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(SGEI) and universal service obligations  
(USO) as an EU law framework for  
curative health care

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# Services of general economic interest (SGEI) and universal service obligations (USO) as an EU law framework for curative health care

Wolf Sauter\*

## Document summary

Services of general economic interest (SGEI) are a legal category in the EC Treaty that is designed to enable proportionate restrictions on the Treaty's market freedoms (including competition) in so far as necessary to attain legitimate public policy objectives defined (in the first instance) at national level. In principle this concerns those cases where market failures cannot be effectively remedied with market-based solutions. This paper aims to set out the history of the SGEI concept and its legal basis in order to examine the question whether it might provide a useful regime for those hospital services that cannot at present be subjected to full market-based provision – while solidarity based state provision is not an option, or is no longer desirable. The answer to this question is that there is indeed scope for applying SGEI.

Especially since the *Altmark Trans* judgment of the European Court of Justice national governments may be expected to become increasingly proactive in designating SGEI in order to obtain state aid immunity. Universal service obligations (USO) that guarantee universal access are one of the most important examples of the way SGEI are operationalised, for which this paper proposes a structured test. Finally, as regards the proportionality test applied to SGEI this paper suggests that in the absence of Community level standards for SGEI this means testing whether intervention is manifestly disproportionate, whereas in cases where pre-emption by Community legislation has taken place, the least restrictive means test applies.

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## 1. Introduction

This paper aims to discuss the following research question: what is the scope for using the legal concept of services of general economic interest to guarantee the provision of universal service in curative health care (or multi-product hospital care)?

### Article 86(2) as an exception to the Treaty rules for undertakings

The starting point is that Article 86(2) EC provides an exception to (or: exemption from) the Treaty rules in relation to undertakings that have been entrusted with carrying out services of general economic interest. This exception covers both the Member States' authorities which entrust carrying out services of general economic interest to one or more undertakings, and the undertakings concerned. It means that they are exempt from the relevant rules, i.e. these do not apply to them to the extent necessary to carry out their tasks. This mainly, but not exclusively, regards the application of the competition rules (i.e. vis-à-vis the Member States, the market freedoms can also be relevant<sup>1</sup>).

The exception of Article 86(2) EC is especially important because otherwise European law can be characterized 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 instantly 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 and has been the basis for much dissatisfaction with the EU legal framework. 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 Treaty articles being applied to the point where legitimate public interests may be threatened.<sup>2</sup>

Evidently this binary system complicates efforts to introduce competition gradually or partially, while doing so is frequently not only a political necessity but also desirable from the perspective of system stability in a liberalization context (e.g. to offer an adjustment period or transition phase, or to experiment with greater and smaller degrees of market freedom).

Article 86(2) EC offers a way out of this binary system because it allows proportionate restrictions on competition to be imposed to the benefit of undertakings charged with services of general economic interest. It allows a tailor-made solution for each service of general economic interest. In the Netherlands, multi-product hospitals markets are an important example of markets that are presently encumbered with state regulation where the introduction of greater degree of competition is contemplated. This is the reason why Article 86(2) EC is examined here as a possible EU legal framework for multi-product hospitals. Another area where Article 86(2) EC may be relevant is long term care.

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<sup>1</sup> Such as with regard to the free movement of goods and services, and the freedom of establishment. Articles 31 (commercial monopolies) 81 and 82 (prohibitions on cartels and dominance abuse) EC can also be relevant vis-à-vis Member States. Buendia Sierra, 'Chapter 6: Article 86' in J. Faull and A. Nikpay (eds), *The EU law on competition* (Oxford: OUP, 2<sup>nd</sup> ed, 2007), pp 632.

<sup>2</sup> Thus Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* [1993] ECR I-637; Case C-70/95 *Sodemare* [1997] ECR I-3395; and Case T-319/99 *FENIN* [2003] ECR II-357, the solidarity element prevailed. The opposite occurred in e.g. Case C-328/94 *FFSA* [1995] ECR I-6025 and Case C-67/96 *Albany* [1999] ECR I-5751; Joined Cases C-115/97, C-116/97, C-117/97 and C-219/97 *Brentjens* [1999] ECR I-6025; and Case C-219/97 *Drijvende Bokken* [1999] ECR I-6121.

### Research question in detail

In greater detail, the research question addressed in this paper is as follows:

Does the Community law concept of services of general economic interest form a possible and appropriate legal framework for those parts of multi-product hospital care in The Netherlands that are deemed:

- of general public interest (e.g. 'universal service'), and
- not suitable for competitive provision (i.e. subject to market failure)?

It should be noted that, so far, the debate on services of general economic interest is not clearly focused in economic terms, notably regarding the use of the market failure concept. However both the incidence of services of general economic interest and the proportionality of the solutions found could usefully be couched in economic terms.

Hence, an additional research question could be whether standard economic reasoning on market failure could be applied to determine the scope or services of general economic interest, and whether in this case the outcomes obtained might differ from those of the existing process. This question will only be addressed briefly, as a possible precursor to further inquiry.

### Scope

The scope of the discussion in this paper is the relevant EU law on competition, free movement, state aid and public procurement. National law is not examined in any detail at this stage, but may be taken up in future. Likewise it may be decided to broaden this paper horizontally, for example by extending it to cover long term care.

### Structure

The structure of this paper is as follows: after this introduction, first, the general scope of Article 86(2) will be discussed; second, the debate on services of general economic interest is described; third, various definition issues including that of universal service, will be addressed, as well as the link with market failure; fourth, the scope of the Article 86(2) EC derogation notably including proportionality; fifth, public service compensation and state aid are discussed; sixth, this framework will be applied to the multi-product hospital sector, and finally, some conclusions are drawn.

## **2. The legal basis and basic purpose of Article 86(2)**

### **2.1. Legal basis**

Services of general economic interest (SGEI) find their legal basis in Articles 16 and 86(2) of the EC Treaty itself, as well as in Article 36 of the Charter on fundamental rights. These provisions will be discussed briefly here.

#### Article 86 EC

Article 86 of the EC Treaty – as originally introduced in the 1957 Rome Treaty on the outset of the European Economic Community – provides a special regime for public monopolies, and for undertakings granted 'special and exclusive rights' by the Member States, in respect to 'the rules contained in the Treaty'.

Within the context of Article 86 EC, Article 86(2) of the EC Treaty provides a special rule for '*services of general economic interest*' (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.

The 86(2) EC exception is not specified or limited (in Article 86 EC or elsewhere) in the Treaty.

While it is possible for the Commission to set out its own interpretation of Article 86(2) EC in greater detail by means of Commission Decisions or Directives based on Article 86(3) EC, this possibility has rarely been used. An important reason for the Commission's reticence is that the European Parliament and Council object to the use of these instruments, which allow the Commission to 'legislate' single-handedly. Parliament and Council see this as lacking in democratic legitimacy, which is perceived as undesirable given the general 'democratic deficit' of the EU. The European Parliament in particular favours instruments adopted on the basis of 'co-decision', which give it a role equivalent to that of the Council. The call for a Framework Directive adopted on the basis of co-decision therefore also addresses a situation that is unsatisfactory for the European Parliament from an institutional point of view. The Commission tries to accommodate these concerns by consulting the European Parliament informally on draft horizontal measures based on Article 86(3) EC.

#### Article 16 EC

Thirty years after Article 86 was introduced in the EEC Treaty, a new Article 16 EC on services of general economic interest was introduced by the Amsterdam Treaty 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 services of general economic interest 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 Article 86(2) EC.

The ambiguity of Article 16 EC may further increase due to the following addition, that was proposed by the European Convention in Article III-122 of the proposed Constitutional Treaty, which otherwise repeats Article 16 EC:

European laws shall define these principles and set these conditions without prejudice to the competence of the Member States, in compliance with the Constitution, to provide, to commission and to fund such services.

It is not clear who will adopt these laws, the Commission based on Article 86(3) EC<sup>3</sup> – with the drawbacks from a democratic perspective mentioned above – or the European Parliament and Council based on Article 95 EC, or a combination of both. Perhaps this provision will eventually be used as (part of) the legal basis for a future Framework Directive on services of general economic interest (i.e. if there is

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<sup>3</sup> Article 86 EC is renumbered Article I-166 by the proposed Constitutional Treaty.

sufficient political support for this among the Member States and in the European Parliament).<sup>4</sup>

In addition, an interpretative protocol will be added to Article 16 Protocol on services of general interest in the upcoming review of the Treaty after the failure of the Constitutional 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.<sup>5</sup>

This protocol appears to add little of substance as regards services of general economic interest themselves, other than highlighting once again the topicality of this issue and the deep concerns held by the Member States that something essential may slip from their control. 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 services of general economic interest. The provision on 'non-economic services of general interest', 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.

