposed along public policy objectives that it might well be judged to include.

The clearest functional definition of universal service is perhaps the following one:

> "It establishes the *right* of everyone to access certain services considered as essential and imposes *obligations* on service providers to offer defined services according to specified conditions including complete territorial coverage and at an affordable price."[32]

This clarification of universal service as a universal right for consumers (including affordability) on the one hand and a set of obligations imposed on undertakings on the other should be highlighted as one of the key characteristics of universal service.

[27] Green Paper, p.4.
[28] Green Paper, p.16, with reference to Art.3(1) of Directive 2002/22 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) [2002] OJ L108/51.
[29] Green Paper, p.16.
[30] Green Paper, pp.16–19.
[31] White Paper, p.4.
[32] White Paper, p.8 (emphasis added).

However the issue of partial overlap with values that are elsewhere presented as possible public policy objectives in their own right remains. Based on the texts available it is therefore an open question whether universal service includes those other values or not—although it is difficult to envisage a meaningful universal service obligation that would, apart from accessibility and affordability, for example fail to provide a specific level of quality (imposing full national coverage for free at zero quality would obviously be pointless). Therefore it is proposed here to regard the various public policy objectives listed alongside universal service as a catalogue of related objectives that belong to the sphere of universal service and must be linked in a meaningful manner in order to achieve a worthwhile universal service guarantee in a particular case.

Like the SGEI concept that is designed to enable the provision of universal service, universal service itself is often described as both a flexible and a dynamic concept. In the Green Paper the Commission proposes the basic principles of universal service are to be defined at Community level, and subsequently to be implemented by the Member States.[33] In a liberalisation setting based on Community legal instruments (such as now exists in telecommunications, posts and a number of other network industries) this may well be appropriate, but it can scarcely be the model where Community legal instruments regulating liberalisation are absent—as is presently the case in areas of social policy such as healthcare or (public) housing. Nevertheless it is useful to take a short look at the examples where SGEI and/or universal service was defined at Community level.

SGEI and universal service defined at Community level

So far there is only a handful of sectors—mainly involving networked industries—where universal service and SGEI have been defined at Community level. These include natural gas[34]; electricity[35]; postal services[36]; and electronic communications.[37] From these examples it may be surmised that, at least where SGEI have so far been defined at Community level:

- universal service obligations predominate as the substantive content of SGEI;
- universal service obligations may be imposed either on all undertakings active in the market, or on a limited number of operators (provider(s) of last resort);
- SGEI and universal service obligations in particular have been a highly useful tool in achieving a working consensus underpinning the liberalisation of the remaining (non-universal service) part of the network sectors concerned;
- universal services in this context tend to be defined clearly in terms of (enforceable) rights and deliverables.

[33] Green Paper, p.16.
[34] Directive 2003/55 concerning common rules for the internal market in natural gas [2003] OJ L176/57.
[35] Directive 2003/54 concerning common rules for the internal market in electricity [2003] OJ L176/37.
[36] Directive 97/67 on common rules for the development of the internal market of Community postal services and the improvement of quality of service [1998] OJ L15/14. It should be noted that the proposed amendments of the Postal Directive, apart from spelling out universal service obligations in much greater detail, abolishes and prohibits exclusive and special rights in this sector: Proposal for a Directive of the European Parliament and of the Council amending Directive 97/67 concerning the full accomplishment of the internal market of Community postal services COM(2006) 594 final.
[37] Directive 2002/22 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) [2002] OJ L108/51.

In summary: the existing reasoning on universal service obligations is incomplete and not always clear. The examples where the Community has defined universal service cannot be relied upon where no Community regime is in place. This means that there is room for interpretation of these obligations at national level, much like there is for SGEI in general. However defining universal service obligations in the network industries played a key role in enabling the liberalisation of these services: once the main public policy concerns were tackled in this manner, the road to liberalizing the remainder of the relevant services was opened. This logic would seem to apply equally at national level. It does not just have the advantages of enhanced efficiency and improved consumer choice associated with liberalisation: once the public interests concerned are clearly defined in terms of deliverables and consumer rights instead of casually identifying pursuit of the public interest with public provision, they are likely to be better served.

Moreover, the apparently hazy relationship between SGEI and universal service need not be taken for granted. The following section is dedicated to formulating some proposals on how to achieve greater clarity on the concepts of SGEI and universal service by linking them to market failure.

Linking SGEI and universal service obligations to market failure

SGEI in relation to universal service obligations

Below the relationship between service of general economic interest and universal service that, due to the absence of clear definitions, could not be clarified at the level of definitions will be addressed again:

- How are SGEI and universal service interrelated?
- Do they overlap or coincide?
- How are they applied or imposed?

A limited scope for SGEI based on three components

Given the absence of a definition and a legal framework for SGEI (such as the elusive Framework Directive might provide) at first sight it remains unclear whether an entire sector (such as public transport, refuse collection or health services) could be designated as a service of general economic interest or only those parts where restrictions on the Treaty rules are necessary in order for the public interest tasks concerned to be performed.

First of all, it is proposed here to deal with this issue from a perspective of proportionality.

It appears consistent with the EU law principle of proportionality to limit the application of the SGEI concept to those cases where it is clear in advance that particular restrictions in relation to EU law obligations concerning free movement, competition, state aid and/or public procurement will be necessary (and therefore proportional) to enable the undertaking(s) charged with SGEI to provide those services, in the sense that they could not otherwise be provided to the requisite standard. Where this is not the case reserving particular services to specific undertakings would simply not be necessary—and should therefore fail the proportionality standard that is explicitly included in Art.86(2) EC.

