The Reform of the State Aid Rules on Financing of Public Services

Paving the Way towards a Clearer, Simpler and more diversified Framework

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I. Introduction

On 20th December 2011, the European Commission approved the new rules for the control of State aid in the field of Services of General Economic Interest (SGEIs) or – as they are more commonly known – public services.

Public services represent an important feature of the European model of social market economy and, although they are defined and structured in very different ways across the 27 Member States of the European Union, the Lisbon Treaty considers them as part of "the shared values of the Union".1

The reform of State aid rules on the financing of SGEIs is the result of a long process of political interchange and dialogue both within the Commission and with stakeholders.

The political guidelines for the mandate of the current European Commission 2009 called for the establishment of “a quality framework for public and social services, thus recognising their importance in the European model of society”.2 And the Commissioner-designate for Competition, in his introductory remarks at the hearing of the European Parliament, stated that "competition policy must [...] help to guarantee accessible and affordable high-quality public services, which are fundamental to citizens' well-being and quality of life and which also contribute to social and territorial cohesion".3

The economic and financial crisis has stressed the importance of ensuring accessible and affordable access to high-quality services. Many people across Europe have since become more dependent on these services, at a time when Europe is facing increasingly severe budgetary constraints. According to a 2010 report,4 public services account for more than a quarter of the GDP of the 27 Member States and employ more than 30.1% of the Union’s workforce. In order to continue to guarantee essential services such as education, health, and social services, but also communications, energy and transport to the general population at affordable conditions, the Member States need to focus on the economic efficiency of public spending.

It is with these policy objectives in mind that the reform of the State aid rules was launched. The review process was concluded after an intense dialogue last 20th December when the Commission approved "A Quality Framework for Services of General Interest in Europe",5 bringing together under a single framework the various actions pursued with regard to public services.

The scope of this overview is to describe the genesis of this reform and its deployment. After reviewing the changes introduced by the Treaty of Lisbon to the legal framework for public services and the terminology used in the Treaty, this paper will look at the main elements of the previous rules on the financing of SGEIs and their application, describe the different stages of the reform and its goals, and finally explain and assess how these have been translated into the texts that compose the new package.

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1 Art. 14 TFEU.
4 “Public services in the European Union and in the 27 Member States”, Mapping of Public Services project, CEFF, May 2010.
II. Public services in the EU architecture

Public services were already mentioned in the Treaties establishing first the European Communities and then the European Union. However, the entry into force of the Lisbon Treaty in 2009 gave them a new and improved place in the overall architecture of the Union, by recognising and protecting both the fundamental role they play in our societal ties establishing first the European Communities and then the European Union.

This twin approach is reflected in particular in the new Protocol 26, devoted to setting out the “interpretative provisions” that apply to public services. But before illustrating the substance of the Protocol’s provisions, some clarification of the terminology is necessary.

The Protocol uses three different terms to designate public services. The title mentions that it deals with Services of General Interest (SGIs), but it provides no definition of such services. In practice, this term is used to refer to all those services which are considered to be in the interest of society as a whole, or – to use the definition given in the Quality Framework – those services that “public authorities of the Member States classify as being of general interest and, therefore, subject to specific public service obligations (PSO).” Therefore, SGI is the Treaty term that better corresponds to the more common phrase “public services” and thus covers both economic and non-economic services of general interest, which are not defined by the Treaty either.

Non-economic services of general interest are mentioned only in Protocol 26, which makes clear that EU law cannot “affect in any way the competence of Member States to provide, commission and organise non-economic services of general interest.” Traditionally, activities such as the army or the police, air navigation safety, compulsory education funded from public resources and activities of a purely social nature, such as the management of compulsory employers’ liability insurance functioning under the principle of solidarity, are considered non-economic in nature because linked to the exercise of State prerogatives and to the fulfilment of State responsibility towards the population. As described in more detail below, the Commission has tried to identify more precisely the distinction between economic and non-economic activities in the new SGEIs Package; however, it is bound in doing so by the case law of the Court of Justice, which is not always straightforward and has to adapt to a dynamic reality. Thus, although the Court has consistently held that “an activity consisting in offering goods and services on a market is an economic activity,” the existence of a market for certain services may vary from one Member State to another and thus the economic nature of certain services may also differ from one Member State to another. Furthermore, the definition of a given service as economic can change over time. The many liberalisations that have taken place in Europe demonstrate that even activities that were reserved to the exclusive exercise of public powers have, in time, turned into economic services. Examples include broadcasting, energy distribution, telecommunications and, more recently, public transport.

It is equally difficult to give a complete ex ante definition of economic services or SGEIs. Apart from market evolution, in fact, the Member States have a very wide discretion in defining a service as an SGEI. Article 1 of Protocol 26 recognises as a “shared value of the Union [...] the essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organising services of general economic interest as closely as possible to the needs of the users”, as well as the diversity that exists across the Member States between various services and “the differences in the needs and preferences of users that may result from different geographical, social or cultural situations”. In practice, this confronts the European Commission with a wide variety of different SGEIs across the twenty-seven Member States.

Last but not least, Article 1 of Protocol 26 also mentions as a shared value “a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights”.