#### Article 36 Charter on Fundamental Rights

Meanwhile, the concept of services of general economic interest has likewise found its way into Article 36 of the Charter on Fundamental Rights, 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.

Substantively these provisions add little if anything at all to Article 86 EC or to the case law of the Court on this provision. Hence, the remainder of this paper will not address Article 16 EC Treaty or Article 36 of the Charter on Fundamental Rights, but will be limited to Article 86 EC. First we will examine its role and structure.

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<sup>4</sup> 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.

<sup>5</sup> Presidency Conclusions of the Brussels European Council of 21/22 June 2007.

## 2.2. The role and structure of Article 86 EC

Article 86 EC provides a special regime not only for undertakings entrusted with providing services of general economic interest, which may be public monopolies, but also more generally for undertakings granted 'special and exclusive rights' by the Member States, with respect to 'the rules contained in the Treaty'. It should be noted that this exception covers all Treaty rules, i.e. not only ('in particular') the free movement and the competition rules, but also the rules on e.g. state aid and public procurement.

Consequently, Article 86 EC is a key provision concerning the distinction between the public and the private spheres in EU law. It is structured as follows:

- Article 86(1) EC formulates the general rule prohibiting the Member States from taking, concerning public undertakings or undertakings enjoying special and/or exclusive rights, any measures contrary to the rules contained in the Treaty. These treaty rules are further specified as the anti-discrimination provisions of Articles 28 and 49 (i.e. free movement), the competition rules, and the rules on state aids.
- Article 86(2) provides a limited derogation from this general rule for services of a general economic interest and revenue-producing monopolies. This exception is limited to cases where the rules of the Treaty, in particular the free movement and competition rules, would obstruct such enterprises in the performance of their public interest tasks, and where state measures involved do not encroach on the Community interest – i.e. repeating the familiar EU law requirements of necessity and proportionality.
- Under Article 86(3) EC the Commission is empowered to enforce the prohibition in Article 86(1) and the application of Article 86(2) EC by way of Directives and Decisions. As is the case for Article 86 EC itself, such Article 86(3) EC Directives are addressed to the Member States, not to undertakings directly (an undertaking charged with infringing Article 82 EC for example, could however invoke the applicability of Article 86(2) EC in its defence).<sup>6</sup>

Article 86 EC is addressed to the Member States, not to undertakings directly. In summary, it prohibits the Member States from taking, in relation to the specific categories of undertakings mentioned above, any measures contrary to the Treaty, with a limited exception for services of general economic interest. The application of both the general rule and its exception are subject to Commission supervision. As such, Article 86 EC is also an elaboration of the principle of Community 'good faith' set out in Article 10 EC (*effet utile*) that has led to extensive case law on market interventions by the Member States (but will not be discussed here).

So far there are few examples of horizontal measures based on Article 86 EC. These are:

- Rules on financial transparency of public undertakings (dating back to 1980)<sup>7</sup>
- Rules on public service compensation (of 2005, twenty-five years later).<sup>8</sup>

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<sup>6</sup> The provisions of Article 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 Article 12 and Articles 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 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.

<sup>7</sup> Now codified in: Commission Directive 2006/111/EC of 16 November 2006 on the Transparency of Financial Relations between Member States and Public Undertakings as well as on Financial Transparency within certain Undertakings, OJ 2006 L318/17.

Apart from this there are only sectoral rules regarding services of general economic interest in various network sectors which (apart from those relating to the telecommunications sector<sup>9</sup>) are not based on Article 86. These will be discussed in section 4.3. below. As mentioned above however, if Article III-122 of the Proposed Constitutional Treaty (ever) enters into force it may eventually be used as an additional legal basis for a Framework Directive on services of general economic interest.

In the proposed Constitutional Treaty Article 86 EC is renumbered Article I-166, without changes apart from the fact that the Commission would henceforth be able to adopt *Regulations* instead of *Directives*. Because Regulations are directly binding and do not require implementing legislation at national level this means the Commission's legislative powers with regard to services of general interest (and special and exclusive rights) would actually be strengthened. This is remarkable considering the long standing objections held by the European Parliament and the Council against Commission legislation based on Article 86(3) EC that were already mentioned above.<sup>10</sup>

### **3. The debate on services of general economic interest**

#### **3.1. Scope of the debate**

A number of landmark decisions by the Court of Justice in the telecommunications sector in the 1990s sparked a debate on Article 86 EC. In these cases, brought by a number of Member States against the Commission, the Court accepted that the Commission could abolish exclusive and special rights in this sector by means of Commission Directives.<sup>11</sup> Proponents of state intervention subsequently felt strengthened by further cases such as *Corbeau* (where the Court found that exclusive rights and cross-subsidies between various activities could be acceptable in the context of ensuring the financial stability of a universal service system for postal services). They sought to broaden the scope for public interest exception in Article 86(2) EC respectively to limit the Commission's powers in order to be able to continue to intervene in 'key' economic sectors without Community intervention based on breaches of the Treaty.<sup>12</sup>

In this debate, parties fearing liberalization and privatization based on EU law campaigned to give the '*service public*' a sound basis in the Treaty itself. Often, France was the standard-bearer for such efforts. However, the Commission appears to have been successful in drowning its opposition in a decade-long consultation exercise generating a series of papers that might charitably be defined as 'harmless'.<sup>13</sup> Although the *service public* concept was eventually written into the new Article 16 EC on services of general economic interest of the Amsterdam Treaty cited above, this was done in a manner involving no substantive changes to Article 86 EC,

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<sup>8</sup> Community framework for State aid in the form of public service compensation, OJ 2005 C297/04; and Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ 2005 C312/67.

<sup>9</sup> Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communications networks and services OJ 2002 L249/21

<sup>10</sup> It remains contested whether or not Article 80(3) EC Directives should be considered legislation, rather than an authoritative interpretation of the Treaty by the Commission.

<sup>11</sup> Case C-202/88 *Terminal Directive* [1991] ECR I-1223; Joined cases C-271/90, C-281/90 and C-289/90 *Services Directive* [1992] ECR I-5833

<sup>12</sup> Case C-320/91 *Procureur du Roi v Paul Corbeau (Corbeau)* [1993] ECR I-2533.

<sup>13</sup> Cf the barrage of communications from the Commission: *Services of general interest in Europe*, OJ 1996 C281/3; *Services of general interest in Europe*, OJ 2001 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.

and which was characterized in the French senate as a mere 'consolation prize'.<sup>14</sup> Equally harmlessly, the *service public* concept has found its way into Article 36 of the Charter on Fundamental Rights (likewise cited above).<sup>15</sup>

As mentioned, the ambiguity of Article 16 was enhanced by the addition that was proposed by the European Convention in Article III-122 of the proposed Constitutional Treaty: 'European laws shall define these principles and conditions'. According to the White paper on services of general interest (White Paper) 'this provision will provide an additional legal basis for Community action in the field of services of general economic interest, within the powers of the Union and within the scope of application of the Constitution.'<sup>16</sup>

The White Paper also states, in the context of the question whether a Framework Directive on services of general (economic) interest is needed, that this question will only be examined once the Proposed Constitutional Treaty enters into force. In the absence of such a Framework Directive it should be noted that apart from the Treaty provision on Article 86(2) EC itself at present no specific legal instruments beyond the Electronic Communications and Transparency Directives, and the public service compensation framework (Notice and Decision) exist. In other words the field is still very much open, and the debate so far has produced very little apart from underlining the importance of Article 86(2) EC.

One outcome of the debate has been that, in addition to services of general economic interest and services of general interest, the 'social service of general interest' has been identified, in spite of the fact that 'under Community law, social services do not constitute a legally distinct category of service within services of general interest'.<sup>17</sup> Although there is a large number of services that might qualify as a social service of general interest the question what they would then qualify for has been wisely left open. Because they were specifically excluded from the Services Directive<sup>18</sup> which gave rise to the discussion on social services of general interest, health services are not covered by this concept (although long term care is) and are instead subject to a separate Commission consultation process.<sup>19</sup> Social services of general interest will therefore not be discussed any further here.

In substance then, there is no relevant change: the entire public debate on services of general economic interest can be seen as a holding exercise by the Commission, intended to diffuse political tension on this topic, without having had much of an impact on the scope or meaning of services of general economic interest. A benefit of this outcome is that the Treaty, and EU law, have not been saddled with a far-reaching *service public* clause that could cripple future liberalization efforts e.g. in

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<sup>14</sup> *Rapport d'information fait au nom de la délégation pour l'Union européenne sur les services d'intérêt général en Europe* (No. 82, 2000-2001 of November 2000, rapporteur Hubert Haenel), at 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 169ff, at 177.