Approaching this issue from the opposite end, that is starting out from those sectors where some measure of governmental intervention in the public interest takes place as a whole, would mean embracing practically all current areas of public policy without providing any clarity in advance on the question whether meaningful restrictions would be involved that actually require resorting to Art.86(2) EC. This would also frustrate a proper discussion on the proportionality of the restrictions on competition that would be necessary (proportional) to ensure they would meet the Art.86(2) EC standards. This is therefore not a workable alternative. The fact that some sectors in some part deliver public goods do not make them, as a whole, SGEI.

What is the role of universal service obligations in this context? Arguably these should coincide with SGEI because they constitute the deliverables which form the objective of entrusting an undertaking with carrying out a SGEI. In addition, as first established in the *Corbeau* case,[38] SGEI should incorporate any restrictions necessary in order for the undertaking concerned to be able to carry out its universal service obligation based on a stable economic footing. A SGEI would then constitute of two or three parts:

- first of all the provision of universal service obligations;
- second, those non-universal service elements of the service necessary to enable its provision (ancillary restraints); and
- third, if necessary, the aspects necessary to make this provision affordable (funding regime).

Adopting this approach would leave us with three distinctive aspects of SGEI and a clear understanding of its relationship to universal service.

As an argument against this proposal it should be mentioned that so far, at least in theory, the concept of SGEI can cover general interest obligations that are not universal service obligations[39] because they are not linked to territorial coverage. Security and continuity of supply would be prime examples of this. However, to the extent these guarantees extend universally there appears to be no logical reason why they could not be subsumed by universal service. For purposes of clarity it would appear beneficial to do so. Moreover if universal accessibility instead of purely territorial coverage is regarded as the keystone of universal service—and access is after all highlighted clearly in both the recent Protocol and Art.36 of the Charter on Fundamental Rights—taking this step comes naturally.

SGEI and market failure

Finally, it is submitted here that the concept of market failure (and/or government failure) is a logical starting point when defining the scope of SGEI and universal service obligations: after all it is only in those cases where the services concerned are not already provided to the requisite standard by the market (and/or by public authorities) that market parties must be entrusted with the provision of particular services in the

[38] *Corbeau* (C-320/91) [1993] E.C.R. I-2533.

[39] *cf.* Buendia Sierra, "Chapter 6: Article 86" in Faull and Nikpay (eds), *The EU Law on Competition*, 2nd edn (OUP, 2007), pp. 642–643.

public interest.[40] It is likewise proposed here that only where markets, in the absence of governmental action, would fail, it will be possible to meet the EU law standard of necessity (proportionality)[41] that is required to successfully invoke the EU law concepts of SGEI and universal service.[42]

Evidently, a Member State does not have to intervene or take additional measures if the public interest objectives (such as accessibility, quality and affordability) are ensured by the functioning of the market mechanism alone. However if a Member State finds the market alone does not ensure the provision of the relevant public goods, i.e. market failure occurs, EU law allows the Member State to designate (one or several) universal service providers as provider(s) of last resort and to compensate them. Such intervention should be objective, transparent, non-discriminatory and proportionate. This will ensure both legitimacy (the rule of law) and overall welfare (the social dimension).

Remarkably enough, so far the definition of SGEI under Community law has not systematically or explicitly been connected with instances of "market failure".[43] At the same time the proportionality standard for SGEI remains undecided: it therefore appears logical to introduce the concept of market failure and the consequences thereof as a guiding principle in formulating the scope of SGEI and in deciding proportionality issues. If market forces left to themselves would suffice to provide the public good at stake there is little point in intervening.

It is important to note at this point that generally market-based remedies are imaginable for specific instances of market failure. For example failures in primary markets can be remedied by means of creating secondary markets, and/or introducing intermediaries, guarantees and standards, quality-certification, etc. This is the case because most frequently market failure is not the result of "too much" competition but more likely the result of a lack of possibilities to compete, and/or a lack of (tradable) property rights.

Moreover even addressing a market failure by imposing a universal service obligation can in many cases likewise be implemented consistent with market principles, i.e. by market parties playing by market rules within a regulatory framework. For instance concerning funding various forms could be envisaged that range from payments by market participants into a universal service fund to funding from general taxation revenues. Any regime relying on funding by transfer payments between market participants should ensure that participants only contribute to the financing of the universal service obligation and not of other activities which are not directly linked to the provision of the universal

[40] Sometimes economic and non-economic objectives are distinguished. This is wrong because the alleged non-economic objectives can usually be couched in terms of public goods and attempts to improve their delivery.

[41] Admittedly the strictness of this test would still depend on whether or not pre-emption by means of secondary EU law had occurred. As will be discussed further below it is proposed here that this test would be whether a measure is "manifestly disproportionate" in cases where there is no Community legislation occupying the field, and 'least restrictive means' where Community rules apply.

[42] The concept only becomes relevant in EU law terms when a Member State invokes Art.86(2) EC, i.e. as long as a Member State does not claim the exception it need not be able to demonstrate a market failure.

[43] An exception is the Green Paper on services of general interest COM(2003) 270 final, p.3. *Cf.* also Van de Gronden, "The internal market, the state and private initiative: A legal assessment of national mixed public-private arrangements in the light of European law", [2006] 33 *Legal Issues of European Integration* 105.

service obligation. Likewise, cross-subsidies benefiting services offered in competition should be avoided. In this context, compensation from general tax revenues may well be preferable as it does not create a barrier to entry (and is subject to parliamentary control as part of the budget procedures).

