

Public Funding of Infrastructure Projects under EC-State Aid Law

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Through infrastructure public authorities seek to give wide access to basic public services at affordable prices. For a long time, concerns about State aid regarding infrastructure funding have been denied due to this general interest. With the development of private participation in the provision of infrastructure, the European Commission has reconsidered several cases in which infrastructure funding could escape Article 87(1) EC and thus the notification requirement. In the light of recent Commission practice, this paper will outline the scope of Article 87(1) EC insofar as it relates to infrastructure.

I. Public infrastructure

We first examine infrastructure facilities that are completely provided by the State. In order to lie outside the scope of Article 87(1) EC, such a public facility must not favour any particular undertaking¹. Infrastructure renders a particular region more attractive to undertakings. While this is an advantage conferred by public action, this benefit is in principle available to all undertakings that choose to locate in the area and hence does not constitute "favouring"². The presence of State aid can be inferred, however, if a facility is not

available to all potential users on a non-discriminatory basis³. A business park must thus be open to all interested undertakings belonging to different sectors on the same conditions; sports facilities and event venues ought to be multifunctional and hence accessible to various groups of users⁴. Moreover, administrative charges to users must not discriminate⁵. This accessibility must exist not only in law but also in fact, since any given facility theoretically open to all undertakings may in practice be used by, or useful to, only one particular undertaking. This was the case in Kimberly-Clark⁶, where the Commission regarded the establishment of a business park exclusively for Kimberly Clark Industries as State aid because the park was tailored to the needs of the company in that it was situated near a river to ensure fresh water supply and sewerage. Whereas the park was theoretically open to all businesses, in practice it was designed for a paper manufacturer like Kimberly. But not every advantage accruing to a company due to its factually exclusive use of the infrastructure automatically constitutes state aid. Rather, the advantage has to be exclusive in the sense that other undertakings locating to the business park at a later time are unable to benefit from it⁷. "Favouring" may also be present if the public can be excluded from the infrastructure for the duration of a specific use⁸. If discriminatory access to the facility grants an advantage to a particular undertaking or group of users, a market price for this use must be paid in order to avoid State aid⁹.

But more than that is needed to fully escape the charge of favouring: Any infrastructure that does not make discrimination within a sector may still be favouring that sector over another, and thus constitute a sectoral aid with an open door clause¹⁰. An oil pipeline, for instance, might be neutral between oil producers, but certainly has an impact on other producers of energy. A public infrastructure installation should therefore be required to satisfy a public interest, i.e. to benefit the economy in general¹¹. The Commission's practice indicates how this term should be interpreted: Investments in urban renewal, facilities for education, transport, and research and development do not count as State aid if they satisfy the conditions explained above¹². Of course, no infrastructure is completely neutral vis-à-vis all economic actors: A road, for example, might be considered as benefiting the economy as a whole, but it will not only favour

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1 Commission, Non-paper on Services of general economic interest (SGEI) and State aid, points 60, 61, available at: www.europa.eu.int/comm/competition/state_aid/others/1759_sieg_en.pdf.

2 Koenig/Kühling, *Die Öffentliche Verwaltung* (DÖV) 2001, pages 881-882.

3 Koenig/Haratsch, *ESTAL* 2004, pages 393 et seq.; Koenig/Pfromm, *Sächsische Verwaltungsblätter* (SächsVBl) 2003, ppages 281-282.

4 Commission, Non-paper on SGEI and State aid, *supra*, point 61.

5 Koenig/Pfromm, *SächsVBl* 2003, pages 281, 282.

6 Communication of the Commission, *Kimberly Clark Industries*, OJ 1994 C 170/B.

7 Koenig/Kühling, *DÖV* 2001, pages 882, 884.

8 Koenig/Pfromm, *SächsVBl* 2003, pages 281, 282.

9 Koenig/Haratsch, *ESTAL* 2004, pages 393, 394; Koenig/Pfromm, *SächsVBl* 2003, pages 281, 282.

10 Santamato/Westerhof, *Europäische Zeitschrift für Wirtschaftsrecht* (EuZW), pages 645-646.

11 Commission, Non-paper SGEI and State Aid, footnote 1 above, point 60; Koenig/Haratsch, *ESTAL* 2004, page 393.

12 Koenig/Kühling, *DÖV* 2001, pages 882, 884. See also Commission decision *Propylen-Pipeline*, COM(2004) 2031 fin. where a notification was necessary.

road transport over rail, but indirectly boost car and other vehicle sales also. Yet "such type of distortion can be accepted if it is motivated by the need to provide a service that falls within the normal responsibilities of the State towards the public"¹³. For public infrastructure may directly provide a service of general economic interest, or at least reduce the costs for such service providers.

Finally, the Commission advises us that the public may then only finance infrastructure if the market is not going to provide that facility on the same conditions¹⁴. This requirement of economic non-viability will be discussed in greater detail in section II.2.b. below.

Therefore there are three conditions to be fulfilled in order to exclude State aid concerns regarding public infrastructure: The facility must be solicited by a responsibility of the State towards the public; the market may not provide it under the same conditions, and it may not favour any particular undertaking. This latter requirement means that the facility must be available to all potential users without discrimination. If it is purpose-built for certain undertakings or groups of users, these must pay an adequate, non-discriminatory market price.

II. Public Private Partnership

Due to limited public resources, some Member States have begun to involve the private sector to a greater extent in the financing and operation of infrastructure. Various degrees of responsibility can be given to the private partner in a so-called "Public Private Partnership" (PPP)¹⁵. Public Private Partnerships inject into the public sector not only private capital but also the technical and management know-how of private operators¹⁶. A PPP frequently takes one of two forms: either a contract-based form of cooperation or a joint-stock company where the shareholders comprise both private and public bodies¹⁷.