<sup>15</sup> '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'.

<sup>16</sup> *White paper on services of general interest*, COM(2004) 374 final, page 6.

<sup>17</sup> COM(2006) 177, *Implementing the Community Lisbon programme: social services of general interest in the European Union*, page 4. The specific characteristics of such social services of general economic interest are listed as including one or more of the following: they operate on the basis of solidarity, in particular by the non-selection of risks or the absence, of equivalence between individual contributions and benefits; they are comprehensive and integrate the response to differing needs; they are not for profit; they include the participation of voluntary workers; they are strongly rooted in (local) cultural traditions; an asymmetric relationship between providers and beneficiaries exists that requires third party financing.

<sup>18</sup> Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, OJ 2006, L376/36, article 2f: 'This Directive shall not apply to: (...) healthcare services whether or not they are provided via healthcare facilities and regardless of the ways in which they are organized and financed at national level or whether they are public or private'.

<sup>19</sup> *Consultation regarding Community action on health services*, SEC(2006) 1195/4.

network sectors or the social sphere. The drawback of this limited outcome is that certain basic elements like definitions, the purpose of services of general economic interest, and the nature of the proportionality test remain hazy.

Before examining the relevant concepts and definitions in further detail the position on services of general economic interest of the main actors involved is briefly restated.

### **3.2. Position on services of general economic interest of the main actors**

Broadly speaking three (types of) institutional actors have developed sometimes contrasting positions on the subject of services of general economic interest.

Commission: The Commission has been engaged in a drawn out consultation process over the past ten years concerning services of general economic interest, initially concerning services of general economic interest as such, then on services of general interest in the context of the Lisbon program, and finally on social services of general interest in the context of the proposed Constitutional Treaty. As mentioned above this was essentially a containment exercise, i.e. a defensive approach designed to forestall any weakening of the Commission's position and/or of Article 86 EC more broadly. More recently, the role of the Commission has become more pro-active:

- by including in Article III-122 of the Draft Constitution an additional legal basis for Community action in the area of services of general economic interest and in article III-166 the possibility of Commission Regulations instead of Directives
- by adopting a Community framework based on a Commission Notice and a Commission Decision in the area of public service compensation and state aid, following innovative case law by the Court of Justice (*Altmark Trans*).<sup>20</sup>

It appears that the Commission would be interested in enacting or sponsoring a General Framework Directive on services of general economic interest but is waiting for adoption and entry into force of the (revised) proposed Constitutional Treaty before making its move.

Member States: The Member States, in most cases led by France,<sup>21</sup> have likewise approached services of general economic interest defensively, albeit from the opposite side: they have invoked the concept as a competition defence in individual cases while trying to construct alternative concept such as *service public* that would provide, in their view, even better cover for state intervention in the market process. When discussing the proposed Constitutional Treaty however, they failed to agree on curtailing the scope of Article 86(2) EC and settled for ambiguous wording that added nothing much that was relevant to the text.

Because the Commission appears to have been successful in its attempt to keep Article 86(2) EC afloat, now may be the time for the Member States to adopt a more pro-active approach and to develop more systematic ideas about services of general economic interest at national level. This concept after all might be useful to shield certain services from competition, in so far as justified (i.e. necessary) in order to carry out a legitimate public service task. It can therefore be a useful tool for a process of managed liberalization e.g. to help contain escalating costs in the social sphere regarding sectors such as healthcare and/or pensions that are no longer affordable as state-run systems.

The Court of Justice: The Court can be said to have constructed a system that allows the Member States the freedom to intervene on behalf of services of general

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<sup>20</sup> Case C-280/00 *Altmark Trans* [2003] ECR I-7747.

<sup>21</sup> Although, embarrassingly, the *service public* idea resurfaced as one of the 'key' objectives of The Netherlands in negotiating a revised (Constitutional) Treaty. It is not clear yet whether this was mere shortsighted pandering to French prejudices or whether there is more behind it.

economic interest, even to the point of creating or maintaining monopolies, albeit subject to a non-discrimination and proportionality test.

Its recent case-law on public service compensation greatly increases the significance of the Article 86(2) EC exception while stressing the need for a formal act of entrustment in order to benefit from this privileged regime. In other words it appears to set out some decisive markers on the requirements to be met while sweetening the package by offering a safe haven from the state aid regime. Arguably this has changed the incentive structure for the Member States, although they may be slow to realize this, continuing (as recently in the Dutch position on changes needed to the proposed Constitutional Treaty that led to the protocol that will be annexed to Article 16 in the impending Treaty revision and was discussed in section 2.1. above) to propose primitive carve-outs from the Treaty regime that lack any precedent, broader legal basis or economic rationale.

#### **4. Definition issues**

##### **4.1. Overlapping and incomplete definitions**

It should not come as a surprise that, as the outcome of a consultation process that was arguably not even intended to produce clear results, the definitions and use of concepts in this area are muddy. For example, the White paper on services of general interest (White Paper) states:

Services of general interest are at the core of the political debate. Indeed they touch on the central question of the role public authorities play in a market economy, in ensuring, on the one hand, the smooth functioning of the market and compliance with the rules of the game by all actors and, on the other hand, safeguarding the general interest, in particular the satisfaction of citizens' essential needs and the preservation of public goods where the market fails.<sup>22</sup>

And:

The debate on the Green Paper has strongly confirmed the importance of services of general interest as one of the pillars of the European model of society. (...) It has also confirmed the existence of a common concept of services of general interest in the Union. This concept reflects Community values and goals and is based on a set of common elements, including: universal service, continuity, quality of service, affordability, as well as user and consumer protection.<sup>23</sup>

It does not immediately inspire great confidence that services of general interest are here declared to constitute no less than a pillar of the European model while this category ('services of general interest') is as such non-existent in EU law. However, this term was apparently devised to be able to discuss the implications of the fact that the Treaty's internal market and competition rules cover only economic activities. In the course of the debate on article 86 at least four different partially overlapping concepts have played a role:

- services of general economic interest;
- universal service (obligations);
- services of general interest;
- social services of general interest.<sup>24</sup>

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<sup>22</sup> *Green paper on services of general interest*, COM(2003) 270 final, p 3.

<sup>23</sup> *White paper on services of general interest*, COM(2004) 374 final, page 4.

<sup>24</sup> *Services of general interest in Europe*, OJ 1996 C281/3; *Services of general interest in Europe*, OJ 2001 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*

### Focus on services of general economic interest and universal service obligations

Because there are no formal or generally accepted definitions of these concepts their mutual demarcation is tricky. For example:

- There is no standard definition of services of general economic interest in the Treaty or in secondary legislation<sup>25</sup> but it is an EU law concept that appears in the Treaty. Descriptions of services of general economic interest provided by the Commission overlap with those of universal service.
- There is no standard definition of universal service (obligations) and it does not appear in the Treaty but universal service obligations have been specified in secondary sectoral legislation, notably for telecommunications (and posts). Moreover, the concept is applied (but not under this name) in other network sectors, in particular transport and energy.
- There are no standard definitions of services of general interest or of social services or general interest and it would not matter much if there were, as they are not EU law concepts but were introduced to facilitate and defuse the debate on services of general economic interest. They are thought to overlap at least in large part with services of general economic interest.

Only services of general economic interest and universal service obligations are EU legal concepts. Moreover, health services (or at least curative care, notably hospital services) have in any event been excluded from the scope of (social) services of general interest. Therefore, the focus of this paper will be on the former two, i.e. services of general economic interest and universal service.

#### **4.2. The lack of a definition of services of general economic interest**

Another way of looking at the absence of a definition is that the definition of services of general economic interest itself was left open because the EC Treaty gives the Member States a wide freedom to define missions of general economic interest and to establish the organizational principles of the services intended to accomplish them. This interpretation is plausible also given that successive (proposed) amendments of the Treaty have not come up with a definition.

Another reason why there is no list of services of general economic interest, or of services that are not, is that the concept of services of general economic interest is a dynamic one. Perceptions of what such services comprise, or what they do not, vary between time and place.<sup>26</sup> Thus, according to the Commission's the Green paper on services of general interest (Green Paper):

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'.<sup>27</sup>

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*interest*, COM(2004) 374 final; *Implementing the Community Lisbon programme: Social services of general interest in the European Union*, COM(2006) 177 final

<sup>25</sup> *White paper on services of general interest*, COM(2004) 374 final, page 7.

<sup>26</sup> 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: 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; basis 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* (Oxford: OUP, 2<sup>nd</sup> ed, 2007), pp 629-630.

