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APPLICATION OF EU STATE AID AND COMPETITION RULES TO THE TYPES OF UNDERTAKINGS UNDER ARTICLE 106 OF THE TFEU AND TURKEY'S OBLIGATIONS WITHIN THIS SCOPE

Doktora Tezi

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ÖZET

AB DEVLET YARDIMI VE REKABET KURALLARININ TFEU'NUN 106. MADDESİNDEKİ İŞLETME TÜRLERİNE UYGULANMASI VE TÜRKİYE'NİN BU KAPSAMDAKİ YÜKÜMLÜLÜKLERİ

Bu tezde Devletin, kamu işletmeleri ile özel veya münhasır haklara sahip işletmeler aracılığıyla pazarda ekonomik faaliyetlerle iştigal etmesi ve bu tip işletmelere rekabet ve Devlet yardımı kurallarının TFEU 106. madde hükümleri doğrultusunda uygulanması konusu incelenmiş ve belirli sonuçlara varılmıştır. Bu doğrultuda, Devletin ya egemenlik yetkisinden kaynaklanan kamu gücünü kullanarak ya da pazarda mal ve hizmet sunmak suretiyle ekonomik faaliyetler yürüterek hareket edebileceği ortaya konmuştur. Devlet faaliyetleri ekonomik nitelikte olup olmamasına göre Birlik Anlaşmalarının farklı hükümlerine tabii olabilecekler ya da tamamen bu hükümlerin kapsamı dışında kalabileceklerdir. Yapılan incelemeler sonucunda da görülmüştür ki AB rekabet ve Devlet yardımı kuralları sadece ekonomik bir faaliyet sözkonusu olduğunda tatbik edilebilir olmaktadır. Bununla birlikte kamu işletmeleri ile özel ve münhasır haklara sahip diğer işletmelerin ekonomik nitelikteki faaliyetleri ise gerekli şartları taşımaları halinde TFEU 106(2) hükmü uyarınca AB rekabet ve devlet yardımı kurallarının uygulanmasından muaf kılınabileceklerdir. Gerek ekonomik faaliyetleri ekonomik olmayan faaliyetlerden ayırabilmek gerekse 106(2) hükmündeki muafiyet şartlarının oluşup oluşmadığını anlayabilmek için her olayın özelliklerine göre bir değerlendirme yapılması gerekmektedir.

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ABSTRACT

APPLICATION OF EU STATE AID AND COMPETITION RULES TO THE TYPES OF UNDERTAKINGS UNDER ARTICLE 106 TFEU AND TURKEY'S OBLIGATIONS WITHIN THIS SCOPE

In this thesis the State's involvement in economic activities on the market place through public undertakings and undertakings having exclusive and special rights, and the application of the competition and State aid rules to these undertakings under the provisions of Article 106 TFEU was analysed and several conclusions were obtained. It was submitted that the State may act either by exercising public powers arising from its sovereignty or by carrying out economic activities by offering goods and services on the market. State activities will be subject to different rules of the EU Treaties or may totally remain outside the scope of such rules according to their economic or non-economic nature. The EU competition and State aid rules are only applicable, when there is an economic activity under consideration. On the other hand, the economic activities of public undertakings and the undertakings with special and exclusive rights might be exempted from the application of EU competition and State aid rules if the requirements are fulfilled under Article 106(2) TFEU. Therefore, in order to distinguish between economic and non-economic activities or to find out that the conditions of the derogation under Article 106(2) are fulfilled, a case-by-case analysis is necessary.

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Istanbul, July 2011.

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3. ARTICLE 106 TFEU AND ITS APPLICATION IN CONJUNCTION WITH COMPETITION AND STATE AID RULES

ABBREVIATIONS

AG	Advocate General
AMKD	Anayasa Mahkemesi Kararları Dergisi
CFI	Court of First Instance
CMLR	Common Market Law Reports
C.M.L.Rev.	Common Market Law Review
EC	European Community
E.C.L.R.	European Competition Law Review
Ed(s)	Editor(s)
ed.	Edition
ECJ	Court of Justice of the European Union
ECR	European Court Reports
EEC	European Economic Community
E.L.Rev.	European Law Review
EStAL	European State Aid Law Quarterly
EU	European Union
p.	Page
para.	Paragraph
PEE	Public Economic Enterprise
PEC	Public Economic Corporation
RG	Resmi Gazete
SEE	State Economic Enterprise
SGI	Services of General Interest
SGEI	Services of General Economic Interest
TEC	Treaty on European Community
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
Vol.	Volume
WTO	World Trade Organisation

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ONAY SAYFASI

Enstitümüz AB Hukuku Anabilim Dalı Doktora öğrencisi Feyza BAŞAR'ın, "***APPLICATION OF EU STATE AID AND COMPETITION RULES TO THE TYPES OF UNDERTAKINGS UNDER ARTICLE 106 OF THE TFEU AND TURKEY'S OBLIGATIONS WITHIN THIS SCOPE***" konulu tez çalışması ile ilgili .06.07.2011..... tarihinde yapılan tez savunma sınavında aşağıda isimleri yazılı jüri üyeleri tarafından oybirliği/ ~~oyçokluğu~~ ile başarılı bulunmuştur.

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1. INTRODUCTION

European Union (EU) was established to realise, *inter alia*, "the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy aiming at full employment and social progress and a high level of protection and improvement of the quality of environment." [1] In order to achieve this objective Member States shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles of stable prices, sound public finances and monetary conditions and a sustainable balance of payments.[2]

In the light of the objectives stated in the Treaties,[3] EU competition rules, in its broader meaning, regulate both the conducts of the market players, i.e undertakings, through Articles 101 and 102 and those of the Member States through the application of Article 106 and the rules on State aid. The competition rules, in its narrower meaning, are addressed to entities engaged in economic activities. However, not only the private entities but also the State itself may be involved in different types of economic activities for different reasons and through various means. Although the means and extent of this involvement varies, it is already confirmed by the case law of Court of Justice of the European Union[4] that the State 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 State is responsible for carrying out certain tasks that only the State can perform and the degree of its involvement in the economic activities largely depends on the economic system or policy it has adopted. As the European Union is originally and

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[1] Article 3(3) of the Treaty on European Union (TEU), Consolidated Version, OJ C 83, 20.3.2010.
[2] Articles 119 and 120 of the Treaty on Functioning of the European Union (TFEU), Consolidated Version, OJ C 115, 9.5.2008.
[3] Hereinafter Treaty on the European Union (TEU) and Treaty on the Functioning of the European Union (TFEU) together shall be referred to as "Treaties", unless otherwise stated.
[4] Hereinafter Court of Justice of the European Union will be referred to as "Court of Justice", "ECJ" or merely "the Court", unless otherwise stated.

primarily an economic community, the Member States are subject to certain rules of the European Treaties when they deal with or regulate such activities which have an impact on the internal market. On the other hand, the State will be subject to different rules of the Treaties according to the nature of the activity or the type of the goal it pursues. Consequently, it is important to distinguish between State activities which are economic and open to actual or potential competition from the local or foreign enterprises and the ones which flow directly from the state's *imperium*.

In this thesis the State's involvement in economic activities on the market place through public undertakings and undertakings having exclusive and special rights, and the application of the competition and State aid rules to these undertakings under the provisions of Article 106 TFEU shall be analysed. According to this Article 106 (ex Article 86 TEC);

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.

2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.

3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives and decisions to Member States.

However, in order for competition and State aid rules of the Treaty to be applicable to the types of undertakings under Article 106 of the Treaty,[5] it is a precondition that there should be an economic activity. In other words, the distinction between economic and non-economic activities is important because non-economic activites are not subject to specific EU legislation, nor are they covered by the internal market or competition and State aid rules.[6]

The EU institutions usually start their analysis by determining whether there is an economic activity in question, when they have to deal with allegations regarding an infringement of EU competition and/or State aid rules. However, defining the notion of economic activity is a very difficult and demanding task. Like other areas of the EU law, especially with regard to the competition rules, the dividing line between economic and non-economic activity is not always clear and it shifts from time to time following the rulings of the EU Courts. It is due to the fact that the EU Courts do not adopt a pure economic approach for defining the concept of economic activity as the EU has also other social objectives to pursue. For this reason the first two parts of the first chapter of this thesis shall be devoted to the notion of economic activity under the principles developed by the case law. In the last part of this chapter, the applicability of competition rules to the regulatory activities of the State, which is deemed to be non-economic in principle, shall also be discussed to understand that not all non-economic activities of the State are immune from the application of competition rules or some of the regulatory activities of the State which appears to be non-economic on the surface are actually of economic nature.

Article 345 TFEU states that the Treaties shall in no way prejudice the rules in Member States governing the system of property ownership. Although the economic policy objectives adopted by the EU favour private over public ownership in the market place, it is not prohibited for the States to own undertakings, which flows from the principle provided

[5] Hereinafter Treaty on the Functioning of the European Union (TFEU) shall be referred to as simply "the Treaty" or "Treaty" unless otherwise stated.
[6] Some aspects of the organisation of non- economic activities may be subject to other rules of the Treaty, such as the principle of non-discrimination.

by Article 345. However, irrespective of their public or private status and how they are financed, all entities shall be subject to the competition and State aid rules of the Treaty as long as they engage in economic activity. In this respect, Article 106(1) of the Treaty indicates that in case of public undertakings and undertakings having special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary, *inter alia*, to the competition and State aid rules. On the other hand, according to Article 106(2) of the Treaty, the undertakings entrusted with the operation of services of general economic interest or having the character of a revenue producing monopoly shall be subject to the rules, *inter alia,* on competition as far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them.

The 'services of general economic interest' is one of the key concepts in the EU law, which plays an important role in the provision of public services. This is because they constitute a limit to the application of competition rules, in its broader meaning that includes State aids, provided that other conditions stipulated in Article 106(2) are also fulfilled. Thus, there are two ways in which the application of competition law to the public services can be limited. First, they may be considered as non-economic and held outside the scope of competition rules or secondly, they benefit from the derogation in Article 106(2) TFEU, despite their economic nature.

In the first part of the second chapter of the thesis, the structure of Article 106 TFEU and its relation with other Treaty provisions shall be examined. In the second part, Article 106(1) and the basic notions of this provision including the notion of undertaking, public undertaking, public undertaking-public authority distinction and the undertakings granted special or exclusive rights shall be analysed. In the third part, application of the competition rules, mainly the application of Article 102 TFEU prohibiting the abuse of dominant position shall be discussed in the light of the case law developed by the Court of Justice. In the fourth part, services of general economic interests with the related concepts and their role in the application of competition rules to the undertakings entrusted with public service obligations under the principles developed by the EU Courts shall be

revealed. In the last part of this chapter the role of Article 106(2) in the application of the State aid rules to the undertakings entrusted with the public service obligation and the recent developments in this field shall be examined.

The main objective of this thesis is to analyse and reach several conclusions as to how the EU competition and State aid rules are applied to the public undertakings and undertakings having special or exclusive rights, and to what extent they can be exempted from the application of such rules when they are entrusted with public service obligations under Article 106 of the Treaty. Within this context, Turkey's obligations under Article 106 TFEU are also dealt with in the last chapter of this thesis. As an accession country Turkey has to align its competition law and State aid practices with the EU *acquis* but Turkey's obligations also arise from the Customs Union which has been in force since 1996. Turkey's obligations and the limited achievements with regard to alignment of competition and State aid rules with the EU legislation with respect to the public undertakings and undertakings having special or exclusive rights shall be analysed in this last chapter.

2. THE NOTION OF ECONOMIC ACTIVITY

2.1. Overview

Economic activity is an evolving concept in the EU law and its definition has gained significance with the rapid technological change, globalisation, the development of capital markets, the liberalisation and restructuring of product and service markets.[7] In particular, liberalisation in the public sector has caused a serious shift in ideology and required a new approach for an economic activity. As a result, the EU institutions have preferred a functional approach to define the notion of economic activity. Formalistic approach based on the legal status of the entity, the status of the law to which this entity is subject or the characteristics of the goods or services provided would not have been appropriate for such a dynamic concept.

First of all, public institutions as well as private ones can be engaged in economic activity even when this activity is subject to public law of the respective State or they can be involved in both economic and non-economic activities at the same time. Moreover, public/private law distinction may be reflected in a different way in a constitutional structure or judicial culture of each Member State, which may put the common perception of this notion throughout the EU in danger.

Secondly, economic activity is still changing and being reshaped, which is the case with competition law itself, and it should not be imprisoned within the limits of a narrowly established, strict definition. Formalistic approach might have probably improved the legal certainty in competition law by shifting the burden from judicial authorities to the legislative authorities to meet the demands emerging from the reality of business practices. On the other hand, frequent amendment of existing laws or enactment of new ones in such a dynamic area would be far more complicated and burdensome.

[7] Erika Szyczak, "Public Service Provision in Competitive Markets", **Yearbook of European Law**, Vol.20, 2001, p.35.

Thus, the EU institutions have decided to employ a functional approach by focusing upon the nature and effects on the market of the activity, rather than characteristics of the actors, including the State itself which performs it. Hence, "provided that an activity is of an economic character, those engaged in it will be subject to Community competition rules."[8] Moreover, even the characteristics or the inherent quality of goods and services is found to be irrelevant in deciding whether there is an economic activity. This approach is more dynamic, practical, flexible and easily adaptable to the changes and developments in economic and social needs of the society.

For the sake of avoiding a formalistic approach, the notion of 'economic activity' is not defined in the Treaty provisions nor is it left to Member States' own discretions which, otherwise, would conflict with the structure of the EU legal system. For competition law purposes, economic activity is defined by the European Court of Justice in two *Commission v Italy* cases as "any activity consisting of offering goods or services on a given market."[9] The issue of what constitutes 'goods' and 'services' is a well developed subject within the jurisprudence of the European Courts concerning free movement of goods and freedom to provide and receive services. The notion of economic activity according to the Courts' approach will be analysed in detail in the following sections.

2.2. Features of Economic Activity in EU Competition Law

2.2.1. Offering Goods and Services on the Market

2.2.1.1. Offer

In general, 'offering' means presenting something for acceptance, refusal or consideration as well as providing access or opportunity. 'Offer' is an important notion as the case law has defined economic activity in terms of the offer, not the acquisition of goods and services. According to the case law, for economic activity to exist, the goods or

[8] Opinion of AG Jacobs in Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 *AOK Bundesverband* [2003] ECR I-2493, para 25.
[9] Case 118/85 *Commission v Italy* [1987] ECR 2599; [1988] 3 CMLR 255, para.7 and Case C-35/96 *Commission v Italy (Customs Agents)* [1998] ECR 1-3851; [1998] 5 CMLR 889 para.36.

services should be offered on a given market. If there is no offer or no market for an offer to take place there is no economic activity.

In *Selex,* where the technical standardisation activities of the Eurocontrol were at stake, the Court of First Instance (CFI) had an opportunity to elaborate on this concept. The CFI rejected the claims against Eurocontrol, saying that "the applicant has not shown that there is a market for technical standardisation services in the sector of ATM equipment."[10] According to the Court, as the results of the development activity stay within the organisation itself and are not offered on a given market, it cannot therefore be considered that Eurocontrol 'offers' to the Member States goods and services.[11] On the other hand, in relation to the assistance to the national administrations in the form of advice at the time of drafting the contract documents for calls etc. by the same institution, the CFI found it precisely a case of an 'offer' of services on the market for advice. This is due to the fact that, there was a market for advice on which private undertakings specialised in this area could also very well offer their services.[12]

2.2.1.2. Goods

Although there are a number of provisions in the Treaty dealing with the free movement of goods, this term is not defined in any of them. Moreover, some provisions, such as Article 29 (ex Article 24 TEC), Article 34 (ex Article 28 TEC) and Article 35 (ex Article 29 TEC), do not even use the term, 'goods', but refer instead to 'products' or to 'imports' and 'exports'. Only, the article containing the derogation from the free movement principle, Article 36 (ex Article 30 TEC), expressly refers to goods. Nevertheless, they all have the same meaning for the Community law purposes.[13]

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[10] Case T-155/04 *Selex Sistemi Integrati SpA v Commission of the European Communities (Selex)* [2007] 4 CMLR 10, para.61.
[11] Ibid.
[12] Ibid., para. 87.
[13] Peter Oliver, **Free Movement of Goods in the European Community,** 3rd ed. London: Sweet and Maxwell, 1996, pp.8-9.

In an earlier case concerning national treasures[14] the Court defined 'goods' as "*products which can be valued in money and which are capable as such, of forming the subject of commercial transactions.*"[15] As a consequence, even if items might be valued for reasons such as cultural, historical, or artistic ones, this does not mean that they are not goods for the purposes of the EC Treaty. Usually, such perceptions in public bring about economic value as well, although this may seem quite ancillary, for example, to the product's cultural value. Otherwise, there would have been a huge gap in the law regarding free movement of goods when they are associated with abstract values such as culture, history, art or religion, which are very difficult to define in practice.[16]

The Court approached the definition of 'goods' in a more flexible way in *Walloon Waste*, which concerned shipments of waste across national borders. In this case, the interesting issue was the treatment of non-recyclable and non-reusable waste, which had no economic value, other than a negative one. The Court did not mention 'value in money' criterion and focused on the existence of the commercial transaction. As a result, the Court held that "objects which are shipped across a frontier for the purposes of commercial transactions are subject to Article 30 [now Article 34], whatever the nature of those transactions."[17] Thus, the Court brought all types of waste within the ambit of the free movement of goods provisions.

Following these two judgements mentioned above, it can be concluded that their monetary value puts the goods *prima facie* within the economic sphere and renders the question of whether they are subject of a commercial transaction less significant for determining whether they fall within the scope of the Treaty. However, when they do not have their own intrinsic value in monetary terms the Court conducts its research as to their capability to be subject of a commercial transaction. In *Laara*, AG La Pergola in

[14] Case 7/68 *Commission v Italy* [1968] ECR 432, p. 428.
[15] For a similar definition given by Advocate General (AG) Reischl in his opinion for Case 155/73 *The State v Sacchi (Saachi)* [1974] 2 CMLR 177.
[16] Lorna Woods, **Free Movement of Goods and Services within the European Community**, Surrey: Ashgate Publishing Company, 2004, p.13.
[17] Case C-2/90 *Commission v Belgium* [1993] 1 CMLR 365, para. 26.

distinguishing slot machines from lottery tickets commented as follows: "The products at issue here, by contrast, are 'products which can be valued in money' and thus in abstract terms are capable of forming the subject matter of sales or other lawful commercial transactions."[18] The Court simply stated that the slot machines "constitute goods capable of being imported or exported."[19] Consequently, goods should also be capable of being exported and imported between Member States. Under the current case law, the notion of 'good' ranges from alcoholic beverages,[20] paintings,[21] petroleum products,[22] to books,[23] electricity[24] and animals[25] as long as they have an economic value. However, public goods, in other words, diffuse services which cannot be produced by the normal market forces are out of the scope of EU law. This notion will be examined in more detail in the following sections.

2.2.1.3. Services

Services, which constitute a wide and diverse category of economic activities, have become an increasingly important part of national economies since the Second World War. The developments with regard to services in national economies have found their reflections in the World Trade Organisation law[26] as well as in the Community law. However, given to the wide range of services, it has not been easy to reach a consensus on a common definition in international law. From an economic point of view, "a service is 'a deed, a performance, an effort' in opposition to goods which are 'objects, devices,

[18] Opinion of AG La Pergola in Case C-124/97 *Laara v Kihlakunnansyyttaja (Laara)* [1999] E.C.R. I-6067, para.18.
[19] Case C-124/97 *Laara* [1999] E.C.R. I-6067, para.24.
[20] See eg. Case 120/78 *Rewe-Zentrale A.G. v Bundesmonopolverwaltung fur Branntwein* [1979] E.C.R. 649.
[21] See eg. Case 48/71 *Commission v Italy* (export tax on art treasures) [1972] E.C.R. 529.
[22] See eg. Case 72/83 *Campus Oil Ltd. v Minister for Industry and Energy* [1984] E.C.R. 2727.
[23] See eg. Case 261/81 *Walter Rau Lebensmittlwerke v de Smedt Pvba* [1982] ECR 3961.
[24] See eg. Case 14/1964 *Costa v Ente Nazionale per l'Energia Elettrica (Enel)* [1964] C.M.L.R. 425 or Case C-379/98 *PreussenElektra Ag. v Schleswag AG* [2001] 2 C.M.L.R. 36.
[25] See eg. Case C-67/97 *Ditlev Bluhme (Danish bees)* [1998] ECR I-8333.
[26] See General Agreement on Trade in Services, which is an undertaking by members to comply with the market access and national treatment obligations undertaken by them and appended to the main text as schedules of specific commitments. For further information see Wendy Kennett, "The European Community and the General Agreement on Trade in Services" in Nicolas Emiliou and David O'Keeffe (Eds) **The European and World Trade Law After the GATT Uruguay Round**, John Willey & Sons, 1996, pp.136-148.

things.'"[27] From the legal point of view; the goods are the object of property rights whereas the services consist of obligations. More detailed definitions have usually concentrated on the non-storable nature of the services and their requirement for immediate provision and consumption.[28] These definitions have been criticised since it is possible to find services that do not fall under these classifications. For example, pension management is a service which is not provided and consumed immediately.[29] Therefore, Nicolaides suggests that services may be thought of as a process, and can be defined as "an agreement or undertaking by the service-provider to perform now or in the future a series of tasks over a specified period of time towards a particular objective."[30]

Another characteristic of services is their intangible nature, which prevents them from being examined prior to consumption. This means that information about service is particularly important to enable the consumer to understand what he/she is about to consume. Especially, for certain professional services, the consumers cannot determine the quality of the service they have received, even after consumption. Furthermore, due to the peculiarity of the market structure, low-quality providers may be able to eliminate high-quality providers, with detrimental consequences for the whole market.[31] Hence, effective consumer protection and the need for correction of the information asymmetries, which is a market failure, justify high degree of regulation and government intervention in this sector.[32]

Article 57(1) (ex Article 50 TEC) states that "services shall be considered 'services' within the meaning of the Treaty where they are normally provided for

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[27] Giorgio Sacerdoti, "The International Regulation of Services: basic concepts and standards of treatment" in Giorgio Sacerdoti (Ed) **Liberalisation of Services and Intellectual Property in the Uruguay Round of GATT**, Pupil Progress and Undercurrents in Public International Law, vol. 6, 1990, p. 28.
[28] Jagdish N. Bhagwati, "Services" in Michael J. Finger and Andrzej Olechowski (Eds) **The Uruguay Round-A Handbook on the Multilateral Trade Negotiations**, Washington: 1987, p.208.
[29] Jukka Snell, **Goods and Services in EC Law- A Study of the Relationship between the Freedoms**, Oxford: Oxford University Press, 2000, p.7.
[30] Phedon Nicolaides, **Liberalising Service Trade-Strategies for Success**, London: Routledge, pp.7-9.
[31] Jukka Snell and Mads Andenas, "Exploring the Outer Limits: Restrictions on the Free Movement of Goods and Services" in **Services and Free Movement in EU Law**, Mads Andenas, and Wulf-Henning Roth (Eds), Oxford: Oxford University Press, 2004, p.73.
[32] Patrick A. Messerlin, "'Services' in The European Community as a World Trade Partner", **European Economy**, No.52, 1993, pp.129-156.

remuneration." Article 57(1) also provides examples of services including activities of a commercial and industrial character and activities of craftsmen and professionals. The case law has extended the scope of this Article to include such services like financial, medical, educational, sporting, recruitment activities and tourism. Other important services like transport, banking and insurance services connected with capital movements are dealt with either in different parts or by different provisions of the Treaty. For instance, for the sporting activities, the Court has consistently held that having regard to the objectives of the European Community, sport is subject to Community law only in so far as it constitutes an economic activity within Article 2 of the Treaty. As a consequence, "where such an activity takes the form of…the provision of services for remuneration, which is true of the activities of professional or semi-professional, it falls, more specifically, within the scope of Articles…49 EC [now 56 TEC]."[33]

The Court defined remuneration as a "consideration for the service in question…, [which] is normally agreed upon between the provider and the recipient of the service."[34] Barrowing from its jurisprudence in respect of workers and Article 45 (ex Article 39 TEC), the Court has held that remuneration need not be of a particular value, provided that it is 'genuine and effective' and not 'purely marginal or ancillary'.[35] Although there must be direct link between the service provider and the recipient,[36] it is not necessary that such remuneration is paid by the person receiving the service. In the *Bond van Adverteerders* case, the Court held that the condition for remuneration was satisfied by the charge made to cable subscribers and it was irrelevant that the broadcasters did not themselves pay for the service of relaying their programmes.[37]

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[33] Case 36/74 *Walrave & Koch v Association Union Cycliste Internationale* [1974] E.C.R. 1405 para.4; Case 13/76 *Dona v. Mantero* [1976] 2 C.M.L.R 578, para.12; Case C-415/93 *Union Royale Belge des Societes de Football Association ASBL v Bosman* [1996] 1 C.M.L.R. 645, para.73; C-191/97 *Deliege v Ligue Francophone de Judo et Disciplines Associees ASBL* [2000] E.C.R.I-2549, para.12.

