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Financing Services of General Interest in the EU: How do Public Procurement and State Aids Interact to Demarcate between Market Forces and Protection?

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Abstract: *The present article reveals the interplay between public procurement and state financing of public services within the regulatory régime of state aids. The symbiotic flexibility embedded in the regime of regulating the award of public contracts which permits the introduction of public policy considerations in dispersing public services is established. This finding removes the often-misunderstood justification of public procurement as an economic exercise, and places its regulation in the centre of an ordo-liberal interpretation of the European integration process. The significance of public procurement for the financing of services of general interest is verified through an asymmetric geometry analysis. The article concludes that the public procurement framework will be relied upon for two main purposes: first to insert competitiveness within the public sector and market forces in the provision of services of general interest and secondly, to be used by the European judiciary and the European Commission as a system to verify conceptual links, create compatibility safeguards and authenticate established principles applicable in state aid regulation.*

I Introduction

Recent developments in jurisprudence at Community level have demonstrated the pivotal position of public procurement in the process of determining the parameters under which public subsidies and state financing of public services constitute state aids. At the centre of the debate regarding the relation between state aids and the financing of services of general interest, within the broader remit of the interplay of subsidies and public services, public procurement has emerged as an essential component of state

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aids regulation.[1] The European Court of Justice has inferred that the existence of public procurement, as a legal system and a procedural framework, verifies conceptual links, creates compatibility safeguards and authenticates established principles applicable in state aid regulation. Public procurement in the common market not only does represent the procedural framework for the contractual interface between public and private sectors,[2] but it also reflects on the character and nature of activities of the state and its organs in pursuit of public interest.[3] Public procurement regulation has acquired legal, economic and policy dimensions, as market integration and the fulfilment of treaty principles are balanced with policy choices.[4]

The implications of the debate are important, not only because of the necessity for a coherent application of state aids regulation in the common market but also because of the need for a legal and policy framework regarding the financing of services of general interest and public service obligations by member states.[5] The significance of the topic is reflected in the attempts of the European Council to provide for a policy framework of greater predictability and increased legal certainty in the application of the State aid rules to the funding of services of general interest.[6] The present article

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[1] See the Commission Communication on services of general interest in Europe, OJ C 17, 19/1/2001; the Green Paper on services of general interest, COM(2003) 270, 21/5/2003, the White Paper on Services of general interest, COM(2004), 12/5/2004.

[2] The Public Procurement regime includes the Public Supplies Directive 93/36/EEC, OJ L 199 9/8/1993 as amended by Directive 97/52/EC OJ L 328 28/11/1997; the Public Works Directive 93/37/EEC OJ L 199, 9/8/1993 as amended by Directive 97/52/EC OJ L 328 28/11/1997; the Utilities Directives 93/38/EEC OJ L 199 9/8/1993 as amended by Directive 98/4/EC OJ L 101 1/4/1998; the Public Services Directive 92/50/EEC, OJ L 209 24/7/1992 as last amended by Directive 97/52/EC OJ L 328, 28/11/1997; the Remedies Utilities Directive 92/13/EEC OJ L 076 23/03/1992; the Public Remedies Directive 89/665/EEC OJ L 395, 30/12/1989. The Public Procurement Directives have been recently amended by Directive 2004/18, OJ L 134 30/4/2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts and Directive 2004/17, OJ L 134 30/4/2004 coordinating the procurement procedures of entities operating in the water, energy, transport, and postal services sectors.

[3] See C. H. Bovis, 'La notion et les attributions d'organisme de droit public comme pouvoirs adjudicateurs dans le régime des marchés publics', *Contrats Publics*, Septembre 2003, 26–30.

[4] See C. H. Bovis, 'Public Procurement and the Internal Market of the 21st Century: Economic Exercise versus Policy Choice' in D. O'Keeffe and T. Tridimas (eds), *EU Law for the 21st Century: Rethinking the New Legal Order* (Hart Publishing, forthcoming). Also Communication from the European Commission to the Council, the European Parliament, the Economic and Social Committee, and the Committee of the Regions, 'Working together to maintain momentum', 2001 Review of the Internal Market Strategy, Brussels, 11 April 2001, COM(2001)198 final. Also, European Commission, Commission Communication, Public procurement in the European Union, Brussels, March 11, 1998, COM(98) 143. See Commission Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement, COM(2001) 566, 15 October 2001. Also, Commission Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement, COM(2001) 274, 4 July 2001.

[5] See A. Bartosch, 'The relationship of Public Procurement and State Aid Surveillance—The Toughest Standard Applies?', 2002 CMLR 35, and the case law provided in the analysis.

[6] See the Conclusions of the European Council of 14 and 15 December 2001, paragraph 26; Conclusions of the Internal Market, Consumer Affairs and Tourism Council meeting of 26 November 2001 on services of general interest; Commission Report to the Laeken European Council on Services of General Interest of 17 October 2001, COM(2001) 598; Communication from the Commission on the application of the State aid rules to public service broadcasting, OJ C 320 2001, at 5; see also the two general Commission Communications on Services of General Interest of 1996 and 2000 in OJ C 281 1996, at 3 and OJ 2001 C 17, at 4.

intends to define the connection between public procurement and services of general interest, and to ascertain the parameters of interplay between public procurement and state financing of public services within the regulatory regime of state aids.

II An Overview of the Concept of Services of General Interest under EU Law

The EU Treaty does not include as a Community objective the provision or the organisation or the financing of services of general interest, and therefore does not assign specific and explicit powers to the Community in the area of services of general interest. Except for a sector-specific reference in the area of transport,[7] services of general economic interest are referred to in Articles 16 and Article 86(2) EC. Furthermore, according to the Charter of Fundamental Rights of the European Union, the Union recognises and respects access to services of general economic interest, in order to promote the social and territorial cohesion of the Union.[8]

Although Article 16 EC confers responsibility upon the Community and the Member States to ensure, each within their respective sphere of competencies, that their policies enable services of general economic interest to fulfil their missions, it does not provide the Community with specific means of action. On the other hand, Article 86(2) EC implicitly recognises the right of the Member States to assign specific public-service obligations to economic operators. It manifest a fundamental principle ensuring that services of general economic interest can continue to be provided and developed in the common market. Providers of services of general interest are exempted from application of the Treaty rules only to the extent that any exemption is strictly necessary to allow them to fulfil their mission to pursue activities of general interest. Thus, such deviation from the Treaty rules is subject to the principles of neutrality, freedom to define, and proportionality.[9] Therefore, in the event of conflict, the fulfilment of a public service mission can effectively prevail over the application of Community rules, including internal market and competition rules, subject to the conditions foreseen in Article 86(2) EC. Consequently, the Treaty protects the effective performance of a general interest task but not necessarily the provider as such.

The concept of *services of general interest* is a surrogate notion of the term services of general economic interest found in Articles 16 and 86(2) EC. However, its remit is broader and covers both market and non-market services which the public authorities regard as being of general interest and subject them to specific public service obligations. Within Community law and practice, the concept of services of general interest refers to services of an economic nature[10] which the Member States or the Community subject to specific public service obligations by virtue of a general interest criterion. It thus covers certain services provided by the big network industries such as transport, postal services, energy, and communications, but it also extends to any other economic activity which is subjected to public service obligations. The term 'public service obligations' denotes specific requirements that are imposed by public authorities on the

[7] See Art 73 TEU.

[8] See Art 36 of the Charter of Fundamental Rights.

[9] See Commission Communication on services of general interest, COM(2000) 553.

[10] See Cases C-180–184/98 *Pavel Pavlov and Others v Stichting Pensioenfonds Medische Specialisten* [2000] ECR I-6451. The Court of Justice pronounced that any activity consisting in offering goods and services on a given market is an economic activity. Thus, economic and non-economic services can coexist within the same sector and sometimes even be provided by the same organisation.

provider of the service in order to ensure that certain public interest objectives are met, for instance, in the matter of air, rail and road transport, and energy. The application of such obligations can be at Community, national, or regional level.

The economic nature of services of general interest is reflected in the Community's attempts to achieve a gradual opening of the markets for large network industries such as telecommunications, postal services, electricity, gas, and transport, in which services of general economic interest can be provided. The Community has adopted a comprehensive regulatory framework for these services, which specifies public service obligations at European level and includes aspects such as universal service, consumer and user rights, and health and safety concerns. These industries have a clear Community-wide dimension and present a strong case for developing a concept of European general interest, as well as a concept of services that pursue such Community-wide public interest. This debate is also reflected and explicitly recognised in Title XV of the EU Treaty, which gives the Community specific responsibility for trans-European networks in the areas of transport, telecommunications, and energy infrastructure, with the dual objective of improving the smooth functioning of the Internal Market and strengthening social and economic cohesion. However, there are services of general interests that are not subject to a comprehensive regulatory regime at Community level, such as waste management, water supply, and public-service broadcasting. The provision of this type of services of general interest is subject to the internal market, competition, and State aid rules, provided that these services can affect trade between Member States, and also *lex specialis* régimes.[11]

III The Concept of Services of General Interest through Public Procurement Jurisprudence

A Public Procurement Rules

The application of public procurement rules, apart from the objective to integrate intra-community public-sector trade, has served as a yardstick in order to determine the nature of an undertaking in its contractual interface when delivering public services. Public procurement regulation has prompted the recognition of a distinctive category of markets within the common market, often described as public markets.[12] Public markets are such fora where the state and its organs would enter in pursuit of public interest.[13] Their respective activity does not resemble the commercial characteristics of private entrepreneurship, in as much as the aim of the public sector is not the max-

[11] For example, specific Community rules on environmental legislation such as Directive 75/442, OJ L 194 25/7/1975, on waste, and Regulation 259/93 OJ L 30, 6/2/1993, on shipment of waste, have establish the *principle of proximity*, which overrides other fundamental community principles. According to this principle, waste should be disposed of as near as possible to the place it was generated. For television broadcasting, the importance of public-service broadcasting for the democratic, social, and cultural needs of each society a specific Protocol on the systems of public broadcasting in the Member States has been annexed to the Amsterdam Treaty. See also the so-called Television without Frontiers Directive 89/552 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities, OJ L 298 17/10/1989.

[12] See C. H. Bovis, 'Public Procurement within the Framework of European Economic Law', (1998) 4.

[13] See P. Valadou, 'La notion de pouvoir adjudicateur en matière de marchés de travaux', (1991) E3 *Semaine Juridique*.

imisation of profits but the serving of public interest.[14] This substitution of public interest for profit maximisation is the fundamental factor for the creation of *public markets.*[15]

There are further variances that distinguish public from private markets. These focus on structural elements of the market place, competitiveness, demand conditions, supply conditions, the production process, and lastly pricing and risk. These variances also indicate different methods and approaches employed in the regulation of public markets.[16] Public markets tend to have monopsony structures—the state and its organs often appear as the sole outlet for an industry's output—and function differently from private markets. In terms of its origins, demand in public markets is institutionalised and operates mainly under budgetary considerations rather than price mechanisms. It is also based on fulfilment of tasks (pursuit of public interest) and it is single for many products. Supply also has limited origins, close ties exist between the public sector and its industries supplying its needs, and there is often a limited product range. Products are rarely innovative and technologically advanced, and pricing is determined through tendering and negotiations. The purchasing decision is primarily based upon the lifetime cycle, reliability, price, and political considerations. Purchasing patterns follow tendering and negotiations and often purchases are dictated by policy rather than price/quality considerations.