<sup>27</sup> *Green paper on services of general interest* COM(2003) 270 final, page 14.

Because the concept of services of general economic interest is a fluid one, providing a list of such services is not very useful. Nevertheless there are several descriptions of key elements of services of general economic interest that are useful. For example, the Green Paper listed the following as common elements of a Community concept of services of general economic interest:

(...) in particular: universal service, continuity, quality of service, affordability, as well as user and consumer protection.<sup>28</sup>

According to the White Paper services of general economic interest mean the following:

(...) in 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).<sup>29</sup>

Here the link between services of general economic interest and specific public service obligations is worth noting. Territorial coverage obligations are also mentioned frequently. It should be noted that all of these factors are also mentioned in relation to universal service, raising the question what the relationship between universal service and services of general economic interest is.<sup>30</sup> This will be discussed in greater detail below.

The Member States' freedom to designate services of general economic interest is almost absolute up until the moment pre-emption occurs, i.e. the point where the relevant services are defined by Community legislation, based either on Article 95 EC harmonization measures or on Article 86(3) EC Commission Decisions or Directives, or both. Until that time the Commission merely checks the definition of services of general economic interest for 'manifest error'. The Community element is introduced only at the level of the proportionality test of the measures concerned. Hence, pre-emption and proportionality are two important categories therefore that will likewise be discussed further below.

First however 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.

#### 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 service of general economic interest where there was none previously).<sup>31</sup>

The Court has made this absolutely clear with regard to public service compensation, where in order to be classified as not constituting state aid the compensation in question has to be paid to an entity formally entrusted with services of general economic interest.<sup>32</sup> The act of entrustment should involve a clearly identified addressee as well as clearly defined obligations based on objective and transparent

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<sup>28</sup> *Green paper on services of general interest* COM(2003) 270 final, page 15.

<sup>29</sup> *White paper on services of general interest*, COM(2004) 374 final, page 7.

<sup>30</sup> Cf. Case C-266/96 *Corsica Ferries France* [1998] ECR I-3949, paras 44-47 which suggest universal service obligations are coextensive with services of general economic interest.

<sup>31</sup> Cf. Cases T-204 and 270/97 *EPAC* [2000] ECR II-2267, paras 125-128 and the references there.

<sup>32</sup> Case C-280/00 *Altmark Trans* [2003] ECR I-7747; *Community framework for State aid in the form of public service compensation*, OJ 2005 C297/04; and *Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest*, OJ 2005 C312/67

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.<sup>33</sup> 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 solutions that are not market-based are likely to require public funding of some sort. Nevertheless, it is clear that an explicit measure of entrustment as a constitutive legal act is highly desirable in any event. This is so not just to build up a file for the defence (as has frequently been the focus of Member States so far), but also in order to have a sound basis for the proportionality test that the services of general economic interest 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 services of general economic interest 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.<sup>34</sup> 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 *by means of obligations and constraints which they impose on such undertakings* (emphasis added).<sup>35</sup>

This does not however constitute '*carte blanche*' for the Member States, as the services of general economic interest concerned must somehow be separated from other economic activities.<sup>36</sup> 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.

### **4.3. The definition of universal service**

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

(...) to guarantee access for everyone, whatever the economic, social or geographic situation, to a service of a specified quality at an affordable price<sup>37</sup>

Slightly different descriptions are:

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<sup>33</sup> Case C-280/00 *Altmark Trans* [2003] ECR I-7747, paras 89-93.

<sup>34</sup> Risk equalization decisions concerning Ireland and the Netherlands. Aid measure N46/2003 Risk equalization system – Ireland; Aid measures N 541/2004 and N 542/2004 Financial reserves and risk equalization system – The Netherlands. In The Netherlands, as a matter of national law relating to services of general economic interest in the context of the cartel prohibition in Article 11, the prohibition of dominance abuse in Article 25 and the context of merger control, Article 41(3) of the Competition Act, in the absence of a formal legal act, it is possible, in highly exceptional circumstances to derive the existence of a service of general economic interest from 'a conglomerate of rules, agreements and decisions'. Kamerstukken II 1995/96, 20 707. nr 3, p 64.

<sup>35</sup> Case 157/94 *CommissioN/Netherlands* [1997] ECR I-5699, para 40.

<sup>36</sup> *State aid cases N541/2004 and N542/2004*, page 27, with reference to Case C-179/90 *Porto di Genova* [1991] ECR I-5889.

<sup>37</sup> *Green paper on services of general interest*, COM(2003) 270 final, page 4.

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.<sup>38</sup>

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'.<sup>39</sup>

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 mentioned alongside universal service as objectives of public policy in their own right.<sup>40</sup> Likewise the common elements of services of general interest cited above include: 'universal service, continuity, quality of service, affordability, as well as user and consumer protection'.<sup>41</sup> Again, universal service is juxtaposed along public policy objectives that it might well be judged to include.

The clearest definition 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.<sup>42</sup>

This clarification of universal service as a universal right for consumers 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.

However there is again partial overlap (affordability) with values that are elsewhere presented as possible public policy objectives in their own right. Based on the texts available so it therefore remains 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, fail to provide a specific level of quality (as imposing full national coverage for free at zero quality would be pointless).

However universal service and services of general economic interest do not fully coincide. The concept of services of general economic interest is broader, and may include other values, beside those set out in universal service obligations.

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. The three core public policy values for healthcare in The Netherlands, quality, affordability and accessibility, would fit very well with such a concept of universal service albeit that in the context of imposing universal service obligations to be met by particular

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<sup>38</sup> *Green paper on services of general interest*, COM(2003) 270 final, , page 16, with reference to Article 3(1) of Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), OJ L108/51.

<sup>39</sup> *Green paper on services of general interest* COM(2003) 270 final, p 16.

<sup>40</sup> *Green paper on services of general interest* COM(2003) 270 final, pp 16-19.

<sup>41</sup> *White paper on services of general interest*, COM(2004) 374 final , page 4.

<sup>42</sup> *White paper on services of general interest*, COM(2004) 374 final , page 8 (emphasis added).

undertakings, they would need to be specified at a particular level, i.e. as a deliverable.

Universal service is further described as both a flexible and a dynamic concept, the basic principles of which are to be defined at Community level, which can subsequently be implemented by the Member States.<sup>43</sup> In a liberalization setting based on Community legal instruments (such as in telecommunications and posts) this may well be appropriate, but it can scarcely be the model where Community legal instruments regulating liberalization are absent – as is presently the case in healthcare. In summary: the existing reasoning on universal service obligations is incomplete and not always clear. On the bright side, this means that there is room for a national interpretation of these obligations, much like there is for services of general economic interest in general.

It should also be noted that despite the conceptual haziness described above defining universal service obligations in telecommunications and posts, and having de facto universal obligations in energy has proven of the greatest importance in enabling the liberalization of these services: once the main public policy concerns were tackled in this manner, the road to liberalizing the remainder of the relevant service was opened. In The Netherlands the situation concerning healthcare is similar (albeit that a broad national consensus on the need for liberalization already exists in the absence of EU law or policy on this point) in that here too basic public policy concerns must be addressed in relation to services not deemed fit for liberalization on public policy grounds as a precondition for further liberalization of services for which competitive provision is feasible.

Because services of general economic interest and universal service obligations are the key relevant EU law categories their interrelationship will be examined further in the next paragraph.

## **5. Services of general economic interest, universal service obligations and market failure**

This brief section is dedicated to formulating some proposals on how to link the concepts of services of general economic interest, universal service and market failure. The starting point is the manner in which universal service has so far in practice been defined at EU level.

### **5.1. Examples of universal service defined at EU level**

So far there is only a handful of sectors – mainly concerning networked industries – where universal service has been defined at Community level.

Natural Gas: Article 3 of the Directive on common rules for the internal market in natural gas (Gas Directive) does not use the word universal service but deals with public service obligations and consumer protection.<sup>44</sup> It allows Member States to impose on gas operators in the general economic interest, public service obligations which may relate to security, including security of supply, regularity, quality and price of supplies and environmental protection, including energy efficiency and climate protection. In addition they may take appropriate measures to protect customers in remote areas, and may appoint a supplier of last resort. In addition the Member States may claim exemption from certain provisions in the Gas Directive to the extent that their application would obstruct the services of general economic interest concerned.

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<sup>43</sup> *Green paper on services of general interest* COM(2003) 270 final, p 16.

<sup>44</sup> Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ 2003, L176/57.