Since the management and provision of facilities for the supply of services constitute an economic activity for the purposes of EC competition law, the undertakings involved in an infrastructure project are also subject to State aid scrutiny¹⁸. It does not matter whether the infrastructure operator is a public or private body¹⁹, as long as it is separate from the State administration: the State aid prohibition applies equally to public and private undertakings, according to Article 86(1) and Article 295 EC²⁰.

1. Tender procedure

The favouring of an undertaking can be excluded if the public authority acts in the same way as a prudent

market economy investor, i.e. if it pays market prices for the infrastructure. Such prices are presumed if the private partner of the project has been selected through an open, transparent and non-discriminatory tender procedure. In particular, if it complies with national and EC-procurement legislation, the tender procedure can also avoid being regarded as State aid²¹. Openness, transparency and non-discrimination foster fair competition for the award of the contract as well as ensuring an objective selection of the best offer. The respect of these three principles can avoid notification unless the project falls within the scope of services of general economic interest (SGEI), an area where the so-called Altmark conditions also have to be respected²². These three requirements apply even outside the scope of EC procurement law, i.e. below the respective thresholds²³. They will now be examined more closely, with an emphasis on the reform of EC procurement law in 2004²⁴.

a. Openness

The requirement of an open procedure is not to be confused with the open tender procedure, one of the four procurement procedures. Here, openness refers to openness to competition, which is initiated through an adequate degree of publicity so that all potentially interested parties can participate in the tender (see *infra*)²⁵.

If procurement law is to be applied according to the respective directives, the choice of the right procurement procedure is important, i.e. one that enables as

13 Santamato/Westerhof, *EuZW* 2003, pages 645, 647.

14 Commission, Non-paper on SGEI and State aid, *supra*, point 60

15 Commission, Guidelines for successful Public-Private Partnerships, pages 18, 21-26; http://europa.eu.int/comm/regional_policy/sources/docgener/guides/ppp_en.pdf; with regard to State aid aspects in particular, see Koenig/Kühling, *DÖV* 2001, pages 881 et seq.; Koenig/Kühling/Theobald, *Recht der Infrastrukturförderung*, chapter 1.

16 Gerstlberger, *Public Private Partnerships*, page 333; Koenig/Kühling, *DÖV* 2001, pages 881, 885. Estimated savings of up to 17 % over publicly owned and traditionally procured facilities are believed to result from involving the know-how of private operators, see Arthur Andersen, *Value for Money drivers in the Private Finance Initiative. A Report by Arthur Andersen and Enterprise LSE*, Commissioned by the Treasury Taskforce, January 2000, pages 3, 52.

17 For instance, the French "sociétés d'économie mixte" constitute such joint-stock companies.

18 CFI, Judgment in Case T-128/98 – *Aéroports de Paris v. Commission*, [2000] ECR II-3929.

19 The Polish PPP law, for example, and the Irish State Authorities (Private Public Partnership Arrangements) Act enumerate what bodies count as public partners.

20 Santamato/Westerhof, *EuZW* 2003, pages 645, 646.

21 Commission, State aid N 264/2002, *London Underground*, point 79; Koenig/Kühling, *NWwZ* 2003, pages 779, 780.

22 Koenig, *Infrastrukturrecht* 2005, page 50. This applies at least to operational aid. Whether and how far the Altmark conditions have to be respected in case of investment aid has not been clarified so far.

23 Koenig/Kühling, *Deutsches Verwaltungsblatt (DVBl)* 2003, pages 298 et seq.

24 Directive 18/2004/EC repeals directives 93/36/EEC, 93/37/EEC and 92/50/EEC. Transposition of the reform package must be achieved by 31 January 2006.

25 ECJ, Judgment in Case C-324/98 – *Telaustria*, [2000] ECR I-10745; rec. 62.

many undertakings as possible to take part. The competitive dialogue, tailored to complex projects, was added to the three existing procurement procedures by the reform of EC procurement law²⁶. It applies where the public authority is objectively unable to define the technical means that would best satisfy its needs or the legal and/or financial form of a project. There is a hierarchy in that both the negotiated procedure and the competitive dialogue are subsidiary to the open and restricted procedures, which in turn are on par under EC law²⁷.

In principle, all four procurement procedures are capable of fulfilling the requirement of openness. But there are a few caveats: First, a call for competition before a negotiated procedure is in some cases optional for the purposes of EC procurement law. However, in order to exclude doubts about State aid it is imperative not to ignore the publication of a prior contract notice. Otherwise, the public authority favours undertakings by choosing to negotiate with them²⁸.

Moreover, the negotiated procedure seems particularly apt for organising a PPP tender, since it gives the greatest flexibility to both partners. In particular, risk transfer to the private partner is one of the core principles and drivers of value for money in PPP²⁹. Yet practice demonstrates that banks have the last word in determining the amount of risk they are prepared to finance – and they are reluctant to become involved in the discussion before a very late stage³⁰. The tenderer thus needs pricing flexibility during the bidding process. But negotiations on fundamental aspects of the contract and on prices are ruled out in the open and restricted procedures. The negotiated procedure thus appears preferable for achieving an optimal risk allocation. Yet the use of the negotiated procedure must be well justified in the authority's written report to guarantee a lawful tender. The Commission's Green

Paper on Public Private Partnerships reiterates in this respect that recourse to the negotiated procedure should remain an exception³¹.

While there are several reasons for allowing the use of the negotiated procedure, this discussion will only mention those that are most likely to apply to infrastructure: The prime reason for the choice of the negotiated procedure pertinent to PPP is that "the nature of the works or the risks attaching thereto do not permit overall pricing"³². The Green Paper emphasizes the limited scope of this derogation, which applies only when there is "uncertainty a priori concerning the nature and the scope of the works to be carried out", not when the difficulty results from the "complexity of the legal and financial package put in place". Provided that procurement law has to be applied, the conclusion that the negotiated procedure is open for PPP projects as such appears thus premature³³.