[34] Case 263/86 *Belgian State v Rene and Marie Therese Humbel (Humbel)* [1988] ECR 5365, para.17.

[35] See Joined Cases C-51/96 and 191/ 97 *Christelle Deliege v Ligue Francophone de Judo et Disciplines Associees ASBL et al*. [2000] ECR I-2540, para.54, citing Case 53/81 *Levin v Staatssecretaris van Justitie* [1982] ECR 1035, para.17 and Case 196/87 *Steymann v Staatssecretaris van Justitie* [1988] ECR 6159, para.13.

[36] The Court found no such link in Case C-159/90 *Society for the Protection of Unborn Children v Grogan* [1991] ECR I-4685.

[37] Case 352/85 *Bond van Adverteerders* [1988] ECR 2124, para.16.

In order to determine whether there is a provision of service for the purposes of the EU law in this field, it is important to understand whether the service in question is the type that 'normally provided for remuneration'. The requirement of remuneration confirms the economic character of the services within the scope of Article 56. In *Schindler*, the Court stated that the economic character of lottery services was not affected by the considerations that there was an element of chance inherent in any return, and that the lottery had an element of recreational activity or that national rules might allocate profits on public interest grounds.[38]

Handoll suggests that the key question appears to be whether the relevant activity is operated with a view to 'commercial profit'.[39] This question is very similar to the one that is asked to define the scope of economic activity itself, which will be discussed in the following section, and it usually arises in relation to a wide variety of public services.

In *Humbel*, the Court was confronted with the question whether courses taught in a technical institute which formed a part of the secondary education provided under the national educational system constituted services within the meaning of Article 50(1) (now Article 57 TFEU) TEC. In the course of his argument, AG Slynn stated that profit-making (or profit seeking) organisations were generally financed by payments for goods sold or services rendered (remuneration). Their object in selling goods or providing services was precisely to receive remuneration. State education, however, like health care, was largely financed from the state taxes.[40] Following the path opened by his Advocate General, the Court held that state-provided education or vocational training would not be regarded as the provision of a service for the purpose of Article 49 (now Article 56 TFEU) since it was not 'normally provided for remuneration'. According to the Court, the State was not seeking to engage in gainful activity but was fulfilling its duties towards its own population in the social, cultural and educational fields, and that the system was generally funded from the public purse. The essential nature of this activity was not affected by the fact that pupils or

[38] Case C-275/92 *Schindler* [1994] ECR I-1039, para.28.
[39] John Handoll, **Free Movement of Persons in the EU**, New York: John Wiley & Sons, 1995, p.88.
[40] Opinion of AG Slynn in Case 263/86 *Humbel* [1988] ECR 5365, at p.5379

their parents sometimes had to pay teaching or enrolment fees as a contribution to the operating expenses.[41] The judgement was confirmed in the *Wirth* Case.[42] In this case the Court, however, added that establishments of higher education financed essentially out of private funds and seeking to make profit were aiming to offer services for remuneration within the meaning of Article 50(1) (now Article 57 TFEU) of the Treaty.[43]

Nevertheless, the demarcation line between the services normally provided for remuneration and public services emanating from the State's responsibilities are not very visible in each case. In *Kohll,* AG Tesauro was of the opinion that the State involvement in financing of the medical benefit in question did not mean that there was no provision of services as the medical treatment provided for consideration and the insured person bore a significant portion of the cost through health insurance contributions.[44] On the other hand, in *Geraets-Smiths and Peerbooms* the AG Ruiz-Jarabo Colomer stated that the payments made by the sickness funds to health care providers for each treatment did not, rigorously speaking, constitute consideration for the treatments provided. The reason was that such payments were not established on the basis of the cost of the treatment itself but on the basis of a series of other elements, sometimes even in the absence of the treatment. However, the Court did not follow Advocate General in this case and held that "the payments made by the sickness insurance funds […] albeit set at a flat rate, are indeed the consideration for the hospital services and unquestionably represent remuneration for the hospital which receives them and which is engaged in an activity of an economic character."[45]

[41] Case 263/86 *Humbel* [1988] ECR 5365, at p.5379 paras.14-20.
[42] Case C-109/92 *Wirth v Landeshauptstadt Hannover (Wirth)* [1993] ECR I-6447.
[43] Ibid, para.17.
[44] Opinion of AG Tesauro in Case C-158/96 *Raymond Kohll v Union des Caisses de Maladie (Kohll)* [1988] ECR I-1931, para.41.
[45] Case C-157/99 *Geraets-Smits v Stichting Ziekenfonds VGZ and Peerbooms v Stichting CZ Groep Zorgverzekeringen (Geraets-Smits and Peerbooms)* [2001] E.C.R. I-5473, para.58. For further discussion see Pedro Cabral, "The Internal Market and the Right to Cross Border Medical Care", **European Law Review (E.L.Rev.)**, vol. 29, No.5, 2004, pp. 673-686.

It may seem hard to reconcile these judgements in the health care services with the Court's decision in *Humbel,*[46] which is related to education. However, when the amount of contributions paid by individuals are compared, it can be realised that the tuition fees paid for the State-provided education is considerably low –sometimes totally free of charge- as the most part of the operating cost is financed from the general State budget. Therefore, there is almost no prospect for making profit for the public institutions providing education financed by the State. On the other hand, all insured persons have to pay premiums to health insurance schemes even if they never fall ill in their entire lives and in most Member States they have to make additional contributory payments for the specific medical treatment they have received. Thus, each case should be analysed on its own merits.

2.2.1.4. Market

Market is the place where the goods and services are offered and it may be local, regional or international. Within the market those goods and services and their suppliers compete with each other to strengthen and extend their positions in a way which is called "a competitive process." In other words, market is a place where the competition occurs.

For the economic activity to take place, participation in market should be a voluntary action. This means that buyers or suppliers must have an incentive to supply or buy a specific good or service in exchange for a remuneration which, at least, covers the actual cost of the product and corresponds to the value of the product. This fact does not exclude the regulation of markets by the State for public interest. However, there can be no market if the State has reserved a certain activity for itself.[47]

In competition law practice, relevant market is a technical term that is defined in terms of geographical area and product/service that is being offered. According to the Commission Notice, *"[a] relevant product/service market comprises all those products/services which are regarded as interchangeable or substitutable by the consumer*,

[46] Case 263/86 *Humbel* [1988] ECR 5365.
[47] Commission Decision of 6 April 2005 (*United Kingdom –Credit Union Provision of Access to Basic Financial Services- Scotland*), N 244/2003.

by reason of the products' characteristics, their prices and their intended use."[48] The same Notice defines the relevant geographical market as follows: "*The relevant geographical market comprises the area in which the undertakings concerned are involved in the supply and demand of products and services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas*."[49] These definitions laid down in the Notice are mainly based on the previous case law of the Court of Justice.[50]

As market is the essential component of competition and trade, there is no economic activity unless there is a market. For example, in one of the cases the CFI considered that the services of travel agencies represent an economic activity for which, at the time of the contested decision, airlines could not substitute another form of distribution of their tickets, and that they therefore constituted a 'market' for services distinct from the air transport market.[51]

2.2.2. Potential to Compete and Make Profit

Although in the current state of the case law, there are few problems as to what constitutes a good or a service for the purposes of Community law, the important question still seems to be whether such goods or services are capable of being offered by a private entity under market conditions. In *Pavlov*[52] and in *Ambulans Glockner*[53] the Court found that doctors and ambulances carry out economic activities, because they offer their services for remuneration and these services do not necessarily have to be provided by public bodies.

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[48] Commission Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law [1997] OJ C372/5 [1998] 4 CMLR 177, para.7.
[49] Ibid., para.8.
[50] See for example; Case 6/72 *Europemballage Corp and Continental Can Co Inc v Commission* [1973] E.C.R. 215, [1973] CMLR 199, para.32; Case 85/76, *Hoffmann -La Roche Co AG v EC Commission* [1979] 3 C.M.L.R. 211, para.28; Case 322/81 *Nederlandesche Banden-Industrie Michelin v Commission* [1983] E.C.R. 3461, [1985] 1 CMLR. 282, para.37.
[51] Case T-219/99 *British Airways plc. v Commission* [2004] 4 CMLR 1008, para. 100.
[52] Joined Cases C-180/98 to C-184/98 *Pavel Pavlov v Stichting Pensioenfonds Medische Specialisten (Pavlov)* [2000] ECR I-6451.
[53] Case C-475/99 *Ambulanz Glockner v Landkreis Sudwestpfalz (Ambulaz Glöckner)* [2001] ECR I-8089.

In *Eurocontrol*, AG Tesauro suggested that an economic activity should be "*capable of being carried on, at least in principle, by a private undertaking with a view to profit*."[54] The Court of First Instance held that "*the fact that an activity may be exercised by a private undertaking is a further indication that the activity in question may be described as a business activity*."[55] Similarly, in a recent case *Selex*, the CFI clearly stated that "*the fact that the services in question are not at that time offered by private undertakings do not prevent their being described as an economic activity, since it is possible for them to be carried out by private entities*."[56]

In the light of the case law, AG Jacobs stated in his opinion to *AOK* that "*[i]n assessing whether an activity is economic in character, the basic test appears…to be whether it could, at least in principle, be carried on by a private undertaking in order to make profits. If there were no possibility of a private undertaking carrying on a given activity, there would be no purpose in applying the competition rules to it*."[57] The underlying rationale of this test is that non-economic activities cannot be carried out by private sector as it is impossible to base them on a contractual relationship between the supplier and the recipient of the service. Gronden calls this test as an 'abstract test' which the Court applies to consider whether certain goods or services may potentially be provided on the market.[58] He also argues that the Court applies 'concrete test', especially in health insurance cases, to scrutinise how much room the national law leaves for competition in the implementation of the social insurance concerned, and whether or not the solidarity principle plays an important role in the system. Drijber thinks that both the 'abstract' and

[54] Opinion of AG Tesauro in Case C-384/92 *Sat Fluggesellschaft v Eurocontrol* [1994] ECR 1-43; [1994] 5 CMLR 208, para.9. See also Opinion of AG Jacobs in Joined Cases C-180/98 to C-184/98 *Pavlov* [2000] ECR I-6451, para. 107.
[55] Case T-128/98 *Aéroports de Paris v Commission of the European Communities* [2000] ECR II-3929; [2001] 4 CMLR 38 upheld in Case C-82/01 *P Aéroports de Paris v Commission of the European Communities* [2002] ECR I-9297 [2003] 4 CMLR 12.
[56] Case T-155/04 *Selex* [2007] 4 CMLR 10, para.89.
[57] Opinion of AG Jacobs in Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 *AOK Bundesverband (AOK*) [2003] ECR I-2493, para 27.
[58] Johan W. Van de Gronden, "Purchasing care: economic activity or service of general (economic) interest?", **European Competition Law Review (E.C.L.R.)**, vol. 25, No.2, 2004, pp.87-94.

'concrete' tests are based on the same question stipulated by AG Jacobs in *AOK.*[59] According to Odudu this question points out to the notion of 'potential to make profits' which is one of the essential elements of an economic activity.[60]

From a different perspective but reaching the same result, AG Maduro calls what the Court applies in its case law as a 'comparative criterion' in his opinion in *FENIN*. In this opinion, Maduro stated that "*comparative criterion lies at the root of a functional and wide-ranging approach to the concept of an undertaking*"[61] which is interlinked with the notion of economic activity. Although it is difficult to apply when the market is not sufficiently competitive, he states that the absence of effective competition on the market does not lead to its automatic exclusion from the scope of competition law. Therefore, the comparative criterion extends the concept of an economic activity to include "*any activity capable of being carried on by a profit-making organisation.*"[62]

The Court applied the abstract and concrete tests in several cases regarding pension funds and health insurance schemes. In *Poucet and Pistre*, the Court found that the sickness funds, and organisations involved in the management of the public social security system, fulfilled an exclusively social function, where the benefits paid were statutory benefits bearing no relation to the amount of the contributions.[63] As their activity was based on the principle of national solidarity and was entirely non-profit-making there remained little or no scope for private pension or insurance providers to compete with them.[64]

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[59] Berend J. Drijber, "Case Comment: Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 AOK Bundesverband A.O. Judgement of the Full Court 16 March 2004, Not yet Reported", **Common Market Law Review (C.M.L.Rev.)**, Vol. 42, 2004, p.528.
[60] Okeoghene Odudu, **The Boundaries of EC Competition Law**, Oxford: Oxford University Press, 2006, p. 35.
[61] Opinion of AG Maduro in Case C-205/03 *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission of the European Communities* [2006] ECR I-6295, para.11.
[62] Ibid., para.12.
[63] Joined Cases C-159/91 and C-160/91 *Christian Poucet v Assurances Generales de France (AGF) and Caisse Mutuelle Regionale du Languedoc-Roussillon (CAMULRAC) and Daniel Pistre v Caisse Autonome Nationale de Compension de l'Assurance Vieillese des Artisans (CANCAVA*) *(Poucet and Pistre)* [1993] ECR I-637, para.18.
[64] See Opinion of AG Jacobs in Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 *AOK* [2003] ECR I-2493, para. 30.

Consequently, the nature of the activity of the sickness funds in this case was not economic.[65]

In contrast, in *FFSA* the Court concluded that *"[a] non-profit making organisation which manages an old-age insurance scheme intended to supplement a basic compulsory scheme, established by law as an optional scheme and operating according to the principle of capitalisation*" was involved in an economic activity.[66] The non-profit character of the organisation was not sufficient to render the activity non-economic as there was a potential in the market to supply similar services and to make profits and the organisation was, in fact, in competition with the life assurance companies. Indeed, it has generally been held that for an activity offering goods or services to be considered as non-economic, one should be able to exclude the existence of a market for comparable goods or services.[67]

Similarly in *Albany*, the Court decided that *"[t]he sectoral pension fund itself determines the amount of the contributions and benefits and that the Fund operates in accordance with capitalisation*."[68] As "*the amount of the benefits provided by the Fund depends on the financial results of the investments made by it*,"[69] such services of the Fund constitute an economic activity in competition with insurance companies.

It is clear from the case law that offering of goods and services constitute an economic activity even if they are provided by the non-profit organisations as long as there is a potential in the market to make profit. In this regard, the fact that the services are not remunerated might be a pointer that there is no existence of economic activity but it is not decisive in itself. The necessity of remuneration for economic activity discussed in *Höfner* where the German Government argued that the employment procurement services were

[65] For the similar conclusion of the Court see Case C-218/00 *Cisal di Battistello Venanzio & Co. Sas v Instituto Nazionale Per L'Assicurazione Contro Gli Infortuni Sul Lavoro (Inail) (Cisal)* [2002] 4 CMLR 24.
[66] Case C-244/94 *Federation Francaise des Societes d'Assurance and Others v Ministere de l'Agriculture et de la Peche (FFSA)* [1996] 4 CMLR 536.
[67] See, e.g. Commission Decision of April 6, 2005 (*United Kingdom, Credit Union of Access to Basic Financial Services, Scotland)*, No.244/2003, para. 41.
[68] Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie (Albany)* [2000] 4 CMLR 446, para.81.
[69] Ibid. para. 82.

financed mainly by contributions from employers, which have no link with each specific service provided to individuals free of charge. As a consequence, the German Government alleged that the employment agency entrusted with an exclusive right to provide such services was not engaged in an economic activity.[70] However, the Court held that "*employment procurement has not always been, and is not necessarily, carried out by public entities*."[71] Indeed, there was an actual market in Germany for such services with a great potential to expand despite the legal monopoly of the public employment agency and the absence of remuneration did not affect the economic characteristic of recruitment services.

Similarly in *Henning Veedfald*, it was held that "*the fact that products are manufactured for a specific medical service for which the patient does not pay directly but which if financed from public funds maintained out of taxpayers' contributions cannot detract from the economic and business character of that manufacture*."[72] Recently in *Selex*, the Court of First Instance held that "*when assessing whether a given activity is an economic activity, the absence of remuneration is only one indication among several others and cannot by itself exclude the possibility that the activity in question was economic in nature*."[73]

The conclusion of the Court in *Höfner* is also in parallel with Article 57(1) (ex Article 50(1) TEC) of the Treaty where services are identified as activities '*normally* provided for remuneration'. In its case law regarding the economic nature of health services in the context of the freedom to provide services the Court of Justice found that even the free provision of medical services to members of a health insurance scheme is a service within the meaning of Articles 49 and 50 EC (now Articles 56 and 57 TFEU), since the

[70] Case C-41/1990 *Klaus Höfner and Fritz Elser v Macrotron GmbH (Höfner)* [1991] ECR I-1979, para.19.
[71] Ibid. para. 22.
[72] Case C-203/99 *Henning Veedfald v Arhus Amstkommune (Henning Veedfald)* [2001] ECR I-3569.
[73] Case T-155/04 *Selex* [2007] 4 CMLR 10.

payments made by the insurance schemes to the doctors or hospitals represent remuneration.[74]

However, AG Maduro in *FENIN* reported that the scope of freedom to provide services and the scope of competition law are not identical. He suggested that main difference between the two fields is as follows: *"[T]he Member States may withdraw certain activities from the field of competition law if they organise them in such a way that the principle of solidarity is predominant with the result that competition law does not apply. By contrast, the way in which an activity is organised at the national level has no bearing on the application of the principle of the freedom to provide services*."[75] He concluded that provision of health care free of charge can be an economic activity for the purposes of Article 49 (now Article 56 TFEU) but it does not necessarily follow from that the organisations which carry on that activity are subject to competition law.[76]

The different approaches of the Community institutions to the nature of economic activity in similar cases in the field of freedom to provide services and in the field of competition law may be explained by the different functions attributed to both types of provisions.[77] Nevertheless, this situation inevitably causes confusion in the application of the Treaty rules to the public services which will be examined in following chapter.

2.2.3. Risk Bearing

Another important component of economic activity appears to be 'risk bearing' which is not directly related to the characteristics of the goods or services offered on the market but is more concerned with the nature of the relationship between the activity and the entity. In *Commission v Italy*, Italian Government argued that although the occupation of customs agent was a liberal profession, customs agents could not be regarded as

[74] Case C-368/98 *Vanbraekel v Alliance Nationale des Mutualities Chretiennes (ANMC)* [2001] ECR I-5363 ; Case C-157/99 *Geraets-Smits and Peerbooms* [2001] ECR I-5473 ; Case C-385/*99 Muller-Faure v Onderlinge Waarborgmaatschappij OZ Zorgverzekeringen UA* [2003] E.C.R. I-4509.
[75] Opinion of AG Maduro in Case C-205/03 *FENIN* [2006] ECR I-6295, para. 51.
[76] Ibid.
[77] Markus Krajewski and Martin Farley, "Case Comment: Non Economic Activities in Upstream and Downstream Markets and the Scope of Competition Law after FENIN", **E.L.Rev.**, Vol. 32, No. 1, 2007, pp.111-124.

undertakings because of the nature of the service which they provided and because the practice of their profession required authorisation and entailed compliance with certain conditions. Against this argument the Court replied that the activity of customs agents had an economic character since they offered for remuneration services consisting in the carrying out of customs clearance formalities and since they assumed the 'financial risk' involved in the exercise of their profession: '*If there is an imbalance between expenditure and receipts, the customs agent is required to bear the deficit himself*."[78] The same line of reasoning was repeated in *Pavlov*, where the medical specialists were considered to be engaged in economic activities as they assumed the financial risks attached to the pursuit of their activity.[79]

In *Poucet and Pistre*, the Court found that the managing bodies of the social insurance schemes under scrutiny did not bear the risk of their unsuccessful management as the risk was spread across the sector. Because the schemes were operated in such a way that "*those in surplus contribute to the financing of those with structural financial difficulties*."[80] Having analysed the other factors as well, the Court concluded that it was not an economic activity.

In another judgement, the Court found the registered members of the Bar in the Netherlands carried out an economic activity when they offer, for a fee, services in the form of legal assistance. The Court stated that "*they bear the financial risks attaching to the performance of those activities since, if there should be an imbalance between the expenditure and receipts, they must bear the deficits themselves*."[81]

As opposed to independent professionals, employees who offer labour in return for remuneration are held outside the scope of competition law because they do not bear any

[78] Case C-35/96 *Commission v Italy* (customs agents) [1998] ECR 1-3851; [1998] 5 CMLR 889, para.37.
[79] Joined Cases C-180/98 to C-184/98 *Pavlov* [2000] ECR I-6451
[80] Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* [1993] E.C.R. I-637, para.12.
[81] Case C-309/99 *Wouters and others v Algemene Raad van de Nederlandse Orde van Advocaten and another (Wouters)* [2002] ECR I-1577, para.48.

financial or economic risk, at least directly, of their practice.[82] Odudu explains this in an 'attributional sense', where the risk is used to confer 'responsibility'. Therefore, the outcome of the employees' conduct is attributable to their employers and the employer has the responsibility in relation to the outside world.[83] In parallel with this view, AG Colomer stated in *Becu* that "*it is that ability to take on financial risks which gives an operator sufficient significance to be capable of being regarded as an entity genuinely engaged in trade*."[84]

Townley does not support this approach, claiming that parties' relations should be analysed in a dynamic way from an economic perspective. According to him, performance in a short term contract is likely to affect the amount of control sought over that individual, if he/she is employed in the future, as well as whether he/she will be employed at all. Thus, this means even workers assume financial risks.[85] However, the risk referred here with respect to employee's relations with his/her employer is completely different from the risk that an economic unit (including employees) faces while engaging in economic or business activities. For example, termination of an employment contract is not the same as bankruptcy of a company. These issues will be analysed in more detail within following sections.

2.3. Non-Economic Activities

2.3.1. Purchasing Activities

In *Commission v Italy*, when the Court had to deal with the question whether the activity of customs agents as an intellectual activity may be regarded as economic, the Court found that "*any activity consisting of offering goods or services on a given market*" was an economic activity. However, at the time of the judgement it was not clear whether

[82] See Case C-67/96 *Albany* [2000] 4 CMLR 446.
[83] Odudu, supra not. 21. pp.34-35.
[84] Case C-22/98 *Criminal proceedings against Jean Claude Becu and Others (Becu)* [1999] ECR I-5665, para.53.
[85] Christopher Townley, "The Concept of an 'Undertaking': The Boundaries of the Corporation- A Discussion of Agency, Employees and Subsidiaries" in Giuliano Amato and Claus-Dieter Ehlermann (Eds) **EC Competition Law –A Critical Assessment**, Oxford: Hart Publishing, 2007, p. 10.

this statement should be regarded as an exhaustive definition of an economic activity, excluding all purchasing activities from the scope of competition law or it was just one version of the definition created on the basis of the special features of this case.

Under the recent developments in EU law, it is clear that the Community institutions make a distinction between the purchasing activities in which the purchased goods and services are used subsequently in a downstream economic activity and the ones that are closely related to 'consumption'. In the former the purchasing activity is regarded as an economic activity whereas in the later it is not. As a result, a purchase falls within the scope of competition law only in so far as it forms part of the exercise of an economic activity.

According to Deringer consumption is not an economic activity because it has "the sole objective of meeting personal needs"[86] which is outside the scope of competition law. Consumption may not be an economic activity in its own right, at least for the purposes of competition law,[87] but it is undisputable that it is the main force behind any economic activity. Although final consumers have just a negligible effect on the market as individuals, it is not the same when the purchaser is a public entity, a non-profit organisation or an association with a considerable economic power to buy but without any intention to put those services or goods purchased into an economic activity. For instance, the State or government is by far the largest customer of such industries, like armaments, and its purchasing behaviour has major implications for the whole economy.[88] Such purchasing activities are also different from that of the individual consumers, whose mere objective is to meet personal needs, in a way that such organisations' conduct is more of dissipation rather than consumption in technical sense especially when they pursue public

[86] Arved Deringer, **The Competition Law of the European Economic Community: A Commentary of the EEC Rules of Competition (Articles 85 to 90) Including the Implementing Regulations and Directives**, New York: Commerce Clearing House, 1968, p.8.
[87] Paul K. E. Lasok, "When is an Undertaking is not an Undertaking", **E.C.L.R.**, Vol. 25, No. 7, 2004, pp.383-385.
[88] Dermot Glynn and Jeremy Liesner, "Does Anti-trust Make Economic Sense", **E.C.L.R.**, Vol. 8, No. 4, 1987, pp.344-370.

interest.[89] Again, the State's defence policy and its procurement policy are supposedly determined primarily by the national interest.