In sum a more economics-focused approach to SGEI seems appropriate even although this is so far rarely made explicit by existing documents on SGEI. The reasoning used to argue the proportionality of the measure imposed would have to address this issue.

Having covered (the lack of) definitions of SGEI and universal service, their relationship and link to the concept of market failure, the scope of the Art.86(2) EC exemption will be discussed next.

Scope of the Article 86(2) EC exemption

A number of formal legal categories determine whether Art.86(2) EC is at issue. These concern:

- first, whether the entity is involved is an undertaking;
- secondly, whether it has been entrusted with a legitimate task of general economic interest; and
- thirdly, whether the restrictions that are imposed are in line with this legitimate public task (proportionality).

The concepts of undertaking and solidarity

This subsection examines the crucial distinction between undertakings and solidarity-based activities in greater detail. First it should be noted that the word "economic" in SGEI refers to the nature of the activity concerned and not to the public interest which may be non-economic in nature (e.g. the promotion of public health).[44] The notion of "economic" services indicates that the exemption of Art.86(2) EC applies to undertakings: public authorities acting as such are not subjected to the competition rules.

Undertakings

The first question is how to define the concept of "undertaking". The case law of the Court on the concept of undertaking is functional in nature. This means that the legal form under which an entity is classified under national law is irrelevant:

> "[H]aving recourse to Member States' domestic law in order to limit the scope of provisions of Community law undermines the unity and effectiveness of that law and cannot, therefore, be accepted. Consequently, the fact that a body has or has not, under national law, legal personality separate from that of the state is irrelevant in deciding whether it may be regarded as a public undertaking within the meaning of the Directive."[45]

[44] Sierra, "Chapter 6: Article 86" in Faull and Nikpay (eds), *The EU Law on Competition*, p.644.

[45] *Commission v Italian Republic (Transparency Directive)* (C-118/85) [1987] E.C.R. 2599 at [11]. *Cf.* Opinion A.G. Cruz Vilaca in *Corinne Bodson v SA Pompes funèbres des régions libérées (Bodson)* (C-30/87)

Instead the core issue is whether or not the entity concerned is engaged in an economic activity:

> "In the context of competition law ... the concept of an undertaking encompasses every entity engaged in an economic activity regardless of the legal status of the entity and the way in which it is financed."[46]

An economic activity in turn is defined as follows:

> ''[A]ny activity consisting of supplying goods and services in a given market by an undertaking constitutes an economic activity, regardless of the legal status of the undertaking and the way in which it is financed."[47]

Hence, offering goods or services in a market, in particular doing so for payment, and while assuming the financial risks involved, means engaging in an economic activity as an undertaking. Likewise, offering goods or services in competition, or offering goods and services that could be subject to competition, means engaging in an economic activity as an undertaking. Thus, in the 1991 case *Klaus Höfner and Fritz Elser v Macrotron GmbH (Höfner)* (C-41/90),[48] the Court held that:

> "The fact that employment procurement activities are normally entrusted to public agencies cannot affect the economic nature of such activities. Employment procurement has not always been, and is not necessarily, carried out by public entities."

Similarly concerning ambulance services in its 2001 case, *Firma Ambulanz Glöckner v Landkreis Südwestpfalz (Glöckner)* (C-475/99),[49] the Court held that, "such activities have not always been, and are not necessarily, carried on by such [private non-profit] organisations or by public authorities." It is therefore possible to base a finding that a particular entity is an undertaking on the fact that the activities concerned could be performed in competition. Clearly this is the case for most activities. Where an entity engages in several different activities these may in part be economic and non-economic in nature and must therefore be analysed separately.[50]

[1988] E.C.R. 2479, point 32. It is nevertheless used as a "sanity check" in clear cases. *Cf.* Opinion A.G. Jacobs, *Klaus Höfner and Fritz Elser v Macrotron GmbH (Höfner)* (C-41/90) [1991] E.C.R. I-1979, points 22, 23.

[46] *Höfner* (C-41/90) [1991] E.C.R. I-1979 at [21]. *Cf.* joined cases *Christian Poucet v Assurances Générales de France and Caisse Mutuelle Régionale du Languedoc-Roussillon (Poucet)* (C-159/91 & C-160/91) [1993] E.C.R. I-637 at [17]; *Fédération Française des Sociétés d'Assurance v Ministère d'Agriculture et de la Pêche (FFSA)* (C-244/94) [1995] E.C.R. I-4013 at [14]; *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie (Albany)* (C-67/96) [1999] E.C.R. I-5751 at [77]; *Brentjens (* C-115/97, C-116/97, C-117/97 & C-219/97) [1999] E.C.R. I-6025 at [77]; and *Drijvende Bokken* (C-219/97) [1999] E.C.R. I-6121 at [67]; *Pavlov v Stichting Pensioenfonds Medische Specialisten (Pavlov)* (C-180/98 to C-184/98) [2000] E.C.R. I-6451 at [74]; *Cisal* (C-218/00) [2002] E.C.R. I-691 at [22]; *AOK Bundesverband v Ichthyol-Gesellschaft Cordes (AOK)* (C-264/01, C-306/01, C-354/01 & C-355/01) [2004] E.C.R. I-2493 at [46].

[47] *Pavlov* (C-180/98 to C-184/98) [2000] E.C.R. I-6451.