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7 Protocol No 26 on services of general interest, OJ 2008 L 115.
8 “A Quality Framework for Services of General Interest in Europe” (fn. 3), p. 3.
9 Protocol No. 26 on services of general interest, Art. 2.
Another common definition relating to public services is that of social services of general interest (SSGs). SSGs are not mentioned in the Treaty or in secondary law. In the Commission’s 2006 Communication on SSGs, two main categories are identified: the social security systems covering the main risks of life (health, work accidents, unemployment, handicap, pension), and other essential services directly delivered to a person and playing a role for social cohesion and inclusion, such as assistance to persons encountering particular problems or crises (e.g., highly indebted persons and drug addicts), activities for the social inclusion in society (such as language training for immigrants) and in the labour market (training), assistance to persons with long-term needs such as the handicapped, and social housing. SSGs are therefore intended to be at the same time broader than SGEIs because they cover services which are both economic and non-economic in nature, but also narrower than SGEIs because they only cover those services that are qualified as “social”.

Thus, in a nutshell, while public services are recognised as being of fundamental importance to Europe as a whole, Protocol 26 gives Member States carte blanche for public services that are non-economic in nature and a wide margin of discretion in establishing public services with an economic aspect. The only limits imposed on this subsidiarity lie in the existence of certain sectors where European rules harmonise public service objectives (for example, with regard to postal services, energy and transport) and to the task of the Commission to ensure that there is no manifest abuse regarding the definition of SGEIs.

This twin approach enshrined in Protocol 26 permeates also Article 14 TFEU, which mandates both the Union and the Member States, each within their respective powers and competences, to ensure that public services operate on the basis of principles and conditions, particularly economic and financial conditions, “which enable them to fulfil their missions”. At the same time, however, Article 14 also calls on the European Parliament and the Council to adopt, on the basis of a proposal by the Commission, regulations establishing the principles and conditions on the basis of which SGEIs should be commissioned, supplied and funded. It thus provides a new legal basis for an action at European Union level that may help ensure the high level of quality, safety and affordability that Protocol 26 defines as a shared value of the Union.

It is on the basis of Article 14 that many stakeholders called upon the Commission to establish a cross-cutting legislative instrument in the field of SGI. In his report on the internal market, Professor Monti discussed the place of public services within the Single Market. With regard to Article 14, he concluded that a proposal for a framework regulation would have limited added value and that its chances of being adopted would be very small. Instead, Professor Monti suggested that the Commission should consider proposing, on the basis of Article 14, regulations ensuring access to basic services when there are gaps in the universal service provision, such as – for instance – by extending universal service in electronic communications to the provision of broadband access.

This view was reflected in the Single Market Act, adopted by the Commission on 13 April 2011. The Single Market Act explicitly addressed the issue under its proposal No 25, which planned the introduction of a series of measures on SGEIs in the course of 2011. The main result of this action was, indeed, the adoption on 20th December 2011 of a Quality Framework, the new SGEIs Package and legislative proposals for a revision of the public procurement directives.

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Some stakeholders have then used the revision of the State aid rules on the financing of SGEIs to ask the Commission to use Article 14 as legal basis. However, Article 14 remains "without prejudice" to the application of Article 106 TFEU. In other words, Article 14 specifically foresees a continued role for competition policy in the shaping of SGEIs.

Under Article 106, undertakings entrusted with providing a public service that is economic in nature are subject to the EU competition rules, as long as these rules do not prevent them from carrying out their public service tasks. In particular, paragraph 2 stipulates that "undertakings entrusted with the operation of services of general economic interest [...] shall be subject to the rules contained in the Treaties, in particular to the rules on competition." This means that in relation to services of general economic interest, the EU rules on State aid apply, as do the EU rules on anticompetitive agreements and abuse of dominance.

In fact, an important aspect in the provision of public services is the compensation that public authorities may need to grant the providers for the performance of these tasks. In 2003, the Court of Justice clarified that, when compensation is granted by public authorities for the performance of public services and is not strictly limited to the amount which would be needed to compensate an efficient operator, this constitutes State aid.15

III. The 2005 SGEI Package

It is on the basis of the ruling of the Court in Altmark that, in 2005, the Commission adopted a set of legal instruments, known as the 2005 SGEIs Package or the Monti-Kroes Package. Its aim was to provide public authorities and market operators with legal certainty on the application of State aid rules. The 2005 SGEIs Package comprised three instruments, commonly known as the 2005 SGEIs Decision,16 the 2005 SGEIs Framework,17 and the Transparency Directive.18

With the 2005 SGEIs Decision, the Commission specified the conditions under which compensation to companies for the provision of public service obligations could be considered compatible with the State aid rules and be exempted, by way of exception to the requirement in Article 108(3) of the Treaty, from ex ante notification to and scrutiny by the Commission. The 2005 SGEIs Decision applied to SGEI compensation granted to hospitals and social housing irrespective of its amount, and to undertakings with an average annual turnover before tax, all activities included, of less than EUR 100 million during the two financial years preceding that in which the SGEI was assigned, and for which annual compensation was less than EUR 30 million.