On the other hand, buying power of public sector, including municipalities, educational institutions, social security systems, State administrative bodies, national defence and military offices is quite significant in their respective markets. Buyer power, which can be described as a situation where the demand side of the market is sufficiently concentrated,[90] may have detrimental effects in the absence of countervailing seller power on the market. Even when those entities do not have a dominant position, they still can influence the competitive structure of the market by entering into agreements or concerted practices with other entities engaged in economic activities. In such situations the characterisation of purchasing activity gains importance in order to determine whether it is possible to deal with the problem by means of competition rules.

The Court had to tackle with the economic/non-economic character of purchasing activities of public entities in just a few cases related to health sector. In *Pavlov*, the Commission contended that, when they are contributing to their own supplementary pension scheme, the medical specialists were not engaged in an economic activity within the meaning of Community competition law. The Commission was of the opinion that a medical specialist, who set up a supplementary pension scheme for himself, was acting as an end user and the decision he took in that context fell outside the scope of competition rules. Remarkably, the Commission compared purchasing decision of the medical specialists to a decision to make investments on the financial markets or to purchase a holiday home.[91] However, the Court found that the payment of contributions by self-employed medical specialists closely connected to the practice of their profession and decided that they were not acting as final consumers when they made contributions to their

[89] For a different view see Opinion of AG Maduro in Case C-205/03 *FENIN* [2006] ECR I-6295, para.64 where he reports that "…purchases intended for use in non-economic activities are comparable to final demand by consumers."
[90] Ioannis Kokkoris, "Buyer Power Assessment in Competition Law: A Boon or a Menace?", **World Competition**, Vol. 29, No. 1, 2006, p.139.
[91] Joined Cases C-180/98 to C-184/98 *Pavlov* [2000] E.C.R. I-6451, para.78.

own supplementary pension scheme.[92] It may be inferred from this judgement that when purchasing is closely related to the economic activity pursued, such as practice of a profession, it will be considered as an economic activity, as well. For instance, when doctors buy medical equipments or lawyers rent offices, they are engaged in economic activities as they are related to their professions.[93] However, the same purchasing activity may constitute consumption when it is performed on its own. Case-by-case analysis is necessary to determine the characteristics of each purchasing activity.

Purchasing activities of the German sickness funds came before the Court in *AOK*, albeit in a different context. In this case, the sickness funds were required by the German legislation to purchase medical services and products and to supply them in kind to the insured persons who needed them. These funds were also empowered to fix maximum amounts payable by the funds in respect of the cost of purchased medicinal products. Consequently, where a fixed amount had been determined, the sickness fund fulfilled its obligation by paying only that amount. The main question before the Court was whether determination of fixed amounts by the funds jointly breached competition law. In relation to the question whether setting of the maximum amounts was an economic activity or not, AG Jacobs, in his opinion, pointed out one of the referring courts' (Oberlandesgericht) suggestion. According to the German court, "purchasing may amount to an economic activity whether or not the entity which purchases is itself active on another market for which goods or services purchased constitute an input."[94] The statement was important especially because these statutory sickness funds were the biggest purchasers on the medicinal product market. However, the Court, looking at the relationship between the funds and the insured persons, concluded that the activities of the funds were not of an economic nature and did not discuss the referring court's suggestion at all.

The Court dealt with the characterisation of purchasing activities in *FENIN*, which was the first case that addressed the direct contractual and economic relationship between

[92] Ibid. paras.79-81.
[93] Opinion of Advocate General in Joined Cases C-180/98 to C-184/98 *Pavlov* [2000] ECR I-6451, para.115.
[94] Opinion of AG Jacobs in Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 *AOK* [2003] ECR I-2493, para. 46.

the providers of healthcare services and the producers of medical goods and services. In this case, FENIN was an association of the majority of the undertakings marketing medical goods and equipment for the hospitals in Spain. The members of this association sold many of those goods to the national health service ('SNS') management bodies. In view of FENIN, these SNS bodies were in breach of competition rules due to their systematic delays in payment. In this respect, it was important to determine whether the purchase of medical goods and services by the SNS bodies was economic in nature. Accordingly, the CFI distinguished between purchasing and supplying activities and stated that "*it is the activity consisting in offering goods and services on a given market that is the characteristic feature of an economic activity…, not the business of purchasing, as such*."[95] The CFI went on to hold that "*it would be incorrect, when determining the nature of that subsequent activity, to dissociate the activity of purchasing goods from the subsequent use to which they are put*."[96] According to the CFI, "*an organisation which purchases goods not for offering goods and services as part of an economic activity, but in order to use them in the context of a different activity, such as one of a purely social nature, does not act as undertaking simply because it is a purchaser in a given market*."[97] Furthermore, in *Selex*, the CFI confirmed that "*the general wording of that sentence [at para.37 of Fenin], in particular the fact that it expressly refers to a social activity only as an example, permits the approach adopted in that judgement to be transposed to any organisation purchasing goods for non-economic activities*."[98] Therefore, the nature of the purchasing activity must be determined according to whether or not the subsequent use of the purchased goods amounts to an economic activity.

FENIN filed an appeal arguing that the CFI's view that purchasing activities could not be seen separately from the activity for which they are purchased was not right. According to them the purchasing activity was an 'economic activity' and could be

[95] Case T-319/99 *Federacion Nacional de Empresas de Instrumentacion Cientifica, Medica, Tecnica Y Dental (FENIN) v Commission of the European Communities* [2003] 5 CMLR 1, para. 36.
[96] Ibid.
[97] Ibid.para.37.
[98] Case T-155/04 *Selex* [2007] 4 CMLR 10, para.67.

'dissociable' from its subsequent use. The Court of Justice upheld the CFI's decision without any further discussion.[99]

The judgements in *FENIN* are very important for their consequences with regard to purchasing activities of the public sector, which might be quite large in most Member States. Particularly, State bodies or public entities generally purchase inputs (upstream) without selling outputs (downstream) to its citizens.[100] As Korah observes, despite the rules on public procurement, this sector has been left free from the constraints of competition rules, which may lead to the unfair treatment of suppliers by the public entities.[101] This approach also involves some practical difficulties since it is not easy to determine at the time of the purchase whether it is intended for economic or non-economic use especially when the entity follows both economic and non-economic activities.[102] Roth, also added that such distinction is effectively impossible to draw with regard to purchases intended for the infrastructure of such an entity.[103] In spite of all these arguments, at the current stage, the Court's case law defines economic activity in terms of the offer not the acquisition of goods and services.

2.3.2. Regulatory Activities

Regulatory activities are not of an economic nature as they obviously do not consist of offering goods or services in the market although their aim may be the regulation of such activities. Selznick, defines regulation as a "*sustained and focused control exercised by a public agency over activities that are valued by a community*." [104] Nevertheless, it is very difficult to define regulation with clarity and precision.

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[99] Case C-205/03 *FENIN* [2006] ECR I-6295, paras. 25-28.
[100] Alexander Winterstein, "Nailing the Jellyfish: Social Security and Competition Law", **E.C.L.R.**, Vol. 20, No. 6, 1999, pp.324-333.
[101] Valentine Korah, **An Introductory Guide to EC Competition Law**, 9th ed., Oxford: Hart Publishing, 2007, p.49.
[102] See FENIN's argument and the Advocate General's response to this argument in AG Opinion in Case C-205/03 *FENIN* [2006] ECR I-6295, para.67
[103] Wulf-Henning Roth (2007). Case Comment: Case C-205/03 *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v Commission,* Judgement of the Grand Chamber of 11 July 2006, [2006] ECR I-6295. **C.M.L.Rev.**, Vol.44, No.4, 2007, pp.1131-1142.
[104] Philip Selznick, "Focusing Organisational Research on Regulation" in R. Noll (Ed), **Regulatory Policy and the Social Sciences,** Berkeley: University of California Press, 1985, p.363.

Acknowledging this difficulty as to its controversial meaning and scope, Morgan and Yeung explain that "*[a]t their narrowest, definitions of regulation tend to centre on deliberate attempts by the state to influence socially valuable behaviour which may have adverse side-effects by establishing, monitoring and enforcing legal rules*."[105] In this context, regulation is closely connected with the exercise of official authority by the State. According to AG Mayras, *"[o]fficial authority is that which derives from the sovereignty, the imperium of the state; it implies, for the one exercising it, the power to enjoy prerogatives which fall outside the ordinary law (exorbittantes du droit commun), privileges of public power, powers of coercion over the citizens*."[106] As AG Tesauro stated in *SAT*, the Court has preferred not to define this concept in abstract terms but followed the path marked out by Mayras in various areas of the Community law where that concept is relevant.[107]

From the legal perspective, in its regulatory activities, law is used as an instrument by the State to achieve the community's chosen collective goals, which may have economic or non-economic character. For instance, in *Bodson*, the Court was asked, *interalia*, whether competition rules were applicable to contracts concluded between French communes and private companies with a view to provide certain funeral services on exclusive basis. French legislation entrusted such services for funerals to communes, whereas some communes granted to a private undertaking a concession, which is an exclusive right, to provide them in their respective regions. The Court stated that the competition rules, particularly Article 81 (now Article 101 TFEU), are applicable to agreements between the entities engaged in economic activities. Thus, those rules do not apply to contracts concluded between communes acting in their capacity as public authorities and undertakings entrusted with the operation of a public service.[108] In this case, it was clear that the conclusion of those contracts with private service providers was not an

[105] Bronwen Morgan and Karen Yeung, **An Introduction to Law and Regulation –Text and Materials**, Cambridge University Press, 2007, p.3.
[106] AG Mayras's Opinion in Case 2/74, *Reyners v The Belgian State* [1974] 2 CMLR 305.
[107] Case C-364/92 *SAT Fluggesellschaft mbH v Eurocontrol* [1994] ECR I-43, AG Opinion, para.9.
[108] Case 30/87 *Corinne Bodson v Pompes Funebres des Regions Liberees SA (Bodson)* [1989] CMLR 984. para.18.

economic activity but a regulatory activity to reach a certain public interest. Similarly, in *Albany*, the Court decided that the request made to the public authorities by the organisations representing employers and workers to make affiliation to the sectoral pension fund set up by them compulsory was part of a regime established under a number of national laws, designed to exercise regulatory authority in the social scheme. As a consequence, this activity was immune from the application of competition rules and the Member States are free to make it compulsory for persons who are not bound as parties to the agreement.[109]

Whilst the regulatory activities of the State cannot be regarded as economic even when they do not pursue purely social goals, such as welfare of the citizens, they have serious impacts on and interactions with economic activities. Welfare economics approach suggests that regulation is a response to imperfections in the market, which are called as 'market failures'. Correction of market failures improves the community's general welfare and is thus in the public sphere.[110] In this respect, Ogus argues that "*regulation is the necessary exercise of collective power through government in order to cure 'market failures' to protect the public from such evils as monopoly behaviour, 'destructive' competition, the abuse of private economic power, or the effects of externalities*."[111]

On the other hand, at its broadest sense, regulation can be seen as encompassing all forms of social control, whether intentional or not, and whether imposed by the State or other social institutions. One of the typical examples of this type of regulation is a classical form of 'self regulation' which "*is generally understood as agreement between those involved in the relevant activity to regulate their own behaviour through the creation of some kind of regulatory body (such as an industry or sports association) entrusted with the task of promulgating and enforcing a code of conduct governing the behaviour of its members*."[112] The power of such a body to develop, apply and enforce a code of conduct

[109] Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie(Albany)* [2000] 4 CMLR 446, para. 66.
[110] Morgan and Yeung, p. 18.
[111] Anthony Ogus, **Regulation: Legal, Form and Economic Theory**, Oxford: Hart Publishing, 2004, p.29.
[112] Anthony Ogus, "Rethinking self-regulation", **Oxford Journal of Legal Studies**, vol.15, 1995, p.97.

derived from the agreement of its members in which the ultimate sanction for violation is typically expulsion from membership. Sometimes, the authority of these bodies, which is usually the case in many Member States for certain public financial or professional bodies, such as bars and bar associations for lawyers or similar institutions for medical practitioners, may derive their powers directly from the State regulations or national constitutions. In such cases, these bodies may constitute associations of undertakings in the sense of Article 101 of the Treaty and their regulatory activities may be subject to competition rules.

It is important to understand that regulatory activities of the State and the regulatory activities of the other institutions which are independent from the State may have different characteristics and produce different results with respect to the Union law. In *Wouters,* the Court held that the Bar of the Netherlands acted as the regulatory body of a profession, the practice of which constitutes an economic activity. Because, when the Bar adopted a regulation it neither fulfilled a social function based on the principle of solidarity nor exercised "*powers which are typically those of a public authority*."[113] The Court also stated that the fact that it was entrusted with the task of protecting the rights and interests of the members of the Bar by legislation could not a priori exclude that professional organisation from the application of Article 85 (now Article 101 TFEU) of the Treaty, even when it performed its role of regulating the practice of the profession of the Bar.[114] The Court had reached a similar result in *Pavlov* concerning medical practitioners, adding that "*a decision taken by a body having regulatory powers within a given sector might fall outside the scope of Article 85 [now Article 101 TFEU] of the Treaty where that body is composed of a majority of representatives of the public authorities and where, on taking a decision, it must observe various public-interest criteria*."[115]

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[113] Case C-309/99 *Wouters and others v Algemene Raad van de Nederlandse Orde van Advocaten and another (Wouters)* [2002] ECR I-1577, para. 58.
[114] Ibid., para.59.
[115] Joined Cases C-180/98 to C-184/98 *Pavel Pavlov v Stichting Pensioenfonds Medische Specialisten* [2000] ECR I-6451, para.87. See also Case C-96/94 *Centro Servizi v Spedizioni Marittima Del Golfo* [1996] 4 CMLR 613 and Case C-35/96 *E.C Commission v Italy* [1998] ECR I-3851.

In *Wouters* the Court draws a distinction between the approaches as to the regulatory activities performed by the professional associations whose regulatory power delegated by the State and those of the professional associations which act independently from the State. Accordingly, in the former case, "*when it grants regulatory powers to a professional association, the State is careful to define the public interest criteria and the essential principles with which its rules must comply and also retains its power to adopt decisions in the last resort*."[116] Thus, such regulatory activities are within the *imperium* of the State and still in the public sphere. On the other hand, in the latter case, "*the rules adopted by the professional association are attributable to this institution alone*,"[117] therefore, they are likely to have economic characteristics and be subject to competition law. This distinction may imply that the regulatory activities of the State or State-like public bodies are non-economic even when they regulate offering of goods or services on the market, because their ultimate aim is to increase the general welfare of the society. However, regulatory activities of the independent public bodies may be economic as they cannot be considered apart from the whole act of offering of goods or services on the market itself, although they still serve a particular public interest.

Although they are not subject to competition rules due to their non-economic character, the regulatory activities of the State may be subject to other appropriate Community rules, such as free movement of goods, workers, services, capital or freedom of establishment or the general rule on non-discrimination. Moreover, the Court decided in *Walrave and Koch* that the free-movement rules "*does not only apply to the action of public authorities but extends to rules of any other nature aimed at regulating in a collective manner gainful employment and the provision of services*."[118] Specifically in those cases where the regulation of the sporting activities was at stake, the Court also held that the prohibitions enacted by those provisions of the Treaty, such as Article 39 (now Article 45

[116] Case C-309/99 *Wouters* [2002] ECR I-1577, para. 68.
[117] Ibid., para.69.
[118] Case 36/74 *Walrave & Koch v Association Union Cycliste Internationale* [1974] ECR 1405, para.17 and also confirmed in Case C-51/96 and C-191/97 *Deliege v Ligue Francophone de Judo et Disciplines Associees ASBL* [2000] ECR I-2549, para 47; Case C-519/04 *Meca-Medina and Majcen v Commission of the European Communities* (*Meca-Medina)* [2006] 5 CMLR 18 para. 24.

TFEU) and Article 49 (now Article 56 TFEU), did not affect rules concerning questions which were of purely sporting interest and, as such, had nothing to do with economic activity.[119]

However, the same case-law also suggests that "*the mere fact that a rule is purely sporting in nature does not have the effect of removing from the scope of the Treaty the person engaging in the activity governed by that rule or the body which has laid it down*."[120] Accordingly, the public body may escape from the application of Community rules, including competition, for its regulatory activities, which are not in the economic sphere, whereas the same body may be subject to Community rules for its other activities in the economic sphere.

As a result, in *Meca-Medina*, the Court, rejecting the CFI's contentions, ruled that "*even if those rules do not constitute restrictions on freedom of movement because they concern questions of purely sporting interest and, as such, have nothing to do with economic activity, that fact means neither that the sporting activity in question necessarily falls outside the scope of Articles 81 (now Article 101 TFEU) and 82 (now Article 102 TFEU) EC and nor that the rules do not satisfy the specific requirements of those articles.*"[121] The wording of this paragraph is rather confusing, because it is very difficult to think about any activity which falls outside the free movement rules because it is not economic but nevertheless falls into the scope of competition rules which are all about economic activities. On the other hand, taking into account the previous paragraphs of the same judgement, it may be explained in a way that the Court meant different aspects of the same activity, as the free movement and competition rules have different objectives and different requirements. Another explanation, which may be more convincing, might be that, as Odudu defends, citing *Wouters*, the Court does not care about whether the activity is economic or not when deciding whether the association of undertakings in question, which

[119] Ibid., para.7. See also Case 13/76 *Dona v Mantero* [1976] 2 CMLR 578, paras.14-15.
[120] Case C-519/04 *Meca-Medina* [2006] 5 CMLR 18, para.27.
[121] Ibid., para. 31.

may be a public professional body, is in breach of competition rules.[122] In other words, association of undertakings may breach competition rules through their regulatory activities even such activities are not considered to be economic.

On the other hand, competition rules (Articles 101 and 102 TFEU), read in conjunction with Article 4(3) TEU (ex Article 10 TEC), require Member States not to introduce or maintain in force measures, even of a legislative or regulatory nature, which may render ineffective the competition rules applicable to undertakings.[123] Moreover, in certain cases attributing regulatory functions to an entity which carries out an economic activity can breach Article 106(1) in conjunction with Article 102.[124] This subject shall be analysed in detail within the following part of this chapter.

2.3.3. Employee-Employer Relations

According to Grossman and Hart an employer-employee relationship is typically characterized by the fact that many details of the work to be carried out are not specified in the contract but are left to the employer's discretion.[125] Thus, in *Lawrie-Blum*[126] the Court of Justice held that the essential feature of an employment relationship is that for a certain period of time a person performs services for and under the direction of another person, in return for which he receives remuneration. This question must be answered on the basis of all the factors and circumstances characterising the arrangements between the parties. However, the 'services' mentioned in this case as part of the essential feature of employment relationship is quite different, in technical sense, from the services defined in Article 57 TFEU. Actually, it is 'work' as defined by Article 45 TFEU not 'service' in the meaning of Article 57 TFEU, which is performed by employees in their relation with the

[122] Odudu, op.cit., p.35
[123] Case C-96/94 *Centro Servizi v Spedizioni Marittima Del Golfo* [1996] 4 CMLR 613, para.20.
[124] See e.g. Case C-18/88 *Régie des télégraphes et des téléphones v GB-Inno-BM SA (RTT)* [1991] ECR I-5981 and 5982, paras. 25-28.
[125] Sanford J. Grossman and Oliver D. Hart, "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration", **Journal of Political Economy**, Vol. 94, No. 691, 1986, p.717.
[126] Case 66/85 *Deborah Lawrie-Blum v Land Baden-Wurttemberg (Lawrie-Blum)* [1986] ECR 2121 para.17.

employer.[127] Nor do employees sell goods to the employer within the meaning of Article 34 TFEU. Consequently, there is no direct offering of goods or services by employees, because they are offered to the market by the entity/ employer they worked for.

The Community Courts have relied on the criteria developed in *Lawrie-Blum* for defining 'economic activity' in relation to the 'employee' concept under Articles 101 and 102 of the Treaty. For example, in *Suiker Unie*, the Court of Justice stated that: "*if such an agent works for his principal he can, in principle, be regarded as an auxiliary organ forming an integral part of the latter's undertaking bound to carry out the principal's instructions and thus, like a commercial employee, forms an economic unit with this undertaking*."[128]

Similarly, in *Becu*, the Court noted that the recognised dockers were employed on short fixed-term contracts for the purpose of performing clearly defined tasks. It went on to conclude that "*the employment relationship which recognised dockers have with the undertakings for which they perform dock work is characterised by the fact that they perform the work in question for and under the direction of each of those undertakings, so that they must be regarded as 'workers' within the meaning of Article 48 [now Article 45 TFEU] of the Treaty, as interpreted by the case law of the Court… Since they are, for the duration of that relationship, incorporated into the undertakings concerned and thus form an economic unit with each of them, dockers do not therefore in themselves constitute 'undertakings' within the meaning of Community competition law*."[129]

According to the case law, employees cannot form an independent economic unit without terminating their employment relation with their employers. As the AG Jacobs argued in *Albany*, dependent labour is by its very nature the opposite of the independent

[127] Odudu, p.27.
[128] Joined Cases 40/73 to 48/73 *Cooperative Vereniging Suiker Unie UA v Commission (Suiker Unie)* [1975] ECR 1663, para. 539.
[129] Case C-22/98 *Criminal proceedings against Jean Claude Becu and Others (Becu)* [1999] ECR I-5665, para.25.

exercise of an economic or commercial activity.[130] Where there is no independence, it is not possible to consider 'risk bearing' concept which is used to detect economic activity. In the same case, the Court accepted that it was beyond question that certain restrictions of competition were inherent in collective agreements between organisations representing employers and workers. The same was true for agreements between workers. The Court said, however, that the social policy arguments would be seriously undermined if management and labour were subject to competition rules, particularly Article 81 TEC (now Article 101 TFEU), when seeking jointly to adopt measures to improve conditions of work and employment. Consequently, the Court held that such agreements should fall outside Article 101(1) TFEU.[131]

Demsetz and Alcian do not share the Court's view as to the dependent nature of employment relationship and the superior position of the employer vis-à-vis his/her employees. According to these authors, the firm does not own all its inputs. Therefore, "*it has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between two people*."[132] Nevertheless, in the current state of the case law, employee-employer relations are not considered to be an economic activity for the above-mentioned reasons.

2.3.4. Redistributive Activities

2.3.4.1. The Notion of Solidarity

Redistributive activities are closely linked to or associated with the notion of solidarity which is exclusively a social function. Social solidarity represents an assumption of welfare responsibilities between the members of a particular community.[133] From the

[130] Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie (Albany)* [2000] 4 CMLR 446, para.215.
[131] Ibid., paras.59-60.
[132] Harold Demsetz and Armen Alchian, "Production, Information Costs, and Economic Organisation" in **Ownership, Control and the Firm**, Harold Demsetz (Ed), Oxford: Basil Blackwell Limited, 1988, p. 119.
[133] Michael Dougan and Eleanor Spaventa, "'Wish You Weren't Here…' New Models of Social Solidarity in the European Union" in Michael Dougan and Eleanor Spaventa (Eds), **Social Welfare and EU Law**, Oxford and Portland: Hart Publishing, 2005, p.184.

financial point of view, solidarity systems are, in particular, based upon the principle of subsidisation. Hence, AG Fennelly defines social solidarity as "*the inherently uncommercial act of involuntary subsidisation of one social group by another*."[134] In this respect, solidarity is a broad concept that includes the rights and obligations of the citizens towards each other, for the achievement of which the State acts as a sort of co-ordinator or supervisor.

The 'social solidarity' emerges from the idea that the State has duties to ensure equal treatment of citizens irrespective of their economic resources,[135] which is very different from the profit oriented model underlying a market economy and economic activity. For example, social protection measures embracing the whole society envisage the redistribution of society's wealth, which would not otherwise result from the free operation of market forces.