Tying the use of the more flexible tender scheme to uncertainty regarding the works in question already captures one of the main sources of efficiency of PPP projects: Output-based specifications of the facility induce innovative solutions³⁴. But it seems that whenever the pricing uncertainty depends on difficulties concerning financing costs or other project related risks, a negotiated procedure is not an option. And this is deplorable, since negotiations may result in a better risk allocation between the partners of a PPP, so that public money could be more efficiently spent.

Before having recourse to the negotiated procedure on grounds of pricing difficulty, however, the public authority must strive to minimise the uncertainty about the nature of the infrastructure project, i.e. specify the tender object as far as possible, even if this requires external assistance. Moreover, the services to be procured need to be unbundled, insofar as this is economically sensible. Only when the possibilities to unbundle and specify have been exhausted can the negotiated procedure then be applied³⁵.

A further possibility to use the negotiated procedure exists if only one undertaking can provide the facility in question, e.g. because it owns the technology or the land to be used for the infrastructure. Naturally, a competition for the contract would then be without purpose. Before that conclusion can be maintained, though, the alternatives have to be explored, e.g. the purchase of another plot of land. But a contract awarded without tender must still be examined for compatibility with State aid law. Proof can be provided that there is no overcompensation to the undertaking, e.g. through benchmarking.

Public procurement law also allows for the negotiated procedure when an open or restricted tender has not brought up offers that meet the requisite criteria. The procurement procedure must normally then be cancelled before a new one can be initiated, for which compelling reasons must be given. Furthermore, a call

26 Article 29, Directive 2004/18/EC.

27 Article 29(1), Directive 18/2004/EC.

28 Koenig/Kühling, *Neue Zeitschrift für Verwaltungsrecht (NVwZ)* 2003, pages 779, 785-786.

29 Arthur Andersen, 2000, footnote 16 above, pages 20-22.

30 Cf. Commission, Report on the Public Consultation on the Green Paper on Public-Private Partnerships and Community law on public Contracts and Concessions, SEC(2005) 629, page 9.

31 Commission, Green Paper on Public-Private Partnerships and Community Law and Public Contracts and Concessions, COM(2004) 327 final, point 24.

32 Article 7(2), Directive 93/37/EEC; cf. also Article 30(1)(b), Directive 18/2004/EC.

33 The Commission has objected to the use of the negotiated procedure in two unpublished opinions to the UK concerning the PPP/PFI contracts for Pimlico School and Community facilities Ipswich; cf. press release IP/00/869 on <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/00/869&format=HTML&aged=1&language=EN&guiLanguage=en>.

34 Arthur Andersen, 2000, footnote 16 above, pages 22-24.

35 Koenig/Kühling, *Neue Zeitschrift für Baurecht (NZBau)* 2003, pages 126, 130.

for competition to participate in the new procedure must be held unless all bidders are transferred to the new tender³⁶. Moreover, the new tender may not differ substantially from the cancelled one.

During a negotiated procedure, care must be taken to uphold competition, which is likely to be reduced through the appointment of a preferred bidder with whom the contract is finalised. In principle, the selection of a preferred bidder is a reasonable procedural step in complex and innovative infrastructure procurement³⁷. It is therefore not automatically excluded due to concerns about favouring, but must be managed carefully in order to avoid distortions of competition³⁸. In the London Underground case, modifications of the contractual terms introduced after the preferred bidders had been selected aroused suspicions of discrimination between bidders. But the fact that changes were made at a late stage does not automatically violate the presumption that the final prices were market prices. The degree of the modifications, however, must not be so substantial that the tender turns into one that would have attracted completely different bidders. In its assessment, the Commission considered that the introduction of changes were operated in "an objective way" since it had been made known to all bidders that modifications had had to take place, e.g. because potential suppliers had shadowed the work of London Underground and were thus able to feed the results of their observations back into the negotiations at any time³⁹.

Adjustment of contracts after the award may in any case distort competition in retrospect. If a company wins the tender due to unrealistic assumptions about demand or delivery date, any subsequent change in these terms would discriminate against the companies that lost the bid because they had used realistic forecasts. Therefore, contract modifications after the award are liable to make competitors complain to the Commission independently of the appointment of preferred bidders.

The desirable flexibility through the negotiated procedure is hence difficult to obtain legally. The introduction of the competitive dialogue may help in this respect, in particular because it encourages negotiations on "all aspects of the contract" and functional specifications of the tender object⁴⁰. On the other hand, it seeks to safeguard competition, for it does not allow substantial changes to be made to the bid after the award⁴¹. According to public procurement law, the competitive dialogue is also subject to the open and restricted procedures; it may only be chosen for particularly complex contracts when the procuring authority "considers that the use of the open and restricted procedures will not allow the award of the contract"⁴². This criterion suggests that authorities have more liberty to hold a competitive dialogue than to follow the negotiated procedure.

b. Transparency

The second requirement for an impeccable tender is transparency, which is an obligation the ECJ derives from the prohibition of discrimination⁴³. It implies that both the procurement process and the final decision should be transparent and comprehensible to all bidders. All tenderers must have access to all relevant information, e.g. procedures, deadlines and selection criteria⁴⁴. The tender notice must moreover be sufficiently publicised, so it is not enough to just contact firms. The degree of publicity that ensures participation of all interested tenderers depends on the value of the contract. If there is potential interest from other Member States, national publication will not suffice⁴⁵. Even beyond the scope of EC-procurement law, a notice announcing the tender in the supplement of the Official Journal of the EC is recommended under State aid law. In addition, this advertisement must not be couched in general terms but specifically refer to the project⁴⁶.