To benefit from the exemption, SGEIs had also to comply with the conditions set out in the Decision. In particular, Article 4 required that the SGEI be entrusted to the provider through an official act, specifying the nature and duration of the obligations, the parameters for calculating, controlling and reviewing the compensation, and the arrangements for avoiding and repaying any overcompensation. Under Article 5, compensation had to be limited to the amount that was necessary to cover the costs incurred in discharging the public service obligations, taking into account the relevant revenues and a reasonable profit. Details on how to calculate costs, revenues and "reasonable profit" were also provided. Finally, Article 6 established the obligation for Member States to check regularly that the public service providers where not overcompensated, i.e. did not receive compensation in excess of the amount determined in accordance with Article 5.

Any aid in the form of SGEI compensation that did not meet the conditions of the SGEI Decision had to be notified to the Commission under Article 108(3) TFEU. In the SGEI Framework, the Commission defined the conditions under which compensation not covered by the Decision would be con-

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16 Decision (EC) No 842/2005 of 28 November 2005 on the application of Art. 86(2) of the EC Treaty to State aid in the form of public services compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ 2005 L 312/67.
The conditions of compatibility laid down in the SGEIs Framework were very similar to those provided in Articles 4, 5 and 6 of the SGEIs Decision. The third element of the 2005 SGEIs Package, the Transparency Directive, was modified to impose that separate accounting took place for all SGEIs receiving financial compensation, whether or not that compensation constituted State aid.

Following their entry into force in 2005, the SGEIs Decision and the SGEIs Framework were the most important basis for the Commission’s assessment of a large number of SGEI-related State aid cases. However, a number of sector-specific State aid rules were also in place, which either substituted or complemented the SGEIs Decision and the SGEIs Framework. For instance, neither the SGEIs Framework nor the SGEIs Decision applied to the land transport sector, for which specific guidelines and rules relating to public services obligations applied (e.g. the Guidelines on railway undertakings and the Regulation on public passenger transport services by rail and by road). In contrast, only the SGEIs Decision applied to the air and maritime transport, and it was supplemented by sectoral rules and guidelines, such as the Guidelines on air transport or the Cabotage regulation. Similarly, the broadcasting sector was covered by the SGEIs Decision and by the terms of the Communication on public service broadcasting.

IV. The reform process

The 2005 SGEIs Package foresaw that the Commission would conduct an evaluation of the existing State aid rules and publish its results. Further more, the SGEIs Framework was due to expire in November 2011. The Commission therefore launched a consultation process in 2008, comprising a reporting exercise from Member States as well as a public consultation of other stakeholders.

By the time the new Commission took office, it was clear that the financial crisis that precipitated at the end of 2008 would affect Europe’s economy for a long time. Member States would have fewer and fewer resources to spend and citizens would need more and more good public services. In this juncture, it was felt that this revision should be the occasion for a thorough rethinking of the system used by the European Commission to control the public compensation of SGEIs.

1. The public consultation

Carried out between 2008 and 2009, the Member State reporting exercise consisted mostly of contributions concerning the practical experience with the Package rather than a research based on detailed statistical information. Many Member States were in fact unable to gather comprehensive data given that SGEI issues were usually considered in an uncoordinated way at different levels of the national administration. This first leg of the consultation therefore revealed that there was scope to improve the effective use of the Package within Member States.

This exercise was then followed, in 2010, by an extensive public consultation. This generated more than 100 responses from a large group of stakeholders active in different economic sectors, ranging from national authorities and municipalities to large private operators, social service providers and ordinary people.

Although the consultation process yielded a wide spectrum of positions, the overall perception was that the 2005 SGEIs Package had had a broadly positive impact. The majority of stakeholders considered that it had increased legal certainty and reduced the administrative burden associated with State aid notifications, namely through the application of the SGEIs Decision.

However, several respondents also highlighted that public authorities did not always apply the 2005 SGEIs Package correctly. Reasons advanced included the level of complexity of the rules, or simply the fact that many authorities were unaware of
the existence of the Package. The consultation process therefore indicated that there was scope to improve the clarity of the Package and render its application more practical and efficient.

Confirming the fact that rules were often not well understood, many stakeholders requested further guidance on concepts underlying the State aid provisions for SGEIs. The list included notions enshrined in primary law such as economic and non-economic activities, effect on trade between Member States, or the criteria of the *Altmark* jurisprudence. Other problematic points were concepts linked to the application of the 2005 SGEIs Package, such as that of an entrustment act. The absence of a common understanding of these notions constituted an important limitation to the efficient application of the Package. However, most of these concepts had not been introduced by the Package itself but were actually either linked to EU primary legislation or part of the jurisprudence of the Court of Justice.

The consultation also highlighted the widespread view that some of the provisions of the Package should be more flexible for specific types of activities. For instance, several stakeholders were of the opinion that the rules were too stringent with regard to social services; although some of these services were provided through an economic model, their purpose was often purely to achieve social objectives, which should be taken into account by the State aid rules. A suggested solution was to expand the list of social activities benefitting from the SGEIs Decision beyond hospitals and social housing.

The case was also made for a more proportionate and simplified application of the Package for small scale services. In particular, several stakeholders suggested that SGEI compensation below a certain amount should not be submitted to any scrutiny. This could be achieved, for instance, through the introduction of a specific SGEI de minimis threshold – set above the general EUR 200,000 threshold existing under the general de minimis Regulation – below which SGEIs would be exempted from any State aid scrutiny, including on entrustment and compensation.