[48] *Höfner* (C-41/90) [1991] E.C.R. I-1979 at [22] and [23]. *Cf. Job Centre Coop Arl* (C-55/96) [1997] E.C.R. I-7119; *Criminal proceedings against Giovanni Carra* (C-258/98) [2000] E.C.R. I-4217; [2002] 4 C.M.L.R. 9. In *Aéroports de Paris v Commission* (C-82/01P) [2002] E.C.R. I-9297 at [82], the Court confirmed "the fact that an activity may be exercised by a private undertaking amounts to further evidence that the activity in question may be described as a business activity".

[49] *Firma Ambulanz Glöckner v Landkreis Südwestpfalz (Glöckner)* (C-475/99) [2001] E.C.R. I-8089 at [20].

[50] *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA* (C-222/04) [2006] E.C.R. I-289; *Aéroports de Paris v Commission* (C-82/01P) [2002] E.C.R. I-9297.

Solidarity

Financial solidarity and exclusion from competitive provision on the other hand are required for classification as a scheme having an exclusively social function which means the entities concerned are not regarded as undertakings and are excluded from the application of the competition rules altogether (but not from the market freedoms and public procurement rules). In this case the following factors are generally weighed[51]:

- the objective pursued by a scheme;
- its compulsory nature;
- the manner in which contributions and benefits are calculated and managed;
- the overall degree of state control;
- redistribution within the scheme by cross-subsidisation;
- the existence of competing schemes.

By examining, on the one hand, whether the entity concerned is active on a market, respectively if the activities concerned could be provided under competitive conditions, and on the other hand whether or not the elements of solidarity prevail, it is established whether a particular entity should be regarded as an undertaking. If it is a public authority the competition rules do not apply, and the concept of SGEI is irrelevant. If it is an undertaking, and if it engages in providing SGEI, this may be invoked as an exemption, provided the demands of proportionality are met.

Rule of reason

Finally it should be noted that it is possible that undertakings engage in activities that restrict competition but are not caught by the competition rules because they pursue an overriding public interest objective in a proportional manner. So far this exception (or rule of reason) has only been applied in the context of Art.81 EC (restrictive agreements), not Art.82 EC (dominance abuse), and remains highly contested.[52]

A legitimate task

The next requirement is that the undertakings concerned should be charged with a legitimate public service task. Hence the relevance of the requirement of an act of entrustment, respectively a comparable legal context, will be addressed as constitutive elements of a service of general economic interest.

[51] *Poucet* (C-159/91 & C-160/91) [1993] E.C.R. I-637; *Freskot AE v Elliniko Dimosio (Freskot)* (C-355/00) [2003] E.C.R. I-5263. *Cf.* Hatzopoulos, "Health law and Policy: The Impact of the EU" in G. de Búrca (ed.), *EU Law and the Welfare State: In Search of Solidarity* (Oxford: OUP, 2005), p.111.

[52] *J.C.J. Wouters v Algemene Raad van de Nederlandse Orde van Advocaten (Wouters)* (C-309/99) [2002] E.C.R. I-1577; and *David Meca-Medina v Commission (Medina)* (C-519/04 P) [2006] E.C.R. I-6991. *Cf. Albany* (C-67/96) [1999] E.C.R. I-5751; *Brentjens* (C-115/97, C-116/97, C-117/97 & C-219/97) [1999] E.C.R. I-6025; and *Drijvende Bokken* (C-219/97) [1999] E.C.R. I-6121.

Act of entrustment

Whether open-ended or not, a service of general economic interest in principle requires an explicit act of entrustment: this can be seen as a constitutive act (i.e. creating the SGEI where there was none previously).[53]

The Court has made this especially clear with regard to public service compensation, where in order to be classified as not constituting state aid the beneficiary of the compensation in question has to be formally entrusted with SGEI.[54] The act of entrustment should involve a clearly identified addressee as well as clearly defined obligations based on objective and transparent parameters, established in advance, for the calculation of compensation. Compensation should not exceed cost, plus a reasonable rate of return, and in cases where a public tender procedure is not followed the compensation should be based on that of a (hypothetical) efficient undertaking.[55] This requirement again underlines the importance of the provision of specific public service obligations by virtue of a general interest criterion (for which compensation is required) as the core of a service of general economic interest.

Evidently many regulatory solutions that are not market-based are likely to require public funding of some sort, which means explicit *ex ante* designations of SGEI are bound to increase. It is also clear that an explicit measure of entrustment as a constitutive legal act is highly desirable in any event in order to have a sound basis for the proportionality test that the SGEI must meet.

Existence derived from broader legal context

Nevertheless the need for an act of entrustment—at least where there is no issue of public service compensation—is not absolute. The Commission has held that in the absence of a legal act clearly entrusting a market party with SGEI it is also possible that the existence of a service of general economic interest can be derived from the broader legal context. It has in fact done so with regard to health insurance companies in state aid cases in relation to risk equalization schemes.[56] This is based on a generous reading of a single Court judgment to this effect:

> "The Member States ... cannot be precluded, when defining the services of general economic interest which they entrust to certain undertakings, from taking account of objectives pertaining to their national policy or from endeavouring to attain them

[53] *cf. Empresa para a Agroalimentação e Cereais, SA v Commission* (*EPAC)* (T-204 & 270/97) [2000] E.C.R. II-2267 at [125]–[128] and the references there.

[54] *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht (Altmark Trans)* (C-280/00) [2003] E.C.R. I-7747; [2003] E.C.R. I-7747; Community framework for State aid in the form of public service compensation [2005] OJ C297/04; and Decision on State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2005] OJ L312/67.

[55] *Altmark Trans* (C-280/00) [2003] E.C.R. I-7747 at [89]–[93].