Transparency also concerns the selection criteria for the award of the contract. For the purposes of a correct tender, the public authority must state in the tender notice all the criteria it intends to employ. Under Directive 18/2004/EC, the relative weight of the criteria for the economically most advantageous bid must be outlined in the tender notice. Only if such weighting is demonstrably impossible should the criteria be listed in descending order of importance⁴⁷. No other criteria may be used to award the contract. Selection criteria must furthermore not discriminate by favouring certain bidders, e.g. local bidders, as this might make it more difficult for undertakings from other Member States to win the contract and thus violate the basic freedoms of the common market. A clarification of selection criteria and priorities in the tender notice seems to be very important to fulfil the transparency obligation, and in this respect the new procurement directive appears to have made progress.

36 Koenig/Kühling, NZBau 2003, pages 126, 132.

37 Commission, State aid N 264/2002, London Underground, point 89.

38 If the tender object is a service of general economic interest, the appointment of a preferred bidder is likely to trigger the application of the fourth Altmark condition, i.e. the need for a benchmark to prove that the compensation is not excessive. See section II. 2.b. below.

39 Commission, State aid N 264/2002, London Underground, points 86-89.

40 Article 29, Directive 18/2004/EC.

41 The clarification, specification and fine-tuning of the winning proposal only are allowed. Cf. Article 29(6) of Directive 18/2004/EC.

42 Article 29(1), Directive 18/2004/EC.

43 ECJ, Judgment in Case C-324/98 – Telaustria, [2000] ECR I-10745, rec. 60.

44 Koenig/Kühling, NWwZ 2003, pages 779, 783.

45 Commission, Decision on aid granted by Italy to Centrale del Latte di Roma, OJ 2000 L 265/15, point 82.

46 Commission Decision on the State aid granted by France to Scott Paper SA Kimberly Clark, OJ 2002 L 12/1, point 146.

47 Article 53(2), Directive 18/2004/EC.

EC procurement law allows the selection of either the cheapest or the economically most advantageous offer⁴⁸. A non-exhaustive list of criteria for the economically most advantageous bid would itemise quality, delivery date or period of completion, technical merit, running costs, aesthetic and functional characteristics, cost-effectiveness, environmental characteristics and technical assistance. In the context of State aid, though, the Commission often seems to consider that the cheapest offer is the one to be selected⁴⁹. How is this to be assessed when the tenderers' bids may vary greatly in their implementation of the procurement specifications? In infrastructure cases, where such a diversity of offers is intended, it would be more sensible to choose the economically most advantageous tender. In fact, one of the efficiency drivers in PPP is the so-called "life-cycle-costing", where the design of the facility is based on a long-term perspective rather than a quest to keep the initial investment low in order to capture the award⁵⁰. In this respect, the competitive dialogue has made advances, for it clearly states that the economically most advantageous tender is to be chosen⁵¹.

c. Non-discrimination

First, non-discrimination refers to the equal treatment of bidders from other Member States. Second, it is also important to guarantee non-discrimination with regard to tenderers from the home country. Equal treatment must be given in all legal and factual respects of the tender. We have already observed that award criteria may not discriminate in favour of local suppliers, and the same applies to conditions and obligations attached to the award of the contract. In the context of non-discrimination, the Commission appears to place particular emphasis on the unconditionality of the procurement in order to avoid State aid⁵². This unconditionality is generally meant to rule out any forms of discrimination with regard to the character of the undertaking other than those solicited by public nuisance, environmental protection and urban planning. Yet an obligation joined to the con-

tract award does not amount to a condition if all potentially interested parties are capable and obliged to meet the requirement⁵³. The Commission interprets this type of unconditionality restrictively, at least the unconditionality concerning the privatisation of undertakings⁵⁴. This may be justified for conditions attached to the sale of undertakings, e.g. job and salary guarantees, because it might possibly result in higher costs to the public⁵⁵. But the State aid perspective differs: As long as the higher costs do not constitute a favouring of the undertaking, the conditions causing them should not cause problems. For the extra cost to the public does not remain with the undertaking, but – in the case of job or salary guarantees – must be passed on to the employees, hence this does not automatically amount to State aid. In this sense, we can compare such conditions to the public service obligations discussed below. Public service compensation is not regarded as State aid as long as the undertaking has passed all advantages on to the end users of the service. Likewise, extra costs due to job guarantees may equally not favour the undertaking if it is clear that they only arise in connection with the employees. As long as all potential bidders are in a position to fulfil such conditions (e.g. a job guarantee), no favouring occurs. Moreover, from the political point of view, the safeguarding of jobs when transforming a facility into a PPP is crucial in order to gain support for PPP projects, especially in cases where administrations are still reluctant to embrace PPP structures.

Typically, discrimination may also imply passing more information through to one undertaking; undue advantages may also arise because a company has already built trade or other relations with the public authority. A tender notice may furthermore discriminate through being tailored to the needs of one particular undertaking⁵⁶.

2. The infrastructure levels of favouring undertakings

While a correct procurement procedure is one way of clearing project funding of State aid allegations (outside the scope of SGEI), it is not always possible to put forward such a tender. This might arise in circumstances where only one undertaking or consortium is interested in, or capable of providing, a certain facility. In other cases, competition is excluded because the undertaking owns the land where the infrastructure is to be constructed. The scope of Article 87(1) EC must then be avoided in another way: To examine whether the funding of a PPP project constitutes State aid, three levels must be distinguished, as exemplified in the Commission Decision *InfraLeuna*⁵⁷. On all three levels, favouring can be present: On the first level we consider the end users of the facility (professional

48 This is preserved in Article 53, Directive 18/2004/EC.

49 See for example Commission Communication on State aid elements in the sales of land and buildings by public authorities, OJ 1997 C 209/3, II.1.