On the contrary, several stakeholders believed that the rules might have been too lenient on large-scale commercial activities. Indeed, the SGEIs Decision seemed to exempt a large number of these activities from State aid scrutiny. More checks also needed to be put in place to ensure that the delivery of these services was done in the most efficient way.

Finally, the consultation revealed the need for increasing the synergies between State aid and public procurement rules. Many contributions highlighted that a tendering procedure conducted according to EU requirements should be sufficient to exclude the existence of State aid. Service providers built on this point, suggesting that procedures for the award of services concessions should also be sufficient to exclude State aid. Furthermore, several social service providers argued for the award criteria to also include qualitative criteria and not be solely based on pricing.

2. The March 2011 Commission Communication and the key principles of the reform

Once all the replies were analysed and the key areas for modification or refinement of the rules identified, the adoption of a Commission Communication was envisaged to present the main guiding principles of the upcoming reform of the 2005 SGEIs Package and to launch the political debate with stakeholders, the Member States and the other institutions.

The Communication was adopted on 23 March 2011 and its stated overall objective was to enhance the contribution of SGEIs to economic recovery. Efficient and high quality public services can in fact support growth and jobs across Europe, while social services can help mitigate the social impact of the crisis. At the same time, the reform aimed at guaranteeing an efficient allocation of public resources for SGEIs so as to ensure the competitiveness of the EU and economic cohesion between Member States. To reach this objective, two key principles were identified for the reform.

The first objective consisted in providing additional clarity on a number of concepts relevant to the application of the State aid rules to SGEIs. The Commission had tried in various occasions to clarify the rules applicable to the financing of SGEIs. In 2007, it published a collection of over 100 Fre-
The Application of EU State Aid rules on Services of General Interest

Available at: http://ec.europa.eu/services_general_interest/

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, 7 December 2010.

In 2008, it launched an Interactive Information Service (IIS) where questions on SGEI rules could be posted directly online. In spite of these efforts, the consultation process still pointed out that the rules were either not applied or applied incorrectly because of a lack of clarity on the key concepts underlying not only the provisions of the 2005 SGEIs Package but also issues of primary EU law.

The Commission therefore announced its intention to discuss how best to design, through the revision of the 2005 SGEIs Package, rules that would be clearer and easier to apply. And, within the limits deriving from primary law as interpreted by the Court of Justice, it also committed to providing clarification as to how it understands and applies the provisions of the Treaties.

As a second objective, the Commission underlined the need to devise a more diversified and proportionate approach to the variety of public services across the Union, depending on the extent to which aid within the different sectors poses a serious risk of creating distortions of competition in the internal market. Under the 2005 SGEIs Package, the rules were applied in a more or less uniform way notwithstanding the great variety of public services covered and the diversity of economic sectors.

This entailed, in the Commission’s intention, a simplification of the rules and less administrative burden for those services whose impact on trade between Member States is very limited due to their small scale or to the peculiarities of their objectives and financing structure. In this context, the Commission proposed to assess, for instance, under which circumstances certain compensations for the provision of SGEIs could be considered as de minimis; for which types of services and under what conditions an individual State aid notification should be required; or whether the thresholds which determine the application of the SGEIs Decision should be modified.

At the same time, the Commission observed that the risk of distortions of competition in the internal market is particularly high in sectors characterised by large scale commercial activities with a clear EU-wide dimension where operators may be entrusted with public service obligations. These concern in particular SGEIs organised in large infrastructure networks such as gas, water, electricity, telecoms, etc. Under the 2005 SGEIs Package, the Commission would declare compatible any compensation granted for the provision of SGEIs that would not be higher than the costs incurred in the provision of the service, minus the revenues the service had generated, plus a reasonable profit margin. No consideration was given to how the costs incurred by the actual provider of the services were generated, in particular whether some of the compensated costs were generated by inefficiencies of the provider rather than by the nature of the service.

When launching the revision of the 2005 SGEIs Package, the Commission was mindful of the fact that, in times of budgetary constraints, in order to preserve the role of public services in the European model of economy, the Commission should take greater account of both efficiency and quality when deciding on the compatibility of State aid as compensation of larger SGEIs. It therefore proposed a reflection on the introduction of measures aimed at taking into account efficiency over the life of an entrustment for large scale services.

The March 2011 Communication was also accompanied by a factual Report, issued as a Staff Working Document. The Report summarised the experience of the Commission in applying the 2005 SGEIs Package, including in specific sectors such as transport, energy, waste and water services, postal services, financial services, broadcasting, broadband, healthcare and social services. The Report also provided details on the 2008-2010 consultation process and a thorough overview of the issues that participating stakeholders put forward concerning the 2005 SGEIs Package, which have been reviewed above.

3. The dialogue with the stakeholders

The March 2011 Communication and the accompanying Report were made available to all stakeholders, to the Member States and to the members of the European Parliament and of the other EU insti-
The contributions of civil society organisations were the most critical on the choice of the legal basis and required the Commission to adopt the new package on the basis of the new legislative procedure of Article 14 TFEU. The Parliament, in particular, considered essential that it be an integral part of the adoption process and highlighted “the clear stipulation in Article 14 TFEU that the Union and the Member States, each within their respective powers and within the scope of application of the Treaty, shall take care that such services operate on the basis of principles and conditions to enable them to fulfil their mission.”