Within the remit of public markets, the funding of services of general interest by the state may emerge through different formats, such as the payment of remuneration for services under a public contract, the payment of annual subsidies, preferential fiscal treatment or lower social contributions. However, the most common format is the existence of a contractual relation between the state and the undertaking charged to deliver public services. The above contractual relation should, under normal circumstances, emerge through the public procurement framework, not only as an indication of market competitiveness but mainly as a demonstration of the nature of the deliverable services as services of 'general interest having non industrial or commercial character'. The latter description appears as a necessary condition for the applicability of the public procurement régime.

B Do Needs in the General Interest have Non-Commercial Character?

For the public procurement régime to apply in a contractual interface between public and private sectors, the contracting authority must be the state or an emanation of the state, and in particular, a *body governed by public law.* The above category is subject to a set of cumulative criteria,[17] *inter alia*, 'it must be established for the specific purpose

[14] See M. Flamme and P. Flamme, 'Enfin l'Europe des Marchés Publics', (1989) *Actualité Juridique—Droit Administratif*.

[15] On the issue of public interest and its relation with profit, see Cases C-223/99, *Agora Srl v Ente Autonomo Fiera Internazionale di Milano* and C-260/99 *Excelsior Snc di Pedrotti Runa & C v Ente Autonomo Fiera Internazionale di Milano*, [2001] ECR 3605; C-360/96, *Gemeente Arnhem Gemeente Rheden v BFI Holding BV*, [1998] ECR 6821; C-44/96, *Mannesmann Anlangenbau Austria AG et al. v Strohal Rotationsdurck GesmbH*, [1998] ECR 73.

[16] See C. H. Bovis, *The Liberalisation of Public Procurement in the European Union and its Effects on the Common Market*, Chapter 1 (Ashgate Dartmouth, 1998).

[17] See Article 1(b) of Directive 93/37. The criteria for bodies governed by public law to be considered as a contracting authority for the purposes of the EU public procurement Directives are: (i) they must be established for the specific purpose of meeting needs in the general public interest not having an industrial or commercial character; (ii) they must have legal personality; and (iii) they must be financed, for

of meeting needs in the general public interest not having an industrial or commercial character'.

The criterion of specific establishment of an entity to meet needs in the general interest having non-commercial or industrial character has been the subject of the Court of Justice's attention in some landmark cases.[18] In order to define the term 'needs in the general interest', the Court of Justice drew its experience from jurisprudence in the public-undertakings field, as well as case law relating to public order.[19] The Court of Justice approached the above concept by a direct analogy to the concept of 'general economic interest', as defined in Article 90(2) EC.[20] The concept 'general interest', under the public procurement régime, denotes the requirements of a community (local or national) in its entirety, which should not overlap with the specific or exclusive interest of a clearly determined person or group of persons.[21] Moreover, the requirement of the *specificity* of the establishment of the body in question was approached by reference to the reasons and the objectives behind its establishment. Specificity of the purpose of an establishment does not mean exclusivity, in the sense that other types of activities may also be carried out without the entity escaping classification as a body governed by public law.[22]

On the other hand, the requirement of non-commercial or industrial character of needs in the general interest has raised some difficulties. The Court of Justice interpreting the meaning of non-commercial or industrial undertakings had recourse to case law relating to public undertakings, where the nature of industrial and commercial activities of private or public undertakings was defined.[23] The industrial or commercial character of an organisation depends largely upon a number of criteria that reveal the thrust behind the organisation's participation in the relevant market. The state and its organs may act either by exercising public powers or by carrying out economic activities of an industrial or commercial nature by offering goods and services on the market. The key factor appears in the organisation's intention to achieve profitability and pursue its objectives through a spectrum of commercially motivated decisions. The distinction between the range of activities which relate to public authority and those

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the most part, by either the state, or regional or local authorities, or other bodies governed by public law; or subject to management supervision by these bodies, or having an administrative or supervisory board, more than half of whose members are appointed by the state, regional, or local authorities, or by other bodies governed by public law. There is a list of such bodies in Annex I of Directive 93/37, which is not an exhaustive one, in the sense that Member States are under an obligation to notify the Commission of any changes to that list.

[18] See cases C-223/99, *Agora Srl v Ente Autonomo Fiera Internazionale di Milano* and C-260/99 *Excelsior Snc di Pedrotti Runa & C v Ente Autonomo Fiera Internazionale di Milano*, [2001] ECR 3605; C-360/96, *Gemeente Arnhem Gemeente Rheden v BFI Holding BV*, [1998] ECR 6821; C-44/96, *Mannesmann Anlangenbau Austria AG et al. v Strohal Rotationsdurck GesmbH*, [1998] ECR 73.

[19] See the Opinion of Advocate General Léger, point 65 of the *Strohal* case.

[20] See Case C-179/90, *Merci Convenzionali Porto di Gevova*, [1991] ECR 1-5889; General economic interest as a concept represents 'activities of direct benefit to the public'; point 27 of the Opinion of Advocate General van Gerven.

[21] See P. Valadou, 'La notion de pouvoir adjudicateur en matière de marchés de travaux', (1991) E3 *Semaine Juridique*, 33.

[22] See Case C-44/96, *Mannesmann Anlangenbau Austria, op. cit.* note 12 *supra*.

[23] For example see Case 118/85 *Commission v Italy* [1987] ECR 2599 para 7, where the Court of Justice had the opportunity to elaborate on the distinction of activities pursued by public authorities and those pursued by commercial undertakings. For a detailed analysis, see C. H. Bovis, 'Recent case law relating to public procurement: A beacon for the integration of public markets', (2002) 39 CMLR.

which, although carried out by public persons, fall within the private domain, is drawn most clearly from case law and judicial precedence of the Court of Justice concerning the applicability of competition rules of the Treaty to the given activities.[24]

The non-commercial or industrial character of an activity is a strong indication of the existence of a general interest activity. The Court of Justice in *BFI*[25] had the opportunity to consider the relationship between bodies governed by public law and the pursuit of activities of general interest having non-industrial or commercial nature. The non-commercial or industrial character is a criterion intended to clarify the term needs in the general interest. In fact, it is regarded as a category of needs of general interest. The Court of Justice recognised that there might be needs of general interest, that have an industrial and commercial character and also that private undertakings can meet needs of general interest that do not have industrial and commercial character. However, the acid test for needs in the general interest not having an industrial or commercial character is that the state or other contracting authorities choose themselves to meet these needs, or to have a decisive influence over their provision.

If an activity that meets general needs is pursued in a competitive environment, there is a strong indication that the pursuing entity it is not a body governed by public law.[26] In the *Agora* case the Court of Justice indicated that the relationship between competitiveness and commerciality has significant implications on the relevant activity that meets needs of general interest. Market forces reveal the commercial or industrial character of an activity, irrespective of whether the latter meets the needs of general interest. However, neither market competitiveness nor profitability can be absolute determining factors for the commercial or the industrial nature of an activity, as they are not sufficient to exclude the possibility that a body governed by public law may choose to be guided by considerations other than economic ones. The absence of competition is not a condition necessarily to be taken into account in order to define a body governed by public law, although the existence of significant competition in the market place may be indicative of the absence of a need in the general interest, which does not carry commercial or industrial elements. The Court of Justice reached this conclusion by analysing the nature of the bodies governed by public law contained in Annex 1 of the Works Directive 93/37 and verifying that the intention of the state in establishing such bodies has been to retain decisive influence over the provision of the needs in question.

Commerciality and its relationship with needs in the general interest is perhaps the most important theme that has emerged from the Court of Justice's jurisprudence, and is highly relevant to the debate concerning the relationship between services of general interest and the organisations that pursue them. In fact, the above theme sets out to explore the interface between profit making and public interest, as features that underpin the activities of bodies governed by public law. Certain activities, which by their nature fall within the fundamental tasks of the public authorities, cannot be subject to a requirement of profitability, and therefore are not meant to generate profits. It is possible, therefore, to attribute the distinction between bodies whose activity is subject to the public procurement legislation and other bodies, to the fact that the criterion of

[24] See Case C-364/92 *SAT Fluggesellschafeten* [1994] ECR 1-43; also Case C-343/95 *Diego Cali et Figli* [1997] ECR 1-1547.

[25] See Case C-360/96, *Gemeente Arnhem Gemeente Rheden v BFI Holding BV* [1998] ECR 6821.

[26] See Case C-223/99, *Agora Srl v Ente Autonomo Fiera Internazionale di Milano* and C-260/99 *Excelsior Snc di Pedrotti Runa & C v Ente Autonomo Fiera Internazionale di Milano*, [2001] ECR 3605C-223/99.

'needs in the general interest not having an industrial or commercial character' indicates the lack of competitive forces in the relevant marketplace. Although the state as entrepreneur enters into transactions with a view to providing goods, services, and works for the public, to the extent that it exercises *dominium*, these activities do not resemble the characteristics of entrepreneurship, inasmuch as the aim of the state's activities is not the maximisation of profits but the observance of public interest. Public markets are the fora where *public interest* substitutes *profit maximisation.*[27]

C The Double Image of Janus: the Dual Capacity of Contracting Authorities

The dual capacity of an entity as a public-service provider and a commercial undertaking, and the weighting of the relevant activity in relation to the proportion of its output, should be the decisive factor in determining whether an entity is a body governed by public law for the purposes of the public procurement regime. This argument appeared for the first time before the Court of Justice in the *Strohal* case.[28] Its was suggested that if the activities in pursuit of the 'public services obligations' of an entity supersede its commercial thrust, the latter could be considered as a body covered by public law and a contracting authority.[29]

In practice, the argument put forward implied a selective application of the public procurement directives in the event of dual-capacity entities. This sort of application is not entirely unjustified as, on a number of occasions,[30] the public procurement directives themselves utilise thresholds or proportions considerations in order to include or exclude certain contracts from their ambit. However, the Court of Justice ruled out a selective application of the directives in the case of dual capacity contracting authorities, based on the principle of legal certainty. It substantiated its position with the fact that only the purpose for which an entity is established is relevant in order to classify it as body governed by public law and not the division between public and private activities. Thus, the pursuit of commercial activities by contracting authorities is incorporated with their public-interest orientation aims and objectives, without taking into account their proportion and weighting in relation to the total activities dispersed, and contracts awarded in pursuit of commercial purposes fall under the remit of the public procurement directives. The Court of Justice recognised the fact that by extending the application of public procurement rules to activities of a purely industrial or commercial character, an onerous constraint would probably be imposed upon the relevant contracting authorities. This may also seem unjustified on the grounds that public pro-

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[27] Flamme and Flamme, *op. cit.* note 14 *supra* at 653, argue along the same lines.

[28] See Case C-44/96, *Mannesmann Anlangenbau Austria AG et al. v Strohal Rotationsdurck GesmbH*, [1998] ECR 73.

[29] In support of its argument that the relevant entity (*Österreichische Staatsdruckerei*) is not a body governed by public law, the Austrian government maintained that the proportion of public interest activities represents no more than 15–20% of its overall activities. For a comprehensive analysis of the case and an insight to the concept of contracting authorities for the purposes of public procurement, see the annotation by C. H. Bovis in (1999) 36 CMLR, at 205–225.

[30] For example, the relevant provisions stipulating the thresholds for the applicability of the Public Procurement Directives (Dir 93/37 Art 3(1); Dir 93/36 Art 5(1); Dir 93/38 Art 14; Dir 92/50 Art 7(1)); the provisions relating to the so-called 'mixed contracts' (Dir 93/37 Art 6(5), where the proportion of the value of the works or the supplies element in a public contract determines the applicability of the relevant Directive; and finally the relevant provisions which embrace the award of works contracts subsidised *directly* by more than 50% by the state within the scope of the Directive (Dir 93/37 Art 2(1)(2)).

curement law, in principle, does not apply to private bodies, which carry out identical activities.[31] The above situation represents a considerable disadvantage in delineating the distinction between private and public-sector activities and their regulation, if the only factor appears to be the nature of the organisation in question. The Court of Justice suggested that that disadvantage could be avoided by selecting the appropriate legal instrument for the objectives pursued by public authorities. As the reasons for the creation of a body governed by public law would determine the legal framework that would apply to its contractual relations, those responsible for establishing it must restrict its thrust in order to avoid the undesirable effects of that legal framework on activities outside its scope.

