II-9.7: The European Commission adopts a decision regarding the exemptions regarding the notification of public service compensation granted to undertakings entrusted with the operation of services of general economic interest, in derogation of the prohibition on State Aids.

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To read the decision, click here.

ABSTRACT

On December 20, 2011, the European Commission adopted a decision based on the *Almark* ruling that expounds upon the four conditions necessary so that compensation paid by a State to any state-owned or private company entrusted with the operation of a public service not require prior notification of the European Commission, despite the general prohibition on State Aids. Each state has a wide margin of discretion in the definition of services that could be classified as being services of general economic interest. A communication and *de minimis* regulation will complete this decision.

CONTEXT AND SUMMARY

This decision was published on December 20, 2011, and replaces and abrogates the decision of November 28, 2005, and explains the conditions under which legitimate public service compensations do not have to be notified to the European Commission under the regime applicable to state aids.

In its preliminary discussion, the European Commission highlights that the Treaty on the Functioning of the European Union explicitly stipulates that certain services of general economic interest require financial support from States in order to cover some or all of the specific costs resulting from the public service obligations.

The Commission cites the Court of Justice's jurisprudence in the *Altmark* case of July 24, 2003, which ruled that these compensations do not constitute State aid if the company that receives them, be it public or private, has actual and precisely defined public service obligations. The ruling adds that the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner. The compensation must not exceed the cost, including a

reasonable profit, that a typical company, well run and adequately provided with the relevant means, would have incurred in providing the service.

The Commission also states that a Communication will be published to clarify these four jurisprudential criteria regarding State aid to companies entrusted with the operation of a public service. It also announces that a Regulation on *de minimis* aid will also be adopted to define the rules on aid that does not meet the four aforementioned criteria. Concerning the question of notification limits, the Commission states that services of general economic interest are marked by the strong development of multi-national providers in a number of sectors of great importance to the internal market, which is why it is necessary to establish lower limits for the amount of compensation that can be exempted from the notification requirement than that established by the previous decision of November 28, 2005.

It also explains the way it expects aid that does not meet these criteria will be notified it in accordance with the rules concerning State aid, and how it will analyze such aid.

The Commission points out that States define what is considered as a service of general economic interest, and that it simply ensures that there was no manifest error with regards to this definition. It takes into account the specific characteristics of certain public services, such as health and social services, whose high cost justifies that they benefit from higher limits for the exemption from the notification requirement. Similarly, the decision also points out that the common rules on compensation for services of general economic interest do not apply in the same way to transport services.

The decision broadly develops upon the four conditions established by the *Altmark* ruling. We will specifically focus upon the highly disputed question of “reasonable profit”. The decision states that a profit that does not exceed the swap rate plus a premium of 100 basis points is not unreasonable, but as usual, the Commission uses a risk-free investment as a reference. But, such profits become unreasonable when the undertaking providing the public service is not subject to any commercial or contractual risk. In such cases, the reference for determining a reasonable profit is the return on capital employed, return on assets, or return on sales. The Commission does not simply use profit as a criterion in its evaluation, but goes further by stating that States should use the notion of reasonable profit in order to introduce incentive criteria relating to quality of service and gains in efficiency.

Therefore, the exemption from notification, or in other words, the possibility for a Member State to legitimately flout the mechanisms for the review of State aid, is primarily applicable to public service

compensations that do not exceed 15 million Euros *per annum* (except for transport) paid to hospitals, certain social services (such as child services), small seaports and airports.

If the period for which the undertaking is entrusted with the operation of the service of general economic interest exceeds ten years, the company must perform a significant investment that needs to be amortized over a longer period in order for this decision's exemptions to apply.

The decision then details the exigencies regarding costs, since the compensation must equal the costs incurred by the execution of the service of general economic interest plus a reasonable profit. The calculation of such costs is explained in minute detail by this decision, as well as what is considered to be "reasonable profit" (see above).

States must ensure that compensation does not exceed net costs, must not provide any overcompensation, and must be able to prove this to the Commission upon demand. For all compensation in excess of 15 million Euros, States must respect the principle of transparency. It must generally make pertinent information available to the Commission for a period of ten years. Every two years, Member States must submit a report to the Commission regarding the implementation of this Decision.

BRIEF COMMENTARY

One observes a double movement that is accentuated by this decision of December 20, 2011: on one hand, the European Commission has moved towards official recognition of what, in France, is known as a "public service", and at the same time, establishes a regime of tutelage over this concept.

Taking the first aspect, one observes that the decision continues the notion established by the *Altmark* ruling that Member States make their own definitions of what falls under the category of services of general economic interest, and are therefore not subject to the prohibition on State aids, since the absence of notification does not mean that they might not be subject to an inquiry by the Commission. Therefore, States—except as concerns the notion of "manifest error"—remain sovereign in their ability to attribute the qualification of "general economic interest" to various sectors of the economy. As explained by professor Jean-François LaChaume, public service has a long future ahead of it, especially thanks to European law.

But, regarding the second aspect, the European Commission keeps States on a very short leash and because the system is a derogation from the system of free trade, companies that benefit from this mechanism of supervised compensation are liable to be required to prove that the compensation

does not exceed the net costs of providing the public service. This justifies the highly regulatory procedural framework: principle of transparency for all compensations that exceed 15 million Euros, and an obligation to provide information at the Commission's request. Furthermore, the European Commission adopts the capital idea of cost-orientation regarding compensation, which is a constant criteria for making State intervention on markets acceptable, whether it acts as a shareholder or a provider of subsidies.

Even though the principle has been recognized, the Commission maintains a firm right of regard over States. The regime of tutelage persists.