Most Member States stressed the importance of the respect of the subsidiarity principle enshrined in Protocol 26 with regard to the definition of what actually constitutes an SGEI. They agreed to a lighter treatment of the smaller public services, whether because of a more local nature or of social character. The contributions of civil society organisations focused on SSGI, without which many citizens would not be able to fully participate in society. These organisations also supported a lighter treatment of the smaller public services. The business community agreed with the need for more competition in the provision of the larger SGEIs and a more effective enforcement of the State aid rules. Further incentives over the lifetime of the public services as well as a stronger alignment with public procurement rules were considered to be necessary conditions to the delivery of efficient and high quality public services and to ensure a tighter link between public spending more and economic growth. However, the business community opposed the extension of any lighter treatment for smaller SGEIs as they considered that a large number of small subsidies, when taken together, are likely to lead to a distortion of competition.

On the basis of these first reactions, in September 2011 the Commission’s services published the draft texts of the revised Package for public consultation. This draft new Package was composed of four texts: a new Communication to clarify the basic concepts, a revised block-exemption decision, a revised framework to assess compatibility, and a new dedicated de minimis regulation.

The new Communication was centred on the interpretation of the key notions underlying the application of the State aid rules to public service compensation. It focused on explaining concepts such as undertaking and economic activity, state resources and effects on trade through concrete examples in various sectors of the economy; it described the criteria established by the Court of Justice under which public service compensation is considered not to constitute State aid, specifying what is an entrustment act, the parameters to establish a correct compensation, and how the use of public procurement procedures may exclude the presence of aid.

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31 The texts were published on the website of DG Competition at: http://ec.europa.eu/competition/state_aid/legislation/sgei.html.
The draft revised block-exemption decision presented a twin-track approach. On the one hand, it enlarged the scope of the block exemption to include, next to hospitals and social housing, all social services irrespective of the amount of the compensation received. The sectors were defined as “SGEIs meeting essential social needs as regards health care, childcare, access to the labour market, social housing and the care and social inclusion of vulnerable groups”. On the other hand, it halved the general threshold of notification that the 2005 Decision fixed at EUR 30 million to EUR 15 million.

Under the draft revised Framework, a compensation mechanism to incentivise the achievement of efficiency gains over the life of the contract was introduced, together with the possibility to impose further conditions to reduce the anticompetitive effects of the aid in case of particularly serious competition distortions. The draft text also foresaw that aid would only be considered compatible if the public authority in question had assigned the service complying or committing to comply with the applicable European rules on public procurement.

Last but not least, the new de minimis regulation established a presumption of no aid for all compensation of public services not exceeding EUR 150,000 per year, granted by local authorities representing a population of less than ten thousands inhabitants and to undertakings with an average annual turnover of less than five million euro.

The consultation on these four texts gave rise to a large set of contributions: twenty coming from the Member States, twelve from other public authorities, and forty-three from other stakeholders.

Once again, the texts were generally well received. There was almost unanimous consensus on the usefulness of the draft Communication and the clarifications it brought. Some stakeholders would have appreciated even clearer definitions but recognised that, to provide legal certainty, the Commission had to limit itself to explaining the jurisprudence of the Court of Justice and had therefore little margin of manoeuvre to go further. The issue which attracted most attention was the interpretation of the first part of the fourth Altmark criterion, or, more precisely, when a public procurement procedure allows for the selection of the tenderer capable of providing those services at the least cost to the community. The Member States argued that the correct approach would be that of equating “least cost” to the concept of “most economically advantageous tender” used by the Court in its jurisprudence on public procurement, which would allow the inclusion of factors other than just price, such as social or environmental criteria. The suggestion of business providers of public services focused on the need to clarify further that the Member States’ wide margin of discretion in the definition of an SGEI is matched by the duty the Commission has to control any “manifest error” in such definition.

The comments on the draft decision focused mainly on two issues: the definition of social services and the lowering of the general threshold to EUR 15 million. On social services, the views were split among those who considered the list should only contain examples and those who advocated the need for a precise and exhaustive list in order to minimise any possibility of abuse. The lowering of the threshold was fiercely opposed by some Member States and welcomed by others. Business strongly supported the lowering of the threshold as a means to increase scrutiny and avoid any possible distortion of competition. Always in the same vein, they also called for stronger reporting obligations on the block exempted aid.

The issue which attracted more attention in the Framework was certainly the inclusion of the efficiency incentives. Some Member States were the most vocal and active opponents to any stronger control on efficiency and to the introduction of further conditions in case of particularly serious anticompetitive effects of the aid, and went as far as declaring these provisions beyond the Commission’s competence. The European Parliament expressed concerns on efficiency checks but also on the alignment with public procurement rules. In particular the 2011 European Parliament report on the SGEIs reform emphasizes that “the Commission’s responsibility, under the TFEU competition rules, is confined to monitoring state aid for the provision of SGEIs, and that these do not provide a legal basis for setting quality and efficiency criteria, out of legislation external to the TFEU”.