Electricity: Article 3 of Directive on common rules for the internal market in electricity (Electricity Directive) provides for an exception for services of general economic interest in much the same language.<sup>45</sup> In this case however it is explicitly provided that the Member States shall ensure a universal service<sup>46</sup> in relation to all household customers and where appropriate, small and medium sized enterprises, including the possibility to appoint a supplier of last resort and to impose an obligation to provide connection according to specified terms. Additional consumer protection measures and an exemption from certain provisions in the Electricity Directive to the extent that their application would obstruct the services of general economic interest concerned are also provided.

Postal Services: Chapter 2 of the Directive on common rules for the internal market in postal services (Postal Directive) is dedicated to extensive rules governing universal service in the postal service.<sup>47</sup> Defined as 'the permanent provision of a postal service of specified quality at all points in the territory at affordable prices for all users' the universal service obligations concerned are specified in great detail in the Directive as minimum norms to be met. The expression 'services of general economic interest' is not used as such, nor are such services addressed apart from universal service: i.e. no services of general economic interest other than universal service are covered. 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.<sup>48</sup>

Electronic Communications: The entire Directive on universal service and users' rights relating to electronic communications (Universal Service Directive) is dedicated to universal service and users rights in this field.<sup>49</sup> Member States must ensure that services covered by the Universal Service Directive are 'made available at the quality specified to all end-users in their territory, independently of geographical location and, in the light of specific national conditions, at an affordable price'. This covers access at a fixed location, directory enquiry services and directories, public pay telephones and special measures for disabled users and a minimum set of leased lines. Member States may designate one or more undertakings to guarantee the provision of universal service and detailed rules on the compensation for universal service tasks are provided. No services of general economic interest other than universal service are covered.

From these examples it may be surmised that, at least where services of general economic interest have so far been defined at Community level:

- Within the context of services of general economic interest other types of public service obligations can and do exist alongside universal service obligations;
- universal service obligations may be imposed either on all undertakings active in the market, or on a limited number of operators (provider of last resort)
- services of general economic interest and universal service obligations in particular have been a highly useful tool in achieving a working consensus underpinning the liberalisation of the bulk of the network sectors concerned.

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<sup>45</sup> Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ 2003, L176/37.

<sup>46</sup> 'That is the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices'.

<sup>47</sup> Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service, OJ 1998, L15/24.

<sup>48</sup> Proposal for a Directive of the European Parliament and of the Council amending Directive 97/67/EC concerning the full accomplishment of the internal market of Community postal services, COM(2006) 594 final.

<sup>49</sup> Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), OJ 2002, L108/51.

## **5.2. Services of general economic interest in relation to universal service obligations**

The above section on definitions leaves a number of questions on the relationship between service of general economic interest and universal service (obligations) unanswered that will be addressed here:

- What is the scope of a service of general economic interest in relation to the scope of universal service, or universal service obligations? Do they overlap or coincide?
- Can one exist without the other? Are they different in scope and content and if so, how?
- How are they applied, c.q. imposed?

Given the absence of a definition and a legal framework for services of general economic interest (such as a Framework Directive may provide in future) 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 application of the Treaty are held necessary in order for the tasks concerned to be performed (with possibly some related services – as ancillary restraints – necessary to make public service provision feasible or affordable).

Likewise it is not quite clear what the role of universal service or universal service obligations should be in this context.

### Proportionality

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

That is to say, in principle it would appear more in line with proportionality to limit the application of the services of general economic interest 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 service of general economic interest to provide those services, in the sense that these services 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 therefore fail the proportionality standard included in Article 86(2) EC.

Approaching this issue from the other end, e.g. starting from sectors where governmental intervention takes place in the public interest as a whole would mean embracing practically all current areas of public policy without any clarity in advance on the question whether meaningful restrictions would be involved that actually require resorting to Article 86(2) EC. It is also unlikely that in this case a proper discussion would take place on the proportionality of the restrictions on competition that would be necessary (proportional) to ensure they would meet the Article 86(2) EC standards. This is therefore not a workable alternative.

This issue is further complicated by the role of universal service obligations. Arguably these should coincide with services of general economic interest to the extent that they constitute the deliverables which form the objective of entrusting an undertaking with carrying out a service of general economic interest, and any restrictions necessary are necessary in order for the undertaking concerned to be able to carry out its universal service obligation based on a stable economic footing. In other words the service of general economic interest would then constitute the provision of universal service plus, conceivably, those non-universal service elements of the service necessary to enable its provision (ancillary restraints) or to make this provision affordable (funding regime).<sup>50</sup>

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<sup>50</sup> It is sometimes held that other types of services of general interest than universal service are conceivable. In the absence of concrete examples this further distinction is not used here. Buendia Sierra,

However, at least in theory, the concept of services of general economic interest can cover public service obligations that are not universal service obligations in that they are in the general interest but not linked to territorial coverage (security of supply – and continuity – are examples of this).

#### Public service compensation

Apart from proportionality another anchor point is the act of entrustment required by the Court to keep public service compensation out of the realm of state aid that will be discussed in greater detail in a separate section below (*Altmark Trans*).

The link between formal entrustment and an Article 86(2) EC exemption from the state aid regime for public service compensation suggests that the Court supports the coincidence or concurrence between services of general economic interest and universal service (obligations). Obviously, the most suitable time to undertake this formal entrustment process would be a liberalization context when certain (parts of) services break out of the solidarity-based vertically integrated state provision, so the market freedoms and competition rules become relevant. Coincidence does not mean that a service of general economic interest must fully correspond with a universal service obligation: it may do so, but may also cover additional elements.

### **5.3. Services of general economic interest and market failure**

When deciding on the scope of services of general economic interest and universal service obligations the concept of market failure (and/or government failure) is a logical starting point: after all it is only in those cases that 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 public interest.<sup>51</sup> It is submitted 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)<sup>52</sup> that is required to successfully invoke the EU law concepts of services of general economic interest and universal service.<sup>53</sup>

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 and to compensate them. Intervention should be objective, transparent, non-discriminatory and proportionate. This will ensure both legitimacy (rule of law) and overall welfare (social dimension).

Remarkably enough so far the definition of services of general economic interest under Community law has not systematically or explicitly been connected with instances of 'market failure'.<sup>54</sup> At the same time there is ample discussion of the proportionality of services of general economic interest: it therefore appears logical

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<sup>51</sup>Chapter 6: Article 86' in J. Faull and A. Nikpay (eds), *The EU law on competition* (Oxford: OUP, 2<sup>nd</sup> ed, 2007), pp 642-643.

<sup>51</sup> 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.

<sup>52</sup> 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.

<sup>53</sup> The concept only becomes relevant in EU law terms when a Member State invokes Article 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.

<sup>54</sup> Cf. however J.W. 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', 33 *Legal Issues of European Integration* 2006, pp 105-137.

to introduce the concept of market failure and the consequences thereof as a guiding principle in formulating the scope of services of general economic interest.<sup>55</sup> If market forces left to themselves would suffice to provide the public good at stake there is little point in intervening.

For example in health care *insurance* markets two types of market failure are commonly said to exist:

- Adverse selection: whereby insurers compete on the risk profile of their customers, seeking to attract lower-risk consumers, rather than on the provision of services;
- Information asymmetry: which means that providers of health care have much better information about the need and scope for treatment, and the quality of services provided than consumers and insurers. At the same time consumers have better information about their own behaviour than the insurers who act as third party payers. This leads to:
  - Producer moral hazard: the problem that producers provide too much production (more than is efficient and socially desirable) and/or too little (less than is efficient and socially desirable), of the wrong kind, at quality levels that are too low and price levels that are too high;
  - Consumer moral hazard: the problem that third party payments (by insurers) may lead consumers to consume more health services than they would if they would have to finance these services directly.

In The Netherlands, these market failures have been addressed by mandatory universal health insurance, a prohibition on risk selection and on premium-differentiation backed up by a risk-equalization fund (risk pooling and risk-adjusted transfer payments), an obligation on insurers to contract for adequate levels of care, and efforts to improve stock-taking, availability and exchange of quality data. Government intervention in other words has served to ensure that the relevant public good – universal affordable healthcare insurance coverage – was attained. According to the Commission, the sum of the measures concerned corresponds to entrusting the health insurers with a service of general economic interest.<sup>56</sup>

Asymmetric information as well as problems of moral hazard, adverse selection and agency problems (when providers of health services oversell) are present in health care markets other than health insurance. Some of these problems can in large part be resolved by means of market-based solutions.

For example consumers of healthcare are uncertain and have asymmetric information compared to the providers of health services. They are unaware if and when they will fall ill (stochastic demand), which types of health care and how much of these they need and where to buy them (idiosyncratic preferences, costly search and coordination) and whether a treatment will be or has been effective (experience and credence good). However consumers don't usually shop directly for health care but act through secondary markets or intermediaries, with insurers absorbing the risk of uncertain demand, primary care physicians aiding consumers in their search for health services and hospitals coordinating the need for complex health services. Finally the risk of over-consumption may for instance be remedied by imposing capitation fees that let hospitals and physicians share the risk of over-consumption.