As the main purpose of the modern welfare is to promote social solidarity and political stability, the State has assumed collective responsibility for achieving, via a combination of economic and social policies, certain objectives. According to Panic, these objectives are: "*equality of opportunity so that the stock of human ability and skills can be developed and employed optimally from an individual and social point of view; reduction in the inequality of income and wealth; and public responsibility for those individuals and household that are unable to achieve a certain ('minimum') standard of living through their own efforts.*"[136]

Therefore, social solidarity involves direct transfers that are part of the Welfare State, as well as those norms that facilitate access to essential services, irrespective of wealth and privilege.[137] This necessitates the regulation of social insurance, public health or

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[134] Opinion of AG Fennelly in Case C-70/95 *Sodemare SA and Others (Federation des Maisons de Repos Privees de Belgique v Regione Lombardia (Sodemare)* [1998] 4 CMLR 667, para.29.
[135] Tony Prosser, **The Limits of Competition Law- Markets and Public Services**, Oxford: Oxford University Press, 2005, p. 35.
[136] Mica Panic, "The Euro and Welfare State" in Michael Dougan and Eleanor Spaventa (Eds), **Social Welfare and EU Law**, Oxford and Portland: Hart Publishing, 2005, p. 30.
[137] Nina Boeger, "Solidarity and EC Competition Law", **E.L.Rev**., Vol.32, No.3, 2007, pp. 319-340.

other public services. Such regulations have the common objective of securing the access to these benefits, which serves not just formal but material equality between citizens.[138] In this respect, the European Welfare State aims to realise the values of freedom and equality by providing insurance against a number of personal risks.[139]

On the other hand, the creation of a common market has not promoted the social policy measures as much as it has protected and developed the fundamental economic freedoms. Indeed economic freedoms constitute the essentials of European model of economic integration. Moreover, the furtherance of the economic law and freedoms has increasingly resulted in the erosion of social rights standards and led to "*factual and legal challenges to the economic, social and legal basis of the welfare state*."[140] This situation can be explained on the basis of the fundamental role allocation between the Member States and the Community, "*in which social solidarity ambitions are to be determined at the national level and the Community administers an economic law that aims to integrate national markets and bring market efficiency*."[141] Nevertheless, it is in the nature of the European Union as an evolutionary system of governance that the influence or reach of Union law extends beyond the formal competencies granted by the Treaty and the interaction between the national and Union law is almost inevitable.[142]

Within this framework, solidarity emerges as a useful medium for the judicial authorities to maintain a balance between the economic freedoms, which may cause, at least in some cases, 'earthly suffering' and the social values that may provide 'heavenly healing' for the citizens within the Union. It also provides for the Member States an autonomous area to manoeuvre and protect some goods or services, which, they assume, cannot be made accessible to all citizens equally under normal market conditions, from the

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[138] Ibid.
[139] Abraham De Swaan, **In Care of the State**, Oxford: Blackwell, 1989, p.19.
[140] Agustin Jose Menendez, "The Sinews of Peace: Rights to Solidarity in the Charter of Fundamental Rights of the European Union" **Ratio Legis**, Vol.16, No.3, 2003, p. 376.
[141] Boeger, opcit.
[142] Tamara K. Hervey, "Social Solidarity: Buttress Against Internal Market Law" in Jo Shaw (Ed), **Social Law and Policy in an Evolving European Union**, Oxford: Hart Publishing, 2000, p. 32.

application of the Union rules. Thus, the solidarity principle defines the limits of economic activities as well as competition law.

As a consequence, solidarity is regarded to be one of the founding values of the Community law and the inclusion of this notion to the Charter of Fundamental Rights of the European Union[143] is a strong affirmation of this fact.[144] The Charter characterises as 'rights to solidarity' the rights aiming at realising the values of freedom and equality, which paves the way for a systematic interpretation of the Union law in the light of such a value.[145] However, under the current state of law, the Charter is not a legal act of the Union but a solemn political declaration.

2.3.4.2. Application of Solidarity Principle in the Case Law

Although Charter of Fundamental Rights is very important in recognition and development of social rights in the Union law, the Courts have been applying the solidarity test to distinguish economic from non-economic activities, especially in the social insurance and health care cases for a long time. However, there is no clear formula or standard developed by the Court yet, which makes it very difficult to predict outcomes. Moreover, the distinction between 'economic' and 'non-economic' activities gets blurred as the Member States turn to the market to provide services to public, by privatising public functions and/or allowing for competition among providers, which is the case in *AOK*. In addition, pension or health care schemes take a variety of forms, ranging from State social security schemes at the one end of the spectrum to private individual schemes operated by commercial insurers at the other.[146] Therefore, the striking feature of the cases involving such schemes, as argued by Jones and Sufrin, that "*the Court has considered not whether the services are such that they may potentially be provided on the market (health insurance*

[143] European Union Charter of Fundamental Rights, as signed and proclaimed by the Presidents of the European Parliament, the Council and the Commission at the European Council at the European Council meeting in Nice on 7 December 2000.
[144] The second paragraph of the Preamble states that the Union is founded on the values of human freedom, dignity, equality and solidarity.
[145] Menendez, p.393.
[146] See Opinion of AG Jacobs in Joined Cases C 430-431/*93 Jeroen Van Schijndel and Johannes Van Veen v Stichting Pensioenfonds voor Fysiotherapeuten (Van Schijndel)* [1996] 1 CMLR 801, para.57.

can undoubtedly be provided on the market and is therefore 'economic' in nature), but whether the details of the schemes demonstrate solidarity."[147]

It is very difficult for a market within the meaning of competition law to exit, if a Member State effectively implements the principle of solidarity and gives effect to redistribution policies. This fact was clearly illustrated by AG Jacobs in *Cisal* where he stated that "*a pension scheme operated according to redistribution principle could not be offered by a private insurer since nobody would be prepared to finance the current pensions of others without the guarantee that the next generation would do the same*."[148] In *Bosman*, AG Lenz explained that redistribution of income among football clubs appears sensible and legitimate from an economic point of view since football is characterised by the mutual economic dependence of the clubs, which is "*a significant difference from the competitive relationships between undertakings in other markets*."[149] As Odudu explains "*redistribution involves unilateral transfer as opposed to exchange, and which requires the altruism to be overcome by compulsion*."[150] Thus, it is almost impossible to gain profit from an activity which is based on solidarity. However, it is not crystal-clear in most cases since not all degrees of solidarity are capable of depriving an activity from its economic nature.

***Poucet and Pistre* Judgement:** In *Poucet and Pistre*, the ECJ found that the social insurance schemes pursued a social objective and embody the principle of solidarity as they were "*intended to provide cover for all the persons to whom they apply, against the risks of sickness, old age, death and invalidity, regardless of their financial status and their state of health at the time of affiliation*."[151] In this case, Court described the main feature of solidarity as "*the redistribution of income between those who are better off and those who,*

[147] Alison Jones and Brenda Sufrin, **EC Competition Law**, 3rd ed., Oxford: Oxford University Press, 2008, p.617.
[148] AG Opinion in Case C-218/00 *Cisal di Battistello Venanzio & Co. Sas v Instituto Nazionale Per L'Assicurazione Contro Gli Infortuni Sul Lavoro (Inail)(Cisal)* [2002] 4 CMLR 24, para.44.
[149] Advocate General Opinion in Case C-415/93 *Union Royale Belge des Societes de Football Association ASBL v Bosman* [1996] 1 CMLR 645, para.227.
[150] Odudu (2006) opcit., p.38.
[151] Joined Cases C-159/91 and C-160/91 *Christian Poucet v Assurances Generales de France (AGF) and Caisse Mutuelle Regionale du Languedoc-Roussillon (CAMULRAC) and Daniel Pistre v Caisse Autonome Nationale de Compension de l'Assurance Vieillese des Artisans (CANCAVA) (Poucet and Pistre)* [1993] ECR I-637, paras. 8-9.

in view of their resources and state of health, would be deprived of the necessary social cover."[152]

It is obvious from the statements made by the Court in *Poucet and Pistre* that the notion of solidarity, "*goes beyond mere mutualisation in that it provides for a transfer of wealth- not based on insurance principles- among members of a given risk group or among different groups*."[153] Depending on the type of the scheme, solidarity can have different shapes and forms: "*it can involve low risk persons subsidizing high risk persons, the richer subsidising the poorer, one generation subsidising another, or more profitable schemes subsidising the less profitable ones*."[154] For example, in the same case the Court held that in the old age insurance scheme, solidarity was embodied in the fact that the contributions paid by active workers served to finance the pensions of retired workers.[155] This type of solidarity is called by AG Tesauro as "*solidarity in time- a future all schemes based on allocation in which there is no direct link between contributions and benefits*."[156] In addition, there was a financial solidarity between various social security schemes, in that "*those in surplus contribute to the financing of those with structural financial difficulties*."[157] There was solidarity in all these schemes in relation to the least well-off, who were entitled to certain minimum benefits even in the absence of contributions paid by them, or at any rate without reference to their amount. Finally, these social security schemes were based on a system of compulsory contribution, which was indispensable for application of the principle of solidarity and the financial equilibrium of them.[158]

Given to the strong element of solidarity detected in the facts of the case, the Court concluded in *Poucet and Pistre* that sickness funds and the organisations involved in the management of the public social security system fulfilled an exclusive social function. As

[152] Ibid.para.10.
[153] Winterstein (1999), opcit.
[154] Jones and Sufrin (2008), opcit.
[155] Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* [1993] ECR I-637, para.11.
[156] Opinion of AG Tesauro in Case C-244/94 *Federation Francaise des Societes d'Assurance and Others v Ministere de l'Agriculture et de la Peche (FFSA)* [1996] 4 CMLR 536, para. 16.
[157] Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* [1993] ECR I-637, para.12.
[158] Ibid., para.13.

the activity was based on the principle of national solidarity and was entirely non-profit-making, where the benefits were the statutory benefits bearing no relation to the amount of the contributions, it was not an economic activity.[159]

***Van Schijndel* Judgement:** In *Van Schijndel*, AG Jacobs found common features between the occupational pension scheme entailing a compulsory membership for physiotherapists and the funds in question in *Poucet and Pistre*. According to Jacobs, the Fund performed a purely social function. Because, it was operated under the Act which aimed to ensure that retirement incomes reflect the rising general level of incomes, to allow younger colleagues to contribute to the higher cost of providing pensions for older colleagues and to provide for pension rights in respect of years prior to the entry into force of the schemes.[160] Apparently, the scheme operated by the non-profit-making Fund, entailed a substantial degree of solidarity between members which went beyond that which would normally be expected of commercial arrangements. Solidarity was, especially, reflected in the fact that, in principle, a standard contribution was levied and a standard pension was paid. That was so regardless of the age at which an individual member entered the profession and regardless of his state of health on joining. Moreover, pensions rights were granted retrospectively for those members who were already engaged in the profession when the scheme entered into force. In addition, insurance cover continued without payment of contributions in the case of incapacity for work.[161]

However, the Court did not analyse these facts nor made any conclusion as to the economic or non-economic nature of this activity. In view of the answers to the procedural questions, the Court did not have to consider the substantive questions of competition law in the preliminary ruling.

***FFSA* Judgement:** In *FFSA* case, the French government had set up a voluntary old-age scheme for agricultural workers to supplement the basic compulsory scheme and

[159] Ibid., paras.18-19.
[160] Opinion of AG Jacobs in Joined Cases C 430-431/*93 Van Schijndel* [1996] 1 CMLR 801, para.62.
[161] Ibid., para.63.

the management of this scheme was entrusted by law to the same body operated the compulsory scheme. Due to the optional status of the scheme, its operation had been structured in accordance with the principle of capitalisation. In other words, "*the benefits to which it confers entitlement depend solely on the amount of contributions paid by the recipients and the financial results of the investments made by the managing organisation*."[162] As a result, the Court found that the managing body carried on an economic activity in competition with life assurance companies.

FFSA case is remarkable from several aspects. First of all, a certain degree of solidarity was reflected in this case. For instance, contributions were not linked to the risks incurred; there was a mechanism for granting exemption from payment of contributions in the event of illness; the suspension of payment of contributions for reasons connected with the economic situation of the holding was possible. However, the Court held that the principle of solidarity was extremely limited in scope, which followed from the optional nature of the scheme and this degree of solidarity was not enough to deprive the activity from its economic nature.[163] Secondly, the French Government had alleged that the pursuit of a social purpose, the requirements of solidarity and the other rules of the managing body and the restrictions to which it was subject in making its investments made the service provided by this scheme less competitive than the comparable service provided by life assurance companies. Nevertheless, the Court, again, stated that neither such limitations nor the non-profit-making structure of the managing body was able to prevent the activity from being regarded as an economic activity.[164]

***Albany* Judgement:** In *Albany*, the key question to be resolved was whether the activity of the provision of supplementary pensions to employees through sectoral pension fund, which had been set up on the basis of the collective agreements between management and labour, was of an economic nature. The facts of the case are very similar to those of *FFSA*, albeit its potential for the compulsory affiliation. In this case the Court found that

[162] Case C-244/94 *FFSA* [1996] 4 CMLR 536, para.17.
[163] Ibid., para.19.
[164] Ibid., paras.20-21.

the operation of the sectoral pension fund was based on the principle of solidarity. Such solidarity was reflected by the obligation to accept all workers without a prior medical examination, the continuing accrual of pension rights despite exemption from contributions in the event of incapacity for work, the discharge by the fund of arrears of contributions due from an employer in the event of the latter's insolvency and by the indexing of the amount of the pensions in order to maintain their value. According to the Court, the principle of solidarity was also apparent from the absence of any equivalence, for individuals, between the contributions paid, which was an average contribution not linked to risks, and pension rights, which were determined by reference to an average salary. As regards the compulsory affiliation the Court emphasised that it was essential otherwise, "*if 'good' risks left the scheme, the ensuing downward spiral would jeopardise its financial equilibrium.*"[165]

Despite the numerous solidarity elements inherent in and the compulsory affiliation to the scheme, the Court concluded that the activity was of an economic nature. The reason of this conclusion lies in the fact that the sectoral fund itself determines the amount of the contributions and benefits and that Fund operates in accordance with the principle of capitalisation.[166] Accordingly, by contrast with the benefits provided by organisations charged with the management of compulsory social schemes of the kind referred to in *Poucet and Pistre*, the amount of the benefits provided by the Fund depended on the investments, in respect of which it was subject to supervision by the Insurance Board that also controls insurance companies.[167] The capitalisation principle and control by the insurance board are indicators that the insurance in question is at least potentially an activity in which a normal insurer might engage.

***Cisal* Judgement:** The Court confirmed the principles established in *FFSA* and *Albany* in the subsequent judgement in *Pavlov*,[168] which concerned a pension fund set up

[165] Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie (Albany)* [2000] 4 CMLR 446, para.75.
[166] Ibid.,para.81.
[167] Ibid.,para.82.
[168] Joined Cases C-180-184/98 *Pavlov v Stichting Pensioenfonds Medische Specialisten (Pavlov)* [2000] ECR I-6451.

by members of a profession which provided pensions to the members of that same profession and was similar to *Van Schiendel* in many respects.

On the other hand, *Cisal* is an interesting case which differs from the above mentioned cases. In this case, the managing body, INAIL, was given the task of operating, on behalf of the State and under its supervision, a system of compulsory insurance for workers against accidents at work and occupational diseases according to the relevant provisions of the Italian constitution. The law provided that the INAIL was to perform the functions attributed to it in accordance with sound economic and business practice, adjusting its organisation on its own initiative to the requirements of efficient and timely collection of contributions and payment of benefits, and managing its movable and immovable assets in such a manner as to optimise income. The government should pursue the same aim in the monitoring and supervision of the INAIL. These principles underlying the performance of INAIL were reminiscent of the undertakings engaged in economic activities, which might cause confusion as to the characteristics of the activities in question. However, the Advocate General was of the opinion that *"[m]ost public authorities will have to operate according to the principle of good administration which will include the obligation to minimise costs and, where appropriate, to maximise income for example through the efficient collection of administrative fees*."[169] Therefore, cutting costs and maximising income was not sufficient alone to indicate that the activities of the managing body were of an economic nature, which was also endorsed by the Court.

The statutory scheme in *Cisal* providing for compulsory social protection for all non-salaried workers in the non-agricultural professions, who carried out an activity classified as 'risk activity' by the law, pursued a social objective. However, as the social aim was not in itself sufficient to preclude an activity from being classified as economic activity it was important to analyse the degree of solidarity on which the scheme was based. First of all, the insurance scheme was financed by contributions the rate of which was not systematically proportionate to the risk insured. Because the rate might not exceed a

[169] AG Opinion in Case C-218/00 *Cisal* [2002] 4 CMLR 24, para.52.

maximum ceiling, even where the activity carried out entailed a high risk. Moreover, the contributions were calculated not only on the basis of the risk linked to the activity but also according to the insured persons' earnings.[170] Secondly, the amount of benefits paid was not necessarily proportionate to the insured persons' earnings.[171] The Court found that there was no direct link between the contributions paid and benefits granted, which were in the last resort fixed by the State, indicated "*solidarity, between better paid workers and those who, given their low earnings, would be deprived of proper social cover if such a link existed.*"[172] Therefore, there was no economic activity for the purposes of competition law.

***Sodemare* Judgement:** In *Sodemare*, the case was about Italian legislation which allowed only non-profit-making private operators to participate in the running of its social welfare system by concluding contracts which entitled them to be reimbursed by the public authorities for the costs of providing social welfare services of a health-care nature. The 'non-profit condition' was challenged before the regional administrative court by three profit-making companies whose request for approval to enter into contractual arrangements was rejected by the regional authority. Having received the questions as to the compatibility of this legislation with the Community law through preliminary ruling mechanism, the Court held that the non-profit condition formed part of the "*system of social welfare, whose implementation is in principle entrusted to the public authorities, based on the principle of solidarity, as reflected by the fact that it is designed as a matter of priority to assist those who are in a state of need owing to insufficient family income, total or partial lack of independence or the risk of being marginalised, and only then, within the limits imposed by the capacity of the establishments and resources available, to assist other persons who are, however, required to bear the costs thereof, to an extent commensurate with other financial means, in accordance with scales determined by reference to family income*."[173] The Court did not discuss clearly whether the degree of solidarity was

[170] Case C-218/00 *Cisal* [2002] 4 CMLR 24, para. 39.
[171] Ibid., para.40.
[172] Ibid., para.41.
[173] Case C-70/95 *Sodemare SA and Others (Federation des Maisons de Repos Privees de Belgique) v Regione Lombardia (Sodemare)* [1998] 4 CMLR 667, para.28.

sufficient to deprive those health-care services of their economic character as it was not the question in this case, but the Court found the solidarity element strong enough to shield them from the application of Community rules straightforward.

2.3.5. Public Goods

2.3.5.1. Characteristics of Public Goods

The roots of the notion of public goods go back as far as 54-51 B.C. when Cicero mentioned *utilitatis communion* with *iuris consensus* in his book *De re publica* as the two pillars that the Roman Republic had been based on. The Latin phrase *res publica* means "public affair or thing" as opposed to *res privata* and refers to the objective behind the Republic's actions, what we call 'public or 'common good' today.[174]

Public goods are defined by Kaul as "*a thing or object we all have a common interest in having available for public consumption*."[175] In other words, "*public goods are those goods or services which, if provided, are open to use by all members of society*."[176] Therefore, public goods have a close relation with the notion of solidarity and responsibility of the State towards its citizens. However, unlike solidarity, it is easier, though not very easy, to define public goods in economic terms. In market economies, pricing system plays a central role by rationing private goods and leading to efficient allocation of resources. On the other hand, public goods are the product of 'market failure' which indicates that the market is not performing efficiently from an economic point of

[174] For further information regarding the historical roots of this concept please see Peter Wivel, "The State and the Citizen: Natural law as a public good" in Erik Andre Andersen and Birgit Lindsnaes (Eds), **Towards New Strategies: Public Goods and Human Rights**, Netherlands: Martinus Nijhoff Publishers, 2007, p. 3.
[175] Inge Kaul, "Defining Global Public Goods" in Inge Kaul, Isabelle Grunberg, and Marc A. Stern (Eds), **Global Public Goods, International Cooperation in the 21st Century**, New York: Oxford University Press, 1999, p.2.
[176] Luca Rubini, **The Definition of Subsidy and State Aid-WTO and EC Law in Comparative Perspective**, Oxford: Oxford University Press, 2009, p.210.

view.[177] The reason of such a failure is the two main characteristics of public goods that distinguish them from private goods.

First, public goods are 'non-rivalrous' (non-competitive) in consumption, which means that "*once produced, an infinite number of consumers can enjoy the good without increased production costs or diminished enjoyment by other consumers*."[178] In other words, it refers to cases for which one person's consumption does not detract or prevent another person's consumption.[179] Typical example of non-competitive public goods is national defence, where the cost of defending the country does not increase when a new baby is born or an immigrant arrives in the country. By the same token, the existing population does not become more vulnerable because there is an additional person to defend. By contrast, private goods are rivalrous or competitive because they are 'scarce'[180] and if it is consumed by one person it cannot be consumed by another.

Secondly, public goods are 'non-excludable' (non-exclusive) as it is impossible or very difficult to exclude someone from the benefits of the good once it is produced. For example, all residents benefit from the national defence and security once the borders of the country are protected and it is not possible to defend the country without defending all the residents. When the exclusion is impossible, the use of price system becomes impossible because individuals have no incentive to pay as they benefit from the good anyway. By contrast, private goods are 'exclusive', which means that not everybody has access to them. Therefore, they can be subject to pricing mechanism where individuals can be excluded from enjoying the good unless they pay for it.

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[177] In this regard, Engel mentions of "merit goods", which he describes as to be goods and services that come into existence only because of the State grants and which otherwise would not have appeared in the marketplace at all or not to the extent they actually did. Christoph Engel, **Limits for Public Special Interest Programmes under the Perspective of E.C. Law**, New York: Vistas, 1996, p.24.

[178] Odudu, p. 42.

[179] Joseph E. Stiglitz, **Economics of the Public Sector**, 3rd ed., New York/London: W.W. Norton & Company, 2000, p. 128.

[180] Erik Andre Andersen and Birgit Lindnaes, "Public Goods: Concept, Definition and Method" in Erik Andre Andersen and Birgit Lindsnaes (Eds), **Towards New Strategies: Public Goods and Human Rights**, Netherlands: Martinus Nijhoff Publishers, 2007, p. 36.

2.3.5.2. Pure and Impure Public Goods

If public goods posses both of these 'non-rivalrous' and 'non-excludable' qualities they are called 'pure public goods'. Stiglitz defines a pure public good as "*a public good where the marginal costs of providing it to an additional person are strictly zero and where it is impossible to exclude people from receiving it*."[181] Consequently, pure public goods are things or conditions not subject to market mechanism either because they are not profitable or because their price cannot be effectively fixed.[182] Therefore, they cannot form the subject matter of economic activity. Only very few public goods can be characterised as such and many public goods that the State provides are not pure public goods in this sense. Classic examples of public goods are defence, light-houses and street-lighting.

When public goods posses only one of the qualities mentioned above they are called 'impure public goods'. Impure public goods are further categorised by Kaul as 'exclusive club goods', which are non-competitive and 'competitive goods', which are not exclusive. As examples of exclusive club goods Kaul mentions research and development, non-commercial knowledge, norms and standards, as well as respect for human rights.[183]

Goods provided by the public sector differ to the extent to which they have these two qualities. Furthermore, the perception of the society as to the same good may change in time, in a different place or under different circumstances. For example, elementary education may be considered as a pure public good, if all children are constitutionally entitled to free and equal access to public schools; or as a competitive (impure) good, if there is not sufficient capacity to admit all potential pupils to schools with adequate resources; or as an exclusive club (impure) good, if certain criteria have to be met for kids

[181] Stiglitz, p.132.
[182] Kaul, opcit.
[183] Inge Kaul and Ronald U. Mendoza, "Advancing the Concept of Public Goods" in Inge Kaul, Pedro Conceiçao, Katell Le Goulven and Ronald U. Mendoza (Eds), **Providing Global Public Goods, Managing Globalisation**, New York: Oxford University Press. 2003, p. 82-83.

to have access to schools; or as a private good, if only pupils with specific qualifications may attend for a fee.[184]

2.3.5.3. Provision of Public Goods

As the people do not have the incentive to pay for the public goods, private producers have no incentive to produce such goods because it is impossible to make profit from a good for which non-payers cannot be prevented from enjoying it. As a result, public goods cannot- or can only to a very slight degree- be procured by means of free competition. Samuelson, acknowledging this difficulty for the private sector, points to the fact that the State has responsibility for bringing about national public goods since it is incumbent on the State to create welfare for its citizens. Samuelson also presupposes that the State is able to predict which goods its citizens wish to consume; that public and private producers can produce these goods in the amounts planned by the State; that the State's resources are optimally apportioned; and that these goods can be distributed so that they benefit all citizens.[185]

State intervention is also necessary since individuals, who have no incentive to pay for public goods voluntarily, must be forced to support these goods through taxation. The reluctance of individuals to contribute voluntarily to the support of public goods is referred to as the 'free rider problem' and only the State has compelling power to tackle with this problem. Stiglitz explains that there are a few cases where non-excludable public goods are provided privately. According to him, usually this is because there is a single, large consumer whose direct benefits are so large that it pays him to provide it for himself, regardless of the benefits that accrue to free riders. However, he concludes that, even if there is some provision of public goods, there will be an undersupply. [186] Undersupply, which is another form of market failure associated with public goods, arises when there is no additional benefit for the supplier to supply additional goods.

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[184] Andersen and Lindnaes, pp. 38-39.
[185] Paul A. Samuelson, "The Pure Theory of Public Expenditure", **Review of Economics and Statistics**, Vol. 36, No. 4, 1954, pp.387-389.
[186] Stiglitz, p.131.

On the other hand, goods or services that could be considered as private goods are sometimes supplied by the public. Provision of private goods by the government may be justified for either efficiency or equity reasons.