32 The Member States that responded to the consultation on the draft texts were: Austria, Belgium, Bulgaria, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, the Netherlands, Poland, Romania, Slovakia, Spain, Sweden, and the United Kingdom.

33 All contributions were made public and can be consulted on the website of DG Competition at http://ec.europa.eu/competition/consultations/2011_sgei/index_en.html.
criteria at European level” and that “the definition of quality and efficiency for SGEI should be established with due regard for the subsidiarity principle.”

Other Member States and the whole business community welcomed both the introduction of efficiency incentives and the further compatibility requirement of the respect of tendering rules.

The new de minimis regulation collected the most unanimous remarks as almost all stakeholders expressed concerns about the three cumulative conditions necessary to exclude the aid nature of a measure. In particular, the criterion related to the size of the granting authority was considered to give rise to excessive disparities across Europe, as the average size of municipalities differs greatly between the Member States. Thus, for instance, while the average municipality size in the United Kingdom is around 137,000 inhabitants, it is only 5,600 in Germany. Some also questioned the need for a turnover limit that would discriminate undertakings operating in a group or having a public shareholding. As for the amount of compensation, many asked for a calculation of the threshold over three years, as it was the case for the general de minimis regulation.

V. The adoption of the new Package

The Commission adopted the final package on 20 December 2011, together with the proposals for revision of the public procurement directives and under the overall umbrella of the President’s Communication for Quality Framework.

The proposals that were presented to the College were based on the policy lines contained in the March 2011 Communication and were the result of the long process of consultation that preceded it.

An in-depth dialogue took place also inside the Commission. After the adoption of the March Communication, on 5 July, Vice-president Almunia prompted a debate in the College on the orientation the draft texts should follow. At services level, the Directorate General for Competition worked in strict contact with all other interested services throughout the process and consulted them formally on the March Communication, on the draft texts to be sent into public consultation, and on the final proposals.

The debate within the Commission was lively and constructive and concentrated mainly on such issues as the correlation with public procurement rules and procedures (especially to exclude aid under the fourth Altmark criterion); the most correct definition of social services and of the general threshold for the block exemption decision (e.g. whether cultural services should also be block exempted); and the legal feasibility as well as the political desirability of efficiency incentives as one of the criteria for compatibility in the framework.

The final Almunia Package, which was adopted at unanimity by the College, includes a Communication, a Decision, a Framework, and a de minimis regulation. In these four instruments, the input of stakeholders is clear and its main achievement was finding a good balance between the very different – and often opposed – interests involved.

1. The new Communication

The new Communication responds to the objective of clarifying key concepts in the field of State aid for SGEIs. This meets the broad request by Member States and stakeholders to increase legal certainty both for public authorities and SGEI providers and therefore should lead to a more accurate implementation of the whole package. In particular, the Communication is meant to guide national, regional and local authorities in the Member States, public service providers, and all other interested parties with regard in particular to basic definitions, such as the concepts of undertaking and economic activity, and the basic notions of the existence of aid, such as those of state resources and effect on trade.

The Communication also clarifies the scope of the Member State’s discretion in the definition of a particular service as an SGEI and the notion of “manifest error”, as well as the requirements for an entrustment act and the Member State’s freedom to choose the most appropriate legal instrument.

34 EU Parliament report (fn.30).
35 Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ 2012 C8/4.
36 Ibid., para. 8-30.
37 Ibid., para. 37-41.
38 Ibid., para. 46-48.
39 Ibid., para. 51-53.
The Communication also explains which public procurement procedure leads to a result which is the least costly to the community, and therefore excludes State aid. In particular, paragraph 66 clarifies that both an open and a restricted procedure can satisfy the fourth Altmark criterion, while a competitive dialogue or a negotiated procedure with prior publication confers a wide discretion on the adjudicating authorities and have to be assessed on a case by case basis. On the contrary, a negotiated procedure without publication of a contract notice cannot ensure that the procedure leads to the selection of the tenderer capable of providing those services at the least cost to the community. As to the award criteria, paragraph 67 explains that, while the "lowest price" obviously satisfies the fourth Altmark criterion, the "most economically advantageous tender" can also be deemed sufficient, "provided that the award criteria, including environmental or social ones, are closely related to the subject-matter of the service provided and allow for the most economically advantageous offer to match the value of the market".

This has been a delicate and sensitive issue throughout the whole process of revision and its cautious drafting reflects both the animated debate and the fact that this is of course a reading of the jurisprudence of the Court, not a matter at the Commission’s discretion. This is however a point that will bring about a significant simplification in the application of State aid rules to SGEIs, as the granting authorities will now be aware of when compliance with the public procurement rules excludes the presence of aid. It will also favour to the extent possible a greater convergence between State aid and the current public procurement rules and, by promoting a larger use of public procurement procedures, it will result in a strengthening of the internal market.