The Court of Justice in *Strohal* established dualism, to the extent that it specifically implied that contracting authorities may pursue a dual range of activities; to procure goods, works, and services destined for the public, as well as to participate in commercial activities. Thus they can clearly pursue other activities in addition to those that meet needs of general interest not having an industrial and commercial character. The proportion of activities pursued by an entity which aim to meet needs of general interest not having an industrial or commercial character, and commercial activities is irrelevant for the characterisation of that entity as a body governed by public law. What is relevant is the intention of establishment of the entity in question, which reflects on the 'specificity' requirement of meeting needs of general interest. Also, specificity does not mean exclusivity of purpose. Instead, specificity indicates the intention of establishment to meet general needs. Along these lines, ownership or financing of an entity by a contracting authority does not guarantee the condition of establishment of that entity to meet needs of general interest not having industrial and commercial character.

The dual capacity of contracting authorities is irrelevant to the applicability of public procurement rules. If an entity is a contracting authority, it must apply public procurement rules irrespective of the pursuit of general interest needs or the pursuit of commercial activities. Also, if a contracting authority assigns the rights and obligations of a public contract to an entity, which is not a contracting authority, that entity must follow public procurement rules. The contrary would be acceptable only if the contract fell within the remit of the entity, which is not a contracting authority, and the contract was entered into on its behalf by a contracting authority.

D Links between Contracting Authorities and Private Undertakings

Contractual and legal or regulatory links between the state and contracting authorities and also between the state and private undertakings expose the inadequacy of the public procurement framework. Such links dilute the concept of contracting authorities, which is essential to the applicability of the public procurement framework, to a degree that the provisions could not apply. Under the domestic laws of the Member States of the European Union, there are few restrictions that could prevent contracting authorities from acquiring private undertakings in an attempt to participate in market activities. The public procurement directives have not envisaged such a scenario, where the avoidance of the rules could be justified by the fact that the entities which award the relevant contracts cannot be classified as contracting authorities within the

[31] See Bovis, *op. cit.* note 16 *supra*.

meaning of the directives. As a consequence, there is a considerable risk in circumventing the public procurement directives if contracting authorities award their public contracts via private undertakings under their control, which cannot be covered by the framework of the directives.

The Court of Justice, prior to the *Stohal* case, did not have the opportunity to examine such corporate relationships between the public and private sectors and the effect that public procurement law has upon them. Even in *Strohal*, the Court of Justice did not rule directly on the subject, but instead it provided the necessary inferences for national courts, in order to ascertain whether such relations between public and private undertakings have the aim or the result of avoiding the application of the public procurement directives. Indeed, national courts of the Member States, when confronted with relevant litigation, must establish *in concreto* whether a contracting authority has established an undertaking in order to enter into contracts for the sole purpose of avoiding the requirements specified in public procurement law. Such conclusions must be beyond doubt based on the examination of the actual purpose for which the undertaking in question has been established. The rule of thumb appears to be the connection between the nature of a project and the aims and objectives of the undertaking that awards it. If the realisation of a project does not contribute to the aims and objectives of an undertaking, then it is assumed that the project in question is awarded 'on behalf' of another undertaking, and if the latter beneficiary is a contracting authority under the framework of public procurement law, then the relevant directives should apply.

The Court of Justice applied the *Strohal* principles to *Teckal*,[32] where it concluded that the exercise, by a contracting authority, of control over the management of an entity similar to that exercised over the management of its own departments prevents the applicability of the Directives. The *Teckal* judgment revealed also the importance of the *dependency test* between contracting authorities and private undertakings. Dependency, in terms of overall control of an entity by the state or another contracting authority presupposes a control similar to that which the state or another contracting authority exercises over its own departments. The 'similarity' of control denotes lack of independence with regard to decision-making.

One of the criteria stipulated in the public procurement directives for the existence of bodies governed by public law as contracting authorities is that they must be financed, for the most part, by either the state, or regional or local authorities, or other bodies governed by public law; or subject to management supervision by these bodies, or having an administrative or supervisory board, more than half of whose members are appointed by the state, regional, or local authorities, or by other bodies governed by public law. To assess the existence of the above criterion of bodies governed by public law, the Court of Justice assumed that there is a close dependency of these bodies on the State, in terms of corporate governance, management supervision, and financing.[33] These dependency features are alternative (in contrast to being cumulative), thus the existence of one satisfies the criterion. The Court of Justice held in *OPAC*[34] that management supervision by the state or other contracting authorities entails not only

[32] See Case C-107/98, *Teckal Slr. v Commune di Viano*, [1999] ECR I-8121.

[33] This type of dependency resembles the Court of Justice's definition in its ruling on state controlled enterprises in case 152/84 *Marshall v Southampton and South West Hampshire Area Health Authority*, [1986] ECR 723.

[34] C-237/99, *Commission v France*, [2001] ECR 934.

administrative verification of legality or appropriate use of funds or exceptional control measures, but the conferring of significant influence over management policy, such as the narrowly circumscribed remit of activities, the supervision of compliance, as well as the overall administrative supervision. Of interest and high relevance is the Court of Justice's analysis and argumentation relating to the requirements of management supervision by the state and other public bodies, where it maintained that entities entrusted to provide social housing in France are deemed to be bodies governed by public law, thus covered by the public procurement directives. The Court of Justice (and the Advocate General) drew an analogy amongst the dependency features of bodies governed by public law on the state. Although the corporate governance and financing feature are quantitative (the state must appoint more than half of the members of the managerial or supervisory board or it must finance for the most part the entity in question), the exercise of management supervision is a qualitative one. The Court of Justice held that management supervision by the state denotes dependency ties similar to the financing or governance control of the entity concerned.

Receiving public funds from the state or a contracting authority is an indication that an entity could be a body governed by public law. However, this indication is not an absolute one. The Court of Justice, in the *University of Cambridge* case,[35] was asked whether (i) awards or grants paid by one or more contracting authorities for the support of research work; (ii) consideration paid by one or more contracting authorities for the supply of services comprising research work; (iii) consideration paid by one or more contracting authorities for the supply of other services, such as consultancy or the organisation of conferences; and (iv) student grants paid by local education authorities to universities in respect of tuition for named students constitute public financing for the university.

The Court of Justice held that only specific payments made to an entity by the state of other public authorities have the effect of creating or reinforcing a specific relationship or subordination and dependency. The funding of an entity within a framework of general considerations indicates that the entity has close dependency links with the state of other contracting authorities. Thus, funding received in the form of grants or awards paid by the state or other contracting authorities, as well as in the form of student grants for tuition fees for named students, constitutes public financing. The rationale for such approach lies in the lack of any contractual consideration between the entity receiving the funding and the state or other contracting authorities, which provide it in the context of the entity's public interest activities. The Court of Justice drew an analogy of public financing received by an entity with the receipt of subsidies.[36] However, if there is a specific consideration for the state to finance an entity, such as a contractual nexus, the Court of Justice suggested that the dependency ties are not sufficiently close to merit the entity financed by the state meeting the third criterion of the term bodies governed by public law. Such a relationship is analogous to the dependency that exists in normal commercial relations formed by reciprocal contracts, which have been negotiated freely between the parties. Therefore, funding received by Cambridge University for the supply of services for research work, or consultancy, or conference organisation cannot be deemed as public financing. The existence of a contract between the parties, apart from the specific considerations for funding, indicates

[35] See Case C-380/98, *The Queen and H.M. Treasury, ex parte University of Cambridge* [2000] ECR 8035.

[36] See paragraph 25 of the Court of Justice's judgment, as well as the Opinion of the Advocate General, para 46.

strongly supply substitutability, in the sense that the entity receiving the funding faces competition in the relevant markets. The Court of Justice stipulated that the proportion of public finances received by an entity, as one of the alternative features of the *dependency* criterion of the term bodies governed by public law, must exceed 50% to enable it meeting that criterion. For assessment purposes of this feature, there must be an annual evaluation of the (financial) status of an entity for the purposes of being regarded as a contracting authority.

E Procurement and Contractualised Governance

The above inferences from the Court of Justice, which point out themes that have emerged within public-sector management such as commercialism and public services, dualism and dependency, prompt the start of an important debate relevant to the main thesis of this article: the nature of governance in delivering (and financing) public services. The dramatic change in the relationship between public and private sectors, the perceptions of the public toward the dispersement of public services, as well as new forms of governance emanating through the privatisation process have witnesses an era of contractualised governance in the delivery of public services.

Whereas, *traditional corporatism* mapped the dimension of the state as a service provider and asset owner, with public procurement as the verification process of public law norms[37] such accountability, probity, and transparency, it failed to mimic the competitive structure of private markets. Corporatism allowed the creation of *marchés publics*, *sui generis* markets where competitive tendering attempted to satisfy public law norms and to introduce a balanced equilibrium in the supply/demand equation.[38] A first step away from corporatism towards government by contract appears to be the process of privatisation.[39] Privatisation, as a process of transfer of public assets and operations to private hands, on grounds of market efficiency and competition, as well as responsiveness to customer demand and quality considerations is often accompanied by simultaneous regulation. It is not entirely clear whether privatisation has reclaimed

[37] See J. Freeman, 'Extending Public Law Norms through Privatization', (2003) 116 *Harvard Law Review* 1285 *et seq*. Freeman argues that privatisation does not curtail the remit of the state. On the contrary it enacts a process of 'publicisation', where through the extension of public law norms to private undertakings entrusted with the delivery of public services the state maintains a dominant position in the dispersement of governance. Also, along the same lines see J. Frug, 'New Forms of Governance, Getting Public Power to Private Actors', (2002) 49 *UCLA Review* 1687.

[38] Corporatism has been deemed as an important instrument of industrial policy of a state, in particular where procurement systems have been utilised with a view to promoting structural adjustment policies and favour 'national champions'. See C. H. Bovis, 'The Choice of Policies and the Regulation Public Procurement in the European Community', in T. Lawton (ed.) *European Industrial Policy and Competitiveness: concepts and instruments* (Macmillan Publishers, 1998).

[39] Alongside privatisation, the notion of *contracting out* represents a further departure from the premises of traditional corporatism. The notion of *contracting out* is an exercise that aims at achieving potential savings and efficiency gains for contracting authorities, when they *test the market* in an attempt to define whether the provision of works or the delivery of services from a commercial operator could be cheaper than that from the in-house team. Contracting out differs from privatisation to the extent that the former represents a transfer of undertaking only, whereas the latter denotes transfer of ownership. Contracting out depicts a price-discipline exercise by the state, against the principle of *insourcing*, where, the self-sufficient nature of corporatism resulted in budgetary inefficiencies and poor quality of deliverables to the public. See S. Domberger and P. Jensen, 'Contracting Out by the Public Sector: Theory, Evidence, Prospects', (1997) Winter *Oxford Review of Economic Policy*.

public markets and transformed them to private ones. The extent to which the market freedom of a privatised entity could be curtailed by regulatory frameworks deserves a complex and thorough analysis, which exceeds by far the remit of this article. However, it could be maintained that through the privatisation process, the previously clear-cut distinction between public and private markets becomes blurred. However, there is strong evidence of public law elements to the extent that regulation is the dominant feature in the relations between public and private sectors with a view to observing public interest in the relevant operations. The economic freedom and the risks associated with such operations are also subject to regulation, a fact which implies that any regulatory framework incorporates more than procedural rules.