2.3.5.4. Public Goods in the Case Law

The European Court of Justice appears to have recognised that it is not possible to make profit from the provision of public goods and thus, it is not an economic activity. Like the regulatory activities, the provision of public goods is closely connected with the use of official authority.

In *Eurocontrol*, the case was about an international organisation "*whose aim is to strengthen co-operation between the Contracting States in the field of air navigation and develop joint activities in this field, making due allowance for defence needs and providing maximum freedom for all air space users consistent with the required level of safety*."[187] In return, Eurocontrol had competence to establish and collect the route charges levied on users of air space, which was challenged by an air navigation company under the competition rules. Therefore, the Court had to decide whether competition rules applicable to such an organisation charged with the air navigation control and safety.

In the proceedings AG Tesauro noted that "*the essential requirements of air navigation control, carried out by Eurocontrol in ways and by means not dissimilar to those normally applied by the States concerned, are to guarantee the safety of passengers as well as of the populations of the territories flown over and, from the same point of view, to ensure the necessary co-ordination with the specific requirements of national defence. Such control, which is in various respects connected with the exercise of State sovereignty, thus constitutes a true function of air space supervision, which can only be pursued by a*

[187] Article 1 of the International Convention on Co-operation for the Safety of Air Navigation –also establishing European Organisation for the Safety of Air Navigation (Eurocontrol)-, signed in Brussels on 13 December 1960, revised and consolidated by the Protocol of June 27, 1997.

public authority, irrespective of the form chosen for its organisation and management."[188] Indeed, State has complete and exclusive sovereignty over the air space above its territory.[189] Thus, it is in the exercise of that sovereignty that the State ensures the supervision of its air space and the provision of air navigation control services.

AG Tesauro also underlined the non-excludable character of the air navigation control, which makes it a public good, pointing to the fact that "*we are dealing with a service, not in economic sense and provided principally for business (airline companies), but aimed at the community as a whole, seems to me to be confirmed by the observation made during the hearing…that control is exercised in respect of any aircraft, within the air space under the authority of the Eurocontrol, irrespective of whether or not the owner has paid the route charges*."[190] As is the case with most public goods, contributory payments for air navigation control services can only be ensured by the State compulsion since the exclusion of non-payers from the system is not possible. As a result, the Court accepted that "*Eurocontrol's activities, by their nature, their aim and the rules to which they are subject, are connected with the exercise of powers relating to the control and supervision of air space which are typically those of a public authority. They are not of an economic nature justifying the application of the Treaty rules of competition*."[191] In another recent case concerning the Eurocontrol's activities, the CFI underlined the fact that other activities which could be separated from its task of managing air space and developing air safety may be considered as economic activities and be subject to competition rules.[192]

2.3.6. Activities of Organisations Performing Social Functions

In general, many activities conducted by organisations performing largely social functions, which are non-profit oriented and which are not meant to engage in industrial or commercial activity, will be excluded from the Union competition and internal market

[188] Opinion of AG Tesauro in Case C-364/92 *SAT Fluggesellschaft mbH v Eurocontrol (Eurocontrol)* [1994] ECR I-43, para.12.
[189] Article 1 of the Convention on International Civil Aviation, signed in Chicago on 7 December 1944.
[190] Opinion of AG Tesauro in Case C-364/92 *Eurocontrol* [1994] ECR I-43, para.13.
[191] Case C-364/92 *Eurocontrol* [1994] ECR I-43, para.30.
[192] Case T-155/04 *Selex Sistemi Integrati SpA v Commission of the European Communities* [2007] 4 CMLR 10, para. 60.

rules. This takes into account several non-economic activities of organisations such as trade unions, political parties, churches and religious societies, consumer associations, charities as well as relief and aid organisations.

This category could have been analysed under the "solidarity" title but such organisations are, usually, not funded out of the State budget or they have only indirect relations with the State. Therefore, taxes paid by the citizens are not involved or are quite negligible. However, the same principle applies: Whenever such an organisation, in performing a task in the public interest, engages in economic activities, such activities will be subject to EU competition or internal market rules.

2.4. Applicability of Competition Rules to the Regulatory Activities of the State

2.4.1. Interaction between Free Movement and Competition Rules

Free movement and competition are essential components of the economic integration between the Member States. The European Court of Justice has already recognised the inter-relationship between the Union's competition policy and the integration of the Common Market. For example, Articles 101 and 102 TFEU (ex Article 81 and 82) prevent private obstacles to the free movement of goods while Article 34 TFEU (ex Article 28) prohibits national measures that impair trade between Member States.[193] Similarly Article 56 TFEU (ex Article 49 TEC) provides the removal of restrictions on the freedom to provide services throughout the EU. In general, it is true to say that free movement rules apply to State measures and the competition provisions to those of private actors. However, the matter is not as simple as it seems and contains a certain degree of complexities.

First, in some cases the free movement provisions can bind private parties. It is submitted that private parties must also respect the principles of an 'open market' policy,

[193] See Trevor C. Hartley, "Federalism, Courts and Legal Systems: The Emerging Constitution of the European Community", **American Journal of Comparative Law**, Vol. 34, 1986, pp. 229- 230.

even though the rules governing that policy are primarily addressed to Member States.[194] The most remarkable example is the 'exhaustion of rights doctrine' which has been developed in the case law on the free movement of goods covering industrial or commercial property rights such as trademarks, patents or copyrights.[195] Another example for a direct application of the rules on the free movement of goods to private operators is to be found in the *Dansk Supermarked* case, in which the Court in interpreting Article 30 (now Article 36 TFEU) stated "*that it is impossible in any circumstances for agreements between individuals to derogate from the mandatory provisions of the Treaty on the free movement of goods*."[196] Examples for the application of free movement rules to private parties can also be found in particular where 'collective' private action is concerned in the area of free movement of persons.[197]

Secondly, some situations raise both free movement and competition issues. The emphasis put by the Court on each case depends upon whether the point of departure is competition law or the free movement of goods. In *Consten*, the Court declared that it is among the fundamental aims of the competition rules to contribute to the establishment of an open market and to prevent compartmentalisation of markets by private arrangements or practices.[198] Since the primary objective of both types of rules is to assist in establishing and maintaining a single market in the EU and preventing the rebuilding of economic barriers, the interaction between them is inevitable. A good example for such cases is *Bosman,*[199] where the Court decided the case on free movement grounds and declined to deal with the competition arguments.[200]

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[194] Pierre Pescatore, "Public and Private Aspects of European Community Competition Law", **Fordham International Law Journal**, Vol.10, 1987, pp. 373-380.
[195] See for e.g. Case 78/70 *Deutsche Grammophon GmbH v Metro-SB-Grossmarkte GmbH & Co. KG* [1971] ECR. 487; Case 187/80 *Merck & Co. Inc. v Stephar BV & Petrus Stephanus Exler* [1981] ECR 2063.
[196] Case 58/80 *Dansk Supermarked A/S v A/S Imerco (Dansk Supermarked)* [1981] ECR 181, para.17.
[197] See Case 36/74 *Walrave & Koch v Association Union Cycliste Internationale* [1974] ECR 1405 and Case 415/93 *Union Royal Belge des Sociétés de Football Association ASBL & others v Jean-Marc Bosman (Bosman)* [1995] ECR I-4921, [1996] 1 CMLR 645.
[198] Cases 56-58/64 *Establissements Consten SARL & Grundig-Verkaufs-GmbH v Commission*, [1966] ECR 299.
[199] Case 415/93 *Bosman* [1995] ECR I- 4921, [1996] 1 CMLR 645.
[200] See also Case C-303/99 *Wouters v Algemene Raad van de Nederlandse Order van Advocaten (Wouters)* [2002] ECR I-1577, [2002] 4 CMLR 913, on the rules of the Dutch Bar, discussed previously.

Thirdly, it is possible to hold some State measures subject to competition provisions. Indeed, application of competition rules to State's regulatory activities has become a very significant law in the EU. As a matter of principle Member States are not obliged to observe Articles 101 and 102 of the Treaty when regulating national trade and industry. If distortion of competition through a regulatory measure stems from a genuine State regulation, this regulation is immune to the Treaty's provisions on competition because it is not deemed to be an economic activity. If, on the other hand, the regulatory measure that distorts competition can be attributed to one or several undertakings, the competition provisions will apply, since, functionally, the regulatory measure does not reflect the will of the State or public interest.[201] Piet Jan Slot calls such situations as 'mixed situations' and explains that they "*exist when government and industry act in close cooperation or where the distinction between public and private conduct has been blurred*."[202] The Court has held in a series of preliminary rulings that the Treaty's competition provisions, Articles 101 and 102, although addressed to private entities, impose constraints upon national regulations.

Article 3(1) TFEU grants the EU an exclusive competence in establishing the competition rules necessary for the functioning of the internal market. Before the Lisbon Treaty this role was played by and the case law of the Court was based on Article 3(f) of the EEC (later it became Article 3(1)(g) of the EC Treaty) according to which the Community aims to institute a system which ensures that competition in the Common Market is not distorted. Likewise on the basis of Article 5(2) of the EEC and later Article 10 of the EC (now Article 4(3) of the TEU) Treaty, the Member States must not jeopardise the effectiveness of the Treaty rules on competition. For that reason the Court has on a number of occasions held that the Member States may not legitimise the conduct of one or more undertakings which distort competition. In this way, they contravene the said Articles by allowing undertakings to escape the constraints of Articles 101 and 102 (ex Articles 85

[201] Morten P. Broberg and Niels Fenger, "National Organisation of Regulatory Powers and Community Competition Law", **E.C.L.R.**, Vol. 16, No. 6, 1995, pp. 346-373.
[202] Piet Jan Slot, "Application of Articles 3(f), 5 and 85 to 94 EEC", **E.L.Rev**., Vol. 12, No.3. 1987, pp.179-189.

and 86 of the EEC Treaty). That will be the case, in particular, if the Member States delegate regulatory powers to undertakings or association of undertakings since such powers, if abused, can distort free competition. Evolution of the case law in this field shall be analysed in detail in the following sections.

2.4.2. Combined Application of Articles 3(f), 5(2) and 85 EEC in the Case Law

2.4.2.1. Early Stages: *Inno, Leclerc, Cullet*

It was in 1987 that the Court of Justice held for the first time that a Member State's legislation was contrary to the second paragraph of, then Article 5 of the EEC Treaty,[203] in conjunction with Article 85 (now Article 101 TFEU). The wording of the second paragraph of Article 5 EEC, which was renumbered by the Amsterdam Treaty as Article 10, stated that Member States "*shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty*." Considering that the competition rules, Articles 85 and 86 EEC (now Articles 101 and 102 TFEU) placed obligations only on private entities, it is significant that the Court recognised this provision as a limit on the Member States' power of economic regulation.[204]

Before the development of the case law the Court had used the free movement provisions, when it was appropriate, to prevent the Member States from restricting the competitive behaviours of private entities by altering or enacting legislation. With the development of the case law, the obligation of the Member States not to use their regulatory powers to defeat competition objectives of the Treaty became concrete. When developing the case law, the Court of Justice was mostly influenced by the "State action doctrine" established in the competition law jurisdiction in the United States. In the United States this doctrine distinguishes State activity, which is exempted from the application of

[203] This Article was renumbered by the Treaty of Amsterdam as Article 10, which is repealed by the Treaty of Lisbon and replaced in substance by Article 4(3) of the Treaty on European Union.
[204] Alan B. Hoffmann, "Anti-competitive state legislation condemned under Articles 5, 85 and 86 of the EEC Treaty: how far should the court go after Van Eycke?", **E.C.L.R**., Vol.11, No. 1, 1990, pp.11-27.

federal antitrust laws, from the private action, which remains subject to such laws.[205] To be more precise, State action doctrine gives immunity to the acts adopted by the State as sovereign and also to the private behaviour which is part of a clearly articulated and affirmatively expressed State policy under the active supervision of the State.[206]

The judgements of the ECJ in *Deutsche Grammophon*[207] and *Continental Can*[208] referred to Article 3(f) EEC as the objectives stated there amounted to an independent norm, the protection of which was to be secured by Article 5(2) EEC. However, it was not until *INNO* that this norm was actually substantiated by the Court. Beginning with *INNO*, the Court's interpretation of the second paragraph of Article 5 of the EEC Treaty (now Article 4(3) of TEU) has evolved entirely on the preliminary references under Article 234 (now Article 267 TFEU) from national courts. This is due to the fact that national courts must disapply national rules that contradict with EU law. In this field, most references arose in a prosecution that had been brought against a trader allegedly violating the relevant regulation. This context allowed the Court to move in measured steps which began with statement of the principle and culminated into considering that it was not necessary to apply the legislation at issue.

***INNO* Judgement:** The very first case in which allegedly anti-competitive State legislation was challenged under Article 5(2) EEC (now Article 4(3) of TEU) was the case *INNO*[209] dated 1977. In this case, a Belgian law required retailers to sell tobacco products at the price set by the manufacturer or importer. This retail selling price appeared on tax labels attached to the product, by the sale of which the State collected tax on the basis of this retail price. The Association of Tobacco Retailers (ATAB) obtained an injunction against INNO, a supermarket chain, to stop the sale of cigarettes below the price on the tax label. This type

[205] Thomas M. Jorde, "Antitrust and the New State Action Doctrine: A Return to Deferential Economic Federalism", **California Law Rreview**, Vol. 75, 1987, pp. 227- 228.
[206] The most important cases to be mentioned here is *Parker v Brown*, 317 U.S. 341.1943 and *California Retail Liquor Dealers Association v Midcal Aluminium,* 445 US. 97.1980.
[207] Case 78/70 *Deutsche Grammaphon GmbH v Metro-SB-Grossmarkte GmbH & Co. KG* [1971] ECR 487.
[208] Case 6/72 *Europemballage Corp and Continental Can Co Inc. v Commission* [1973] ECR 215, [1973] CMLR 199.
[209] Case 13/77 *NV GB-INNO-BM v Vereniging Van De Kleinhandelaars In Tabak (Inno)*, 1997 ECR 2115.

of price fixing agreement was prohibited by the EC competition rules when entered by private undertakings.

As to the infringement of the competition rules, the question referred by the Belgian High Court was whether Articles 3(f), 5(2) (now Article 4(3) of TEU) and 86 EEC (now Article 102 TFEU), in conjunction with one another, prohibit national legislation that encourages one or more companies to abuse a dominant position in the Common Market within the meaning of Article 86 EEC (now Article 102 TFEU). Secondly, the Belgian Court asked whether the Belgian law was a restriction on imports in violation of Article 30 EEC (now Article 34 TFEU).

Instead of the competition rules in the Treaty, the Court began its analysis with the restatement of the standard used in determining whether Member State laws violate Article 30 EEC. In other words, it should be revealed whether the law in question "hinders, directly or indirectly, actually or potentially, trade within the Common Market". The Court noted that the single market system excludes any national system of regulation that cannot withstand scrutiny under that standard.[210]

With regard to the first question the Court held that the general objective set forth in Article 3(f) EEC is made specific by the Treaty's competition rules, including Article 86 EEC (now Article 102 TFEU).[211] Article 5(2) EEC forbids national legislative measures that could jeopardise Treaty objectives. Thus, even though Article 86 EEC addresses the conduct of private undertakings; Article 5(2) EEC imposes a duty on Member States not to adopt or maintain in force any measure which could deprive Article 86 EEC of its effectiveness. The Court then made an analogy to Article 90 EEC (now Article 106 of TFEU), which prohibits State measures contrary to the competition rules in connection with public undertakings or undertakings granted special or exclusive rights by a State.[212] The ruling did not determine whether the Belgian measure violated Article 5(2), but it offered

[210] Ibid, para. 28. This test was first developed in *Dasonville* (Case 8/74, 1974 ECR 837).
[211] Ibid., para.29.
[212] Ibid., paras. 37-38.

clues to the national court as to what might render Article 86 EEC (now Article 102 TFEU) ineffective. Despite the ruling, neither the Court, nor the Commission had ever held that the Court's approach in *INNO* served to abolish all national regulation affecting free competition. The extent and limitation of its rationale had been elaborated in subsequent cases.

After *INNO*, the Court returned to Article 5(2) EEC (now Article 4(3) of the TEU) in *Van de Haar,*[213] which arose out of the prosecution of a wholesaler that allegedly undercut tax label resale prices for tobacco products in disregard of a Dutch law. In this case, the national legislation was very similar to Belgian measure in question in *INNO*. However, this time the defendant argued that the laws infringed Article 5(2) EEC in conjunction with Article 85 EEC (now Article 101 of TFEU), not Article 86 EEC (now Article 102 of TFEU). The Court dismissed the argument, simply stating that Article 85 EEC applies to private undertakings and thus is not relevant to legislation such as involved in the case.[214] Therefore, there had been no significant development in the case law until *Leclerc.*

***Leclerc* Judgement:** With its ruling in *Leclerc*,[215] the Court began to recognise the role of Article 5(2) EEC (now Article 4(3) TEU) in conjunction with Article 85 EEC (now Article 101 TFEU) as a potential limit to the anti-competitive State action. This case was about another prosecution for violation of a national resale price maintenance scheme with regard to retail book sales in France. The regulation required retailers to observe the price fixed by the publisher or importer of each book, at least within a margin of five per cent. French Booksellers' Association brought proceedings against Leclerc supermarket which sold discounted books. French Appeal Court applied to the Court of Justice through

[213] Case 177 and 178/82 *Criminal Proceedings against Jan van de Haar and Kaveka de Meern BV (Van de Haar)* [1984] ECR 1797.
[214] Ibid., para. 578. See also Case 5/79 *Procueur Général v Buys,* [1979] ECR 3203-3231, in which a national price freeze was held not to violate Article 5 in conjunction with Article 85.
[215] Case 229/83 *Association des Centres distributeurs Edouard Leclerc and others v Sarl Au blé vert and others (Leclerc),* [1985] ECR 1. This case was confirmed in the subsequent cases regarding French book cartel, see Case 299/83 *Saint-Harblain v Syndicat des Libraires* [1985] ECR 2515; Case 355/85 *Driancourt v Cognet* [1986] ECR 3231; Case 168/86 *Procureur Général v Rousseau* [1987] ECR 995; Case 160/86 *Ministere public v Verbrugge* [1987] ECR 1783; Case 254/87 *L'Aigle Distribution* [1988] ECR 4457.

preliminary ruling procedure. The question arose as to whether national legislation which rendered corporate behaviour of the type prohibited by Article 85(1) EEC superfluous, by making the book publisher or importer responsible for freely fixing binding retail prices, deprives Article 85 EEC (now Article 101 TFEU) of its effectiveness and was therefore contrary to the second paragraph of Article 5 EEC (now Article 4(3) TEU) of the Treaty.

Leclerc argued that the French Law on book prices did not introduce price controls but rules restricting price competition, since the prices were freely fixed by publishers and importers. According to Leclerc, the law established a collective system of price maintenance which undertakings were precluded from establishing by Article 85(1) EEC (now Article 101 TFEU) of the Treaty and which was contrary to the system of undistorted competition in the Common Market which Article 3(f) EEC designated as one of the aims of the Community. In this respect, such measures were likely to render Article 85 EEC ineffective by enabling private undertakings to circumvent the constraints embodied therein and were thus likely to jeopardise the attainment of one of the aims of the Treaty.[216]

In this case the Commission declared that the Member States cannot be deprived of all power in the economic sphere, however, also acknowledged that a national law might be contrary to the Member State's obligation not to interfere with the competition rules. Accordingly, Article 5(2) could be infringed where a Member State:

(-) prescribed, promoted or facilitated the conclusion of restrictive agreements incompatible with Article 85(1) and (3) or the abuse of a dominant position within the meaning of Article 86;

(-) heightened the impact of such agreements or abuses by inducing undertakings which were previously not parties to or participants therein;

[216] Ibid., para.10.

(-) adopted a measure restricting competition with the sole aim of enabling undertakings to circumvent Articles 85 and 86, without being able to claim that this was in the public interest.[217]

In the light of the arguments, the Court, as in *INNO*, repeated that Member States might not introduce or maintain in force measures, even of a legislative nature, which may render ineffective the competition rules applicable to undertakings. On the other hand, it was difficult for the Court to establish the infringement of Article 85(1) EEC (now Article 101 of TFEU) because there was no agreement or concerted practice of the domestic publishers, importers or retailers. The measure instead imposed on publishers a statutory obligation to fix retail prices unilaterally. The Court declined to strike down this measure by observing that the Commission had not yet made up its mind as to whether national resale price maintenance agreements were contrary to Article 85 EEC.

Consequently, the Court ruled that "*as Community law stands, Member States' obligations under Article 5 of the EEC Treaty, in conjunction with Article 3(f) and 85 are not specific enough to preclude them from enacting legislation of the type at issue*."[218] In other words, although Member States were bound by the competition rules there were no specific rules for Member States in this matter. Then the Court turned to Article 30 EEC (now Article 36 TFEU) to find that one particular provision of the French law was "*liable to impede trade between Member States and was therefore incompatible with the Community law*."[219]

***Cullet* Judgement:** The Court further clarified its understanding of State liability under competition rules in *Cullet,*[220] which followed *Leclerc* in less than three weeks. Once again, the French court referred its question to the Court of Justice through preliminary ruling and Leclerc, again, was the challenger to the State measure in question. The legislation was about minimum retail prices for gasoline set by the French government. At

[217] Ibid., para 12. These conditions are also laid down in the Commission's Fifteenth Report on Competition Policy.
[218] Ibid.,paras.15-20.
[219] Ibid.,para.25.
[220] Case 231/83 *Cullet v Leclerc*, [1985] ECR 335.

the wholesale level (ex-refinery price) the Government imposed a price ceiling based on complex considerations. Refineries or importers were free to sell at any price below the ceiling, but in practice usually offered their products at the ceiling price. A maximum retail price was then set for each retailer to allow a certain margin over the ex-refinery price of each retailer's supplier. Finally, a minimum price was calculated for each region at an amount below the average maximum price for that region. It was only the minimum prices that were challenged by Leclerc.

The French court asked whether the minimum prices were prohibited by Articles 3(f) and 5 EEC. At the beginning the Court of Justice repeated the introductory paragraphs of *Leclerc* on Member States' obligations under Article 5 (now Article 4(3) of TEU) in conjunction with Article 85 EEC (now Article 101 of TFEU). After examining the facts, the Court stated that rules such as those concerned in this case were not intended to compel suppliers and retailers to conclude agreements or to take any other action of the kind referred to in Article 85(1) of the Treaty. On the contrary, *they entrust responsibility for fixing prices to the public authorities, which for that purpose consider various factors of a different kind*. They were not capable of depriving the rules on competition applicable to undertakings of their effectiveness.[221] However, as was the case in *Leclerc*, the Court once more shifted the problem to Article 30 EEC (now Article 36 TFEU). On the basis of this provision, the Court stated that the French system was incompatible with Community law because it put imported products at a disadvantage in 'competition'.[222]

In this case, the Court found no violation by the State measure in question under Article 5 in conjunction with Article 85(1) EEC but gave important clues as to its future approach. Accordingly, if restraints were imposed directly by the State itself, as opposed to private entities acting under the authority of the State, the restraints would not deprive Article 85 or 86 EEC (now Articles 101 and 102 TFEU) of their effectiveness and consequently would not infringe Article 5 EEC (now Article 4(3) TEU). In other words, it

[221] Ibid., para.17 (emphasis added).
[222] Ibid.paras.26-29. Each paragraph contains a reference to competition.

is not the anticompetitive effect, but the degree of the undertakings' involvement in the activities of the State that determines whether the State can be held liable under those provisions.

2.4.2.2. Establishing the Principles: *Asjes, Vlamsee* and others

Starting with *Asjes*, the Court used its power to rewrite the question from the referring court to formulate narrow questions, the answer to which would not prevent the further expansion of the doctrine. Its approach had given the Court both maximum flexibility and a minimally-disconcerting way of developing what could be a major limitation on State power.

***Asjes* Judgement:** The next step in the development of the combined application of Articles 3(f), 5(2) and 85 EEC came in 1984, one year after *Cullet*, in *Asjes.*[223] This case paved the way for significant cases beginning with *Vlaamse,*[224] by adopting the first part of the Commission's position in *Leclerc*[225] where it is stated "*a Member State would violate Article 5 in conjunction with Article 85 if it were to require or favour the adoption of agreements, decisions or concerted practices contrary to Article 85 or to reinforce the effects thereof.*"[226]

The case emerged from criminal prosecutions brought against directors of airlines and travel agencies for violating French law by selling tickets at prices lower than the tariff approved by the Minister for Civil Aviation. The criminal trial court found that the tariff approval procedure required price-fixing agreements between airlines in breach of Article 85 EEC. Therefore, the criminal trial court referred the case to Court of Justice, asking whether the tariff rules were in conformity with Community law.[227]

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[223] Cases 209-213/84 *Ministére public v Asjes (Asjes)* [1986] ECR 1425.
[224] Case 311/85 *ASBL Vereniging van Vlaamse Reisbureaus v ASBL Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten (Vlamsee)*, [1987] ECR 3801.
[225] Case 229/83 *Leclerc* [1985] ECR 1.
[226] Cases 209-213/84 *Asjes*, para. 72.
[227] Ibid., para. 5.