Another highly debated and sensitive issue is considered in paragraph 13, which clarifies that "the decision of an authority not to allow third parties to provide a certain service (for example, because it wishes to provide the service in-house) does not rule out the existence of an economic activity”. Very few Member States had asked the Commission to exclude the application of State aid rules to public services provided by in-house entities, as it is the case for public procurement rules. This was not considered possible in light of the difference that exists in the Treaty between the rules on State aid and the rules on public procurement. In fact, while the latter provide expressly for an in-house exception, there is no such exception in the Treaty rules on State aid control as interpreted by the European Courts. And indeed there is a good reason for that: public procurement rules do not need to apply when the service is not procured while State aid rules need still to apply to make sure that no overcompensation takes place. Furthermore, the activity of the in-house company is not necessarily confined to the public service in question but can expand in other areas and, money being fungible, any advantage stemming from overcompensation can be used to compete in other markets. Paragraph 13 was therefore maintained and footnote 1 was added to the paragraph to explain why in-house provision of SGEIs is considered an economic activity by reference to the Court jurisprudence, the corresponding provision of the land transport regulation on PSO, and to an example of the Commission’s previous case practice.

2. The new Decision

The new SGEI decision responds to the objective of simplification and aims at creating a more flexible approach for local and social services than was the case under the previous Package.

Thus, the decision significantly broadens the exemption for social services by extending it from the current sectors – hospitals and social housing – to a much wider range of services covering basic social needs. Although a few voices inside and outside the Commission expressed the fear that such an enlargement of the scope of the decision could shield from competition services that the market already provides satisfactorily, the consensus was certainly in favour of the need to simplify the State aid rules for the basic social services. The real challenge lay rather in finding a definition of such services precise enough to be workable in a block exemption decision, but also flexible enough to ensure that all main social services across the
27 Member States can be included in it. The text of the definition was thus conceived and refined thanks to the contribution of the experts in the domain of SSGIs both inside and outside the Commission and finally reads “services of general economic interest meeting social needs as regards health and long term care, childcare, access to and reintegration into the labour market, social housing and the care and social inclusion of vulnerable groups”.

The final decision also maintained the lower threshold of notification for purely commercial SGEIs to EUR 15 million. This change aims to address the stakeholders’ objection that the previous ceiling of EUR 30 million of annual compensation was too high as it withdrew entirely from the Commission’s ex ante scrutiny very sizeable contracts in areas of great importance for the internal market. Indeed, experience has shown that in those areas that are still subject to the compensation threshold, important aid measures – for example service contracts for drinking-water distribution in important European cities – fall in the range of EUR 15 million to EUR 30 million. Those services, which can raise important competition concerns, are therefore more appropriately dealt with by the framework. The lowering of the threshold also responds to the objective of a more diversified approach to the control of State aid. The EUR 30 million ceiling had been set at quite a high level in the 2005 SGEIs Decision in order to apply to most social services, since only hospitals and social housing benefited from an exemption regardless of the amount of compensation. This justification has become obsolete now that the new decision extends the exemption to the large majority of social services.

Towards the end of the reform process, a few stakeholders inside and outside of the Commission asked for cultural services to be also exempted from notification. This request was finally discarded for two main reasons. First, although Member States enjoy a wide margin of appreciation to define SGEI and could thus qualify cultural services as SGEIs if they are not provided under acceptable conditions by the market, the Commission had received no data during its lengthy consultations to justify such block exemption. In other terms, the Commission, although well aware that culture is subsidised across the member States, had no data to show that this public support takes the form of compensation of public services. Second, the Treaty contains a dedicated legal basis for culture in Article 107(3)(d) TFEU and it was therefore considered that any exemption from notification would require a modification of the Council Enabling Regulation. At any rate, cultural aid in the form of SGEIs benefits from the simplified compatibility regime of the decision as long as the compensation is below EUR 15 million.

Regarding the substance of the compatibility assessment, both the new decision and the new framework present a number of novel provisions aimed at reinforcing and simplifying the application of the discipline for aid in the form of public service compensation. Thus, the validity of any act of entrustment has been reduced to ten years, with the exception of those cases in which “a significant investment is required from the service provider that needs to be amortised over a longer period in accordance with generally accepted accounting principles.” The scope of this provision is to avoid the closure of certain markets for an excessively long period of time, not justified by economic considerations. To simplify the application of the rules, the Commission has also decided to reduce the uncertainty linked to the determination of a reasonable profit. Thus, the decision and the framework foresee what has been labelled as a “safe harbor” clause, that is to say a presumption that, under certain conditions, profit not exceeding the relevant swap rate plus 100 basis points is to be regarded as reasonable. Both texts have also strengthened the reporting obligations of the Member States by imposing a frequency of two years compared to the previous three and by specifying the exact information to be submitted. The goal of these provisions is to tighten the ex post monitoring of the Commission.

42 Ibid., Art. 2.1(c).
44 Ibid., Art. 2(2).
46 See Art. 9 of the Decision (fn. 41); and para. 62 of the Framework (fn. 45).
In contrast, the Commission has been careful in excluding the SGEIs covered by the decision from the application of other rules set by the framework, such as the preferred use of the net avoided costs methodology, the need to comply with public procurement rules or the compulsory use of efficiency incentives.  

3. The new Framework

Any compensation of public services not covered by the block exemption decision needs to be notified to the Commission and is covered by the new SGEI Framework, which becomes the legal basis for assessing the compatibility of large compensation amounts granted to operators outside the social services field.