In various jurisdictions within the common market, the socio-economic climate is very much in favour towards public–private-sector partnerships, in the form of joint ventures or in the form of private financing of public projects.[40] Member States increasingly use public-private schemes, including design-build-finance-operate contracts, concessions, and the creation of mixed-economy companies to ensure the delivery of infrastructure projects or services of general interest. However, it would be difficult, in legal and political terms, to justify the empowerment of the private sector in as much as it could assume the role of service deliverer along the public sector across all Member States of the European Union. Constitutional provisions could nullify such attempts and often a number of socio-economic factors would collide with the idea of private delivery of public services. The evolution of public/private-sector relations has arrived in times when the role and the responsibilities of the state are in the process of being redefined.[41] Constitutionally, the state and its organs are under obligation to provide a range of services to the public in the form of e.g. healthcare, education, transport, energy, defence, social security, policing. The state and its organs then enter the market place and procure goods, works, and services in pursuit of the above objective, on behalf of the public.[42] The state, in its own capacity or through delegated or legal monopolies and publicly controlled enterprises, has engaged in market activities in order to serve public interest. Traditionally, the function of the state as a public service provider has been linked with ownership of the relevant assets. The integral characteristics of privately financed projects reveal the degree that the state and its organs are prepared to drift away from *traditional corporatism* towards *contractualised governance*. Departure from traditional corporatism also reflects the state's perception vis-à-vis its responsibilities towards the public. A shift towards contractualised governance would indicate the departure from the assumption that the state embraces both roles as asset owner and service deliverer. It should also insinuate the shrinkage of the state and its organs, and the need to define a range of core activities that are not to be contractualised.[43]

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[40] A classic example of such approach is the views of the UK Government in relation to the involvement of the private sector in delivering public services through the so-called Private Finance Initiative (PFI), which attempts to create a framework between the public and private sectors working together in delivering public services. See in particular, *Working Together—Private Finance and Public Money*, Department of Environment, 1993. *Private Opportunity, Public Benefit—Progressing the Private Finance Initiative*, Private Finance Panel and HM Treasury, 1995.

[41] See J. Freeman, 'The Private Role in Public Governance', (2000) 75 *New York University Law Review* 534 *et seq*. Also C. H. Bovis, *Understanding Public Private Partnerships* (Alexander Maxwell Law Scholarship Trust, 2002).

[42] See the ratione of the Court of Justice in *BFI*, *Strohal*, and *Agora*.

[43] For example, defence, policing or other essential or core elements of public governance. It is maintained here that activities related to *imperium* (the use of force by way of regulatory or criminal law) could not

Lastly, in practical terms, it would be very difficult to prove the intention of a contracting authority to circumvent the public procurement rules and enforce their application on private undertakings.

F The 'Public' Nature of Public Procurement: Formality Versus Functionality

The remit and thrust of public procurement legislation relies heavily on the connection between contracting authorities and the state. A comprehensive and clear definition of the term *contracting authorities*, a factor that determines the applicability of the relevant rules is probably the most important element of the public procurement legal framework. The structure of the directives is such as to embrace the purchasing behaviour of all entities that have a close connection with the state. These entities, although not formally part of the state, disperse public funds in pursuit or on behalf of public interest. The directives describe as contracting authorities the *state*, which covers central, regional, municipal, and local government departments, as well as *bodies governed by public law*. Provision has been also made to cover entities, which receive more than 50% subsidies by the state or other contracting authorities. The enactment of the Utilities Directives[44] brought under the procurement framework entities operating in the water, energy, transport, and telecommunications sectors. A wide range of these entities is covered by the term *bodies governed by public law*, which is used by the Utilities Directive for the contracting entities operating in the relevant sectors.[45] Another category of contracting authorities under the Utilities Directive includes *public undertakings.*[46] The term indicates any undertaking over which the state may exercise direct or indirect dominant influence by means of ownership, or by means of financial participation, or by means of laws and regulations, which govern the public undertaking's operation. Dominant influence can be exercised in the form of a majority holding of the undertaking's subscribed capital, in the form of majority controlling of the undertaking's issued shares, or in the form of the right to appoint the majority of the undertaking's management board. Public undertakings cover utilities operators, which have been granted exclusive rights of exploitation of a service. Irrespective of their ownership, they are subject to the Utilities Directive in as much as the *exclusivity* of their operation precludes other entities from entering the relevant market under substantially the same competitive conditions. Privatised utilities could be, in principle, excluded from the procurement rules when a genuinely competitive régime[47] within the relevant

be the subject of contractualised governance. A useful analysis for such an argument is provided in Case C-44/96, *Mannesmann Anlangenbau Austria AG et al. v Strohal Rotationsdurck GesmbH* [1998] ECR 73, where the notions of public security and safety are used to described a range of activities by the state which possess the characteristic of 'public service obligations'. For a commentary of the case, see C. H. Bovis, 'Redefining Contracting Authorities under the EC Public Procurement Directives: An Analysis of the case C-44/96, Mannesmann Anlangenbau Austria AG et al. v. Strohal Rotationsdurck GesmbH', (1998) 36 CMLR.

[44] EC Directive 90/531, as amended by EC Directive 93/38, OJ L 199.

[45] Article 1(1) Dir 93/38.

[46] Article 1(2) of Dir 93/38.

[47] The determination of a genuinely competitive rgime is left to the utilities operators themselves. See Case C 392/93, *The Queen and H.M. Treasury, ex parte British Telecommunications*, [1996] ECR I-1631. This is perhaps a first step towards self-regulation, which could lead to the disengagement of the relevant contracting authorities from the public procurement régime.

market structure would rule out purchasing patterns based on non-economic considerations.

Although the term contracting authorities appears rigorous and well-defined, public interest functions are dispersed through a range of organisations, which *stricto sensu* could not fall under the ambit of the term 'contracting authorities', since they are not formally part of the state, nor all criteria for the definition of bodies governed by public law are present.[48] The Court of Justice addressed the *lex lacuna* through its landmark case, *Beentjes*.[49] The Court of Justice diluted the rigorous definition of contracting authorities for the purposes of public procurement law, by introducing a *functional dimension* of the state and its organs. In particular, it considered that a *local land consolidation committee* with no legal personality, but with its functions and compositions specifically governed by legislation as part of the state. The Court of Justice interpreted the term 'contracting authorities' in *functional terms* and considered the local land consolidation committee, which depended on the relevant public authorities for the appointment of its members, its operations were subject to their supervision and it had as its main task the financing and award of public works contracts, as falling within the notion of state, even though it was not part of the state administration in *formal terms*.[50] The Court of Justice held that the aim of the public procurement rules, as well as the attainment of freedom of establishment and freedom to provide services, would be jeopardised, if the public procurement provisions were to be held inapplicable, solely because entities that were set up by the state to carry out tasks entrusted to by legislation were not formally part of its administrative organisation.

In two recent cases, the Court of Justice applied the functionality test, when it was requested to determine the nature of entities that could not meet the criteria of bodies governed by public law, but had a distinctive public interest remit. In *Teoranta*,[51] a private company established according to national legislation to carry out the business of forestry and related activities was deemed as falling within the notion of the state. The company was set up by the state and was entrusted with specific tasks of public interest, such as managing national forests and woodland industries, as well as providing recreation, sporting, educational, scientific, and cultural facilities. It was also under decisive administrative, financial, and management control by the state, although the day-to-day operations were left entirely to its board. The Court of Justice accepted that, since the state had at least indirect control over the *Teoranta's* policies, in functional terms the latter was part of the state. In the *Vlaamese Raad*,[52] the Flemish parliament of the Belgian federal system was considered part of the 'federal' state. The Court of Justice held that the definition of the state encompasses all bodies that exercise legislative, executive and judicial powers, at both regional and federal levels. The

[48] This is particularly the case of non-governmental organisations (NGOs), which operate under the auspices of the central or local government and are responsible for public interest functions. See C. H. Bovis, 'Public entities awarding procurement contracts under the framework of EC Public Procurement Directives', (1993) 1 *Journal of Business Law* 56–78; S. Arrowsmith, *The Law of Public and Utilities Procurement* (Sweet & Maxwell, 1997) 87–88.

[49] Case 31/87, *Gebroeders Beentjes B.V. v State of Netherlands* [1988] ECR 4635.

[50] The formality test and the relation between the state and entities under its control was established in cases C-249/81, *Commission v Ireland* [1982] ECR 4005; C-36/74 *Walrave and Koch v Association Union Cycliste International et al.* [1974] ECR 1423.

[51] See Cases C-353/96 *Commission v Ireland* and C-306/97 *Connemara Machine Turf Co Ltd v Coillte Teoranta*, [1998] ECR I-8565.

[52] See Case C-323/96 *Commission v Kingdom of Belgium*, [1998] ECR I-5063.

Raad, as a legislative body of the Belgian state, although under no direct control by the state,[53] was held as falling within the definition of the state and thus being regarded as a contracting authority.

The functional dimension of contracting authorities has exposed the Court of Justice's departure from the formality test, which has rigidly positioned an entity under state control on *stricto sensu* traditional public law grounds. In addition to the elements of management or financial control, functionality, as an ingredient of assessing the relationship between an entity and the state, demonstrates the importance of constituent factors such as the intention and purpose of establishment of the entity in question. Functionality depicts a flexible approach in the applicability of the procurement directives, in a way that the Court of Justice, through its precedence, established a pragmatic approach as to the nature of the demand side of the public procurement equation.

IV Financing Public Services and State Aids: an Interplay between Legal Certainty, a Rule of Reason, and Universal Obligations

Market mechanisms and competitive forces offer insufficient assurances for the provision of services of general interest. The need for specific arrangements appears necessary in order to ensure their universal access, security of continuity, or full geographical coverage. Member States have enjoyed a wide range of discretion as to the financing of services of general interest and the calculation of any extra cost attributed to their provision. Legal and policy traditions, and the specific nature and characteristics of the services concerned, lead Member States to apply different mechanisms such as direct financial support through the state budget (in the form of subsidies or other financial advantages such as tax reductions), special or exclusive rights (such as a legal monopoly), contributions by market participants (in the form of a universal service fund), tariff averaging (for example a uniform country-wide tariff in spite of considerable differences in the cost of provision of the service), and solidarity-based financing (in the form of social security contributions).

In many instances, public service compensations are used as a funding mechanism of services of general economic interest, with only guidance from state aid rules that over-compensation is prohibited. In some cases, sector-specific legislation lays down specific rules for the financing of the extra cost of public service obligations. For electronic communications, sector-specific regulation requires Member States to withdraw all special or exclusive rights, but it provides for the possibility of creating a fund to cover the extra cost of providing a universal service on the basis of contributions from market participants.[54] With reference to postal services, the Postal Directive allows a defined postal monopoly to be maintained and a universal service fund to be created for the purposes of financing the postal service.[55] In the field of air transport, Member

[53] The fact that the Belgian Government did not, at the time, exercise any direct or indirect control relating to procurement policies over the Vlaamese Raad was considered immaterial on the grounds that a state cannot rely on its own legal system to justify non-compliance with EC law and particular directives. For these comments, see also Case C-144/97 *Commission v France*, [1998] ECR 1-613.

[54] See Art 13 Dir 2002/22/EC, OJ L 108, 24/4/2002, on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive).