50 Arthur Andersen, 2000, footnote 16 above, pages 24-26.

51 Article 29(1), Directive 18/2004/EC.

52 Koenig/Kühling, NVwZ 2003, pages 779, 781.

53 Commission Communication on State aid elements in the sale of land and buildings by public authorities, OJ 1997 C 209/3, II. 1(b) and (c).

54 Commission, Decision on State aid granted by Germany to Gröditzer Stahlwerke GmbH and its subsidiary Walzwerk Burg GmbH, OJ 1999 L 292/27, point 87.

55 Bartosch, CMLR 2002, pages 551, 572.

56 Koenig/Kühling, NVwZ 2003, pages 779, 783.

57 Commission, Decision on measures by Germany to assist *InfraLeuna Infrastruktur* and *Services GmbH*, OJ 1999 L 260/1, pages 11-15.

users, such as event managers, or private users, like the spectators of a football game); on the second level we look at the undertaking that owns and/or operates the infrastructure, and on the third level, we consider the shareholders of the undertakings involved.

a. End users: non-selectivity and pricing

It is important to notice that the same characteristics that point to a publicly owned infrastructure as favouring a certain undertaking also apply in the case of semi-private facilities⁵⁸. A facility must hence serve a basic public purpose and benefit the economy in general rather than being directed at a specific undertaking.

Secondly, if the end users are undertakings, as e.g. in *InfraLeuna*, prices must be carefully considered. If the infrastructure services are offered at prices below cost, an indirect favouring of the user companies can be implied. The *InfraLeuna* case furthermore demonstrates that there can be a conflict between this and other requirements: If the infrastructure operator is bound by the low-profit principle (with a view to avoid a monopolistic exploitation of its position, i.e. State aid), prices may be lower than prices on a market where suppliers of infrastructure are seeking to make a genuine profit. This may indirectly favour the professional customers of the infrastructure service while, at the same time, it seems to be necessary in order not to grant an advantage to the infrastructure operator by allowing it to exploit a monopoly in its services. Prices must therefore be oriented towards market prices and avoid two extremes: they must remain cost-oriented and must not constitute monopoly prices that would permit excessive profits to be made by the undertaking providing the facility. In *InfraLeuna*, this dilemma has been resolved by the imposition of a fixed price calculation mechanism in the monopoly areas. *InfraLeuna Infrastruktur und Service GmbH* must pass on all its costs to its customers while it is being prevented from cross-subsidising its prices through the prohibition of lump-sum loss compensation by public authorities. Another possibility is to demonstrate the appropriateness of the prices by obtaining a certificate from a chartered accountant⁵⁹.

b. Owner and operator

Economic non-viability of the project

It has often been argued that infrastructure has to be provided publicly because it is characterised by high upfront investments that represent sunk costs. If the future revenue through user charges is not expected to cover these costs, this facility would not have been built under normal market conditions, at least not at the same quality or on the same scale. Here, public funding is meant to induce the private party to participate in a project that would otherwise not be finan-

cially sound. Generally speaking, State finance does not constitute aid to the undertakings involved if it merely enables the company to execute construction and operation of the facility.

Yet this requirement of economic non-viability must be carefully interpreted. It may be said that the fact that no such infrastructure would be provided under normal market conditions does not reflect a market failure warranting state intervention⁶⁰. For unless there are no possibilities to exclude free riders from the use of the facility, every user charge can be raised to a level that allows the initial investment to be recovered, i.e. to a price equal to the marginal cost of producing the service. But this charge is not necessarily what users are prepared to pay. How much of the investment can be recouped through user charges thus essentially depends on the demand curve for the facility on downstream markets. Put differently: How much are the users willing and able to pay for the infrastructure provision? A public subsidy is hence necessary not because the initial investment cannot be regained on the market, but because it is the goal of public policy to supply certain goods at a particular price below marginal cost or at a particular quality above that provided under pure market conditions⁶¹. In this regard, Santamato and Westerhof rightly remark that such intervention in favour of lower prices or higher quality is only justified within the normal responsibilities of the State towards its citizens⁶².

But before reaching the conclusion that public funding of such infrastructures does not involve State aid, the following caveats should be considered. At first, different kinds of end user have to be distinguished. If they are citizens (non-professional users of a facility), no State aid concerns arise. If the end users are undertakings, as in the case of business parks, "inability to pay" must not serve as a pretext for claiming a subsidised price that is below market value. Of course, this reference market price also depends on demand for the facility and will thus be lower in economically less-developed areas than elsewhere. Still, a price may be set below that value. Such a scheme falls into the scope of Article 87(1) EC and must be notified to the Commission in order to apply for exemption.

Secondly, there is also the risk of favouring the owner/operator of the infrastructure, since providing reassurance through public compensation for operational losses may lead to inefficiency on the part of the owner/operator, which is then masked as the end

58 Koenig/Pffromm, *SächsVBl* 2003, pages 281, 282.

59 See for example Koenig, *Europäische Zeitschrift für Wirtschaftsrecht (EuZW)* 2004, page 385.

60 Santamato/Westerhof, *EuZW* 2003, page 645.

61 Cf. Nicolaidis, *ESTAL* 2003, pages 183, 190, 199.

62 Santamato/Westerhof, *EuZW* 2003, pages 645, 647.

user's "inability to pay". Subsidies may thus end up at a level above that required as a minimum to establish the facility. If it is not possible to hold a bidding procedure; aid to the owner/operator undertaking is minimised by passing on all advantages to the end users. The benchmarking of costs with those of an efficiently managed undertaking (see below) can be used to prove that the undertaking has not been favoured. Again, a certificate issued by a chartered accountant may be used as an alternative means of supporting this claim⁶³.