Of the four instruments, this is the one that best translates the objective of diversification set out in the 2011 March Communication: whereas compensations to hospitals and all social services do not need to be notified, compensation to other services above EUR 15 million is to be assessed under much more stringent compatibility requirements. The scope of the modified rules is in particular to increase efficiency and reduce potential distortions of competition for the large SGEIs with a clear impact on the internal market.

Under the previous framework, the compensation granted for the provision of public services could cover all the costs incurred by the provider plus a reasonable profit margin. Some of the costs compensated by Member States to providers could thus be generated not by the requirements of the public service itself but rather by low efficiency levels in the provision of such service. The Commission has considered that such a situation could seriously distort the functioning of markets and ultimately harm service quality. In addition, it was considered not sustainable in the current economic environment and in contrast with the general public policy objective of efficiency in public spending and correct resource allocation.

Thus, the main change in the new framework relates to the introduction of a compulsory compensation mechanism in order to incentivise efficiency gains, as it is already the case for land transport services. Member States will be free to design how these efficiency incentives work. Efficient gains can be retained by the providers as “additional reasonable profit” when the undertaking performs better than initially expected. The introduction of efficiency incentives was one of the most controversial issues in all the revision process. Some of the fiercest opponents were some Member States, that is to say, paradoxically, those that should ensure the best use of public money, while public service providers were generally in favour of efficiency incentives as they considered that they reflected their business logic of reducing costs while at the same time allowing them to keep part of the savings realised, which – under the old framework – they would have lost as overcompensation.

A similar degree of discussion was generated by the insertion, for particularly serious competition distortions, of the possibility to check – on the basis of Article 106(2)(2) TFEU – whether further conditions need to be imposed to reduce the anticompetitive effects of the aid, such as limiting the duration of the contract or granting third-party access to a particular infrastructure financed through the compensation.

In reality, the Commission could have gone further in its compatibility requirement by imposing a full efficiency test or even a necessity test in line with Article 106(2), but chose not to do so and to introduce the lighter mechanism in the form of efficiency incentives. The efficiency incentives should make a valuable contribution to the objective of ensuring that high-quality SGEI services are delivered by competitive providers, operating under fair conditions of competition. It will also contribute to a more orderly public spending, a very important objective at this delicate juncture.

Apart from the modification already mentioned in the previous section, applicable also to the decision, the new Framework also foresees with more precision the methods to calculate the costs that can be compensated, in line with what is already foreseen in the sectoral rules such as those for electron-

47 See para. 39 to 43 of the Decision (fn. 41).
48 Framework for State aid in the form of public service compensation (fn. 45).
ic communications or postal services.\textsuperscript{50} In particular, the net avoided cost methodology; i.e. the difference between the net cost of operating with the public service obligation and the net cost or profit operating without the public service obligation, is now considered the preferred methodology.\textsuperscript{51}

4. The \textit{de minimis} regulation

Last but not least, the \textit{de minimis} regulation is a major tool of simplification, under which compensation for small, local SGEIs are deemed not to constitute State aid. This means that the Commission’s scrutiny is not necessary and therefore that the administrative burden is greatly reduced.

The drafting of the \textit{de minimis} regulation has also greatly benefitted from an intense dialogue with stakeholders. Compared to the draft text published in September 2011, in fact, the conditions have been simplified by recognising only a single threshold of EUR 500,000 over three fiscal years. This amount has been chosen to align the State aid \textit{de minimis} with the provision included in the proposed public procurement directive,\textsuperscript{52} while the three-year period reflects that of the general \textit{de minimis} regulation. The Commission chose however to include text in the regulation to clarify that \textit{de minimis} aid shall not be cumulated with any other compensation in respect of the same SGEI. This means in practice that public support will only fall under this regulation if the entire amount of compensation does not exceed the threshold of EUR 500,000 over three fiscal years.

The criterion of the aid granted by local authorities with a population of less than 10,000 inhabitants was removed at the request of most Member States, which found the ceiling too discriminatory across Europe and dependent on choices of organisation of the public administration over the territory of a State that are difficult to modify. The Commission chose also to drop the last criterion of providers with an average annual turnover of less than EUR 5 million as the similar threshold contained in the previous block exemption decision had proved quite challenging to apply in practice.

Although it was approved by the College of Commissioners on 20th December 2011 with the other three instruments, the \textit{de minimis} regulation is the only act of the new SGEIs Package that has not entered into force at this time of writing (31st March 2012). Under the rules of procedures, the Commission has to consult the Member States twice on its regulations and therefore the December 2011 approval only related to the text to be sent in second public consultation. The final version of the \textit{de minimis} regulation has still to be adopted by the Commission and some amendments are therefore still possible if not in its underlying philosophy and principles, certainly in its details.

VI. Conclusions?

Conclusions should be written at the end of a story. As this paper goes to print, the Almunia package has had only one application,\textsuperscript{53} hence much too little to draw any conclusion.

The four instruments do bring a degree of simplification in substance and in form, and a much needed clarification; they also reflect well the diversity of public services that exist in Europe.

Some of the rules approved will require a lot more discipline from our public authorities; respect of public procurement procedures, introduction of efficiency incentives, and other aspects are all issues that require careful consideration and planning.

The challenge therefore lays now in the application of the rules introduced with the reform by the national, regional and local authorities of the 27 Member States to the whole gamut of Europe’s public services.