[55] See Arts 7 and 9(4) of Dir 97/67/EC, OJ L 15 21/1/1998, on common rules for the development of the internal market of Community postal services and the improvement of quality of service, as amended by Directive 2002/39/EC, OJ L 176 5/7/2002.

States can grant a temporary exclusive licence on the basis of an open tender in order to ensure a regular service on certain routes for which the market does not offer an adequate service.[56] In public transport, the Community has laid down rules for the calculation of compensation.[57]

The rules governing the function of the Internal Market, competition law and policy, and the application of state aid rules aim to ensure that any financial support granted to providers of services of general economic interest does not distort the competitive equilibrium and functioning of the Internal Market. In addition, the sector-specific legislation in place seeks only to ensure that the financing mechanisms put in place by the Member States are least distortive of competition and facilitate market entry.

A The Court of Justice and its Approach to the Financing of Services of General Interest

There are three approaches under which the European judiciary and the Commission have examined the financing of public services: the *state aids approach*, the *compensation approach*, and the *quid pro quo approach.* These approaches reflect not only conceptual and procedural differences in the application of state aid control measures within the common market, but also raise imperative and multifaceted questions relevant to the state funding of services of general interest.[58]

The State aids approach[59] examines state funding granted to an undertaking for the performance of obligations of general interest. It thus regards the relevant funding as state aid within the meaning of Article 87(1) EC,[60] which may however be justified under Article 86(2) EC,[61] provided that the conditions of that derogation are fulfilled

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[56] See Art 4 of Reg 2408/92, OJ L 240, 24/8/1992, on access for Community air carriers to intra-Community air routes.

[57] See Reg 1169/69, OJ L 156 28/6/1969, on action by the Member States concerning the obligations inherent in the concept of a public service in transport by rail, road, and inland waterway, as last amended by Reg 1893/91, OJ L 169 29/6/1991.

[58] See A. Alexis, 'Services publics et aides d'Etat', (2002) *Revue du droit de l'Union Européenne* 63; D. Grespan, 'An example of the application of State aid rules in the utilities sector in Italy', (2002) 3 *Competition Policy Newsletter* 17; J. Gundel, 'Staatliche Ausgleichszahlungen für Dienstleistungen von allgemeinem wirtschaftlichem Interesse: Zum Verhδltnis zwischen Artikel 86', (2002) 3 *Absatz 2 EGV und dem EG-Beihilfenrecht, Recht der Internationalen Wirtschaft* 222; M. Nettesheim, 'Europäische Beihilfeaufsicht und mitgliedstaatliche Daseinsvorsorge', (2002) 6 *Europäisches Wirtschafts und Steuerrecht* 253; P. Nicolaides, 'Distortive effects of compensatory aid measures: a note on the economics of the Ferring judgment', (2002) *European Competition Law Review* 313; P. Nicolaides, 'The new frontier in State aid control. An economic assessment of measures that compensate enterprises', (2002) 37(4) *Intereconomics* 190; C. Rizza, 'The financial assistance granted by Member States to undertakings entrusted with the operation of a service of general economic interest: the implications of the forthcoming Altmark judgment for future State aid control policy', (2003) *Columbia Journal of European Law*; C. H. Bovis, 'Public procurement, state aids and the financing of public services: between symbiotic correlation and asymmetric geometry', (2003) November *European State Aids Law Quarterly* 563–577.

[59] See Case C-387/92 [1994] ECR I-877; Case T-106/95 *FFSA and Others v Commission* [1997] ECR II-229; Case C-174/97 P [1998] ECR I-1303; Case T-46/97 [2000] ECR II-2125.

[60] Article 87(1) EC defines State aid as 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods . . . in so far as it affects trade between Member States'.

[61] Article 86(2) EC stipulates that 'Undertakings entrusted with the operation of services of general economic interest . . . shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar 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'.

and, in particular, if the funding complies with the principle of proportionality. The state aids approach provides for the most clear and legally certain procedural and conceptual framework to regulate state aids, since it positions the European Commission, in its administrative and executive roles, at the centre of that framework.

The compensation approach[62] reflects upon a 'compensation' being intended to cover an appropriate remuneration for the services provided or the costs of providing those services. Under that approach, state funding of services of general interest amounts to state aid within the meaning of Article 87(1) EC, only if and to the extent that the economic advantage that it provides exceeds such an appropriate remuneration or such additional costs. European jurisprudence considers that state aids exist only if, and to the extent that the remuneration paid when the state and its organs procure goods or services, exceeds the market price.

The choice between the state aids approach and the compensation approach does not only reflect upon a theoretical debate; it mainly reveals significant practical ramifications in the application of state aid control within the common market. Whilst it is generally accepted that the pertinent issue of substance is whether the state funding exceeds what is necessary to provide for an appropriate remuneration or to offset the extra costs caused by the general interest obligations, the two approaches have very different procedural implications. Under the compensation approach, state funding that does not constitute state aid escapes the clutches of EU state aid rules, and need not be notified to the Commission. More importantly, national courts have jurisdiction to pronounce on the nature of the funding as state aid without the need to wait for an assessment by the Commission of its compatibility with the *acquis*. Under the state aid approach, the same measure would constitute state aid, which must be notified in advance to the Commission. Moreover, the derogation in Article 86(2) EC is subject to the same procedural regime as the derogations in Article 87(2) and (3) EC, which means that new aid cannot be implemented until the Commission has declared it compatible with Article 86(2) EC. Measures which infringe that standstill obligation constitute illegal aid. Another procedural implication from the application of the compensation approach is that national courts must offer to individuals the certain prospect that all the appropriate conclusions will be drawn from the infringement of the last sentence of Article 88(3) EC, as regards the validity of the measures giving effect to the aid, the recovery of financial support granted in disregard of that provision and possible interim measures.

Departing from the rationale of the above approaches, a third approach has been introduced in order to assist in understanding the relationship between the funding of public services and state aids. The *quid pro quo* approach distinguishes between two categories of state funding; in cases where there is a direct and manifest link between the state financing and clearly defined public service obligations, any sums paid by the state would not constitute state aid within the meaning of the Treaty. On the other hand, where there is no such link, or where the public service obligations were not clearly defined, the sums paid by the public authorities would constitute state aids.

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[62] See Case 240/83, *Procureur de la République v ADBHU,* [1985] ECR 531; Case C-53/00, *Ferring SA v Agence centrale des organismes de sıcurıtı sociale (ACOSS)*, [2001] ECR I-09067; Case C-280/00, *Altmark Trans GmbH and Regierungsprδsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH and Oberbundesanwalt beim Bundesverwaltungsgericht*, [2003] ECR 1432.

The quid pro quo approach[63] positions a distinction between two different categories at the centre of the analysis of state funding of services of general interest; (i) the nature of the link between the financing granted and the general interest duties imposed; and (ii) the degree of clarity in defining those duties. The first category would comprise cases where the financing measures are clearly intended as a *quid pro quo* for clearly defined general interest obligations, or in other words where the link between, on the one hand, the state financing granted and, on the other hand, clearly defined general interest obligations imposed, is direct and manifest. The clearest example of such a direct and manifest link between state financing and clearly defined obligations are public service contracts awarded in accordance with public procurement rules. The contract in question should define the obligations of the undertakings entrusted with the services of general interest and the remuneration that they will receive in return. Cases falling into that category should be analysed according to the compensation approach. The second category consists of cases where it is not clear from the outset that the State funding is intended as a *quid pro quo* for clearly defined general interest obligations. In those cases, the link between state funding and the general interest obligations imposed is either not direct or not manifest or the general interest obligations are not clearly defined.

The *quid pro quo* approach appears at first instance consistent with the general case law on the interpretation of Article 87(1) EC. In addition, it gives appropriate weight to the importance of services of general interest, within the remit of Article 16 EC and of Article 36 of the EU Charter of Fundamental Rights. On the other hand, the *quid pro quo* approach presents a major shortcoming: it introduces elements[64] of the nature of public financing into the process of determining the legality of state aids. According to state aids jurisprudence, only the effects of the measure are to be taken into consideration,[65] and as a result of the application of the *quid pro quo* approach legal certainty could be undermined.

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[63] See Opinion of Advocate General Jacobs in Case C-126/01, *Ministre de l'economie, des finances et de l'industrie v GEMO SA*, [2003] ECR 3454.

[64] For example, the form in which the aid is granted (See Cases C-323/82 *Intermills v Commission* [1984] ECR 3809, paragraph 31; Case C-142/87 *Belgium v Commission*, cited in note 18, paragraph 13; and Case 40/85 *Belgium v Commission* [1986] ECR I-2321, paragraph 120, the legal status of the measure in national law (See Commission Decision 93/349/EEC of 9 March 1993 concerning aid provided by the United Kingdom Government to British Aerospace for its purchase of Rover Group Holdings over and above those authorised in Commission Decision 89/58/EEC authorising a maximum aid to this operation subject to certain conditions (OJ 1993 L 143, p. 7, point IX), the fact that the measure is part of an aid scheme (Case T-16/96, *Cityflyer Express v Commission*, [1998] ECR II-757), the reasons for the measure and the objectives of the measure ((case C-173/73 *Italy* v *Commission* [1974] ECR 709; *Deufil v Commission*, [1987] ECR 901; Case C-56/93 *Belgium v Commission*, [1996] ECR I-723; Case C-241/94 *France v Commission* [1996] ECR I-4551; Case C-5/01 *Belgium v Commission* [2002] ECR I-3452) and the intentions of the public authorities and the recipient undertaking (Commission Decision 92/11/EEC of 31 July 1991 concerning aid provided by the Derbyshire County Council to Toyota Motor Corporation, an undertaking producing motor vehicles (OJ 1992 L 6, p. 36, point V).

[65] See Case C-173/73 *Italy v Commission* [1974] ECR 709, paragraph 27; *Deufil v Commission*, [1987] ECR 901; Case C-56/93 *Belgium v Commission*, [1996] ECR I-723 paragraph 79; Case C-241/94 *France v Commission* [1996] ECR I-4551, paragraph 20; and Case C-5/01 *Belgium v Commission* [2002] ECR I-3452, paragraphs 45 and 46.

B Public Service Obligations: Towards Universality of Services and their Financing

A category of services of general interest is the concept of public service obligations with reference to the Common Transport policy of the Community and the way the Treaty and also secondary legislation regulate their financing and their relationship with state aids. It appears that the financing of public service obligations and its interplay with state aids follows the compensation approach, where the state provides for adequate and fair compensation to undertakings in order to provide the relevant services that have public interest characteristics. However, the regulation of the funding of such services is *lex specialis*, in the sense that Article 84 EC expressly excludes the application of state aids provisions to air transport and therefore, the reimbursement of undertakings costs for fulfilling public service obligation requirements must be assessed on the basis of the general rules of the Treaty, which apply to air transport.[66] The Treaty provides that state aids are compatible with its principles, if they meet the needs of coordination of transport or if they represent reimbursement for the discharge of certain obligations inherent in the concept of public service.[67] In the context of air transport, public service obligation is defined[68] as any obligation imposed upon an air carrier to take, in respect of any route which it is licensed to operate by a Member State, all necessary measures to ensure the provision of a service satisfying pre-determined standards of continuity, regularity, capacity, and pricing, which standards the air carrier would not assume if it were solely considering its economic interest.[69] A Member State may thus reimburse the air carrier selected for carrying out the imposed public service obligation[70] by taking into account the costs and revenue (that is, the deficit) generated by the service.[71]

The acceptability of the reimbursement shall be considered in the light of state aid principles as interpreted by the Court of Justice. In this context, it is important that the airline, which has access to a route on which a public service obligation has been imposed, may be compensated only after being selected by public tender. However, Community rules on public procurement contracts do not apply to the awarding by law or contract of exclusive concessions, which are entirely regulated by the procedure provided for pursuant to Article 4(1) of Regulation 2408/92, which has set out uniform and non-discriminatory rules for the distribution of air traffic rights on routes upon which public service obligations have been imposed.