The question asked by the national court was not found to be specific enough and the Court reformulated it as follows: *[T]he question must be understood as asking whether and to what extent it is contrary to the Member State's obligations to ensure that competition in the common market is not distorted, laid down by Article 5, Article 3(f) and Article 85 of the EEC Treaty, to apply the provisions of a Member State which lay down a compulsory procedure for the approval of air tariffs…where it is found that tariffs are the result of an agreement, a decision or a concerted practice contrary to Article 85.*"[228]

Due to the preliminary considerations arisen during the first stage of the proceedings, the Court was not able to give a concrete answer to the question it composed. As a result, the Court found suffice it to say "*if the appropriate national authorities or the Commission decided that regulatory tariffs resulted from a price-fixing agreement, the tariffs would be State action infringing Article 5.*"[229]

***Vlamsee* Judgement:** Finally, at the end of 1987, in two rulings separated by only two months, the Court found that the State interventions contravened those Member States' obligations vis-à-vis Community competition policy. The first one is about a Belgian law relating to travel agency business, which was brought before the Court in *Vlamsee*.[230]

According to the Belgian Royal Decree of 1966, the following acts, *inter alia*, were deemed to be acts contrary to fair commercial practice: (e) failure to observe prices and fares agreed upon or imposed by law; (f) the sharing of commissions, the granting of rebates, and the offer of benefits of any kind contrary to commercial practices. This clause was adopted into law from the 'code of conduct' of the Belgian Travel Agents Union. This Union was a trade association, in other words, association of undertakings within the meaning of Article 85 EEC (now Article 101 TFEU). Formerly, the code was only binding on members of the Union but it was extended to cover also the non-members. One of such non-members, a social agency providing travel agency services to public employees, passed

[228] Ibid., para. 17.
[229] Ibid., paras.76-77.
[230] Case 311/85 *Vlamsee* [1987] ECR 3801.

on to its customers as rebates the commissions paid by tour operators. It was sued by a trade association of Flemish Travel Agencies which sought an injunction to prevent further violations of the Decree.

The Belgian court, through preliminary ruling, referred a question to the Court of Justice asking whether the law was compatible with Article 85(1) of the Treaty, without mentioning Article 5(2) EEC. The Court of Justice, again, composed its own question, on the basis of Article 5 (now Article 4(3) TEU) in conjunction with Article 85 EEC (now Article 101 TFEU). The Court started with the statement that Article 5 EEC imposed the duty on Member States not to deprive Articles 85 and 86 of their effectiveness. An instance in which this duty would be breached was the one affirmed in *Asjes* that "*if a Member State were to require or favour the adoption of agreements, decisions, or concerted practices contrary to Article 85 or to reinforce their effects*."[231] Then the Court set out a two-step analysis to be followed in determining whether the Belgian regulation had this character: Was that conduct in violation of Article 85? If so, was the law intended to reinforce or does it have the effect of reinforcing the effects of that conduct?

At the end of its analysis, the Court concluded that the Royal Decree was not compatible with Belgium's obligations under Article 5 EEC (now Article 4(3) TEU). Accordingly, Article 85 EEC (now Article 101 TFEU) was infringed by a "system of agreements" among travel agents and tour operators. The travel agents' trade association had adopted the rule against commission rebates that was later passed into law. Under the standard form contract a tour operator may refuse to sell to agents who refuse to comply with the rules of commercial practice and act contrary to the spirit of the legislation. That wording allowed tour operators to rescind their contracts with travel agents who do not observe the rules of commercial practice applicable to them, including those prohibiting the sharing of commissions and the granting of rebates. Therefore, the Decree reinforced the effects of these agreements because: (a) it made the trade association rules permanent; b) it created an injunctive remedy as a means of enforcing the rule against non-members of the

[231] Ibid., para.5.

association; c) it added the sanction against both members and non-members of possible loss of the licence to operate an agency.[232] As a result, the legislation in question had the same effect on the market as an anti-compatitive agreement entered into by undertakings.[233]

BNIC v Aubert* Judgement*: The facts of *BNIC v Aubert*[234] are very similar to the ones that of *Vlamsee*. The National Intertrade Board for Cognac was created by order of the French Minister of Agriculture to be composed of representatives from the trade associations of winegrowers, on the one hand, and commercial distillers, dealers and brokers, etc. on the other. The members were selected by the Minister from candidates submitted by the associations. A government Commissioner was also appointed to attend the Board's meeting. The Board was authorised to reach agreements relating to diverse aspects of the market, including minimum prices, but in this case had set production quotas for spirits used in making cognac for the asserted purpose of compensating for dropping sales and overproduction. Where, as was the case with the quotas, the Board put a request to the Minister, who would issue an order to making the Board's agreement binding on all members of the represented trades. Aubert was a winegrower who was sued by the Board for a levy as a penalty for exceeding his quota.

The French court sought an interpretation of Article 85(1) EEC (now Article 101(1) TFEU) in the context of the case but failed to mention Article 5 EEC (now Article 4(3) TEU) and left an ambiguity as to whether the Board's agreement, the ministerial order or both were to be examined. This time the Court of Justice reformulated the question both to test the order under Article 5 EEC and to recall the two-step analysis of *Vlamsee*.[235]

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[232] Ibid., paras.13-17.
[233] See Kelyn Bacon, "State Regulation of the Market and EC Competition Rules: Article 85 and 86 Compared", **E.C.L.R.** Vol. 5, 1997, pp.283-291.
[234] Case 136/86 *Bureau National Interprofessionel du Cognac v Aubert (BNIC v Aubert)* [1988] 4 CMLR 331.
[235] Ibid.,paras.10-11.

The Court easily reached the conclusion that Board's agreement violated Article 85 EEC. As the Court had already ruled in *BNIC v Clair*,[236] the Board was not exempt from Article 85 EEC on account of the French government's encouragement for its activities.[237] The quotas would harm competition by freezing the relative market positions of the producers. Therefore, the governmental order ran contrary to France's duty under Article 5 EEC not to defeat the effect of Article 85 because the order strengthened the illegal agreement by extending it, presumably to non-members of the trade associations represented on the Board.[238]

***Ahmed Saeed* Judgement:** *Ahmed Saeed*[239] has made a special contribution to the theoretical development of the case law based on Articles 3(f), 5(2) in conjunction with Articles 85 or 86 revealing their relationship with Article 90 (now Article 106 of TFEU) of the EEC Treaty. The case concerned a German law prohibiting the application of air tariffs that had not been approved by the competent minister. The Court considered, among other questions, whether in requiring governmental approval of the tariffs agreed between airlines German law was compatible with Articles 5 and 90(1) of the EEC Treaty.

After reitreating the case law on Article 5(2) combined with Articles 85 or 86 EEC, the Court held that the approval and encouragement by the aeronautical authorities of tariff agreements were not compatible with Community law.[240] Concerning Article 90 EEC (now Article 106 TFEU), the Court stated that even though there is secondary Community legislation which allows tariff consultations, "*Treaty nevertheless strictly prohibits Member States from giving encouragement, in any form whatsoever, to the adoption of agreements or concerted practices with regard to tariffs contrary to Article 85(1).*"[241] Neither does the inaction of the Commission under Article 90(3) preclude the application of paragraphs (1)

[236] Case 123/83 *Bureau National Interprofessionel de Cognac v Clair (BNIC v Clair)* [1985] ECR 391, paras.16-23. In this case the Court decided that an agreement by the Board fixing the minimum prices with the intention of seeing that the restrictions were enacted into law was contrary to Article 85(1).
[237] Case 136/86 *BNIC v Aubert*, [1988] 4 CMLR 331, paras. 12-13.
[238] Ibid., paras.22-14.
[239] Case 66/86 *Ahmed Saeed* [1989] ECR 803.
[240] Ibid., paras. 48-49.
[241] Ibid., para.52

and (2) of that Article."[242] Thus the Court referred Article 90 EEC as a source of particular rights and obligations, which enables the effective application of the general provisions such as Articles 3(f) and 5 EEC to protect fair competition within the Community.

2.4.2.3. Formulation of the Test: *Van Eycke* and after

The invocation of Articles 3(f), 5 (now Article 4(3) TEU) and 85 (now Article 101 TFEU) or 86 EEC (now Article 102 TFEU) by the Court of Justice in an effort to ensure the effectiveness of the Treaty principles had triggered an important discussion among the scholars, which could be represented by the debate between Judge Pescatore and Giuliano Morenco. Judge Pescatore, welcoming the move the Court had made, contended that control over State actions interfering with competition within the Community's jurisdiction should be strengthen.[243] On the other hand, Morenco saw great danger in the trend of recent judgements of the Court relating to the interpretation of Articles 3(f) and 5 EEC and stated that Member States would be deprived overnight of important regulating powers and the Community would take a step away from the decentralised approach towards more centralism.[244] Despite all discussions, the Court continued to establish principles by adding new steps to the test developed to examine whether States measures were in conformity with their obligations under the competition rules of the Treaty.

***Van Eycke* Judgement:** *Van Eycke*[245] was a result of long proceedings which was started by a person, Mr. Van Eycke. This person wanted to open a savings account at a Belgian bank called ASPA on the basis of the information he received from bank's advertisement about the interest rates. When this person applied to the bank, he was told that the advertised rate was unavailable because of a State Decree. Accordingly, Belgian holders of certain savings accounts benefitted from a revenue tax exemption on condition

[242] Ibid., paras.53. This statement makes a striking contrast to the Court's ruling in *Leclerc*: As Community law stands Member States' obligations under Article 5 of the Treaty in conjunction with Articles 3(f) and 85 are not specific enough to preclude them from enacting legislation of the type at issue on competition in the retail prices of books (Case 229/83 [1985] ECR 1, para.20).
[243] Pescatore, opcit..
[244] Giuliano Marenco, "Competition between National Economies and Competition between Business –A Response to Judge Pescatore", **Fordham International Law Journal**, Vol.10, 1987, pp. 442-443.
[245] Case 267/86 *Pascal Van Eycke v ASPA NV (Van Eycke)* [1988] ECR 4769, [1990] 4 CMLR 330.

that the banks offered them interest rates below the rate set by the Minister of Finance in a Royal Decree of 13 March 1986. That rate was comprised of a fixed maximum basic rate and a fidelity premium which could not exceed 35% of the maximum rate. Holders of savings accounts at bank offering a higher interest rate than the rate allowed by the Royal Decree lost the tax exemption, thus making it unattractive for banks to offer higher interest rates. Mr. Van Eycke brought proceedings against ASPA, arguing that it could not legitimately rely on the Decree for it was contrary to Article 85 EEC (Now Article 101 TFEU). Belgian court referred its questions to the Court through preliminary ruling.

As it did in the previous cases, the Court of Justice reformulated the national court's questions to examine the Decree under Article 5 (now Article 4(3) TFEU) of the EEC Treaty. The Court observed that Articles 85 and 86 EEC alone do not regulate national legislation, but only corporate behaviour. Articles 85 and 86 read in conjunction with Article 5 EEC, however, oblige the Member States to refrain from adopting or keeping in force measures, including laws and regulations, capable of depriving Articles 85 and 86 of their effectiveness. Measures contravening that obligation are those through which the State;

> (1) require or encourage the adoption of agreements, decisions, or concerted practices that were contrary to Article 85, or reinforce their effects, or
>
> (2) deprive its own legislation of its official character by delegating to private entities the responsibility to make decisions in the economic sphere.[246]

The second part of the test was new, despite the impression the Court made as if the two-prong test was taken from the previous rulings. Regarding the first prong of the test, the Court acknowledged that prior to the issuance of the Decree the banks had reached a voluntary accord with the encouragement of the government to limit interest rates. However, there was nothing in the record to show that some or all of its terms or the terms of any other agreement or practice were adopted by the Decree. It required a further factual

[246] Ibid.,para.16.

investigation to resolve any doubts on this point. In the absence of such a finding, the Court found that the Decree by definition could not be characterised as having reinforced the effects of illegal practices. The authorities had not delegated the power to fix interest rates to any private entity and the legislation retained its official character. This was so even though the preamble of the Decree stated that consultations with the industry were made before its enactment.[247] As a result, the second prong of the test was also resolved in favour of the Belgian law.

***Meng, Ohra, Reiff* Triology:** Confirming *Van Eycke*, three cases were decided on 17 November 1993. Among these cases, *Meng*[248] concerned the compatibility with Articles 3(f), 5(2) (now Article 4(3) TEU) and 85(1) EEC (now Article 101(1) TFEU) of the Treaty of the German rules prohibiting paying over of a commission as regards sickness insurance, accident insurance and legal protection. The Court adopted the *Van Eycke* test to analyse the case referred. As regards 'require or favour' criteria, the Court observed that German rules neither require nor encouraged the conclusion of an unlawful agreement by insurance agents, for the prohibition which it contained was sufficient in itself.[249] The Court reached a similar conclusion regarding the State measures' reinforcement effect of the restrictive private agreement. In this respect, the Court held that the rules applicable to a particular insurance sector could be regarded as reinforcing the effects of a previous agreement only if they were confined to adopting the items of an agreement which had been concluded by private interests in the sector.[250] Finally, the Court pointed out that the rules themselves contained the prohibition on granting benefits to policy-holders and did not delegate to private agents the responsibility for taking decisions to intervene in the economic sphere.[251] As a result, the German legislation was held compatible with Article 3(f), 5(2), and 85(1) of the EEC Treaty.

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[247] Ibid.,paras.18-19.
[248] Case C-2/91 *Criminal preceedings against Wolf W. Meng (Meng)* [1993] ECR I-5751.
[249] Ibid.,para.15.
[250] Ibid.,para.19.
[251] Ibid.,para.20.

On the basis of the same reasoning, the Court in *Ohra*[252] ruled that Articles 3(f), 5(2) and 85(1) EEC did not preclude Dutch rules which prohibited insurance companies from granting financial advantages to clients or the beneficiaries of insurance policies. The *Reiff*[253] case concerned the German law on the carriage of goods by road, which provides that tariffs for the long-distance transport of goods by road were to be fixed by tariff boards and were to be made compulsory for all economic agents after approval by the public authority. The facts of the case revealed certain similarities with a previous case, *BNIC v Clair,*[254] but were different in substance. In this case, the Court held that as the members of those boards, although chosen by the public authority on a proposal from the relevant professional sectors, were not representatives of those sectors called on to negotiate and conclude agreement on prices, which had been the case in *BNIC v Clair*. These experts were independent experts who were called on to fix the tariffs on the basis of public interest consideration.[255] Therefore, there was no agreement within the meaning of Article 85 EEC (now Article 101 TFEU). The Court also pointed out that public authority did not abandon its prerogatives, making certain in particular that the board fix the tariffs by reference to considerations of public interest and if necessary, substituting the decision of the responsible minister for that of the boards. Consequently, the Court found no delegation of regulatory powers in relation to the fixing of tariffs to private economic operators.[256]

2.4.3. Conditions of Liability in the Case Law

2.4.3.1. Requirement, Encouragement or Reinforcement of Anti-Competitive Practices by the State

Requirement or encouragement of collusive practices by the Member States is the first prong of Van-Eycke test, which has been present since the beginning of the case law in this field. In *Asjes*, the Court affirmed that the reproduction of an anti-competitive

[252] Case C-245/91 *Ohra Schadeverzekeringen NV (Ohra)* [1993] ECR I-5851.
[253] Case C-185/91 *Bundesanstalt für den Güterfernverkehr v Gebrüder Reiff GmbH & Co KG (Reiff)* [1993] ECR I-5801.
[254] Case 123/83 *BNIC v Clair* [1985] ECR 391.
[255] Case C-185/91 *Reiff* [1993] ECR I-5801, para.17.
[256] Ibid.,para.23.

agreement in national legislation is contrary to the responsibility of the State to ensure that the effectiveness of Articles 85 (now Article 101 TFEU) and 86 EEC (now Article 102 TFEU) is not endangered.[257] This means that the State liability arises under Articles 3(f), and 5 in conjunction with Articles 85 or 86 EEC when the effect of an anti-competitive agreement between undertakings, a decision of trade associations or a concerted practice is reinforced by national legislation.[258] Article 106(1) in combination with Article 102 TFEU also applies if a Member State requires or otherwise facilitates a public undertaking or an undertaking benefiting from exclusive or special rights to engage in a conduct contrary to Article 102 TFEU.

Before deciding that the conduct contrary to Article 85 EEC (now Article 101 TFEU) was required, favoured, encouraged or reinforced by the Member States, the Court examined whether such conduct had actually existed. Therefore, it is different from the 'delegation' criterion in the second prong of the Van Eycke test. Delegation of regulatory powers takes place before the anti-competitive conduct begins whereas; requirement or reinforcement appears after the anti-competitive conduct has begun. In many cases Article 85 EEC (now Article 101 TFEU) was held not to apply either because there was no such agreement, decision or practice prior to the State involvement or the public interest function was found to be dominant in the cases concerned.

According to the Court's statement in *Van Eycke*, legislation may be regarded as intended to reinforce the effects of pre-existing agreements, decisions or concerted practices only if it incorporates either wholly or in part the terms of agreements concluded between undertakings and requires or encourages compliance on the part of those undertakings. Indeed, it is difficult to see how legislation can reinforce an agreement if the legislation does not contain, in whole or in part, the terms of the agreement. Thus, there

[257] Case 209-213/84 *Ministere public v Lucas Asjes and Others; Andrew Gray and Others; Jacques Maillot and Others; Léo Ludwig and Others* [1996] ECR 1425.
[258] Malin Thunström, Johan Carle and Stefan Lindeborg, "State Liability Under the EC Treaty Arising From Anti-Competitive State Measures", **World Competition**, Vol. 25, No.4, p.516.

must be a connection between the agreement and the allegedly reinforcing national legislation.[259]

2.4.3.2. Delegation of Regulatory Power to Private Entities by the State

The power to exercise public authority in order to favour one's own commercial interest is an obvious example of competitive advantage. Thus, delegating authority to a private entity with commercial interests in the area which the authority has been delegated creates a significant danger that the delegated authority will be abused in order to distort competition. On this basis the Court acknowledged that the requirement of effectiveness of the Community competition rules implies that the Member States are precluded from delegating regulatory powers that emanate from public authority to undertakings and association of undertakings.

Although the legal context was not clear, the Court first faced the question of delegation in the cases *BNIC v Clair* and *BNIC v Aubert* which represented the initial approach to be developed in the future. In these cases the Court held that the decisions of a national board intervening in the free competition were not necessarily exempted from complying with the competition provisions of the Treaty, even if the members of the Board have been appointed by a minister and under national law, the board is viewed as a public body. The Court emphasised that when in reality the board members are to be regarded as representatives of the commercial interests concerned, because the members have been proposed by trade organisations, then Article 85 (now Article 101 TFEU) of the EEC Treaty is applicable to agreements entered into through the board even though the legal framework, within which the board works, has been set up by the State.

In *Van Eycke*, the Court held that: "*Articles 85 [now Article 101] and 86 [now Article 102] of the Treaty, in conjunction with Article 5, require the Member States not… to deprive [their] own legislation of its official character by delegating to private traders*

[259] Ulla B. Neergard, "**Competition & Competences –The Tensions between European Competition Law and Anti-Competitive Measures by the Member States**", Copenhagen: Djof Publication, 1998, p. 72.

responsibility for taking decisions affecting the economic sphere."[260] As is mentioned earlier, the Court formalized this test as a restatement of a principle it had established in earlier cases that dealt with scenarios where private collusion was rendered superfluous by State legislation.[261] According to Broberg and Fenger, the idea underlying this test is that although presented as a State measure such delegated regulatory power is in reality not an expression of an affirmatively articulated State policy but rather a cover designed to make it possible to engage in anti-competitive acts to the detriment of the achievement of the aims of the Union.[262] Indeed, Judge Juliet also explained that the Court had "*raised an objection in principle to the adoption of legislation in which the State gives up its role and confers on undertakings the powers required to give effect to their policy. In other words, undertakings must either operate under the supervision of the public authorities or be subject to market rules, but they must not be entrusted with powers of public authority, since they only represent specific interests*."[263]

An important point related to this test concerns the meaning of 'delegation', which is highly controversial. Simply, delegation test is all about determining with whom the final responsibility of a decision restricting competition will rest. When the wording of the doctrine is taken as a whole, 'delegation' seems to be a separate prohibition from the norm requiring, favouring or reinforcing private infringements of Article 101 (ex Article 85 EEC) of the Treaty. This is also supported by the case law subsequent to *Van Eycke*, in which the Court had consistently applied the delegation test even where it found no signs of favouring, requiring or reinforcing private anti-competitive behaviour under the first test.[264]

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[260] Case 267/86 *Van Eycke* [1990] 4 CMLR 330, paras.18-19.
[261] See Opinion of AG Darmon in Case C- 185/91 *Reiff* [1993] ECR I-5801, para.47.
[262] Morten P. Broberg and Niels Fenger, "National Organisation of Regulatory Powers and Community Competition Law", **E.C.L.R.**, Vol. 16, No. 6, 1995, pp. 364-375.
[263] René Joliet, "National Anti-competitive Legislation and Community Law", **Fordham International Law Journal**, Vol.12, 1989, p. 172.
[264] See eg. Case C-332/89 *Marchandise* [1991] ECR I-1027; Case C-245/91 *OHRA Schadeverzekeringen* [1993] ECR I-1027; Case C-185/91 *Reiff* [1993] ECR I-5801; Joined Cases C-401&402/92 *Tankstation 't Heuske* [1994] ECR I-2199; Case C-153/93 *Delta* [1995] ECR I-2517; Case C-96/94 *Spediporto v Spedizioni Maritimma del Golfo* [1995] ECR I-2883; Joined Cases C-140-142/94 *DIP v Bassono del Grappa and Chioggia* [1995] ECR I-3257; Case C-38/97 *Librandi v Cuttica* [1998] ECR I-5955.

One understanding of the test is that the delegation of regulatory powers is an objectionable State action that undermines the objective of a system of undistorted competition even in the absence of any connection with private parties' engaging in the kind of behaviour prohibited by Article 101(1).[265]According to this view, if the prohibition of delegation were conditional upon anti-competitive behaviour by the private parties granted regulatory responsibilities, the second prong of Van Eycke test would not make any sense on its own. However, in *Van de Haar,*[266] which is a pre-Van Eycke case, the Court ruled that State liability under Articles 3(f) and 5 in conjunction with Article 85 or 86 EEC could be imposed only when undertakings have contributed to anti-competitive behaviour. This approach was confirmed in *Meng,*[267] a post-Van Eycke case, where the Court held that Articles 3(f), and 5(2) and 85 of EEC did not apply to State legislation "*in the absence of any link with conduct on the part of undertakings of the kind referred to in Article 85(1) of the Treaty*."[268]

Interestingly, the Court prefers to apply two-prongs of Van Eycke test cumulatively to strike down a national legislation. For example, in *Commission v Italy*, where the Court found a delegation, it also found that the State required an agreement contrary to Article 85(1) of the EEC Treaty. On the contrary in *Reiff*, the Court of Justice concluded that there was no agreement between undertakings in the sense of Article 85(1) EEC and there was no delegation either. In this case, the Court held that there would be no agreement or delegation of power "*if the members of [the] boards, although chosen by the public authorities on a proposal from the relevant trade sectors, are not representatives of the latter called on to negotiate and conclude an agreement on prices but are independent experts called on to fix the tariffs on the basis of considerations of public interest and if the public authorities do not abandon their prerogatives but in particular ensure that the*

[265] Harm Schepel, "Delegation of Regulatory Powers to Private Parties under EC Competition Law: Towards a Procedural Public Interest Test", **C.M.L.Rev**.,Vol. 39, 2002, pp.31-51.
[266] Case 177 and 178/82 *Van de Haar* [1984] ECR 1797.
[267] Case C-2/91 *Meng* [1993] ECR I-5751.
[268] Ibid., para.23. A.G. Jacobs and A.G. Léger expressed their dissatisfaction with Meng's requirement of a 'link' in their Opinions in Joined Cases C-180-184/98 *Pavlov* [2000] ECR I-6451 and Case C-35/99 *Criminal Proceedings against Manuele Arduino* [2002] ECR I-1529.

boards fix the tariffs by reference to considerations of public interest and, if necessary, substitute their decision for that of the boards."[269] This expression was repeated in *Delta*[270] but disappeared in the later judgements.