[56] These were decisions concerning risk equalisation schemes in Ireland and the Netherlands: Aid measure N46/2003, Risk equalization system—Ireland; Aid measures N541/2004 and N542/2004, Financial reserves and risk equalisation system—The Netherlands.

> *by means of obligations and constraints which they impose on such undertakings* (emphasis added)."[57]

This does not however constitute "*carte blanche*" for the Member States, as the SGEI concerned must somehow be separated from other economic activities.[58] Because in addition no public service compensation must be at issue (or it is subject to the state aid rules) the relevance of this approach is likely to be limited in terms of the number of cases affected.

EU law rules affected by Article 86(2) EC

Next is the question which type of EU rules may be subject of the Art.82(2) EC exemption. The relevant rules are those on:

- free movement (of goods, services and capital, freedom of establishment);
- competition;
- state aid;
- public procurement;
- commercial monopolies.

In principle the rules on free movement and public procurement and concessions apply to public authorities, and the competition and state aid rules apply to undertakings.

It is important to note that the Community objective of market integration and national public policy objectives are not necessarily in conflict: the opening of services to competition generally leads to lower prices and increased choice for consumers.[59] Sometimes however, the achievement of national policy objectives and Community policy objectives must be coordinated. It is for this purpose that Art.86(2) EC exists:

> "[W]hich provides that services of general economic interest are not subject to the application of Treaty rules to the extent that this is necessary to allow them to fulfil their general interest mission",

and:

> "This means that under the EC Treaty and subject to the conditions set out in Article 86(2) the effective performance of a general interest task prevails, in case of tension, over the application of Treaty rules."[60]

The starting point therefore is that Art.86(2) EC provides an exception to the Treaty rules for SGEI. Second however this exception only applies to the extent that this is strictly necessary for performing the functions of SGEI concerned. This raises the crucial issues of proportionality and pre-emption.

[57] *Commission v Kingdom of The Netherlands (Dutch Electricity Monopoly)* (C-157/94) [1997] E.C.R. I-5699 at [40].

[58] State aid cases N541/2004 and N542/2004, p.27, with reference to *Merci convenzionali porto di Genova SpA v Siderurgica Gabrielli SpA (Porto di Genova)* (C-179/90) [1991] E.C.R. I-5889.

[59] Sierra, "Chapter 6: Article 86" in Faull and Nikpay (eds), *The EU Law on Competition*, p.626.

[60] White Paper on services of general interest COM(2004) 374 final, p.7.

Proportionality and pre-emption

First of all it is important to highlight that because Art.86(2) EC is an exception, it is interpreted in a restrictive manner and must be invoked by the parties that seek to benefit from it, i.e. the Member State and/or the undertaking concerned, if challenged, must invoke the exemption and accordingly must meet the relevant burden of proof. This section is primarily concerned with the question what this burden of proof amounts to in the context of proportionality.

Under Community law there are in principle two types of proportionality test, with a different degree of stringency. To determine whether national measures can qualify as entailing infringements of the Treaty rules that are "necessary" in order to ensure SGEI it is therefore important which type of proportionality test is applied, and when. The two types of proportionality test are:

- *Manifestly disproportionate* (the "mild" test). In this case it will suffice if the measures imposed are prima facie suitable to achieving the task at hand.
- *Least restrictive means* (the "strict" test). In this case of all imaginable measures the one chosen must involve the least restrictions on market freedom.

Key to this issue is the 1990 agriculture case *R. v Ministry of Agriculture, Fisheries and Food Ex p. FEDESA (FEDESA)* (C-331/88).[61] Here the Court distinguished between the "manifestly disproportionate" and "least restrictive means" regimes as follows in a case regarding the legality of a number of Council Directives in the agricultural field:

> "The Court has consistently held that the principle of proportionality is one of the general principles of Community law. By virtue of that principle, the lawfulness of the prohibition of an economic activity is subject to the condition that the prohibitory measures are appropriate and necessary in order to achieve the objectives legitimately pursued by the legislation in question; *when there is a choice between several appropriate measures recourse must be had to the least onerous*, and the disadvantages caused must not be disproportionate to the aims pursued.
> However, with regard to judicial review of compliance with those conditions it must be stated that in matters concerning the common agricultural policy the Community legislature has a discretionary power which corresponds to the political responsibilities given to it by Articles 40 and 43 of the Treaty. Consequently, the legality of a measure adopted in that sphere can be affected only if the measure is *manifestly inappropriate* having regard to the objective which the competent institution is seeking to pursue."[62]

It is submitted here that regarding the Member States the same logic applies, but with a reverse outcome: where there is no Community norm that has occupied the field (pre-emption), the lighter "manifestly disproportionate" administrative law test prevails;

[61] *R. v Ministry of Agriculture, Fisheries and Food Ex p. FEDESA (FEDESA)* (C-331/88) [1990] E.C.R. I-4023; [1991] 1 C.M.L.R. 507.

[62] *FEDESA* (C-331/88) [1990] E.C.R. I-4023; [1991] 1 C.M.L.R. 507 at [13]–[14] (emphasis added), with reference to *Hermann Schräder HS Kraftfutter GmbH & Co KG v Hauptzollamt Gronau (Schräder)* (C-265/87) [1989] E.C.R. 2237 at [21]–[22].

where pre-emption has occurred, Member States may only intervene based on 'the least restrictive means'.