The provision of services of general economic interest Infrastructure serves a public purpose in that it benefits the economy in general, i.e. it comes within the scope of "services of general economic interest" (SGEI). In the absence of a community definition of what constitutes such services, Member States have the prerogative of interpreting this term and allocating such tasks⁶⁴. But Community institutions have broadly clarified the limits of this concept: SGEI are specific tasks entrusted to particular undertakings⁶⁵ and they exhibit certain characteristics: openness to all consumers, supply at any given time at uniform tariff rates and on terms which may not vary except in accordance with objective criteria⁶⁶. The Commission has the task to ensure that "manifest errors" in the application of the term SGEI are avoided⁶⁷. In its Cableways decision, cableway installations supporting a sporting activity were considered as not being SGEI-type services. In fact, SGEI are characterised more by their non-commercial nature and the fact that they satisfy basic needs of the population as an essential part of daily life. The fact that business conduct and pricing are subject to public authorisation (i.e. regulation) does not automatically convert the service into an SGEI⁶⁸.

Various infrastructures may qualify as SGEI at the discretion of individual Member States. The Commission has implicitly recognised the public service func-

tion of infrastructure in cases of open transport facilities like roads, ports, airports, underground transport as well as infrastructure used for broadband networks, conference centres and sports stadiums⁶⁹. It has however been made clear that it does not consider concessions to be SGEI, a view that is not legally binding but which does indicate how the Commission will apply its power to prevent erroneous application of the concept⁷⁰.

A decision of the ECJ has been given on when compensation for the provision of SGEI can count as State aid in its landmark judgment in the case *Altmark Trans*⁷¹. The following four conditions must all be fulfilled to avoid compensation being regarded as State aid:

"First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined. [...]"

Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings. [...]"

Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit. [...]"

Fourth, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport 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."

In July 2005, the Commission adopted several legislative proposals on SGEI implementing this judgement and documenting how the four conditions were to be interpreted. Moreover, these proposals provided for further different conditions in order to minimise the distortion of competition. The Commission exempts small amounts of public service compensation to undertakings of limited turnover as well as hospitals and providers of social housing from the notification requirement⁷². The Community Framework for State aid in the form of public sector compensation specifies under what conditions public service compensation within the scope of Article 87(1) EC can be compatible with the Common Market under Article 86(2) EC⁷³.

63 Koenig, *Europäische Zeitschrift für Wirtschaftsrecht (EuZW)* 2004, page 385.

64 Communication from the Commission, "Services of general economic interest in Europe", OJ 2001 C 17/4, point 22.

65 Draft Commission Decision on the application of Article 86 of the Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of the general economic interest, point 10 of the Introduction; Draft Community Framework for State aid in the form of public service compensation, point 8. Both documents are available on the internet at http://europa.eu.int/comm/competition/state_aid/others/.

66 Commission, Non-Paper on SGEI and State Aid, footnote 1 above, point 19.

67 Commission, Non-Paper on SGEI and State Aid, footnote 1 above, point 12; Draft Community Framework, supra, point 8.

68 Commission Communication to the Member States concerning State aid N 376/01, Aid scheme for Cableways, OJ 2002 C 172/2, points 41-43.

69 Santamato/Westerhof, *EuZW* 2003, pages 645, 647.

70 Commission, Non-Paper on SGEI and State aid, footnote 1 above, point 21.

71 ECJ, Case C-280/00 – *Altmark Trans*, [2003] ECR I-7747, rec. 89-93, 95.

72 Draft Decision, Articles 1, 2. The precise turnover thresholds and the final scope of the decision are to be determined in a consultation process.

It should be noted that these conditions apply to SGEI in addition to the requirement of submission of an impeccable tender as described above. This results in stricter treatment of undertakings entrusted with SGEI than of those not entrusted with such services. For the latter are able to escape the scope of Article 87(1) EC simply through a correct tender, while the former are also obliged to comply with the Altmark requirements, including prior definition of remuneration parameters and the net additional cost test. Past experiences of overcompensation and cross-subsidising explain this seemingly paradoxical treatment of undertakings with public service duties. While cultural, social and charitable aspects do play a strong role, they obscure the clear-headed cost calculations necessary to avoid overcompensation⁷⁴.

The first Altmark condition: The Act of Entrustment

The first condition states that the private partner must have been entrusted with genuine service obligations (as opposed to merely fictional duties) by the State. Essentially, these obligations must be clearly defined and have been assigned by way of an official act which, "depending on the law in the Member States, may take the form of one or more legislative or regulatory instruments or a contract"⁷⁵. The act must specify the precise nature of the obligations as well as the undertaking and the territory concerned; it can originate from a central, regional or local public authority⁷⁶. Furthermore, exclusive or special rights assigned to the undertaking must be outlined. This first requirement may sound superficial, but its importance ought not to be underestimated. In *Enirisorse*, the ECJ has confirmed its willingness to apply it rigorously⁷⁷.

In contract-based PPP, this requirement may easily be fulfilled by the underlying PPP agreement. It is naturally in the interests of both parties to have as clear a base as possible for long-term cooperation. PPPs organised as joint-stock companies must obtain an act of entrustment in line with the above-mentioned guidelines.

The second Altmark Condition:

The Parameters of Compensation

The second condition requires that the parameters of compensation for the public service must be established in advance in an objective and transparent manner. The act of entrustment has to clarify the parameters for calculating and reviewing the compensation and also define the reasonable profit permitted under the third Altmark condition. Moreover, the arrangements for repaying overcompensation and for State intervention in the case of under-compensation also have to feature⁷⁸.

Any compensation for losses the parameters of which have not been established beforehand therefore falls within the scope of Article 87(1) EC⁷⁹. But already

if the parameters of compensation are not clearly laid out, State aid is *prima facie* present. It is therefore crucial to include all such mechanisms in the contract, not least because operators/owners may have underestimated the project risks before winning the contract. In the post-Altmark legal practice, several cases have come within the scope of Article 87(1) EC as a consequence of failing this test⁸⁰.