2.4.4. Obligation to Disapply State Measures Contrary to EU Competition Law

For the first time in *Walt Wilhelm*[271], the Court used both the 'effectiveness' and 'full and uniform application' language with regard to the relationship between Article 85 EEC (now Article 101 TFEU) and national competition rules. At the time of the judgement, there was no specific provision allocating competences or governing the relations between Member States and the Community institutions in the application of competition rules. In this case the Court made clear that Article 85 has left room for the parallel application of national competition laws but that it takes precedence over them as soon as they enter into a direct conflict with it. This would be the case if under national law a cartel prohibited by Article 85 would be held lawful or a cartel enjoying an exemption under Article 85(3) (now Article 101(3) TFEU) would be prohibited. The Court qualified such conflictual situations as being governed by the principle of supremacy of Community law.[272] Interestingly, the Court made no reference to Article 5 (now Article 4(3) TFEU) of the EEC Treaty.

In the light of the principle stipulated in *Walt Wilhelm*, Gyselen submits that national economic regulations must be regarded as being 'preempted' by Article 85 (now Article 101 TFEU), by virtue of its supremacy, when they have as their object to require or encourage undertakings to enter into cartels prohibited by Article 85 or reinforce the effects thereof. In all these cases there is indeed a direct conflict between these regulations and Article 85 EEC, since the formal conditions for its application are fulfilled. As a result, he assumes that there is no need to rely on Articles 3(f) and 5(2), since real issue here is not

[269] Case C-185/91 *Reiff* [1993] ECR I-5801, para.17.
[270] Case C-153/93 *Bundesrepublik Deutschland v Delta Schiffahrts-und Speditiongesellschaft mbH*, [1994] ECR I-2517, para.14.
[271] Case 14/68 *Walt Wilhelm* [1969] ECR 1.
[272] Ibid., points 5,6 and 9 at 14-15. For the principle of supremacy see Case 6/64 *Filaminio Costa v ENEL* [1964] ECR 585.

the obligation imposed by these provisions on Member States but the supremacy of Community law over national law.[273] However, as there is no conflict between the principle of supremacy and the obligation of Member States to observe this principle under the general provisions of Treaty, they can be applied together, as complementary to each other.

Application of the supremacy principle and the recognition of Member States' obligations in this respect were clearly revealed by the Court in *Fiammiferi* Case.[274] This case arose from proceedings by which the Consorzio Industrie Fiammiferi (the Italian consortium of domestic match manufacturers-CIF) challenged a decision of the Italian national competition authority. This decision declared the legislation which established and governed the CIF to be contrary to Articles 10 (now Article 4(3) TEU) and 81 TEC (now Article 101 TFEU). It also found that the CIF and the undertakings which were members of it had infringed Article 81 EC through the allocation of production quotas and ordered them to terminate the infringements found. CIF had enjoyed a commercial and fiscal monopoly relating to the manufacture and sale of matches. The price was fixed by the State.

After recalling the Van Eycke test, the Court of Justice stated that in accordance with settled case law, the primacy of Community law requires any provision of national law which contravenes a Community rule be disapplied. This is regardless of whether it was adopted before or after that rule. The duty to disapply national legislation which contravenes Community law applies not only to national courts but also to all organs of the State, including administrative authorities.[275] It imposes, if the circumstances so require, the obligation to take all appropriate measures to enable Community law to be fully applied. This obligation also applies to national competition authorities, since such authorities are responsible for ensuring that, *inter alia*, Articles 81 (now Article 101 TFEU) of the Treaty is observed. This is an inevitable result of the obligation of Member States to refrain from introducing measures which are contrary to the Community competition rules under Article

[273] Luc Gyselen, "State Action and the Effectiveness of the EEC Treaty's Competition Provisions", **C.M.L.Rev.,** Vol. 26, 1989, p.36.
[274] Case C-198/01 *Consorzio Industrie Fiammiferi (CIF) v Autorita Garante della Concorrenza a del Mercato (Fiammiferi)* [2003] ECR I-8055.
[275] Case 103/88 *Fratelli Costanzo* [1989] ECR 1839, para.31.

10 (now Article 4(3) TEU) of the EC Treaty. Those rules would be rendered less effective if, in the course of an investigation into the conduct of undertakings under Article 81 TEC (now Article 101 TFEU), the national authority were not able to declare a national measure contrary to either of these Articles. They would also be ineffective, if, as a consequence, the authority failed to disapply it. In that regard, the Court of Justice, considered that it is of little significance where undertakings were required by national legislation to engage in anti-competitive conduct, they cannot also be held accountable for infringement of Articles 81 and 82 TEC (now Articles 101 and 102 TFEU). As a result, the Court, without any hesitation, reached the conclusion that the duty for a national competition authority to disapply national law is a straightforward consequence of the principle of primacy of Community law.

Fiammiferi judgement constitutes an important step as to the direct effect of EU competition rules upon the obligation of Member States to disregard the conflicting national rules. In the past, the inapplicability of the national regulations was linked to situations which the national law limited the rights granted by Community law to individuals. According to the *Fiammiferi*, the inapplicability of the national law contrary to Community law would even be to the detriment of private individuals, at least of those who had complied with the obligations imposed by national law.[276]

With the entry into force of the Lisbon Treaty, the old Article 3 TEC was abolished and replaced by a new provision within the Treaty on the Functioning of the European Union. According to new Article 3(1)(b) TFEU, "*[t]he Union shall have exclusive competence, inter alia, in establishing of the competition rules necessary for the functioning of the internal market*." This provision inserted in the new Treaty is a reflection of the principles which have been developed through the case law since *Walt Wilhem*. As a result, now it is precise that the establishing of competition rules applicable throughout the Union is within the exclusive competence of the Union, and Member States are prohibited

[276] Fernando Castillo de la Torre, "State Action Defence in EC Competition Law", **World Competition**, Vol. 28, No. 4, 2005, p. 411. See also Alina Kaczorowska, "The Power of a National Competition Authority to Disapply National Law Incompatible with EC Law and its Practical Consequences", **E.C.L.R.**, Vol. 25, No. 9, 2004, p.595.

from enacting or maintaining in force any legislation in contradiction with the Union competition rules.

2.4.5. Liability of Undertakings Complying with Anti-Competitive State Measures

Since States have at their disposal numerous powerful means to influence economic activity, a pressing 'recommendation' will often leave the undertakings with no other practical choice but to respect.[277] Therefore, it is important to make clear to what extent the undertakings can be held responsible for the infringement of EU competition rules when they simply comply with the national law requiring, favouring or encouraging that specific anti-competitive practice.

According to the case law, for a State measure to be caught by Articles 3(f), 5(2) (now Article 4(3) TEU) in conjunction with the competition rules there should be a link with the conduct on the part of undertakings of the kind referred to in Article 85 or Article 86 EEC (now Articles 101 and 102 TFEU). However, in order to find such conduct, undertakings should be acting autonomously. It was a settled principle in the case law that applicability of Articles 85 (now Article 101 TFEU) and Article 86 EEC (now Article 102 TFEU) depended on the extent to which the undertaking concerned could have behaved autonomously. As long as the undertaking was still capable of autonomous conduct, Article 85 or 86 EEC would apply. Once the undertakings concerned were precluded from acting autonomously, it was no longer within the scope of those Articles. Moreover, undertakings might still be held responsible, even if the State measure was in compliance with the Treaty objectives. Blomme calls this approach as 'autonomy criterion'.[278]

Another approach in this respect is called 'state measure legality criterion', which linked the applicability of Articles 85 (now Article 101 TFEU) and Article 86 (now Article 102 TFEU) to the conduct of the undertakings with the compatibility of the Member State

[277] Michel Waelbroeck and Aldo Frignani, **European Competition Law**, New York: Transnational Publishers, 1999, pp.143-149.
[278] Eric Blomme, "State Action as a Defence Against 81 and 82 EC", **World Competition**, Vol.30, No.2, 2007, p. 243.

action with Articles 3, 5 and 85 or 86 EEC.[279] According to this approach whether the undertakings behaved autonomously was irrelevant. State measure legality criterion was evolved by the Court of First Instance (CIF) in *Rendo*[280] and *Ledbroke*[281] cases but overruled by the Court of Justice.

In *Ladbroke*, the Court of Justice adopted 'autonomy criterion' and decided that: "*the compatibility of national legislation with the Treaty rules on competition cannot be regarded as decisive in the context of an examination of the applicability of Articles 85 and 86 of the Treaty to the conduct of undertakings which are complying with that legislation. Although an assessment of the conduct of the racing companies and the PMU in the light of Articles 85 and 86 of the Treaty requires a prior evaluation of the French legislation, the sole purpose of that evaluation is to determine what effect that legislation may have on such conduct*."[282]

In *Ladbroke*, the Court made a further clarification as to the formulation of a general principle with regard to the responsibilities of undertakings which comply with an anti-competitive State action. Accordingly, if anti-competitive conduct is required by national legislation or if the later creates a legal framework which itself eliminated any possibility of competitive activity on their part, Articles 85 and 86 EEC do not apply. However, those Articles may apply if it is found that the national legislation does not preclude undertakings from engaging in autonomous conduct which prevents, restricts or distorts competition.[283]

The criterion developed in *Ladbroke*, which has become firmly established in the case law[284] and the Commission's practice, clarifies that Articles 85 and 86 (now Articles

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[279] Ibid.,p.244.
[280] Case T-16/91 *Rendo NV, Centraal Overijsselse Nutsbedrijven NV and Regionaal Energiebedrijf Salland NV v Commission (Rendo)* [1992] ECR II-2417, paras.105-107.
[281] Case T-548/93 *Ladbroke Racing Ltd. v Commission (Ladbroke)* [1995] ECR II-2565, paras. 47-49.
[282] Joined Cases C-359/95 *P Commission v Ladbroke Racing Ltd*. [1997] ECR I-6265, paras.31-32.
[283] Ibid.,paras. 33-34.
[284] See e.g., Case T-228/97 *Irish Sugar plc. v Commission* [1999] ECR II-2969, para.130; Case T-513/93 *Consiglio Nazionale degli Spedizioneri Doganali v Commission* [2000] ECR II-1807, paras.58-59; Joined Cases T-191, 212 and 214/98 *Atlantic Container Line AB and Others v Commission* [2003] ECR I-3275, para.1130.

101 and 102 TFEU) will be inapplicable in two situations: (1) when a State measure requires anti-competitive conduct and (2) when a State measure creates a legal framework which itself eliminates any possibility of competitive activity. This criterion applies both to private and public undertakings equally. For example, when a Member State induces or otherwise facilitates a public undertaking or an undertaking benefiting from exclusive or special rights to engage in anti-competitive practices the responsibility of the undertaking will coexist with the responsibility of the Member State under Article 86 (now Article 102 TFEU), but this time in combination with Article 90 EEC (now Article 106 TFEU).[285]

Another question is whether in order for undertakings to get immunity from the application of competition rules, the State measure that they comply with should have a binding effect on them. The CFI dealt with this question in *Asia Motors France III* case and decided that: *"[i]n the absence of any binding regulatory provision imposing the conduct at issue, the Court considers that the Commission is entitled to reject the complaints for want of autonomy on the part of undertakings in question only if it appears on the basis of objective, relevant and consistent evidence that this conduct was unilaterally imposed upon them by the national authorities through the exercise of irresistible pressures, such as, for example, the threat to adopt State measure likely to cause them to sustain substantial loses.*"[286] In other words, in case of a non-binding State measure, the undertakings will, in principle, be held responsible for breach of the competition rules. Such measures can only lead to the disapplicability of Article 85 (now Article 101 TFEU) or 86 EEC (now Article 102 TFEU) only in exceptional circumstances. These Articles will remain applicable if the Member State has only fostered or encouraged the anti-competitive behaviour.[287]

It is firmly established case law that fines may be reduced for undertakings complying with binding or non-binding State measures, in the event that the conditions mentioned in *Ladbroke* or *Asia Motor France* are not met. If a national law precludes

[285] See Opinion of A.G. Van Gerven in Cases C-48/90 and C-66/90 *Dutch PTT* [1992] ECR I-616, paras. 38- 39.
[286] Cases T-387/94 *Asia Motor France SA, Jean Michel Cesbron, Monin Automobiles SA, Europe Auto Services (EAS) SA and SA Somaco SARL v Commission* [1996] ECR II-961, paras.65-81.
[287] See eg. Case 13/77 *INNO v ATAB* [1977] ECR 2115, para.34.

autonomous conduct, then the Community law principle of legal certainty ensures that the undertakings cannot be exposed to criminal or administrative penalties in respect of the past conduct.[288]

2.5. Concluding Remarks

It is clear from the development of the case law that 'economic activity' is still an evolving concept which should not be imprisoned within the strict boundaries of a formal approach. However, in order to increase the legal certainty and predictability of what constitutes an economic activity for the future cases, it is possible to draw some conclusions from the case law.

First of all, according to the settled case law, an economic activity is any activity consisting in offering goods and services on a given market. Hence, purchasing goods or services is not within the definition of economic activity unless their subsequent use amounts to an economic activity. An economic activity presupposes the assumption of risk for the purpose of making profit in return for remuneration and in competition with the other entities offering similar goods and services on the market. This suggests that an economic activity is the voluntary offer of goods and services under the conditions that generate profit or return or at least cover the costs of the goods or services in question. As a result, provision of public goods or services in which the solidarity element is dominant does not constitute economic activity. It follows from that an activity is non-economic when there can be no market for comparable goods and services because there is no voluntary participation as the costs cannot be recovered or the State has reserved it for itself.

Secondly, with the exception of the activities that emerge from the *imperium* of State, the characteristics or inherent qualities of the activity is also important to determine whether it is of an economic nature. In this sense, employer-employee relations or the regulatory activities are not economic, because they do not aim to make profit by offering

[288] Case 267/86 *Van Eycke v ASPA* [1988] ECR 4769, para.53.

goods or services on the market. However, sometimes, not the characteristics of an activity but the way in which it is realised is the decisive factor. For instance, some services, such as education, health-care, social insurance, etc., can be described as economic or non-economic activities according to the conditions under which they are provided.

Thirdly, the regulatory activities of the State, in principle, are considered to be non-economic activities and therefore, the competition rules do not apply such activities of the State. However, since the Member States are under the obligation by virtue of 4(3) TEU in combination with Article 101 and 102 TFEU to facilitate the achievements of the Unions's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives, they can be held liable for breach of competition rules of the EU. Under the settled case law, this is especially the case when the State were to require or favour the adoption of agreements, decisions or concerted practices contrary to Article 101 TFEU, or reinforce their effects, or to deprive its own legislation of its official character by delegating to private traders responsibility for taking decisions affecting the economic sphere. This is due to the fact that in such cases, although exceptional, the State is not regarded to be acting in the public interest but in the specific interests of private undertakings. Thus, the State measure in question is actually a cover of private agreements in breach of competition rules. Under the principle of supremacy of Union law and by virtue of Article 3(1)(b) TFEU the State, including national courts, national competition authorities and all other public authorities under an obligation to disapply State measures conflicting with the Union's competition rules. Even the private undertakings can be held liable for complying with such State measures if they are able to act autonomously despite the existence of the State measure in question.

3. ARTICLE 106 TFEU AND ITS APPLICATION IN CONJUNCTION WITH COMPETITION AND STATE AID RULES

3.1. The Structure and Purpose of Article 106 TFEU

3.1.1. Overview

As is mentioned in the previous chapter, the European Union is based on the free market economy which functions on the principle of free competition. Accordingly, while competition guarantees the maximum freedom in economic decisions and the highest degree of efficiency, the State has a task of ensuring the undistorted and unhindered functioning of the competition mechanism. Such economic system does not totally exclude State intervention; on the contrary, it presupposes that State provides for the necessary legal and administrative framework for the smooth operation of the system.

As the best stimulant of economic activity, competition is the driving force of the Union. This is a result of certain provisions of the Treaty, in particular those which require the removal of the barriers to the integration of national markets. For instance, the elimination of customs duties and quantitative restrictions in the free movement of goods fosters competition. Other freedoms established in the Treaty - free movement of persons, services, capital and freedom of establishment- promote competition throughout the Union by means of the prohibition of any discrimination based on nationality. The EU Courts, giving a broad interpretation to such provisions, play an important role in establishing free competition in the common market. In this respect, the very notion of a 'common market' shows a direct connection with free competition.

However, establishing a system which makes competition inevitable is not sufficient to guarantee that the competitive mechanisms actually work. Appropriate measures should be adopted to prevent the artificial distortion or limitation of the effects of the elimination of barriers to competition. For this reason, Articles 101 and 102 TFEU

applies to all undertakings- public and private- to prohibit practices in restraint of competition.

On the other hand, Articles 101 and 102 TFEU, themselves, are not able to avoid a much greater risk that competition could be distorted or restricted by State activity. There are various reasons that may be a cause of such risk. As Pappalardo explains, the State, in the broader sense of public authorities- including the local governmental bodies- pursues general economic objectives which may not be compatible, in part or in whole, with the objectives of the Common Market.[289] Moreover, State intervention is capable of expanding to or affecting, directly or indirectly, the most important sectors of the economy.

When State intervention, degree of which depends on the features of the economic system adopted, exists in the form of State-owned or State-controlled undertakings, there is a serious threat of discriminatory treatment on the market place between private and public enterprises. State-controlled undertakings are, usually, not subject to the same disciplines as those in the private sector. Since they have the assurance of the State for their business activities, such undertakings do not need to compete on equal terms with private sector companies which operate under the threat of financial failure or bankruptcy.[290] The variety of their motives, particularly the non-commercial ones, may cause uncertainty on the market as their reactions to the economic situations are not easily predictable for the competing undertakings. All these factors may distort the competitive forces which are expected to lead to the efficient allocation of resources in a market economy.

However, for the competition rules, as well as the other Treaty provisions, to be effective, they must apply to all enterprises equally. To ensure that Member States do not permit public enterprises or those to which the State has granted exclusive or special rights, to avoid the competition rules, Article 106 TFEU specifically prohibits the States from enacting or maintaining in force any measure enabling them to do so. Therefore, Article

[289] Aurelio Pappalardo, "State Measures and Public Undertakings: Article 90 of the EEC Treaty Revisited", **E.C.L.R.,** Vol. 12, No. 1, 1991, pp. 29-39.
[290] Richard Taylor, Rosemary Bointon and Adam Collinson, "UK Merger Control and State-Controlled Companies", **E.C.L.R**., Vol. 12, No. 4, 1991, pp. 133-138.

106 of the Treaty entrusts the Commission with the task of ensuring that, in case of public undertakings and undertakings enjoying special or exclusive rights, Member States comply with their obligations under the Union law.

3.1.2. Article 106 and its Relation with the Other Treaty Provisions

3.1.2.1. Place of Article 106 in the Treaty

Article 106 TFEU is located under Title VII (Common Rules on Competition, Taxation and Approximation of Laws), Chapter 1 (Rules on Competition), and Section 1 (Rules Applying to Undertakings) of the Treaty. The location of Article 106 in the Treaty may seem quite awkward at first glance since it is addressed to Member States rather than undertakings. However, Article 106 TFEU occupies a significant position between the competition rules applying to private undertakings (Articles 101 and 102 TFEU) and the rules relating to State intervention in the form of State aids (Articles 107 to 109 TFEU). This position of Article 106 justifies the confusion that it may cause initially. In this respect, Article 106 is an instrument to maintain the fragile equilibrium between "*the increasing momentum of the single market and the remaining autonomy of the Member States in the sphere of domestic economic policy*."[291]

The wording of Article 106 TFEU is as follows:

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.

2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the

[291] Kelyn Bacon, "State Regulation of the Market and EC Competition Rules: Article 85 and 86 compared", **E.C.L.R.**, Vol. 18, No. 5, 1997, pp. 283-291.

application of such rules do 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 Union.

3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.

It is clear from its wording and as the Court has indicated in its several judgements that Article 106 TFEU is a particular application of certain general principles which bind the Member States. This is especially the case with Article 3(1) TFEU and Article 4(3) TEU. When Articles 3(1) TFEU and 4(3) TEU are read together with Article 106 and Article 37 TFEU, it is revealed that the Member States have extremely limited competence to intervene in the market through monopolies and undertakings with special or exclusive rights.

3.1.2.2. Article 3(1) TFEU and Article 4(3) TEU

The obligations in Article 106 is closely related to Article 3(1)(b) TFEU which indicates that Union shall have exclusive competence in, *inter alia*, the establishing of the competition rules necessary for the functioning of the internal market. In the former Article 3(1)(g) TEC it was stated that the activities of the Community shall include, *inter alia*, a system ensuring that competition in the internal market is not distorted. In *GB-INNO-BM v ATAB*, the Court referred to the general objectives of the Treaty as excluding any national system of regulation which hinders trade within the Community. The Court also pointed to the fact that the general obligation in Article 3(1)(g) TEC is made specific in several Treaty provisions concerning the rules on competition and Article 86 TEC (now Article 106 TFEU) is one of them.[292] The Commission's powers in Article 106(3) to control State interference in economic activities in individual cases and to adopt legislation prohibiting

[292] Case 13/ 77 *INNO* [1977] ECR 2115, paras 28-29. See also Case T-54/99 *Maxmobil v Commission* [2002] ECR II-313, para. 52.

certain types of State interference in certain fields also arise from the former Article 3(1)(g) of the Treaty.

The case law clearly shows that the obligations of Member States under Article 106(1) are the specific application of a general duty which binds Member States in Article 4(3) TEU (ex Article 10 TEC).[293] Under Article 4(3) TEU Member States must take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of the Treaty or resulting from action taken by the institutions of the Union. In addition, Member States must abstain from any measure which could jeopardise the achievement of the objectives of the Treaty. In this respect, both Articles are concerned with ensuring that the objectives and obligations established by the Treaty are respected by Member States. According to these provisions, Member States cannot avoid their obligations as regards the free circulation of goods by delegating powers to public or private undertakings. By the same token, Member States are not allowed to deprive competition rules of their effectiveness by adopting rules that oblige their public undertakings to breach them.[294]

Despite the similarities shared by these two Articles, wording of Article 106 is more specific and concrete in forbidding the measures contrary to the Treaty. In other words, Article 106 TFEU is more specific than Article 4(3) TEU because it identifies the main Treaty provisions with which the State measures should comply rather than making a vague reference to Treaty objectives which should be protected. Therefore, the effect of Article 106 TFEU is not limited to general requirements of the Treaty but it establishes specific obligations with direct effect and its own means of enforcement.

In practice, the Court applies Article 106(1) TFEU mainly in conjunction with Article 102 TFEU without resorting to the independent use of Article 4(3) TEU. The reason is that Article 4(3) TEU cannot be applied independently whenever the situation is

[293] See Case C-260/89 *Elliniki Radiophonia Tilerosi (ERT) v DEP* [1991] ECR I-2925; Case C-320/91 *Procureur de Rot v Corbeau* [1993] ECR I-2533.
[294] Case 13/77 *INNO* [1977] ECR 2146, para. 42; Case 66/86 *Ahmed Saeed* [1989] ECR 852, para. 50.

governed by a specific provision of the Treaty such as Article 106(1).[295] Nevertheless, the Court had frequently used Article 10 TEC (now Article 4(3) TEU) in conjunction with Articles 3(1)(g) TEC (now Article 3(1)(b) TFEU) and Article 81 TEC (now Article 101 TFEU) in certain cases holding that it is a provision which obliges Member States not to adopt measures which restricted competition.[296]

Chung argues that Article 106 TFEU performs a dual role: "one as *lex specialis* for the application of the competition rules to the public sector, the other as *lex generalis* for the delimitation of the scope of the Treaty principles, in particular free competition, as against State intervention in the economy."[297] As *lex generalis*, Article 106 presupposes the regulatory power of Member States which may restrict the scope of competition rules. In this respect, Article 106 TFEU defines the criteria to be applied in order to reconcile the obligation to facilitate the achievement of undistorted competition imposed by Article 4(3) TEU (ex Article 10 TEC and former Article 5 EEC) with the residual power of Member States.[298] Article 106 contains a delicate balance between what may be considered to be a legal use of State power in the public sector and the illegal State intervention when it breaches the provisions of the Treaty, particularly those on competition. Therefore, Article 106 TFEU functions as an intermediary between conflicting economic models: free market and State planning, despite it favours the free market economy as is reflected clearly on the case law.

As *lex specialis* Article 106(1) imposes special obligations on Member States in relation to public undertakings and undertakings granted special or exclusive rights.[299] Article 106(2) allows a limited possibility of derogation from the Treaty principles for the operation of services of general economic interest or the revenue producing monopoly.

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[295] Case C-323/93 *Société Agricole du Centre d'Insémination de la Crespelle v Cooperative d'Elevage et d'Insemination Artificielle du Département de la Mayenne* [1994] ECR I-5077, para.15; Joined Cases C-78/90 to C-83/90 *Compaigne Commerciale de l'Quest and Others* [1992] ECR I-1847, para.19.
[296] This subject is analysed in the previous chapter.
[297] Chan Mo Chung, "The Relationship between State Regulation and EC Competition Law: Two Proposals for a Coherent Approach", **E.C.L.R.**, Vol. 16, No. 2, 1995, pp. 87-97.
[298] ibid.
[299] For a different opinion see Kelyn Bacon, "State Regulation of the Market and EC Competition Rules: Articles 85 and 86 Compared", **E.C.L.R.**, Vol. 18, No. 5, 1997, pp. 283-291.