This issue has been resolved in the *Corbeau*, *Almelo* and *Ambulanz Glöckner* cases where the Court was willing to accept monopolies for SGEI that were broader in scope than the universal service concerned.[63] Implicitly therefore such restrictions (ancillary restraints) were held not to be manifestly disproportionate, while they would evidently have failed a least restrictive means test, because other measures (such as funding of universal service obligations from general tax revenue) would of course have been available. In such cases the Member State has to be prepared to demonstrate that the broader scope is necessary to perform the universal service obligation, i.e. that the performance thereof is not merely hindered or made more difficult, but would otherwise be impossible.[64] This requires comparing the net cost of providing a universal service against the economic advantages inherent in the state measure at issue as well as any other forms of compensation received (such as state aid).[65] Evidently, over time circumstances may change: restrictions that are regarded as proportionate today may no longer be so in future under the light of changed circumstances.

The conclusion that pre-emption is relevant to the proportionality test may be drawn from the 1997 *Electricity* cases (below). When faced with the Art.226 EC Treaty infringement Cases concerning national electricity monopolies in The Netherlands, France and Italy, the Court clearly opted for judicial restraint by stating the burden of proof on the Member States:

> "*[C]annot be so extensive as to require the Member States . . . to . . . prove, positively, that no other conceivable measure, which by definition would be hypothetical, could enable those tasks to be performed* under the same conditions."[66]

The Court went on to show that the Commission had neglected to elaborate on the nature of the Community interest involved—even in terms of the effect on Community trade.[67] It clearly held that the Commission should have acted under Art.86(3) EC to back up its allegations:

> "[I]t was incumbent on the Commission, in order to prove the alleged failure to fulfil obligations, to define, subject to review by the Court, the Community interest in relation to which the development of trade must be assessed. In that regard, it must be borne in mind that Article 90(3) [now 86(3)] of the Treaty expressly requires the

[63] *Corbeau* (C-320/91) [1993] E.C.R. I-2533 at [15] *et seq.*; *Almelo* (C-393/92) [1994] E.C.R. I-1477 at [46] *et seq*. *Cf. Glöckner* (C-475/99) [2001] E.C.R. I-8089 which suggests the outer limit of such ancillary restraints is the ability to effectively meet demand, i.e. to maintain efficient operations in the associated services (in this case patient transport services in addition to emergency services).

[64] *Air Inter SA v Commission* (T-260/94) [1997] E.C.R. II-997 at [138]–[139].

[65] *cf*. Sierra, "Chapter 6: Article 86" in Faull and Nikpay (eds), *The EU Law on Competition*, pp.640–641.

[66] *Commission v Kingdom of The Netherlands (Dutch Electricity Monopoly)* (C-157/94) [1997] E.C.R. I-5699 at [58]; *Commission v French Republic (French Electricity and Gas Monopoly)* (C-159/94) [1997] E.C.R. I-5815 at [101]; *Commission v Italian Republic* (*Italian Electricity Monopoly)* (C-158/94) [1997] E.C.R. I-5789 at [54] (emphasis added).

[67] *Dutch Electricity Monopoly* (C-157/94) [1997] E.C.R. I-5699 at [66]–[73]; *French Electricity and Gas Monopoly* (C-159/94) [1997] E.C.R. I-5815 at [109]–[116].

> Commission to ensure the application of that article and, where necessary, to address appropriate Directives or Decisions to Member States."[68]

Specifically, the Court held that the Commission should have demonstrated how:

> "*[I]n the absence of a common policy* in the area concerned, development of direct trade between producers and consumers, in parallel with the development of trade between major networks, would have been possible."[69]

Hence, in the absence of Community measures the Court will not consider itself bound to judge on the feasibility of alternative regulatory solutions, even if these may theoretically be more consistent with EU law.

In order to pass the mild "not manifestly disproportionate" test the following must be shown:

> "[I]n order that the derogation to the application of the rules of the Treaty set out in Article 90(2) [now 86(2)] thereof may take effect, it is not sufficient for the undertaking in question merely to have been entrusted by the public authorities with the operation of a service of general economic interest, but it must be shown in addition that the application of the rules of the Treaty obstructs the performance of the particular tasks assigned to the undertaking and that the interests of the Community are not affected . . ."[70]

Thus, depending on the criterion used the proportionality test involves two or three steps:

- first, a causal link between the measure and the objective of general interest;
- second, the restrictions caused by the measure are balanced by the benefits obtained in terms of the general interest (this is last step of the "not manifestly disproportionate" test);
- third, the objective cannot be achieved by less restrictive means (this is the last step of the "least restrictive means" test).

It is held here that—in the absence of pre-emption—the second step would suffice in the context of a "not manifestly disproportionate" test. However, it should be noted that this approach to proportionality remains contested and merits further separate consideration in follow-up research across various EU law procedures where the concept is applied.

[68] *Dutch Electricity Monopoly* (C-157/94) [1997] E.C.R. I-5699 at [69]; *French Electricity and Gas Monopoly* (C-159/94) [1997] E.C.R. I-5815 at [113].

[69] *Dutch Electricity Monopoly* (C-157/94) [1997] E.C.R. I-5699 at [58]; *French Electricity and Gas Monopoly* (C-159/94) [1997] E.C.R. I-5815 at [71] (emphasis added). *Cf. Deutsche Post AG v International Express Carriers Conference (IECC) (Deutsche Post)* (C-147/97 and C-148/97) [2000] ECR I-3061. Here, in the absence of agreements on terminal dues between postal operators that would allow Deutsche Post to execute its public service task in a financially balanced manner, legislation allowing Deutsche Post to charge international mail at (higher) national rates did not cause it to infringe Art.86 EC.