In the context of the second Altmark requirement, the public partner must make sure that the remuneration parameters still retain some incentives in order to maintain the quality and price standards agreed upon. The PPP contract may therefore impose penalties for bad performance on a scale that put the permitted "reasonable profit" in jeopardy, possibly even a part of the cost coverage too.

Once the contract has been awarded, it is difficult to induce the operator to improve efficiency. For if the operator beats agreed projections, for reasons of State aid it is not allowed to retain any excess profits generated. This removes all incentive for the undertaking to become more efficient and paradoxically results in State aid legislation causing a decrease in efficiency – quite the opposite of the goals of competition policy!⁸¹ Only a periodic review of costs and a consequent adjustment of compensation during the contract may be of help to capture efficiencies generated through learning effects. Sometimes, PPP contracts already include a clause that foresees a split between the private and public parties of refinancing gains that may accrue if the project develops better than anticipated. This is equally to be recommended to avoid questions arising about favouring.

If a tender is made, the prior definition of remuneration parameters must moreover already figure in the tender notice. Yet a static definition of the compensation would undermine the creativity which functional output specifications are designed to stimulate in a competitive dialogue. The second Altmark condition must therefore be opened to embrace all param-

73 The Commission's State aid Action Plan of June 2005 foresees adoption of these measures until 2009 (point 34), available at: www.europa.eu.int/comm/competition/state_aid/others/action_plan/saap_en.pdf.

74 Koenig, *Infrastrukturrecht* 2005, page 50.

75 Draft Decision, footnote 65 above, Article 4; Draft Community Framework, *supra*, point 10.

76 Draft Community Framework, footnote 65 above, point 9.

77 ECJ, Judgment in Joined Cases C-34/01 to C-38/01 – *Enirisorse SpA*, [2003] ECR I-14243, rec. 32-37.

78 Draft Community Framework, footnote 65 above, point 10. It is furthermore possible to specify costs borne by the undertaking in regions referred to in Article 87(3)(a) and (c) EC, i.e. in areas of below-average economic development.

79 ECJ, Judgment in Case C-280/00 – *Altmark Trans*, [2003] ECR I-7747, rec. 91.

80 See, for example ECJ, Judgment in Joined Cases C-34/01 to C-38/01 – *Enirisorse SpA*, [2003] ECR I-14243, rec. 35-40; Commission decision State aid C 85/2001, RTP; Commission Decision State aid C 62/99, RAI.

81 Cf. Hansen/van Ysendyck/Zühke, *ECLR* 2004, pages 202, 222; Nicolaidis, *ESTAL* 2003, pages 183, 190, 202.

ters for compensation negotiated during the tender. The procurement notice may hence contain an upper limit, thus preserving the freedom to develop a cost-effective solution within the framework of the functional output specification.

*The third Altmark Condition:
The Net Additional Cost Test*

The third condition is directly concerned with the acceptable level of compensation. It must not exceed what is necessary to cover, fully or partially, the costs incurred in the operation of the public service, minus the relevant receipts for this service provision while allowing for a reasonable profit. Compensating these so-called net additional costs does not favour the undertaking since they are no more than the quid pro quo of their service obligations. Given that a SGEI is not kept profitable on the prices desired by public policy, subsidising the net additional costs will not distort competition but will rather compensate for the disadvantage suffered by undertakings charged with SGEI due to their public obligations, i.e. the fact that they have to accept a price below market level⁸². In this way, the package remains the minimum remuneration necessary in order to enable the service to be provided⁸³. This helps to prevent overcompensation and a cross-subsidy of commercial services provided by the same undertaking: All benefits must be passed on to the end consumer rather than remain at the level of the facility owner or operator⁸⁴.

Net additional costs are calculated as follows: The revenues include "all advantages granted by the State with State resources"⁸⁵, i.e. not just the entire revenue earned from the service provision, but also other advantages through the provision of the service. Moreover, excessive profits generated by other SGEI entrusted to the same undertaking are considered. Put differently, the undertaking is obliged to cross-subsidise unprofitable public services with revenues derived from profitable public services:

"If the undertaking in question enjoys any special or exclusive rights linked to another SGEI that generates profit in excess of the reasonable profit [...] or benefits from other advantages granted by the State,

these must be taken into consideration, irrespective of their classification for the purposes of Article 87, and are added to its revenue"⁸⁶.

Member States may also demand that revenue from outside the scope of the entrusted service be taken into account.

The relevant costs include all costs required for the provision of the service. These may cover all the variable costs incurred in the operation of the service, an adequate contribution to fixed costs as well as an appropriate return on capital, inasmuch as it is needed for the service. Costs that occur outside the scope of the provision of a SGEI may not be imputed to its operation⁸⁷. The transparency directive demands that undertakings running both SGEI and commercial services must keep separate accounts for each⁸⁸. Accounting separation is designed to prevent a disguised cross-subsidy of commercially run services from the subsidies in support of SGEI.

The reasonable allowable profit refers to a rate of return on the invested capital that reflects the commercial risk (or absence thereof) in the SGEI provision. The return should not normally exceed the "average rate for the sector concerned in recent years"⁸⁹. If there are no similar undertakings in the relevant Member State, comparably situated undertakings in other Member States may serve as a benchmark. To ensure value for money, the level of profit may be linked to the quality of service provision⁹⁰. In fact, the reasonable profit may be regarded as the opportunity cost of the capital invested by the private partner, i.e. a long-term interest rate plus a mark-up for the risk involved in the public service.

These constituent elements serve to calculate the amount of compensation that would not be considered as State aid following the Altmark decision: What ought to be regarded as cost has already been defined. The net costs are those that remain once the revenues have been subtracted from the costs, i.e. the receipts and the other advantages generated for the undertaking by the public service provision. Additional costs are the net costs when they are generated by the provision of the public service. This means that they are equal to the difference between the net costs of an undertaking entrusted with public service obligations and the costs of an undertaking not burdened by such obligations. Therefore, remunerating the net additional costs enables the provision of those services that would not be provided under pure market conditions. This statement is true in quantitative and qualitative respects. If a subsidy is needed to produce a higher quantity of services, only the marginal costs of those services that would otherwise not be produced may be taken into account⁹¹.