This tendering procedure enables Member States to value the offer for that route, and make their choice by taking into consideration both the consumers interest and

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[66] See Case 156/77 *Commission v Belgium* [1978] ECR 1881.

[67] A similar approach is followed for maritime transport. See the European Commission's Guidelines on State aid to maritime transport, OJ C 205 1997.

[68] See Art 2 of Reg 2408/92.

[69] Such public service obligations may be imposed on scheduled air services to an airport serving peripheral or development regions in its territory, or on a thin route to any regional airport in its territory provided that any such route is considered vital for the economic development of the region in which the airport is located.

[70] See Art 4(1)(h) of Reg 2408/92 OJ L 240 1992 on access for air carriers to intra-Community air routes.

[71] The development and the implementation of these schemes must be transparent. The Commission would expect the selected company to have an analytical accounting system sophisticated enough to apportion the relevant costs (including fixed costs) and revenues.

cost of the compensation. Furthermore, the criteria for calculation of the compensation have been clearly established. A reimbursement is calculated on the basis of the operating deficit incurred on a route, and cannot involve any overcompensation of the air carrier. Such a system excludes the possibility of state aid elements being included within the reimbursement for public service obligations. A compensation of the mere deficit incurred on a specific route (including a reasonable remuneration for capital employed) by an airline that has been fairly selected following an open bidding procedure, is a neutral commercial operation between the relevant State and the selected airline, which cannot be considered as aid. The essence of an aid lies in the benefit for the recipient;[72] a reimbursement limited solely to losses sustained because of the operation of a specific route does not bring about any special benefit for the company, which has been selected on the basis of the objective criteria.

Therefore, the Commission considers that compensation for public service obligations does not involve aid provided that: (i) the undertaking has been correctly selected through a call for tender, on the basis of the limitation of access to the route to one single carrier; and (ii) the maximum level of compensation does not exceed the amount of deficit as laid down in the bid. However, the fact that the public tender has not been conducted in accordance with the public procurement régime gives rise to certain concerns.

Where there is clear evidence that the Member State has not selected the best offer, the Commission may request information from the Member State in order to be able to verify whether the award includes State aid elements. In fact, such elements are likely to occur where the Member State engages itself to pay more financial compensation to the selected carriers than it would have paid to the carrier that submitted the best (not necessarily the cheapest) offer. Although the public tendering process under Regulation 2408/92 refers to the compensation required as just one of the criteria to be taken into consideration for the selection of submissions, the Commission considers however, that the level of compensation is the main selection criterion.[73] Indeed, other criteria such as adequacy, prices, and standards required are generally already included in the public service obligations themselves. Consequently, it is possible that the selected carrier could be other than the one that requires the lowest financial compensation. However, if the Commission concludes that the Member State concerned has not selected the best offer, it is likely to consider that the chosen carrier has received aid pursuant to Article 92 EC. Should the Member State not have notified the aid pursuant to Article 93(3) EC, the Commission would consider the aid as illegally granted where compensation has already been paid, and would open the procedure pursuant to Article 93(2) EC.[74]

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[72] See Case 173/73, *Italian Government v Commission* [1974] ECR 709.

[73] See Cases C301/87 *France v Commission* [1990] ECR I-307; Case C142/87 *Belgium v Commission* [1990] ECR I-959.

[74] Article 5 of Regulation 2408/92 allows for exclusive concessions on domestic routes granted by law or contract, to remain in force, under certain conditions, until their expiry, or for three years, whichever deadline comes first. Possible reimbursement given to the carriers benefiting from these exclusive concessions may well involve aid elements, particularly as the carriers have not been selected by an open tender (as foreseen in the case of Art 4(1) of Reg 2408/92).

V Public Procurement and Financing of Public Services

A The Role of Public Procurement in the Assessment of State Aids

The application of the state aid approach creates a *lex* and a *policy lacunae* in the treatment of funding of services of general economic interest and other services, which is filled by the application of the public procurement régime. In fact, it presupposes that the delivery of services of general economic interest emerge and take place in a different market, where the state and its emanations act in a public function. Such markets are not susceptible to the private operator principle,[75] which has been relied upon by the Commission and the European courts[76] to determine the borderline between market behaviour and state intervention. The state aids approach runs parallel with the assumption that services of general interest emerge and their delivery takes place within distinctive markets, which bear little resemblance to private markets in terms of competitiveness, demand and supply substitutability, structure, and even regulation.

European jurisprudence distinguishes the economic nature of state intervention and the exercise of public powers.[77] The application of the private operator principle is confined to the economic nature of state intervention,[78] and is justified by the principle of equal treatment between the public and private sectors,[79] which requires that intervention by the state should not be subject to stricter rules than those applicable to private undertakings. The non-economic character of state intervention[80] renders the test of private operator immaterial because profitability, and thus the *raison d'être* of the private investment, is not present. It follows that services of general economic interest cannot be part of the same demand/supply equation, as other normal services the state

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[75] See the Communication of the Commission to the Member States concerning public authorities' holdings in company capital (*Bulletin EC* 9-1984, point 3.5.1). The Commission considers that such an investment is not aid where the public authorities effect it under the same conditions as a private investor operating under normal market economy conditions. See also Commission Communication to the Member States on the application of Arts 92 and 93 EEC and of Art 5 of Dir 80/723/EEC to public undertakings in the manufacturing sector (OJ 1993 C 307, p. 3, point 11).

[76] See, in particular, Case 234/84 *Belgium v Commission* [1986] ECR 2263, para 14; Case C-142/87 *Belgium v Commission* (*'Tubemeuse'*) [1990] ECR I-959, paragraph 26; and Case C-305/89 *Italy v Commission* (*'Alfa Romeo'*) [1991] ECR I-1603, paragraph 19.

[77] See Joined Cases C-278/92 to C-280/92 *Spain v Commission* [1994] ECR I-4103.

[78] For example where the public authorities contribute capital to an undertaking (Case 234/84 *Belgium v Commission* [1986] ECR 2263; Case C-142/87 *Belgium v Commission* [1990] ECR I-959; Case C-305/89 *Italy* v *Commission* [1991] ECR I-1603), grant a loan to certain undertakings (Case C-301/87 *France v Commission* [1990] ECR I-307; Case T-16/96 *Cityflyer Express v Commission* [1998] ECR II-757), provide a state guarantee (Joined Cases T-204/97 and T-270/97 *EPAC* v *Commission* [2000] ECR II-2267), sell goods or services on the market (Joined Cases 67/85, 68/85 and 70/85 *Van der Kooy and Others v Commission* [1988] ECR 219; Case C-56/93 *Belgium v Commission* [1996] ECR I-723; Case C-39/94 *SFEI and Others* [1996] ECR I-3547), or grant facilities for the payment of social security contributions (Case C-256/97 *DM Transport* [1999] ECR I-3913), or the repayment of wages Case C-342/96 *Spain v Commission* [1999] ECR I-2459).

[79] See Case C-303/88 *Italy v Commission* [1991] ECR I-1433, paragraph 20; Case C-261/89 *Italy v Commission* [1991] ECR I-4437, paragraph 15; and Case T-358/94 *Air France v Commission* [1996] ECR II-2109, paragraph 70.

[80] For example where the public authorities pay a subsidy directly to an undertaking (Case 310/85 *Deufil v Commission* [1987] ECR 901), grant an exemption from tax (Case C-387/92 *Banco Exterior* [1994] ECR I-877; Case C-6/97 *Italy v Commission* [1999] ECR I-2981; Case C-156/98 *Germany v Commission* [2000] ECR I-6857) or agree to a reduction in social security contributions (Case C-75/97 *Belgium v Commission* [1999] ECR I-3671; Case T-67/94 *Ladbroke Racing v Commission* [1998] ECR II-1).

and its organs procure.[81] Along the above lines, a convergence emerges between public procurement jurisprudence and the state aid approach in the light of the reasoning behind the *BFI*[82] and *Agora*[83] cases. Services of general economic interest are *sui generis*, having as main characteristics the lack of industrial and commercial character, where the absence of profitability and competitiveness are indicative of the relevant market place. As a rule of thumb, the procurement of such services should be subject to the rigour and discipline of public procurement rules and in analogous *ratione*, classified as state aid, in the absence of the competitive award procedures. In consequence, the application of the public procurement régime reinforces the character of services of general interest as non-commercial or industrial and the existence of *marchés publics.*[84]

Of interest is the latest case, *Chronopost*,[85] where the establishment and maintenance of a public postal network such as the one offered by the French La Poste to its subsidiary Chronopost was not considered as a 'market network'. The Court of Justice arrived at this reasoning by using a market analysis, which revealed that under normal conditions it would not have been rational to build up such a network with the considerable fixed costs necessary in order to provide third parties with the assistance of the kind at issue in that case. Therefore the determination of a platform under which the normal remuneration a private operator occurs would have constituted an entirely hypothetical exercise. As the universal network offered by La Poste was not a 'market network', there were no specific and objective references available in order to establish what normal market conditions should be. On the one hand, there was only one single undertaking, i.e. La Poste, which was capable of offering the services linked to its network, and none of the competitors of Chronopost had ever sought access to the French Post Office's network. Consequently, objective and verifiable data on the price paid within the framework of a comparable commercial transaction did not exist. The Commission's solution of accepting a price that covered all the additional costs, fixed and variable, specifically incurred by La Poste in order to provide the logistical and commercial assistance, and an adequate part of the fixed costs associated with maintaining the public postal network, represented a sound way in order to exclude the existence of state aid within the meaning of Article 87(1) EC. The *Chronopost* ruling disapplied the private investor principle from state aids regulation, by indirectly accepting the state aids approach and therefore the existence of *sui generis markets* within which services of general interest emerge and are delivered, and which cannot feasibly be compared with private ones.

B The Interaction of Public Procurement with the Three Approaches of State Aids Assessment

The compensation approach relies heavily upon the real advantage theory to determine the existence of any advantages conferred to undertakings through state financing.[86]

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[81] See the analysis in the Joined Cases C-278/92 to C-280/92 *Spain* v *Commission* [1994] ECR I-4103.

[82] See Case C-360/96, *Gemeente Arnhem Gemeente Rheden v BFI Holding BV.*

[83] Cases C-223/99, *Agora Srl v Ente Autonomo Fiera Internazionale di Milano* and C-260/99 *Excelsior Snc di Pedrotti Runa & C v Ente Autonomo Fiera Internazionale di Milano, op.cit.*

[84] See M. Bazex, *Le droit public de la concurrence* (RFDA, 1998); L. Arcelin, *L'enterprise en droit interne et communautaire de la concurrence* (Litec, 2003); Guézou, Droit de la concurrence et droit des marchés publics: vers une notion transverale de mise en libre concurrence, (2003) Mars *Contrats Publics.*

[85] See Joined Cases C-83/01 P, C-93/01 P and C-94/01 *Chronopost and Others* [2003], not yet reported; see also the earlier judgment of the CFI Case T-613/97 *Ufex and Others v Commission* [2000] ECR II-4055.

[86] See A. Evans, *European Community Law of State Aid* (Clarendon Press, 1997).