[70] *Porto di Genova* (C-179/90) [1991] E.C.R. I-5889 at [26], citing the judgments in *Centre belge d'études de marché—Télémarketing (CBEM) v SA Compagnie luxembourgeoise de télédiffusion (CLT) and Information publicité Benelux (IPB) (Télémarketing)* (C-311/84) [1985] E.C.R. 3261 at [17], and in *Klaus Höfner and Fritz Elser v Macrotron GmbH (Höfner)* (C-41/90) [1991] E.C.R. I-1979 at [24].

A three-step approach

In order to minimise issues of overlap and to provide a logical sequence in the steps taken in defining a SGEI and the universal service obligations that form its core, the following three-step approach, or "structured test" is proposed here. This is based on the earlier proposal to see SGEI as constituting three parts: universal service obligations; ancillary restraints; and—to the extent this is constituted separately—a funding regime.

- First the universal service obligations should be defined: this means deciding which consumer rights are deemed to exist (or to be necessary) with regard to a particular service.
- Second an analysis is necessary of which of these consumer rights, as a result of market failure, would not be adequately provided in a market setting—i.e. after market-based remedies against the market failure concerned are imposed—and might therefore require imposing universal service obligations, and what the precise content of these obligations would be.
  The answer to the latter can be determined based on the following questions:
  - — What would be the *proportionate remedy* to the market failure concerned that could benefit from an exemption? Is it necessary to impose obligations on all undertakings in the market or should one or more operators with specific obligations be designated? Again when looking at remedies solutions that enable competition to work should be considered a first choice.
  - — Do the undertakings concerned need an *exemption from certain Treaty obligations* in order to perform their task to the required standard?
- The third question is that of the need for ancillary restraints. Should the undertakings concerned receive any *rights and/or obligations in excess of the scope of the universal service and/or other public service obligations* themselves?
  - — The answer to this last question then defines the *scope* of the service of general economic interest.[71]
  - — An *act of entrustment* and *an objective, transparent and proportional compensation mechanism* are required (subject to the *Altmark Trans* case law of the Court and the Commission framework on public service compensation that will be discussed in the next section).

The proportionality test discussed in the preceding section would be subsumed under this three step test, providing for a consistent approach to SGEI.

Choice of organisation

It is for the public authorities involved to decide whether they provide these services directly through their own administration or whether they entrust the service to a third party (private or public entity). Designating "in house" service providers as charged with SGEI can lead to an infringement of the competition rules in the following three cases:

[71] The notion that a service of general economic interest might involve services broader than the universal service concerned in order to guarantee its economic viability can be traced back to *Corbeau* (C-320/91) [1993] E.C.R. I-2533.

- where the public service requirements concerned are not (properly) specified;[72]
- where the provider charged is manifestly unable to meet demand;[73]
- where there is an alternative way of fulfilling the service of general economic interest requirements that would have a less detrimental effect in competition.[74]

Where a third party is selected the public procurement rules will generally apply, or in the event that this is not the case, rules of transparency, equal treatment, mutual recognition and the protection of individual rights apply (alongside the norms set out in Commission's Communication on concessions).[75]

Compensation for public service obligations

Relatively recently a complete framework for public service compensation has been created, as the Court's decision in *Altmark Trans* was followed by a Commission Notice and Decision on this issue. The importance of this framework goes beyond compensation as such because it addresses the issue of the legal basis of SGEI and changes the incentive structure for Member States and undertakings alike. As a result there are now clear benefits to a formal designation as a service of general economic interest. At the same time a clear legal basis facilitates carrying out a proper proportionality test.

The Altmark Trans four-part test

In its *Altmark Trans* Case of 2003, the Court for the first time set out a four-part test to determine whether or not, in the context of Art.86(2) EC, a state aid might be involved:

> "First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined . . .
> Second, the parameters of the basis on which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings . . .
> Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations. . .
> Fourth, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer 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 which a typical undertaking, well run and adequately

[72] *Ahmed Saeed Flugreisen and Silver Line Reisebüro GmbH v Zentrale zur Bekämpfung unlauteren Wettbewerbs e.V (Ahmed Saeed)* (C-66/86) [1989] E.C.R. 803.

[73] *Höfner* (C-41/90) [1991] E.C.R. I-1979.

[74] Green Paper on services of general interest COM(2003) 270 final, p 24, citing *Vlaamse Televisie Maatschappij NV v Commission (VTM)* (T-266/97) [1999] E.C.R. II-2329.

[75] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Public-Private Partnerships and Community Law on Public Procurement and Concessions COM(2005) 569 final.

> provided . . . so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations . . .”[76]

Compensation for public service missions that meets these criteria will not constitute state aid. If such compensation does not meet these criteria it will be subject to the state aid rules. Note the fourth condition of *Altmark Trans* which provides for the situation “where the undertaking which is to discharge public service obligations, in a specific case is not chosen pursuant to a public procurement procedure” in which case the funding is based not on actual costs but on the costs of a (hypothetical) effective undertaking.

The Commission Notice and Decision

Following the *Altmark Trans* judgment of the Court of Justice the Commission has spelled out the conditions under which compensation for SGEI is not considered state aid. It should be noted that a related question is whether charging particular undertakings with the provision of SGEI is subject to the public procurement rules.

The Commission has built on *Altmark Trans* by adopting a Notice [2005] OJ C297/04,[77] and a Decision [2005] OJ L312/67[78] to deal with those cases where the public service compensation concerned does not meet the *Altmark Trans* criteria and therefore constitutes state aid.

