Altmark Trans: European Court of Justice outlines conditions for public services compensation

On 24 July 2003, the European Court of Justice issued a preliminary ruling confirming earlier case law in *Ferring* to the effect that financial support that merely represents compensation for public service obligations imposed by EU member states does not constitute state aid. The ECJ also further developed the substantive test for assessing when state funding of public services does go beyond compensation and so must be examined under the EC state aid rules. The new test appears to be far stricter than that under earlier jurisprudence.

*Contributor: Marc Hansen, Susanne Zuehlke and Anne van Ysendyck, Latham & Watkins, London and Brussels*

**Background**

The *Altmark* case was referred to the European Court of Justice (ECJ) for a preliminary ruling by the German Bundesverwaltungsgericht (the highest German administrative law court) (*Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, judgment of 24 July 2003*). In the first instance proceedings, a competitor sought annulment of licences granted to Altmark Trans GmbH to provide regional transport services. Altmark Trans had shown that the routes realised a loss of 0.58 DM per km and received compensation for this negative return. The competitor argued that Altmark Trans relied on illegal subsidies to provide the services, and that the licences were therefore illegal under German law. The national judges asked the court to decide whether compensation received by Altmark Trans for providing the transport services contained illegal state aid under Articles 73 or 87 of the EC Treaty.

The judgment has several significant procedural and practical implications for EC state aid law enforcement. First, the judgment confirms that public service compensation falls outside the legal scope of state aid as defined under Article 87 of the EC Treaty. This means that where funding qualifies as compensation there is no prior notification or standstill requirement. Second, the
judgment provides a substantive test for judging when state funding of public services goes beyond compensation and must be assessed under the EC state aid rules. This is particularly important insofar as it increases the risk of recovery orders against public service providers and opens new angles of attack for the European Commission or competitors.

**Compensation versus state aid approach**

In *Altmark*, the ECJ confirms its earlier (and widely criticised) judgment in *Ferring* (Case C-53/00 [2001] ECR I-9067), holding that compensation for public services does not contain aid when four conditions are met:

- The recipient undertaking must actually have public service obligations to discharge and those obligations must be clearly defined.
- The parameters on the basis of which the compensation is calculated must be established both in advance and in an objective and transparent manner.
- The compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, taking into account the relevant receipts and a reasonable profit.
- Where the undertaking is not chosen in a public procurement procedure, the level of compensation must be determined by a comparison with an analysis of the costs that a typical transport undertaking would incur (taking into account the receipts and a reasonable profit from discharging the obligations).

Procedurally, this means, that EU member states need not notify such compensation to the Commission. Of course, the Commission remains free to take up cases on its own initiative or on a competitor’s complaint. It may order compensation payments to be recovered, when it considers that the conditions set out by the court are not met.

**The limits on compensation for public service obligations**

In setting out the above four conditions, the ECJ seems to limit the ability of member states to argue that public service compensation is outside the scope of the state aid rules of the EC Treaty. The four conditions, each of which must be satisfied for the state funding to escape state aid control, are developed in a manner not seen in earlier judgments.
Two of the conditions have long been part of the public services analysis:

- First, public services obligations (such as public broadcasting, certain postal services, port services, waste disposal or public transport) must be **clearly defined and imposed** by public authorities.

- Second, compensation may **not exceed the reasonable costs** for providing the service. This means in particular that income from the service must be set-off against costs and compensation may include a reasonable profit.

The ECJ seems, however, to chart new territory with two of its conditions:

- The Court holds that the parameters for compensation must be **set objectively and transparently at the outset** of a public services relationship. This means that a public service provider must ensure that all compensable cost factors are identified and budgeted for before assuming the obligation.

This appears to go beyond the current practice which focuses on the costs incurred and allow for retroactive adjustment of compensation. In Ferring, for instance, there was no clear nexus between specific tax benefits and projected costs, and it seemed sufficient that tax benefits did not exceed the actual costs. Equally, in two further pending proceedings (Case C-126/01 Gemo and Case C-34-38/01 Enirisorse), it does not appear that tax benefits designed to compensate for public services, such as animal waste disposal or port services, are established on the basis of projected costs.

The test set out by the ECJ also raises the issue whether public service providers who beat agreed projections must forego the resulting profit because under the remaining conditions they may not receive compensation that exceeds actual costs. This may set the wrong incentives.

- The second new condition seems to go even further. If compensation is not determined through an open, public and unconditional bid, **it may not exceed costs that an average, well-managed and adequately equipped company would have incurred [...] to execute the public service obligations, taking account of the revenues arising therefrom and a reasonable profit [...]. [Own translation.]**

Until now, service providers have had to show that the costs were necessary for providing the service and that they had, in fact, incurred the costs. Now
it seems that the “necessity” of the compensation will be determined by benchmarking the operations of the public service provider against a new and vague market-oriented standard.

The raises a number of questions: What is “an average, well-managed company”? Against whom does one benchmark when, as is often the case for public services, there is no company that offers comparable services, or at least not in the same (local) market? Does this test allow use of a benchmark company in another EU member state, even where benchmark is not operating in the same geographic market? When assessing a company that has several distinct public service obligations, does the test require benchmarking of the costs against each of the public service obligations? If so, does this imply that bundling of public service obligations becomes more difficult to manage as no public service provider can be equally efficient in providing each service? How would such a test apply to a public service broadcaster that is required to carry party political programmes, children’s programming, local news, sports and educational content.

Last, the judgment requires that whether the public service provider has adequate equipment for the execution of the public service obligation be part of the equation. This presumably means not only that you cannot benchmark against a low-cost competitor who is unlikely to satisfy quality requirements because of under-investment (e.g. no adequate back-up resources if buses fail), but also that where the public service provider has over-invested and “gold-plated” its operations as compared with the average competitor, such over-investment cannot be compensated without falling under state aid scrutiny. This could have a significant impact on former state monopolies that may be saddled with excessive production assets (or have chosen to over-invest because of traditions in the public sector).

To summarise, where the Commission or a competitor can prove that a public service provider was inefficient in comparison to “the average, well-managed company”, or “over-equipped” for providing a given public service, any compensation for costs representing such inefficiencies will be considered state aid. In most cases, such state aid would be deemed operating aid and would therefore be unlikely to meet the conditions for approval and would be subject to retroactive recovery if already paid out.

Judgments in two further preliminary rulings, *Gemo* and *Enirisorse*, are expected soon. These cases will likely further elaborate on the conditions for public services compensation. It is also expected that the Commission
will clarify its position either in the form of guidelines or possibly in a block exemption regulation.

Marc Hansen is a partner and Susanne Zuehlke and Anne van Ysendyck are associates at Latham and Watkins, London and Brussels offices.