Thus, under the real advantage theory, the advantages that are conferred by the public authorities to undertakings and threaten to distort competition are examined together with the obligations on the recipient of the aid. Public advantages thus constitute aid only if their amount exceeds the value of the commitments the recipient enters into. The compensation approach treats the costs offsetting the provision of services of general interest as the baseline over which state aids should be considered. That baseline is determined by the market price, which corresponds to the given public/private contractual interface and is demonstrable through the application of public procurement award procedures. The application of the compensation approach reveals a significant insight into the financing of services of general interest. A quantitative distinction emerges, over and above which state aids exist. The compensation approach introduces an applicability threshold of state aids regulation, and that threshold is the perceived market price, terms, and conditions for the delivery of the relevant services.

An indication of the application of the compensation approach is reflected in the *Stohal*[87] case, where an undertaking could provide commercial services and services of general interest, without any relevance to the applicability of the public procurement rules. The rationale of the case runs parallel with the real advantage theory, up to the point of recognising the different nature and characteristics of the markets under which normal (commercial) services and services of general interest are provided. The distinction begins where, for the sake of legal certainty and legitimate expectation, the activities undertakings of dual capacity are equally covered by the public procurement regime and the undertaking in question is considered as *contracting authority* irrespective of any proportion or percentage between the delivery of commercial services and services of general interest. This finding might have a significant implication for the compensation approach in state aids jurisprudence: irrespective of any costs offsetting the costs related to the provision of general interest, the entire state financing could be viewed under the state aid approach.

Nevertheless, the real advantage theory upon which the compensation approach seems to rely runs contrary to the apparent advantage theory which underlines Treaty provisions[88] and the so-called 'effects approach'[89] adopted by the Court of Justice in determining the existence of state aids. The real advantage theory seems to underpin the *quid pro quo* approach, and it also creates some conceptual difficulties in reconciling jurisprudential precedent in state aids regulation.

The *quid pro quo* approach appears to define state aids no longer by reference solely to the effects of the measure, but by reference to criteria of a purely formal or procedural nature. This means that the existence of a procedural or a substantive link between the state and the service in question lifts the threat of state aids regulation, irrespective of any effect the state measure has on competition. However, the Court of Justice considers that to determine whether a state measure constitutes aid, only the

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[87] C-44/96, *Mannesmann Anlangenbau Austria AG et al. v Strohal Rotationsdurck GesmbH, op. cit.* note 9 *supra*. See also the analysis of the case by Bovis, *op. cit.* note 43 *supra*, at 205–225.

[88] According to Advocate General Léger in his Opinion on the *Altmark* case, the apparent advantage theory occurs in several provisions of the Treaty, in particular in Art 92(2) and (3), and in Art 77 of the EC Treaty (now Art 73 EC). Article 92(3) of the Treaty provides that aid may be regarded as compatible with the common market if it pursues certain objectives such as the strengthening of economic and social cohesion, the promotion of research and the protection of the environment.

[89] See Case C-173/73 *Italy v Commission* [1974] ECR 709; *Deufil v Commission*, [1987] ECR 901; Case C-56/93 *Belgium v Commission*, [1996] ECR I-723; Case C-241/94 *France v Commission* [1996] ECR I-4551; Case C-5/01 *Belgium v Commission* [2002] ECR I-3452.

effects of the measure are to be taken into consideration, whereas other elements[90] typifying a measure are not relevant during the stage of determining the existence of aid, because they are not liable to affect competition. However, the relevance of these elements may appear when an assessment of the compatibility of the aid[91] with the derogating provisions of the Treaty takes place.

The application of the *quid pro quo* approach amounts to introducing such elements into the actual definition of aid. The presence of a direct and manifest link between the state funding and the public service obligations amounts to the existence of a public service contract awarded after a public procurement procedure. In addition, the clear definition of public service obligations amounts to the existence of laws, regulations or contractual provisions that specify the nature and content of the undertaking's obligations. The borderline of the market price, which will form the conceptual base above which state aids would appear, is not always easy to determine, even with the presence of public procurement procedures. The state and its organs as contracting authorities (state emanations and bodies governed by public law) have wide discretion to award public contracts under the public procurement rules.[92] Often, price plays a secondary role in the award criteria. In cases when the public contract is awarded to the lowest price,[93] the element of *market price* under the compensation approach could be determined. However, when the public contract is to be awarded by reference to the most economically advantageous offer,[94] the market price might be totally different to the price the contracting authority wishes to pay for the procurement of the relevant services. The mere existence of public procurement procedures cannot, therefore, reveal the necessary element of the compensation approach: the market price that will determine the 'excessive' state intervention and introduce state aids regulation.

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[90] For example the form in which the aid is granted, the legal status of the measure in national law, the fact that the measure is part of an aid scheme, the reasons for the measure, the objectives of the measure and the intentions of the public authorities and the recipient undertaking.

[91] For example certain categories of aid are compatible with the common market on condition that they are employed through a specific format. See Commission notice 97/C 238/02 on Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ 1997 C 283).

[92] According to Art 26 of Dir 93/36, Art 30 of Dir 93/37, Art 34 of Dir 93/38 and Art 36 of Dir 92/50, two criteria provide the conditions under which contracting authorities award public contracts: *the lowest price* or the *most economically advantageous offer.* The first criterion indicates that, subject to the qualitative criteria and financial and economic standing, contracting authorities do not rely on any other factor than the price quoted to complete the contract. The Directives provide for an automatic disqualification of an 'obviously abnormally low offer'. The term has not been interpreted in detail by the Court of Justice and serves rather as an indication of a 'lower bottom limit' of contracting authorities accepting offers from the private sector tenderers See Case 76/81, *SA Transporoute et Travaux v Minister of Public Works* [1982] ECR 457; Case 103/88, *Fratelli Costanzo S.p.A. v Comune di Milano* [1989] ECR 1839; Case 295/89, *Impresa Dona Alfonso di Dona Alfonso & Figli s.n.c. v Consorzio per lo Sviluppo Industriale del Comune di Monfalcone* [1991] ECR 2967.

[93] An interesting view of the lowest price representing market value benchmarking is provided by the case C-94/99, *ARGE Gewässerschutzt, op. cit*, note 9 *supra*, where the Court of Justice ruled that directly or indirectly subsidised tenders by the state or other contracting authorities, or even by the contracting authority itself, can be legitimately part of the evaluation process, although it did not elaborate on the possibility of rejection of an offer, which is appreciably lower than those of unsubsidised tenderers by reference to the of abnormally low disqualification ground.

[94] The meaning of the most economically advantageous offer includes a series of factors chosen by the contracting authority, including price, delivery or completion date, running costs, cost-effectiveness, profitability, technical merit, product or work quality, aesthetic and functional characteristics, after-sales service and technical assistance, commitments with regard to spare parts and components and maintenance costs, security of supplies. The above list is not exhaustive.

Lastly, the *quid pro quo* approach relies on the existence of a direct and manifest link between state financing and services of general interest, existence indicative through the presence of a public contract concluded in accordance with the provisions of the public procurement directives. Apart from the criticism it has received concerning the introduction of elements into the assessment process of state aids, the interface of the *quid pro quo* approach with public procurement appears as the most problematic facet in its application. The procurement of public services does not always reveal a public contract between a contracting authority and an undertaking.

The *quid pro quo* approach appears to define state aids no longer by reference solely to the effects of the measure, but by reference to criteria of a purely formal or procedural nature. This means that the existence of a procedural or a substantive link between the state and the service in question lifts the threat of state aids regulation, irrespective of any effect the state measure has on competition. However, the Court of Justice considers that to determine whether a State measure constitutes aid, only the effects of the measure are to be taken into consideration, whereas other elements[95] typifying a measure are not relevant during the stage of determining the existence of aid, because they are not liable to affect competition. However, the relevance of these elements may appear when an assessment of the compatibility of the aid[96] with the derogating provisions of the Treaty takes place. The application of the *quid pro quo* approach amounts to introducing such elements into the actual definition of aid. Its first criterion suggests examining whether there is a direct and manifest link between the State funding and the public service obligations. In practice, this amounts to requiring the existence of a public service contract awarded after a public procurement procedure. Similarly, the second criterion suggests examining whether the public service obligations are clearly defined. In practice, this amounts to verifying that there are laws, regulations or contractual provisions which specify the nature and content of the undertaking's obligations.

Although the public procurement régime embraces activities of the *state*, which covers central, regional, municipal, and local government departments, as well as *bodies governed by public law*, and public utilities, in-house contracts are not subject to its coverage. The existence of dependency, in terms of overall control of an entity by the state or another contracting authority renders the public procurement régime inapplicable. Dependency presupposes a control similar to that which the state of another contracting authority exercises over its own departments. The 'similarity' of control denotes lack of independence with regard to decision-making. The Court of Justice in *Teckal*,[97] concluded that a contract between a contracting authority and an entity, which the former exercises a control similar to that which exercises over its own departments and at the same time that entity carries out the essential part of its activities with the contracting authority, is not a public contract, irrespective of whether that entity is a contracting authority or not. The similarity of control as a reflection of

[95] For example, the form in which the aid is granted, the legal status of the measure in national law, the fact that the measure is part of an aid scheme, the reasons for the measure, the objectives of the measure, and the intentions of the public authorities and the recipient undertaking.

[96] For example, certain categories of aid are compatible with the common market on condition that they are employed through a specific format. See Commission notice 97/C 238/02, OJ 1997 C 283 on Community guidelines on State aid for rescuing and restructuring firms in difficulty.

[97] See Case C-107/98, *Teckal Slr v Comune di Viano*, [1999] ECR I-8121.

dependency reveals another facet of the thrust of contracting authorities: the non-applicability of the public procurement rules for in-house relationships.

Along the same line of arguments, contracts to affiliated undertakings escape the clutches of the Directives. Article 6 of the Services Directive provides for the inapplicability of the Directive to service contracts that are awarded to an entity which is itself a contracting authority within the meaning of the Directive on the basis of an exclusive right which is granted to the contracting authority by a law, regulation, or administrative provision of the Member State in question. Article 13 of the Utilities Directive provides for the exclusion of certain contracts between contracting authorities and affiliated undertakings. For the purposes of Article 1(3) of the Utilities Directive, an affiliated undertaking is one the annual accounts of which are consolidated with those of the contracting entity in accordance with the requirements of the seventh company law Directive.[98] These are service contracts, which are awarded to a service-provider, which is affiliated to the contracting entity, and service contracts, which are awarded, to a service-provider, which is affiliated, to a contracting entity participating in a joint venture formed for the purpose of carrying out an activity covered by the Directive.[99]

In addition, the connection between the state and entities that operate in the utilities sector and have been privatised is also weak to sustain the presence of a public procurement contract for the delivery of services of general interest. Privatised utilities could be, in principle, excluded from the procurement rules when a genuinely competitive régime[100] within the relevant market structure would rule out purchasing patterns based on non-economic considerations. Under the Tokyo Round GATT Agreement on Government Procurement, the term public authorities confined itself to central governments and their agencies only.[101] The new World Trade Organization Government Procurement Agreement (GPA) applies in principle to all bodies which are deemed as 'contracting authorities' for the purposes of the Public Supplies and Public Works Directives. As far as utilities are concerned, the GPA applies to entities, which carry out one or more of certain listed 'utility' activities,[102] where these entities are either

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[98] See Council Directive 83/349, OJ 1983 L193/1.