The Commission Notice restates the fact that Member States have wide discretion in designating SGEI, and that the Commission can only control for manifest errors in this designation. It encourages the Member States to consult widely, in particular among consumers, prior to defining public service obligations. An official act is required, which must specify the:

- precise nature and the duration of the public service obligations;
- undertakings and the territory concerned;
- nature of any exclusive or special rights assigned to the undertaking;
- parameters for calculating, controlling and reviewing the compensation;
- arrangements for avoiding and repaying any overcompensation.

Concerning compensation the Notice emphasises that cross-subsidisation of activities not constituting SGEI constitutes incompatible state aid. Compensation must be based on costs plus a reasonable profit, including “all or some of the productivity gains during an agreed limited period”. A reasonable rate of return means taking into account the risk or absence of risks incurred by the undertaking, in particular in the presence of special and exclusive rights. Accounting separation is required where the undertaking concerned carries out other activities alongside the provision of SGEI. Detailed rules pertaining to costs include a definition of costs to be taken into account as covering all variable

[76] *Altmark Trans* (C-280/00) [2003] E.C.R. I-7747 at [89]–[93]. *Cf. Enirisorse SnA v Ministero delle Finanze (Enirisorse)* (C-34/01 to C-38/01) [2003] E.C.R. I-14243 at [31] *et seq*. The *Enirisorse* case finally clarified that collecting and allocating (part of) charges levied on other undertakings to the benefit of an undertaking charged with SGEI may constitute state aid.

[77] Community framework for State aid in the form of public service compensation [2005] OJ C297/04.

[78] Decision on State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2005] OJ L312/67, Preamble, para.16.

costs associated with the service of general economic interest and where applicable a proportion of fixed costs common with other activities.

The Commission Decision is dedicated to public service compensation that does not meet the criteria set out in *Altmark Trans* and/or the Commission Notice and consequently constitutes state aid that may be either admissible as such, or inadmissible (i.e. that is illegal and must be repaid). To avoid the need for notification a *de minimis* rule is linked to quantified aid limits specified per sector, provided the service of general economic interest is imposed by an official act that meets the requirements set out in the Notice (and listed above).

SGEI and the Services Directive

Finally, Directive 2006/123 [2006] OJ L376/36[79] (Services Directive) that has to be transposed by the end of 2009 provides a special regime for SGEI that is be discussed briefly here. Its Art.2 provides an exception for a number of sectors where SGEI play an important role such as electronic communications, transport, healthcare, social housing and audiovisual services.[80]

In addition SGEI are excluded from the evaluation requirement of Art.15 of the Services Directive in so far as this would obstruct the performance of the tasks assigned. Article 17 of the Services Directive also provides that the specific rules in Art.16 on the free movement of services do not apply to SGEI which are provided in another Member State, in particular in the postal, electricity, gas, water and waste water and waste treatment sectors. The scope of this latter exception is not further limited (not even by a proportionality requirement as applied to Art.15 of the Services Directive). The fact that this special regime was created may be regarded as illustrative of the growing relevance of SGEI. It also illustrates the greater impact the Member States were apparently able to have in the context of secondary legislation than regarding the Treaty provisions.

Conclusion

In principle the national public interest should usually be in line with the EU market freedoms and competition law because the latter generally result in lower prices and greater choice for consumers. This is, after all, the purpose of having market freedoms and competition rules in the first place. However, where market failure may lead to sub-optimal provision of public goods there may be a case for public intervention in terms of imposing universal service obligations on one or more undertakings that are active in the market as provider(s) of last resort. Even in this case competitive provision within certain limits may be feasible and should be explored within the context of SGEI—not least in order to meet the requisite proportionality standard.

It is for the purpose of balancing the public interest and market freedoms that Art.86(2) EC provides an exception to the Treaty rules for SGEI. This exception only applies to

[79] Directive 2006/123 on services in the internal market [2006] OJ L376/36.
[80] Non-economic services of general interest are excluded as a whole.

the extent that it is strictly necessary to perform the functions of SGEI concerned. It serves to reconcile the public interest identified as such at national level as the reason for introducing a SGEI with respect for the Treaty rules by means of a proportionality test.

Based on an analysis of the Community experience so far a SGEI consists of:

- universal service rights for consumers and related universal service obligations for one or more undertakings; and
- ancillary services necessary to fulfil those universal service obligations and other public service guarantees; and
- where necessary, a compensation mechanism (financial remuneration).

To be recognised as such, in principle SGEI are set out in a formal act of entrustment, the contents of which have been specified in the Community framework on public service compensation based on the *Altmark Trans* judgment of the ECJ. Compensation is based on costs plus a reasonable rate of return. If public procurement procedures were not used to select the provider of the SGEI the standard used is that of an efficient firm. If these standards are met the state aid rules do not apply.

The proportionality test (necessity) requires the scope of SGEI to remain restricted to the necessary minimum. In the context of harmonisation this test is based on the least restrictive means criterion. In the absence of harmonisation the Member States retain greater freedom and the relevant test is whether the measures concerned are manifestly disproportionate.

Using the instrument of SGEI requires taking clear decisions to define closely the public interest involved because the legitimate scope of SGEI is limited to what is necessary to attain the relevant public interest objectives. Market failure arguments will be key here. By defining SGEI in this manner the road to liberalisation and market-based provision of the remaining services is opened. At the same time the definition of particular universal service obligations provides transparent, verifiable and enforceable consumer rights in terms of deliverables, instead of vague notions conflating public provision and the provision of public goods as somehow inherently identical with scant attention paid to what is actually being delivered in practice. This exercise will be particularly useful in markets in transition where, in a liberalisation context, the need for public interest exceptions is raised.