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<sup>55</sup> An exception is the *Green paper on services of general interest*, COM(2003) 270 final, page 3

<sup>56</sup> At present subject to appeal in Case T-84/06 *Azivo v Commission*, action brought on 13 March 2006 on Aid measures N 541/2004 and N 542/2004.

In other cases it may be necessary to intervene, for example to guarantee access to emergency services within certain minimum time- or distance limits according to public good standards which may be higher than what the market on its own would provide. Academic (teaching) hospitals, research, top-referential care and expensive pharmaceuticals are at first sight other possible candidates for such intervention.

It should be noted that a market failure could be addressed in terms of e.g. imposing a universal service obligation, which could then still be implemented consistent with market principles, i.e. by market parties playing by market rules. Compensation from general tax revenues does not create a barrier to entry (and is subject to parliamentary control as part of the budget procedures). Funding by 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 service obligation.

One pertinent example is provided by the risk equalization funds in health insurance mentioned above. In the event that such a solution is not feasible in some cases there may be a case for public provision or public service compensation (again various forms could be envisaged that range from a universal service fund to funding from general taxation revenues). In sum an economics-focused approach to services of general economic interest seems appropriate even although this is so far not made explicit by existing documents on services of general economic interest. The reasoning used to argue the proportionality of the measure imposed would have to address this issue.

Finally it is important to realise that numerous market-based remedies of market failure are imaginable. 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 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.

## **6. Scope of the Article 86(2) EC exemption**

A number of formal legal categories determine whether Article 86(2) EC is at issue. These concern, first, whether the entity is involved is an undertaking, second, whether it has been entrusted with a task of general economic interest, and third, whether the restrictions imposed are in line with the legitimate public task.

### **6.1. The concepts of undertaking and solidarity**

This subsection deals with the question which types of entities may claim an Article 86(2) EC exemption. In the first place it should be noted that the word 'economic' in services of general economic interest 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.<sup>57</sup> The notion of 'economic' services is important in that the exemption of article 86(2) EC applies to undertakings: public authorities acting as such are not subjected to the competition rules.

#### Undertakings

The first question is therefore 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:

(...) having 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

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<sup>57</sup> Buendia Sierra, 'Chapter 6: Article 86' in J. Faull and A. Nikpay (eds), *The EU law on competition* (Oxford: OUP, 2<sup>nd</sup> ed, 2007), p 644.

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.<sup>58</sup>

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.<sup>59</sup>

An economic activity in turn is defined as follows:

(...) any 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.<sup>60</sup>

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 *Höfner* Case, 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.<sup>61</sup>

Similarly concerning ambulance services in its 2001 *Glöckner* Case 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.<sup>62</sup>

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. Hence it may be concluded that 'very few bodies involved in the organization of health care are not to be considered undertakings'.<sup>63</sup>

### 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

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<sup>58</sup> Case 118/85 *Transparency Directive* [1987] ECR 2599, para 11. Cf. Opinion AG Cruz Vilaca in Case 30/87 *Bodson* [1988] ECR 2479, point 32. It is nevertheless used as a 'sanity check' in clear cases. Cf. Opinion AG Jacobs, Case C-41/90 *Höfner* [1991] ECR I-1979, points 22, 23

<sup>59</sup> Case C-41/90 *Höfner* [1991] ECR I-1979, para 21. Cf. Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* [1993] ECR I-637, para 17; Case C-244/94 *FFSA* [1995] ECR I-4013, para 14; Case C-67/96 *Albany* [1999] ECR I-5751, para 77; Joined Cases C-115/97, C-116/97, C-117/97 and C-219/97 *Brentjens* [1999] ECR I-6025, para 77; and Case C-219/97 *Drijvende Bokken* [1999] ECR I-6121, para 67; Joined Cases C-180/98 to C-184/98 *Pavlov et al v Stichting Pensioenfonds Medische Specialisten (Pavlov)* [2000] ECR I-6451, para 74; Case C-218/00 *Cisal* [2002] ECR I-691, para 22; Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 *AOK* [2004] ECR I-2493, para 46.

<sup>60</sup> Joined Cases C-180/98 to C-184/98 *Pavlov* [2000] ECR I-6451.

<sup>61</sup> Case C-41/90 *Höfner* [1991] ECR I-1979, paras 22 and 23. Cf. Case C-55/96 *Job Centre Coop* [1997] ECR I-7119; Case C-258/98 *Giovanni Carra et al* [2000] ECR I-4217. In Case C-82/01P *Aéroports de Paris* [2002] ECR I-9297, para 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'.

<sup>62</sup> Case C-475/99 *Firma Ambulanz Glöckner* [2001] ECR I-8089, para 20.

<sup>63</sup> Hatzpoulos, '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, at p 148.

from the application of the competition rules altogether (but not from the market freedoms and public procurement rules). I.e. in this case Article 86(2) EC does not come into play because the activities concerned fall completely outside the scope of competition. In this case the following factors are generally weighed:<sup>64</sup>

- The objective pursued by a scheme;
- Its compulsory nature;
- The manner in which contributions (i.e. not based on person-specific risks) and benefits are calculated and managed (i.e. based on redistribution of contributions or on capitalization involving active fund management);
- The overall degree of state control;
- Redistribution within the scheme by cross-subsidization;
- The existence of competing schemes.

By examining, on the one hand, whether the entity concerned is active on a market, respectively the activities concerned could be provided under competitive conditions, and on the other hand whether or not the elements of solidarity prevail, it can be ascertained whether a particular entity should be regarded as an undertaking to which the competition rules apply. If it is a public authority the competition rules do not apply, and Article 86(2) EC is irrelevant. If it is an undertaking, and if it engages in providing services of general economic interest, Article 86(2) EC 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 Article 81 EC (restrictive agreements), not article 82 EC (dominance abuse), and remains highly contested.<sup>65</sup>

### **6.2. EU law rules affected by Article 86(2) EC**

As mentioned above Article 86(2) EC serves to balance Community objectives of market integration with national public service objectives. At the outset it should be noted that these two are not 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.

Keeping this in mind, next is the question which type of EU rules may be subject of the Article 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;
- concessions.

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.

The Community objective of market integration and national public policy objectives are not necessarily in conflict: the opening of services to competition generally leads

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<sup>64</sup> Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* [1993] ECR I-637; Case C-355/00 *Freskot* [2003] ECR 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.

<sup>65</sup> Case C-67/96 *Albany* [1999] ECR I-5751; Joined Cases C-115/97, C-116/97, C-117/97 and C-219/97 *Brentjens* [1999] ECR I-6025; Case C-219/97 *Drijvende Bokken* [1999] ECR I-6121; Case C-309/99 *Wouters* [2002] ECR I-1577; and Case C-519/04 P *Medina* [2006] ECR I-6991.

to lower prices and increased choice for consumers.<sup>66</sup> Sometimes however, the achievement of national policy objectives and Community policy objectives must be coordinated. It is for this purpose that Article 86(2) exists:

(...) which 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.<sup>67</sup>

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

### **6.3. Proportionality and pre-emption**

In the first place it is important to highlight that because Article 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 is 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 services of general economic interest 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 *Fedesa*. 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.

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<sup>66</sup> Buendia Sierra, 'Chapter 6: Article 86' in J. Faull and A. Nikpay (eds), *The EU law on competition* (Oxford: OUP, 2<sup>nd</sup> ed 2007), p 626.

<sup>67</sup> *White paper on services of general interest*, COM(2004) 374 final, page 7.

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.<sup>68</sup>

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

This issue has been resolved in the *Corbeau* and *Almelo* cases where the Court was willing to accept monopolies for services of general economic interest that were broader in scope than the universal service concerned.<sup>69</sup> 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.<sup>70</sup> 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).<sup>71</sup> Evidently, over time circumstances may change.

The conclusion that pre-emption is relevant to the proportionality test may be drawn from the Electricity cases. When faced with the Article 226 EC Treaty infringement Cases concerning national electricity monopolies in The Netherlands, France and Italy, the Court has clearly opted for judicial restraint by stating the burden of proof on the Member States '*cannot 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*'.<sup>72</sup>

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.<sup>73</sup> It clearly held that the Commission should have acted under Article 86(3) EC to back up its allegations:

(...) it 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 Article 86(3)] of the Treaty expressly requires the Commission to ensure the application of that

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<sup>68</sup> Case C-331/88 *Fedesa* [1990] ECR I-4023, paras 13-14 (emphasis added), with reference to Case 265/87 *Schraeder* [1989] ECR 2237, paras 21-22.