[99] The explanatory memorandum accompanying the text amending the Utilities Directive (COM (91) 347-SYN 36 1) states that this provision relates, in particular, to three types of service provision within groups. These categories, which may not or may not be distinct, are: the provision of common services such as accounting, recruitment, and management; the provision of specialised services embodying the know-how of the group; the provision of a specialised service to a joint venture. The exclusion from the provisions of the Directive is subject, however, to two conditions: the service-provider must be an undertaking affiliated to the contracting authority and, in which at least 80 per cent of its average turnover arising within the European Community for the preceding three years derives from the provision of the same or similar services to undertakings with which it is affiliated. The Commission is empowered to monitor the application of this Article and require the notification of the names of the undertakings concerned and the nature and value of the service contracts involved.

[100] The determination of a genuinely competitive régime is left to the utilities operators themselves. See Case C-392/93, *The Queen and H.M. Treasury, ex parte British Telecommunications PLC*, [1996] ECR I-1631. This approach by the Court of Justice is reflected into the current proposals of the public procurement directives to disengage from the relevant régime genuinely competitive entities and replace public procurement regulation with a sort of sectoral/industry self-regulation.

[101] See Council Decision 87/565, OJ L 345 1987.

[102] The listed utility activities which are covered under the new GPA include (i) activities connected with the provision of water through fixed networks; (ii) activities concerned with the provision of electricity through fixed networks; (iii) the provision of terminal facilities to carriers by sea or inland waterway; and (iv) the operation of public services in the field of transport by automated systems, tramway, trolley bus, or cable bus.

'public authorities' or 'public undertakings', in the sense of the Utilities Directive. However, the GPA does not cover entities operating in the utilities sector on the basis of *special and exclusive rights*. In many instances, Member States grant special or exclusive rights in order to ensure the financial viability of a provider of a service of general economic interest. The granting of such rights is not *per se* incompatible with the Treaty. The Court of Justice has ruled that Article 86(2) EU permits the Member States to confer on undertakings to which they entrust the operation of services of general economic interest exclusive rights which may hinder the application of the rules of the Treaty on competition insofar as restrictions on competition, or even the exclusion of all competition, by other economic operators are necessary to ensure the performance of the particular tasks assigned to the undertakings possessed of the exclusive rights.[103] However, Member States must ensure that such rights are compatible with internal market rules and do not amount to abuse of a dominant position within the meaning of Article 82 by the operator concerned. Generally speaking, exclusive or special rights may limit competition on certain markets only insofar as they are necessary for performing the particular public service task. In addition, Member States' freedom to grant special or exclusive rights to providers of services of general interest can also be restricted in sector-specific Community legislation.

VI The Demarcation between Market Forces and Protection

A Jurisprudential Inferences

The European Court of Justice and the Court of First Instance have approached the subject of financing services of general interest from different perspectives. These perspectives show a degree of inconsistency, but they shed light on the demarcation of competitiveness and protection with respect to the financing of public services. Also, the inconsistent precedent has opened a most interesting debate focusing on the role and remit of the state within the common market and its relation with the provision and financing of services of general interest. The conceptual link between public procurement and the financing of services of general interest reveals the policy implications and the interplay of jurisprudence between public procurement and state aids. The three approaches used by the courts to construct the premises upon which the funding of public service obligations, services of general interest, and services for the public at large could be regarded as state aids, utilise public procurement in different ways. On the one hand, under the state aids and compensation approaches, public procurement sanitises public subsidies as legitimate contributions towards public service obligations and services of general interest. From procedural and substantive viewpoints, the existence of public procurement award procedures, as well as the existence of a public contract between the state and an undertaking reveals the necessary links between the markets where the state intervenes in order to provide services of general interest. In fact, both approaches accept the *sui generis* characteristics of public markets, and the role the state and its organs play within such markets. On the other hand, the *quid pro quo* approach relies on public procurement to justify the clearly defined and manifest link between funding and the delivery of a public service obligation. It assumes that without these procedural and substantive links between public services and their financing, the financing of public services is state aids.

[103] See Case C-320/91, *Corbeau v Commission* ECR [1993] I-2533 point 14.

In most cases, public procurement connects the activities of the state with the pursuit of public interest. The subject of public contracts and their respective financing relates primarily to services of general interest. Thus, public procurement indicates the necessary link between state financing and services of general interest, a link which takes state aids regulation out of the equation. The existence of public procurement and the subsequent contractual relations ensuing from the procedural interface between the public and private sectors neutralise state aids regulation. In principle, the financing of services of general interest, when channelled through public procurement, reflects market value. However, it should be maintained that the safeguards of public procurement reflecting genuine market positions are not robust and the foundations upon which a quantitative application of state aids regulation is based are not stable. The markets within which the services of general interest emerged and are delivered reveal little evidence of similarities and do not render meaningful any comparison with private markets, where competitiveness and substitutability of demand and supply feature. The approach adopted by the European judiciary indicates the presence of *marchés publics*, *sui generis* markets where the state intervenes in pursuit of public interest. State aids regulation could be applied, as a surrogate system of public procurement, to ensure that distortions of competition do not emerge as a result of the inappropriate financing of services.

B A New Approach: a Touch of Ambiguity

The debate of the delineation between market forces and protection in the financing of public services has taken a twist. The Court of Justice in *Altmark*[104] followed a hybrid approach between the compensation and the *quid pro quo* approaches. It ruled that where subsidies are regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations, they do not constitute state aids. Nevertheless for the purpose of applying that criterion, national courts should ascertain that four conditions are satisfied: first, the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined; second, the parameters on the basis of which the compensation is calculated has been established beforehand in an objective and transparent manner; third, the compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations; fourth, where the undertaking that is to discharge public service obligations is not chosen in a public procurement procedure, the level of compensation needed has been determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with appropriate means so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

The first criterion, which requires the existence of a clear definition of the framework within which public service obligations and services of general interest have been entrusted to the beneficiary of compensatory payments runs consistently with Article 86(2) EC jurisprudence, where an express act of the public authority to assign services

[104] See Case C-280/00, *Altmark Trans GmbH, Regierungspr*δ*sidium Magdeburg et Nahverkehrsgesellschaft Altmark GmbH, Oberbundesanwalt beim Bundesverwaltungsgericht*, (third party), judgment of 24 July 2003.

of general economic interest[105] is required. However, the second criterion, which requires the establishment of the parameters on the basis of which the compensation is calculated in an objective and transparent manner departs from existing precedent,[106] as it establishes an *ex post* control mechanism by the Member States and the European Commission. The third criterion, that the compensation must not exceed what is necessary to cover the costs incurred in discharging services of general interest or public service obligations, is compatible to the proportionality test applied in Article 86(2) EC. However, there is an inconsistency problem, as the European judiciary is rather unclear to the question whether any compensation for public service obligations may comprise a profit element.[107] Lastly, the fourth criterion, which establishes a comparison of the cost structures of the recipient on the one hand and of a private undertaking, well run and adequately provided to fulfil the public service tasks, in the absence of a public procurement procedure, inserts elements of subjectivity and uncertainty that will inevitably fuel more controversy.

The four conditions laid down in *Altmark* are ambiguous. In fact they represent the hybrid link between the compensation approach and the quid pro quo approach. The Court of Justice appears to accept unequivocally the parameters of the compensation approach (*sui generis* markets, remuneration over and above normal market prices for services of general interest), although the link between the services of general interest and their legitimate financing requires the presence of public procurement, as procedural verification of competitiveness and cost authentication of market prices. However, the application of the public procurement régime cannot always depict the true status of the market. Furthermore, the condition relating to the clear definition of an undertaking's character in receipt of subsidies to discharge public services in an objective and transparent manner, in conjunction with the costs attached to the provision of the relevant services could give rise to major arguments across the legal and political systems in the common market. The interface between public and private sectors in relation to the delivery of public services is in an evolutionary state across the common market. Lastly, the concept of 'reasonable profit' over and above the costs associated with the provision of services of general interest could complicate matters more, since they appear as elements of subjectivity and uncertainty.

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[105] See Case 127/73 *BRT v SABAM* [1974] ECR 313, para. 20; Case 66/86 *Ahmed Saeed Flugreisen v Commission* [1989] ECR 803, para 55.

[106] The standard assessment criterion applied under Article 86(2) EC only requires for the application of Article 87(1) EC to frustrate the performance of the particular public service task, allowing for the examination being conducted on an *ex post facto* basis. See also the *ratione* behind the so-called 'electricity judgments' of the Court of Justice of 23 October 1997; Case C-157/94 *Commission v Netherlands* [1997] ECR I-5699; Case C-158/94 *Commission v Italy* [1997] ECR I-5789; Case C-159/94 *Commission v France* [1997] ECR I-5815 and C-160/94 *Commission v Spain* [1997] ECR I-5851; a great deal of controversy exists as to whether the material standard of the frustration of a public service task under Article 86(2) EC had lost its strictness. See S. Magiera, Gefährdung der öffentlichen Daseinsvorsorge durch das EG-Beihilfenrecht?', (2000) *FS für Dietrich Rauschning*.

[107] See Opinion of Advocate General Lenz, delivered on 22 November 1984 in Case 240/83 *Procureur de la République v ADBHU* [1985] ECR 531 (536). Advocate General Lenz held that the indemnities granted must not exceed annual uncovered costs actually recorded by the undertaking, taking into account a reasonable profit. However, in the *ADBHU* case, the Court of Justice did not allow for the permissibility of taking into account such a profit element. Interestingly, the approach of the Court of First Instance on Article 86(2) EC has never allowed any profit element to be taken into account, but instead focused on whether without the compensation at issue being provided the fulfilment of the specific public service tasks would have been jeopardised.

VII Conclusions

The principle of the Member States' autonomy to make policy choices regarding services of general economic interest equally applies with regard to financing their provision. Member States enjoy a wide margin of discretion when deciding whether and how to finance the provision of services of general economic interest. The financing mechanisms applied by Member States include direct financial support through the state budget, special or exclusive rights, and contributions by market participants, tariff averaging and solidarity-based financing. In the absence of Community harmonisation, the main limit to this discretion is the requirement that such financing mechanism must not distort competition within the common market. However, other relevant criteria for selecting a financing mechanism, such as the efficiency of the financial mechanism, its redistributive effects, the long-term investment of providers on services and infrastructure, and finally the security of service provision could introduce a new debate platform, from where a *lex specialis* approach or a sector-specific regulation could be adopted.

The relation of public procurement with state aids reveals a symbiotic flexibility embedded in the régime of regulating the award of public contracts. That flexibility conferred to contracting authorities is augmented by a wide margin of discretion available to Member States to introduce public policy considerations in dispersing public services. State aids, as regional development considerations, or as part of a national of EU-wide industrial policy are inherently a part of this symbiotic policy approach. This finding removes the often-misunderstood justification of public procurement as an economic exercise and places it in the heart of an ordo-liberal interpretation of the European integration process. On the other hand, the conceptual interrelation of public procurement with the financing of services of general interest reveals the policy and jurisprudence links between public procurement and state aids. These links offer a prism of an asymmetric geometry analysis, where the three approaches used to conceptualise the funding of public service obligations, services of general interest, and services for the public at large, utilise public procurement in different ways. The presence of public procurement award procedures, as well as the existence of a public contract between the state and an undertaking verifies the state aid approach and the compensation approach to the extent that they provide the necessary links between the markets where the state intervenes in order to provide services of general interest. On the other hand, the *quid pro quo* approach relies on public procurement to justify the clearly defined and manifest link between the funding and the delivery of a public service obligation. Even the hybrid approach adopted by *Altmark* confirms the delineation between market forces through competitiveness and protection through state aids in the financing of services of general interest. The public procurement framework not only will be used to insert competitiveness and market forces within *marchés publics*, but more importantly, in the author's view, it will be used by the European judiciary and the European Commission as a system to verify conceptual links, create compatibility safeguards, and authenticate established principles applicable in state aids regulation.