In other words: Costs that may normally be recouped on downstream markets generally do not constitute net additional costs as long as users are will-

82 Nicolaidis, ESTAL 2003, pages 183, 190, 194.

83 Santamato/Westerhof, EuZW 2003, pages 645, 647.

84 Koenig/Pffromm, SächsVBl 2003, pages 281, 282; Koenig/Pffromm, NZBau 2004, page 375.

85 Draft Decision, footnote 65 above, Article 5; Draft Community Framework, footnote 65 above, point 17.

86 Draft Community Framework, footnote 65 above, point 15.

87 Draft Decision, footnote 65 above, Article 5(2).

88 Directive 80/723/EC; see also Draft Decision, supra, Article 6.

89 Draft Decision, footnote 65 above, Article 5(4).

90 Draft Community Framework, footnote 65 above, point 16.

91 Koenig, Betriebsberater (BB), pages 2185, 2186-2187.

ing and able to pay such charges. Only when the passing on of these costs to downstream markets would jeopardise the social function of the facility may net additional costs be generated that could be compensated without implying State aid⁹². The compensation of these costs can be considered as merely enabling the SGEI provision. If no net additional costs arise, the State is not allowed to subsidise the facility⁹³.

The fourth Altmark Condition: A Benchmark

If the operator of the SGEI has not been selected through a correct tender procedure, the level of compensation allowed must be tested for State aid in another way: The Court requests that the costs of the SGEI be benchmarked against the cost that a "typical undertaking, well run and adequately provided [...] so as to be able to meet the necessary public service requirements, would have incurred"⁹⁴. The costs of this comparable undertaking are then adjusted for the receipts and the profits, exactly in the way that net additional cost are calculated.

Similarly placed undertakings that have been awarded their contracts following tenders may serve as comparisons since their compensation for the SGEI constitutes a market price. The attribute "well run" indicates that efficiency costs, not the objective costs, of the undertaking may be compensated. The Court thus replaces the lack of actual competition with a simulation of competition through a benchmark of the remuneration⁹⁵. This aims to introduce competition in sectors where State subsidies result in a "quiet life". Proof of compliance with the benchmarks should be provided by the issue of a certificate from a chartered accountant⁹⁶.

It should be noted that the court insists on a "public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community"⁹⁷. A literal interpretation of the court's ruling would probably jeopardize the quality improvements that could be achieved through output specifications and life-cycle costing. The "least cost to the community" must therefore be interpreted as the economically most advantageous offer. Doubts about the existence of the "least cost to the community" arise if the offer has been negotiated with a preferred bidder, as this selection removes competitive pressure from the tenderer in a phase crucial to the determination of service compensation.

c. The shareholders of the owner/operator undertaking

The third level to be examined for a possible favouring concerns the shareholders of the owner/operator undertaking, independently of whether or not the infrastructure qualifies as a SGEI. This is particularly relevant where the shareholders have possibly conflicting interests in the PPP project: In the *InfraLeuna* case,

they were identical with the clients of the operator undertaking; in many PPP deals where the owner/operator undertaking is a special purpose vehicle, it sub-contracts works to the shareholding undertakings.

To exclude any favouring of the shareholders, they must not enjoy privileged access to the facility, e.g. through lowering user charges⁹⁸. Moreover, the design of the infrastructure may be influenced by the shareholders and thus prioritise their interests. In this respect, only the final design counts while the mere possibility of influencing the design process is not yet a problem.

A further benefit might arise from profits of the owner/operator undertaking. As long as they remain within the market reference brackets, as demanded above for the purposes of SGEI compensation, State aid concerns can be excluded. But the public subsidy may raise the value of the undertaking. A share sale might then generate windfall profits for the shareholders. This danger can be countered, however, by temporarily banning share and asset sales⁹⁹.

III. Conclusion

This paper has raised quite a few different cases where infrastructure funding falls outside the scope of Article 87(1) EC and is thus not subject to the notification requirement. Undertakings charged with SGEI – at any rate at the moment they receive operational aid – must fulfil the four Altmark criteria in addition to meeting the obligations of an open, transparent and non-discriminatory tender procedure. If a PPP infrastructure does not provide a SGEI, the public authority must compare its activities to those of a market economy investor, i.e. require a market return on its investments. It is therefore highly unlikely that it would become at all active, since market operators would presumably already have seized the initiative and established the facility if there were any suitable business openings to do so.

92 Koenig, *Infrastrukturrecht* 2005, pages 50, 52.

93 With respect to PPP, contract length is of interest here. The Green Paper emphasises that the duration of the partnership must not go beyond what is needed to recoup the investment and gain a reasonable profit, cf. Commission, Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions, COM(2004) 327 final, point 46. Any longer period may raise the profit to an above-average level. But avoiding the scope of State aid already presupposes the economic non-viability of the project. The extra revenue earned due to longer contract duration thus lowers the public subsidy for the facility. An extended contract length is therefore not objectionable.

94 ECJ, Judgment in Case C-280/00 – *Altmark Trans*, [2003] ECR I-7747, rec. 93.

95 Koenig, *Betriebsberater* (BB) 2003, pages 2185, 2187.

96 Koenig, *EuZW* 2004, page 385.

97 ECJ, Judgment in Case C-280/00 – *Altmark Trans*, [2003] ECR I-7747, rec. 93.

98 Koenig/Haratsch, *ESTAL* 2004, pages 393, 396.

99 Koenig/Haratsch, *ESTAL* 2004, pages 393, 397.