<sup>69</sup> Case C-320/91 *Corbeau* [1993] ECR I-2533, paras 15ff; Case C-393/92 *Almelo* [1994] ECR I-1521 paras 46ff. Cf Case C-475/99 *Firma Ambulanz Glöckner* [2001] ECR I-8089 which suggests the outer limit of such ancillary restraints is the ability to meet demand, i.e. to maintain efficient operations in the associated services (in this case patient transport services in addition to emergency services).

<sup>70</sup> Case T-260/94 *Air Inter* [1997] ECR II-997, paras 138-139.

<sup>71</sup> Cf Buendia Sierra, 'Chapter 6: Article 86' in J. Faull and A. Nikpay (eds), *The EU law on competition* (Oxford: OUP, 2<sup>nd</sup> ed, 2007), pp 640-641.

<sup>72</sup> Case C-157/94 *Dutch Electricity Monopoly* [1997] ECR I-5699, para 58; Case C-159/94 *French Electricity and Gas Monopoly* [1997] ECR I-5815, para 101; Case C-158/94 *Italian Electricity Monopoly* [1997] ECR I-5789, para 54 (emphasis added).

<sup>73</sup> Case C-157/94 *Dutch Electricity Monopoly* [1997] ECR I-5699, paras 66-73; Case C-159/94 *French Electricity and Gas Monopoly* [1997] ECR I-5815, paras 109-116.

article and, where necessary, to address appropriate Directives or Decisions to Member States.<sup>74</sup>

Specifically, the Court held that the Commission should have demonstrated how '*in 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'.<sup>75</sup> 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.

Because in healthcare so far no Community framework is in place – i.e. there is no pre-emption of national rules by Community rules – this means that the mild 'not manifestly disproportionate' test should be applied. In fact, this is also the test applied by the European Commission in the Irish and Dutch risk equalization scheme cases.<sup>76</sup>

In order to pass this test the following must be shown:

(...) in order that the derogation to the application of the rules of the Treaty set out in Article 90(2) [now Article 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 (...).<sup>77</sup>

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

1. a causal link between the measure and the objective of general interest
2. 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)
3. finally 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. Meanwhile 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.

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<sup>74</sup> Case C-157/94 *Dutch Electricity Monopoly* [1997] ECR I-5699, para 69; Case C-159/94 *French Electricity and Gas Monopoly* [1997] ECR I-5815, para 113.

<sup>75</sup> Case C-157/94 *Dutch Electricity Monopoly* [1997] ECR I-5699, para 58; Case C-159/94 *French Electricity and Gas Monopoly* [1997] ECR I-5815, para 71 (emphasis added). Cf. Joined Cases C-147/97 and C-148/97 *Deutsche Post AG v Gesellschaft für Zahlungssysteme mbH (GZS) and Citicorp Kartenservice GmbH* [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 Article 86 EC.

<sup>76</sup> Risk equalization decisions concerning Ireland and the Netherlands. Aid measure N46/2003 Risk equalization system – Ireland; Aid measures N 541/2004 and N 542/2004 Financial reserves and risk equalization system – The Netherlands.

<sup>77</sup> Case C-179/90 *Porto do Genova* [1991] ECR I-5889, para 26, citing the judgments in Case 311/84 *CBEM v Compagnie Luxembourgeoise* [1985] ECR 3261, para 17, and in Case C-41/90 *Höfner*, [1991] ECR I-1979, para 24.

#### 6.4. A three step approach

In order to minimize issues of overlap and to provide a logical sequence in the steps that need to be taken in defining a service of general economic interest and its related universal service and other public service obligations the following three-step approach is proposed

- First the universal service and/or other public services should be defined: this means deciding which rights are deemed to exist (or to be necessary) with regard to a particular service to consumers.
- Second an analysis is necessary of which of these consumers' 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 or other public service obligations, and what the precise content of these obligations would be. This latter question 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 solution that allow competition to work (e.g. the risk equalization system) should be considered as 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.<sup>78</sup>
  - 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).

#### 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 services of general economic interest can lead to an infringement of the competition rules in the following three cases:

- where the public service requirements concerned are not (properly) specified<sup>79</sup>
- where the provider charged is manifestly unable to meet demand<sup>80</sup>
- where there is an alternative way of fulfilling the service of general economic interest requirements that would have a less detrimental effect in competition.<sup>81</sup>

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

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<sup>78</sup> 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 Case C-320/91 *Procureur du Roi v Paul Corbeau (Corbeau)* [1993] ECR I-2533.

<sup>79</sup> Case C-66/86 *Silver Line Reisebüro* [1989] ECR 803.

<sup>80</sup> Case C-41/90 *Höfner* [1991] ECR I-1979.

<sup>81</sup> *Green paper on services of general interest*, COM(2003) 270 final, page 24, citing the CFI in Case T-266/97 *Vlaamse Televisie Maatschappij* [1999] ECR II-2329.

recognition and the protection of individual rights apply (alongside the norms set out in Commission's Communication on Concessions under Community Law).

## **7. 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 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.

### 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 Article 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 provided (...) so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations (...).<sup>82</sup>

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 services of general economic interest is not considered state aid. It should be noted that a related question is whether charging particular undertakings with the provision of services of general economic interest is subject to the public procurement rules.

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<sup>82</sup> Case C-280/00 *Altmark Trans* [2003] ECR I-7747, paras 89-93. Cf. Joined Cases C-34/01 to C-38/01 *Enirisorse SnA v Ministero delle Finanze (Enirisorse)* [2003] ECR I-14243, para 31ff. The *Enirisorse* case, finally clarified that collecting and allocating (part of) charges levied on other undertakings to the benefit of an undertaking charged with services of general economic interest may constitute state aid.

The Commission has built on *Altmark Trans* by adopting a Notice with a Community framework for state aid in the form of public service compensation (Commission Notice),<sup>83</sup> and a Commission Decision to deal with those cases where the public service compensation concerned does not meet the *Altmark Trans* criteria and therefore constitutes state aid (Commission Decision).<sup>84</sup>

The Commission Notice restates the fact that Member States have wide discretion in designating services of general economic interest, 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 emphasizes that cross-subsidization on activities not constituting services of general economic interest 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 services of general economic interest. Detailed rules pertaining to costs include a definition of costs to be taken into account as covering all variable 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). The Decision provides explicitly that hospital funding is exempt from the obligation of prior notification of services of general economic interest provided by hospitals under the state aid rules as long as it is proportionate to the actual costs of the services provided, irrespective of the amounts received, and provided that these services are qualified as services of general economic interest. Thus paragraph 16 of the preamble of the Commission Decision on SGEI compensation:<sup>85</sup>

(...) hospitals providing medical care, including where applicable, emergency services and ancillary services directly related to the main activities, notably in the field of research (...) should benefit from the exemption from notification provided for in this Decision, even if the amount of compensation they receive exceeds the thresholds laid down in this Decision, *if the services performed are qualified as services of general economic interest by the Member States.*

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<sup>83</sup> *Community framework for State aid in the form of public service compensation*, OJ 2005 C297/04.

<sup>84</sup> Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ 2005, L312/67, preamble, para 16.

<sup>85</sup> Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ 2005, L312/67, preamble, para 16.

It appears the possibility to benefit from this provision in itself would put an exceptional premium on formally qualifying the relevant parts of hospital services as services of general economic interest.

## **8. Particular reasons for researching services of general economic interest in hospital care**

Health services were considered in principle to form part of services of general economic interest in the White paper,<sup>86</sup> and to form the topic of a paper on health services and social services. Eventually, after health services were dropped from the Services Directive<sup>87</sup> however they were not covered by the Paper on social services of general interest<sup>88</sup> but by a separate communication (which in turn was focused on trans-national provision of health services and not on services of general economic interest).<sup>89</sup>

There are a several reasons for researching the possible usefulness of the services of general economic interest concept in relation to healthcare in The Netherlands.

- First, it appears that the liberalization of (important) parts of curative hospital care (but also planned future liberalization of long term care) gives rise to increasing problems in EU law terms. Oddly, full state provision is met with relative indifference in EU law whereas even partial liberalization gives rise to tension in relation to the competition, state aid and free movement rules, to name a few.<sup>90</sup>

Arguably, qualification as (a) service(s) of general economic interest could be a safe haven for those parts of curative hospital care that have 'universal service' characteristics but are not suited for provision under competitive terms, and therefore require an alternative funding regime to the market mechanism.

- Second, simultaneously the European Commission, after a number of years of defensive back-peddling on services of general economic interest, has latched onto recent case law (notably *Altmark Trans*)<sup>91</sup> to launch a more pro-active approach on the funding side of the SGEI issue ('public service compensation'). Notably a legal act is required to benefit from the services of general economic interest exemption under the state aid regime, with important consequences for funding.

For hospital services in particular an even more relaxed EU regime is in place, provided that a formal act of entrustment with carrying out a service of general economic interest is involved.

- Third, at the same time, after being excluded both from the Services Directive and the recent communication on social services of general

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<sup>86</sup> *White paper on services of general interest*, COM(2004) 374 final pp 16-17.

<sup>87</sup> Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, OJ 2006, L376/36, article 2f excludes health services. The Services Directive contains a special regime for services of general economic interest. According to its Article 1(3) The Directive does not require the Member States to abolish their monopolies, nor does it derogate from the freedom of the Member States to designate services of general economic interest, and the financing of services of general economic interest is outside the scope of the Services Directive. Its Article 15(4) on the freedom of establishment provides that services of general economic interest are not subject to the procedural requirements set out in that Article insofar as their application obstructs the performance, in law or in fact, of the particular task assigned to them. Article 17(1) determines that services of general economic interest benefit from a derogation from the freedom to provide services.

<sup>88</sup> *White paper on services of general interest*, COM(2004) 374 final p 3

<sup>89</sup> *Consultation regarding Community action on health services*, SEC(2006) 1195/4.

<sup>90</sup> Query as to whether this discrepancy in fact exists, and how it is triggered.

<sup>91</sup> Case C-280/00 *Altmark Trans* [2003] ECR I-7747.

interest, hospital services are the subject of a special track based on a separate consultation.<sup>92</sup> The Commission was scheduled to report on this before the summer of 2007.

It should be noted that although health services are not covered by the Services Directive they remain subject to the Treaty provisions on free movement and competition.<sup>93</sup> The exception to these rules for services of general economic interest therefore remains relevant.

- Fourth, The Commission and the Court have recognized the existence of services of general economic interest in respect of general health insurance<sup>94</sup> respectively emergency ambulance services.<sup>95</sup> In combination with the finding that most health services are provided by undertakings, this means that in principle there should be appreciable scope for defining services of general economic interest in health care, respectively multi-product hospital services.<sup>96</sup>

Both health care and long term care (of which the former is not covered by the Services Directive and social services of general interest, while the latter is covered by both) are subject to market failures that could provide reasons for the services of general economic interest instrument to be applied.

Focusing on multi-product hospital markets, the main areas where market-based solutions are at present usually considered insufficient to remedy the market failures at hand are the following four:

- Emergency care (including emergency ambulance services)
- Top-referential care
- Academic training and care
- Very expensive and rare pharmaceuticals.

These areas are mentioned here only by way of example – it may well be that where economies of scale in emergency care and top-referential care are significant competition ‘for’ the market is possible instead. Likewise, if better product descriptions and better measures of output for academic training and care become available market-based solutions may well work here too.

Nevertheless, excluding (even by way of example) these areas from the market-oriented reform now planned in The Netherlands for multi-product hospitals (subject to a price-cap based on yardstick competition) means that alternative funding systems and regulatory solutions have to be found. And if political pressures are taken into account they are at least presently the prime candidates for a designation as services of general economic interest.

For long term care the main category where the scope for market-based solutions is extremely limited concerns care for multiple handicapped where funding cannot be based on risk-equalization schemes. It should be noted however that even where competition on insurance markets may in this case not be feasible this should not mean that competition among providers could not work (even at the level, much

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<sup>92</sup> *Consultation regarding Community action on health services*, SEC(2006) 1195/4.

Note however that there is no comparable exception for long term care, which is consequently covered by the Services Directive. What are the consequences of this?

<sup>93</sup> Providing Healthcare is an economic activity: Joined Cases C-180/98 to C-184/98 *Pavlov* [2000] ECR I-6451. Third-party paying makes no difference to this: Case C-352/85 *Bond van Adverteerders* [2988] ECR 2085.

<sup>94</sup> Aid measures N 541/2004 and N 542/2004, at present subject to appeal in Case T-84/06 *Azivo v Commission*, action brought on 13 March 2006.

<sup>95</sup> Case C-475/99 *Firma Ambulanz Glöckner* [2001] ECR I-8089

<sup>96</sup> Joined Cases C-180/98 to C-184/98 *Pavlov* [2000] ECR I-6451.

neglected in today's practice, of using proper procurement mechanisms). The latter should therefore be examined as the solution of first resort.

Other examples that may be relevant candidates for services of general economic interest include, e.g. immunization programmes, where considerable externalities are at play.

## **9. Conclusion**

In principle the national public interest should usually be in line with the EU market freedoms and competition law because the latter result in lower prices and greater choice for consumers. However, where market failure may lead to sub-optimal provision of public goods (such as the desired level of health care or of specific healthcare services such as emergency services) there may be a case for public intervention in terms of imposing universal service obligations (provider of last resort) on one or more undertakings that are active in the market. Even in this case competitive provision within certain limits may be feasible (e.g. health insurance markets subject to universal coverage without risk selection) and should be explored even within the context of services of general economic interest – not least in order to meet the requisite proportionality standard.

It is for the purpose of balancing the public interest and market freedoms that Article 86(2) EC provides an exception to the Treaty rules for services of general economic interest. This exception only applies to the extent that this is strictly necessary for performing the functions of services of general economic interest concerned. It serves to reconcile the public interest identified as such at national level as the reason for introducing a service of general economic interest with respect for the Treaty rules by means of a proportionality test.

In the absence of a Community standard, the applicable proportionality test is whether the infringements of the Treaty rules were 'manifestly disproportionate' or not. Where secondary Community law applies (i.e. pre-emption of national norms by Community norms) a stricter 'least restrictive means' test may be applied. In a number of economic sectors (notably the network industries c.q. utilities) the scope and content of services of general economic interest has been defined at Community level by means of Directives. This has served to identify clearly the scope of the exception involved and thereby the application of the general rule, i.e. the development of open markets with full competition.

Based on the Community experience so far a service of general economic interest normally consists of:

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

To be recognised as such, in principle services of general economic interest are set out in an 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 European Court of Justice. Compensation is based on costs plus a reasonable rate of return. Where public procurement procedures were not used to select the provider of the service of general economic interest the standard used is that of an efficient firm. If these standards are met the state aid rules do not apply.

If services of general economic interest fail to meet the criteria set out in *Altmark Trans* but are designated *for healthcare* according to the standards set out for an act

of entrustment the related financial compensation do not require prior notification as state aid. If services of general economic interest are designated as such this has an impact not only in EU law but, at least in The Netherlands, also in national law, given the use of a services of general economic interest standard across the board in the Dutch competition law: i.e. concerning the cartel prohibition, prohibition of dominance abuse and merger control.

The proportionality test (necessity) requires that the scope of services of general economic interest remains restricted to the necessary minimum. In the context of harmonisation this text is based on least restrictive means, in the absence of harmonisation the Member States retain greater freedom and the relevant test is whether the measures concerned are manifestly disproportionate. This approach can help to resolve debate on the possibility of liberalising certain health services given that e.g. universal service to consumers can be guaranteed in this way, opening up the road to liberalisation.

Using the instrument of services of general economic interest requires taking clear decisions to define closely the public interest involved because the scope of services of general economic interest is limited to what is necessary to attain the relevant public interest objectives. Market failure arguments will be key here. By defining services of general economic interest the scope for liberalisation and market-based provision of the remaining services also becomes clearer. This exercise would therefore be particularly useful in markets in transition where, in a liberalisation context, the need for public interest exceptions is raised. Hence, services of general economic interest deserve to be analysed further as a tool to guarantee the public interest in the context not only of multi-product hospital care, but also in relation to long term care.

In the context of a more thorough analysis *inter alia* the following question should be addressed: would the application of the services of general economic interest framework not only provide for the requisite exceptions to the free movement, state aid, public procurement and competition rules – but also be compatible with adequate safeguards against distortions of competition in the competitive segments of the multi-product hospital market(s)? And, if so, how could this be guaranteed?

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# NZa

The Dutch Healthcare Authority (NZa) is the regulator of health care markets in the Netherlands. The NZa promotes, monitors and safeguards the working of health care markets. The protection of consumer interests is an important mission for the NZa. The NZa aims at short term and long term efficiency, market transparency, freedom of choice for consumers, access and the quality of care. Ultimately, the NZa aims to secure the best value for money for consumers.



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even if they do not necessarily fall within 'Law & Economics' in the sense of the specific school of thinking which has arisen out of the work of US academics and is now well-established everywhere.

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