Finally, Article 106(3) provides the Commission with special power to enact general rules to specify obligations arising from the Treaty that are binding on the Member States with regard to the undertakings mentioned in the Article 106(1) and (2).[300] For a better understanding of this provision each paragraph shall be analysed in detail after its relation with Article 37 TFEU has been explained.

3.1.2.3 Article 37 of the Treaty

Article 37 of the EC Treaty is as follows:

1. Member States shall adjust any State monopolies of a commercial character so as to ensure that no discrimination regarding the conditions under which goods are procured and marketed exits between nationals of Member States.

The provision of this Article shall apply to any body through which a Member State, in law or in fact, either directly or indirectly supervises, determines or appreciably influences imports or exports between Member States. These provisions shall likewise apply to monopolies delegated by the State to others.

2. Member States shall refrain from introducing any new measure which is contrary to the principles laid down in paragraph 1 or which restricts the scope of the Articles dealing with the prohibition of customs duties and quantitative restrictions between Member States.

3. If a Member States monopoly of a commercial character has rules which are designed to make it easier to dispose of agricultural products or obtain for them the best return, steps should be taken in applying the rules contained in this Article to ensure equivalent safeguards for the employment and standard of living of the producers concerned.

[300] See for example: Case 202/88 *French Republic v Commission of the European Communities* [1991] ECR I-1223, paras. 14 and 21; Joined Cases C-271/90, C-281/90 and C-289/90 *Kingdom of Spain, Kingdom of Belgium and Italian Republic v Commission of the European Communities* [1992] ECR I-5833, para.12.

Article 37 TFEU is located in Part III (Union Policies and Internal Actions), under Title II (Free Movement of Goods), Chapter III (Prohibition of Quantitative Restrictions between Member States). It is directly addressed to Member States, imposing specific obligations upon them. The text refers only to the elimination of discrimination in the procurement and marketing of goods and the abolition of quantitative restrictions. Therefore, Article 37 is not part of the competition rules. Whilst Article 106 TFEU functions as a sort of bridge between the competition rules addressed to undertakings and State aid rules addressed to the Member States, Article 37 acts as a hinge between the rules relating to the free circulation of goods and the competition rules.[301]

As is clear from the wording of Articles 106 and 37 TFEU, both Articles deal with the regulation of State monopolies in the Common Market. Although Article 345 TFEU allows the Member States to determine the extent and the internal organisation of their public sectors, Articles 106 and 37 extremely limit their competence to shape their economic policies by intervening through State monopolies or public undertakings. In *IGAV v ENCC* the Court stated that Articles 86 (now Article 106 TFEU) and 31 TEC (now Article 37 TFEU) belong to a wider group of "*provisions relating to infringements of the normal functioning of the competition system by actions on the part of the states*."[302] As a result, both Articles require the Member States not to enact any new measure with regard to the State monopolies of a commercial character (Article 37) and/or to the public undertakings and undertakings granted special or exclusive rights (Article 106), which may be contrary to the provisions of the Treaty.

The main motive behind these two Articles is the fact that public monopolies have undeniable effects- even when it is negligible- on trade between the Member States. Even though the restrictive effects of the State monopolies may be justified on the public policy grounds, this is not the case for every Member State. For example, France, Italy and

[301] Jose Luis Buendia Sierra, **Exclusive Rights and State Monopolies under EC Law: Article 86 (former Article 90) of the EC Treaty**, New York: Oxford University Press, 1999, p. 77.
[302] Case 94/74 *Industria Gomma Articoli Vari (Igav) v Ente Nazionale per la Cellulosa E per la Carta (ENCC)* [1975] ECR 1164.

Germany used to and/or still have a certain number of State monopolies whereas Benelux countries do not have such a tradition in their economic systems.[303] The domestic economic policies of the Member States have become more diverse with the recent enlargements of the European Union in 2004 and 2007. Therefore, Articles 106 and 37 TFEU aim to achieve not only the equal treatment of public and private entities within the same Member State but also the equal treatment of the Member States with different economic histories and policies.

Although both articles have similar motivations or effects, this does not mean that they are identical to each other. First of all, Article 37 TFEU applies to the situations where State monopolies of a commercial character or any body through which a Member State supervises, determines or appreciable influences imports and exports between Member States are involved. In other words, Article 37 TFEU comes into play where a public undertaking enjoys a legal monopoly in the import or export of specific products. Therefore, Article 37 of the Treaty is not, in general, applicable to monopolies in services but to commercial goods.[304] Although, the Court has accepted that Article 37 TFEU may apply to monopolies in the energy sector which provide goods and services,[305] it might be considered as an exceptional case arising from the specificities of the sector. On the other hand, the scope of Article 106 TFEU, which concerns mainly the public undertakings and undertakings with special or exclusive rights, is broader in scope. Article 106 TFEU applies to all such undertakings irrespective of whether they are involved in services sector or commercial trading.

Article 106(2), which brings an exception to the main principle mentioned in the Article 106(1), applies specifically to the undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing

[303] Erika Szyszcak, **The Regulation of the State in Competitive Markets in the EU**, Oxford and Oregon: Hart Publishing, 2007, p.107, ft.1.
[304] See e.g. Case 155/73 *Giuseppe Sacchi (Sacchi)* [1974] ECR at 428-429, paras. 9-10 and Case C-17/94 *Criminal proceedings against Denis Gervais, Jean-Louis Nougailon, Christian Carrard and Bernard Horgue (Gervais)* [1995] ECR at I-4380, para. 35.
[305] Case C-393/92 *Almelo* [1994] ECR I-1477, para.28; Case C-158/94 *Commission v Italy* [1997] ECR I-5789.

monopoly. Although a "revenue producing monopoly" may correspond to the "state monopoly of a commercial character" mentioned in Article 37(1) TFEU, in practice Article 106(2) TFEU usually applies to the undertakings operating in the public service field, to which Article 37 is not applicable.

Secondly, although Article 106 has an exception laid down in Article 106(2), Article 37 TFEU does not contain any explicit exceptions or derogations through which a Member State may justify a measure that is in the public interest. Article 36 of the Treaty is the only justification for the free movement of goods provisions of Articles 34 and 35 TFEU and it refers only to Articles 34 and 35, without any mention of Article 37. In *SAIL*[306] the Commission and the AG Roemer had supported the idea that Article 36 could apply to Article 37, although the Court did not deal with the issue. However, in *Greek Oil Monopoly*[307] the Court accepted the idea but appeared to demand a high level of proof.

Another difference between Article 37 and Article 106 TFEU is that whilst the former is exclusively addressed to the Member States, the situation is different for the latter. Although Article 106(1) is addressed to the Member States themselves, Article 106(2) is addressed to the undertakings providing them with a limited immunity from the application of Treaty rules. Despite being addressed to the undertakings, Article 106(2) can be invoked by Member States in relation to exclusive or special rights that they have granted.

It is important to point out that Article 37 of the Treaty does not apply to regulatory activities of the State, such as licensing, and applies only to activities intrinsically connected with the specific business of a commercial monopoly.[308] On the other hand, Article 106 can be applicable to the State measures and consequently to the regulatory activities of the State if they put public undertakings and undertakings with exclusive or special rights to a place where they cannot avoid infringing Treaty rules.

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[306] Case 82/71 *Ministére public de la Italian Republic v Societa agricola industria latte (SAIL)* [1972] ECR 119.
[307] Case C-347/88 *Greek Oil Monopoly* [1990] ECR I-4789.
[308] Case 118/86 *Nertsvoederfabriek Nederland BV* [1987] ECR 3883; Case 86/78 *SA des grandes distelleries Peureux v directeur des Services fiscaux de la Haute-Saone et du territoire de Belfort* [1979] ECR 897.

3.2. Types of Undertakings under Article 106(1)

3.2.1. The Scope of Article 106(1)

The wording of Article 106(1) is as follows:

"*In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 18 and Articles 101 to 109.*"

It is clear from the language of Article 106(1) that it applies to the breach of all Treaty rules, not just those dealing with competition, even though it is included in the section on competition rules. Such provisions include, Article 34 on free movement of goods, [309] Article 45 on free movement of workers, [310] Article 49 on freedom of establishment[311] and Article 56 on freedom to provide services.[312] Therefore, Article 106(1) ensures that there is no possibility of avoiding the application of the Treaty rules by virtue of State interference in the economic activities of an undertaking. On the other hand, Article 106(1) refers in particular to Article 18 (non-discrimination) and to Articles 101 to 109 (competition and State aid rules). The emphasis given to these articles reveals the importance Article 106(1) has for competition law.

Like Article 4(3) TEU, Article 106(1) TFEU is a reference provision and can only apply in conjunction with one or more other articles of the Treaty. In this respect, Article 106(1) has a direct effect only when it is applied with another provision also having a direct effect. [313] One of the Court's earlier decisions was concerned a small port on a river managed by a public corporation to which the State of Luxembourg had granted exclusive

[309] Case C-18/88 *RTT v GB-Inno-BM* [1991] E.C.R. I-5941.
[310] Case C-179/90 Merci *Convenzionali Porto di Genova SpA v Siderurgica Gabrielli SpA* [1991] E.C.R. I-5889.
[311] Case 33/74 *Van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid* [1974] E.C.R. 1299.
[312] Case 2/74 *Reyners v Belgium* [1974] E.C.R. 631.
[313] See Case C-179/90 Merci *Convenzionali Porto di Genova SpA v Siderurgica Gabrielli SpA* [1991] E.C.R. I-5889, para.23; Case C-242/95 *GT-Link A/S v Danske Staatsbaner* (DSB) [1997] E.C.R. I-4449 para.57; Case C-22/98 *Becu* [1999] ECR I-5665, para.21; Case C-258/98 *Giovanni Carra* [2000] ECR I-4217, para.11.

rights. In this case, the Court held that an undertaking entrusted with the task of establishing a port which is the only outlet of the State concerned for inland water traffic may be qualified under Article 90(2) (now Article 106(2) TFEU) to enjoy certain exclusive rights. However, the Court added that the provisions of Article 90 (now Article 106 TFEU) were of no avail in such a case, as they could not be relied upon by private persons for lack of direct applicability.[314] However, this judgement of the Court was overruled by the subsequent case law. Now it is accepted that individuals have the right to rely upon those provisions against other parties in their own respective countries.[315] National courts must give effect to those provisions as part of the Community law and set aside the infringing national law.[316]

For a better understanding of the purpose of Article 106(1) it is necessary to take Article 345 into account. Article 345 states that the "*Treaty shall in no way prejudice the rules in Member States governing the system of property ownership*." The wording of Article 106(1), read in the light of Article 345, implies the existence of state-owned or controlled (public) undertakings or undertakings having special or exclusive rights. However, this does not mean that such rights are necessarily compatible with the Treaty.[317]

It is also necessary that there should be no unjustified discrimination between the public and private undertakings in the application of competition rules in the Treaty. Given that Article 106(1) TFEU concerns public undertakings and undertakings having exclusive or special rights, it is important to determine whether a particular body is an undertaking and, if it is, whether it is a public undertaking.

[314] Case 10/71 *Public Prosecutor of Luxembourg v Muller* [1971] ECR 723, paras.10-16.
[315] Case C-41/90, *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979, [1993] 4 CMLR 306.
[316] Case 155/73 *Sacchi* [1974] E.C.R. 409;
[317] C-202/88 *French Republic v Commission of the European Communities (Telecommunications Terminal Equipment)* [1991] E.C.R. I-1270.

3.2.2. The Notion of Undertaking

3.2.2.1. Definition

The notion of undertaking is the main subject of EU competition law. This notion is not defined in the Treaty or in the secondary legislation and, obviously, the application of competition rules requires a common notion of 'undertaking'. In this respect, the Union law employs a distinct and separate use of the term from those contained in the national legal systems. In other words, 'undertaking' should be understood as a Union concept operating independently of national conceptions.

The case-law on the EU competition law reflects the fact that the EU Courts have preferred the functional approach rather than the formalistic one when defining the notion of undertaking, which is also in compliance with the functional approach adopted for the notion of economic activity. In *Höfner*, the ECJ stated that "*the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity or the way in which it is financed*."[318] In this case the Court classified German federal public employment agency as an 'undertaking' because it found employment procurement to be an economic activity. The definition given by the Court in *Höfner* relates to the material or sectoral scope of application of the competition law.[319] The most crucial thing to verify, therefore, is that whether an entity is engaged in an activity consisting in offering goods or services on a given market.

The question of whether an entity is in fact an undertaking arises very often in Article 106 cases. As the functional approach is adopted to define 'undertaking', it is

[318] Case C-41/90 *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979, [1993] 4 CMLR 306, para.21. See also Case C-222/04 *Cassa di Risparmio di Firenze and Others* [2006] ECR I-289, para.107. Article 1 of Protocol 22 concerning the definition of 'undertaking' and 'turnover' (Article 56) attached to the Agreement on the European Economic Area provides that "for the purposes of the attribution of individual cases pursuant to Article 56 of the Agreement, an 'undertaking' shall be any entity carrying out activities of a commercial or economic nature" which is very similar to the definition in *Höfner*.

[319] Wouter P.J.Wills, "The Undertaking as Subject of EC Competition Law and the Imputation of Infringements to Natural or Legal Persons", **E.L. Rev.**, Vol.25, No.2, 2000, pp. 99-116.

considered irrelevant that the entity is not profit-making[320] or that is not set up for an economic purpose[321] as long as the activity pursued is an economic activity. In *Albany*, a sectoral pension fund, which had an exclusive right to manage a supplementary pension scheme in an industrial sector in a Member State, was considered to be an undertaking.[322] In another case, Deutsche Post, which had been granted exclusive rights as regards collection, carriage and delivery of mail, was regarded as an undertaking.[323] Similarly, in *Almelo* the Court described as undertakings both the regional electricity distributor and the local distributors, even though these entities were controlled by the provincial and local public authorities. The essential point in describing them as such is the fact that they carried out an economic activity, which was the distribution of electricity.[324]

A particular entity might be regarded as an undertaking for one part of its activities or functions while the rest falls outside the competition rules. That is the case, particularly, when public bodies are engaged in economic activities on the market but exercise public authority at the same time. A given entitity may be engaged on the one hand in administrative activities which are not economic, such as police tasks, and on the other hand in purely commercial activities.[325] The Court also ruled that an entity can be engaged in non-economic activities where it behaves like a charity fund and at the same time compete with other operators for another part of its activity by performing financial and real estate operations, even on a non-profit basis.[326]

Similarly in *AOK*, the Court held that the activity of the sickness funds in question was based on the principle of national solidarity and not economic in nature; therefore, those funds did not constitute undertakings within the meaning of Article 101 and 102 of

[320] C-244/94 *FFSA* [1995] ECR I-4013, [1996] 4 CMLR 446, para.21; Case C- 67/96, *Albany* [1999] ECR I-5751, [2000] 4 CMLR 446, para.85.
[321] Case 155/73 *Italy v Sacchi* [1974] ECR 409, [1974] 2 CMLR 177, paras. 13-14.
[322] Cases C- 67/96 *Albany* [1999] ECR I-5751, [2000] 4 CMLR 446, para. 90.
[323] Case C-148/97 *Deutsche Post AG v Gesellschaft für Zahlungssysteme mbH (GZS) and Citicorp Kartenservice GmbH* [2000] ECR I-825, [2000] 4 CMLR 838, para.37.
[324] Case C-393/2 *Municipality of Almelo and others v NV Energiebedrijf Ijsselmij* [1994] ECR I-1517, para.31.
[325] Case C-82/01 *Aéroports de Paris v Commission* [2002] ECR I-9297.
[326] Case Case C-222/04 *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Frenze SpA, Fondazione Cassa di Risparmio di San Miniato and Cassa di Risparmio di San Miniato SpA* [2006] ECR I-289.

the Treaty. The Court also added as follows: "*However, the possibility remains that, besides their functions of an exclusively social nature within the framework of management of German social security system, the sickness funds and the entities that represent them, namely the fund associations, engage in operations which have a purpose that is not social and is economic in nature*". In that case the decisions which they would be led to adopt could perhaps be regarded as decisions of undertakings or of associations of undertakings. It must therefore be examined "*whether determination of the fixed maximum amounts by the fund associations is linked to the sickness funds' functions of an exclusively social nature or whether it falls outside that framework and constitute an activity of an economic nature.*"[327] In this respect, it is of the key importance to identify what 'economic activity' is, which has already been analysed in the First Chapter.

3.2.2.2. The Scope

An undertaking must be a body capable of having legal rights and obligations and acting in cooperation with other parties.[328] The capacity of independent decision making and acting in its own right is important to be held liable under competition rules as an undertaking but it is irrelevant whether or not the entity has a legal personality. However, it is necessary for the undertaking to form part of an entity with a legal personality capable of having rights and obligations. In other words, an entity may be an undertaking even where it does not have an independent legal personality but forms part of an independent legal personality, like a State's general administration, if it is engaged in 'economic' activities.[329]

In *Hydrotherm v Compact*, the Court decided that 'in competition law' the term "*undertaking must be understood as designating an economic unit for the purpose of the subject-matter of the agreement in question even if in law that economic unit consists of*

[327] Cases C-264/01, 306/01, 354/01, and 355/01 *AOK Bundesverband and Others v Ichtyol-Gesellschaft Cordes and Others* [2004] 4 CMLR 1261, paras.58-59.
[328] Daniel G. Goyder, **EC Competition Law**, 3rd ed., Oxford: Oxford University Press, 2003, p.87.
[329] See Commission Decisions in this paralel, *Spanish Courier Services* [1990] OJ L233/19, [1991] 3 CMLR 560, *Aluminium Products* [1985] OJ L92/1, [1987] 3 CMLR 813. See also Case 118/85 *Commission v Italy* [1987] ECR 2599, paras.7 and 8.

several persons natural or legal."[330] Similarly in *Shell*, the CFI held that Article 81 EC (now Article 101 TFEU) of the Treaty "*is aimed at economic units which consist of a unitary organisation of personal, tangible and intangible elements which pursue a specific economic aim on a long-term basis and can contribute to the commission of an infringement of the kind referred to in that provision*."[331] However, employees, for the duration of their employment relationship, being incorporated into the undertakings that employ them and thus forming part of an economic unit with them do not constitute undertakings within the meaning of the Union competition law.[332] It is the same for an entity which only works for another entity within which it is integrated. For an undertaking to exist, the economic activity should be carried out on the market and for the sake of the market. Occasional activities by the entity would also be sufficient to consider it an undertaking, as far as those particular activities are concerned.

On the other hand, members of liberal professions can be undertakings as long as they are engaged in an economic activity. In *Commission v Italy,*[333] the ECJ stated that customs agents in Italy, who offered, for payment, services consisting of the carrying out of customs formalities in relation to the import, export and transit of goods were undertakings and National Council of Customs Agents was an association of undertakings despite its public law status. Similarly, in *Wouters,*[334] the Court held that members of the Bar which offered, for a fee, services in the form of legal assistance carried out an economic activity and were undertakings for the purposes of the competition rules. The fact that they constitute a regulated profession and that the services are of an intellectual, technical or specialised nature and that they are provided on a personal and direct basis does not remove it from the scope of Article 101(1).[335]

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[330] Case 170/83 *Hydrotherm Geratebau GmbH v Compect de Dott. Ing. Mario Andreoli & C.S.A.S.* [1984] E.C.R. 2999, [1985] 3 C.M.L.R. para.11.
[331] Case T-11/89 *Shell v Commission* [1992] E.C.R II-884, para.311.
[332] Case C-22/98 *Criminal proceedings against Jean Claude Becu, Annie Verweire, Smeg NV and Adia Interim NV* [1999] ECR I-5665, [2001] 4 CMLR 968.
[333] Case C–35/96 *Commission v Italy* [1998] ECR I–3851, [1998] 5 CMLR 889.
[334] Case C–309/99 *Wouters v Alegemene Raad van den Nederlandse Order van Advocaten* [2002] ECR I-1577, [2002] 4 CMLR 913.
[335] Commission Decision (*Coapi),* OJ 1995 L 122/37, [1995] 5 CMLR 468, para.32.

A body which simply carries out regulatory activities without getting involved in carrying out an economic activity is not an undertaking. However, a body which carries out an economic activity and at the same time has regulatory functions or engages in another type of non-economic activity is an undertaking in respect of the economic activities that it pursues. In certain cases attributing regulatory functions to an entity which carries out an economic activity may breach Article 106 in conjunction with Article 102 TFEU,[336] which will be analysed in detail later. The Court has thus adopted a functional and Community-based concept of an 'undertaking', something which may also be comparable to the concept of 'public service' in Article 45(4) with regard to an exception to the principle of freedom of movement for workers.

3.2.2.3. Single Economic Entity Doctrine

Article 101(1) TFEU does not apply to agreements between undertakings that form a single economic entity as it refers only to relations between economic entities which were capable of competing with one another. Consequently, agreements or concerted practices between entities belonging to the same economic group are not within the scope of this provision provided that they form an economic unit. However, a particular conduct of a single economic entity may violate Article 102 TFEU if its conditions are fulfilled.

Subsidiaries, usually, do not enjoy 'economic independence'[337] or 'real freedom to determine its course of action on the market' [338] even if they have separate legal personalities. Thus, when subsidiaries only carry out the instructions issued to them by the parent company controlling them, Article 101(1) does not apply to their conduct.[339] For example in *Centrafarm*, the Court ruled that Article 101 TFEU is not applicable to undertakings "*belonging to the same concern and having the status of parent company and subsidiary, if the undertakings form an economic unit within which the subsidiary has no*

[336] See, for example, Case C- 18/*88 Régie des télégraphes et des téléphones v GB-Inno-BM SA (RTT)* [1991] ECR at I-5981-5982, paras. 25-28.
[337] Case 22/71 *Béguelin Import v GL Import-Export* [1971] ECR 949, [1972] CMLR 81, para.8.
[338] Case 15/74 *Centrafarm BV and Adnaan De Peijper v Sterling Drug Inc* [1974] ECR 1183, [1974] 2 CMLR 480, para.41.
[339] Case C–73/95 P *Viho Europe BV v Commission* [1996] ECR I–5457, [1997] 4 CMLR 419, para.16.

real freedom to determine its course of action on the market, and if the agreements or practices are concerned merely with the internal allocation of tasks as between the undertakings."[340] Because, if the parent company is able to exercise decisive control over the strategic commercial behaviour of the subsidiary, the subsidiary cannot have real freedom to determine its course of action on the market. The Court further clarified its approach in *Bodson*, where it indicated that in order to ascertain whether the conditions set out in *Centrafarm* were met, it had to be verified whether the companies belonging to the same group "*pursue the same market strategy, which is determined by the parent company*." [341] In contrast, distribution arrangements concluded between independent undertakings may be caught by Article 101(1) TFEU.

In order to determine whether they are independent undertakings or a single economic entity, various factors such as, the share holding structures, composition of the board of directors, profit sharing and decision making mechanisms of these entities should be taken into account. One of the distinctive characteristics of a single economic entity is the existence of authority or the power to exercise control over people and physical assets. For example, in *Hydrotherm*, a natural person and two companies completely controlled by him were considered to be a single undertaking.[342] Also in *Shell*, the Court found that Shell and the Shell group operating companies constituted a single undertaking.[343]

According to the 'single economic entity' doctrine, parent companies are responsible for the conducts of their subsidiaries within the Community, even when the parent company operates outside the Community as long as the subsidiary does not enjoy autonomy and its actions are attributed to the parent.[344] Thus, this doctrine enables EU competition rules to be applied to companies outside the jurisdiction of the Community for their activities implemented through their subsidiaries. In some cases both the parent and

[340] Case 15/74 *Centrafarm v Sterling* Drug [1974] ECR 1167, para.41.
[341] Case 30/70 *Bodson v Pompes funébres des regions libérées* [1988] ECR 2513, para.20.
[342] Case 170/83 *Hydrotherm Geratebau GmbH v Compect de Dott. Ing. Mario Andreoli & C.S.A.S.* [1984] ECR 2999, [1985] 3 CMLR, paras.10-11.
[343] Case T-11/89 *Shell v Commission (Shell)* [1992] ECR II-884, para.312.
[344] Cases 48, 49, and 51–7/69 *ICI v Commission (Dyestuffs)* [1972] ECR 619, [1972] CMLR 557, paras.125–46.

subsidiary companies may be held liable for the violation of competition rules and fined under Article 23 of the Council Regulation 1/2003.

3.2.3. Public Undertakings

3.2.3.1. Public Authority-Public Undertaking Distinction

According to the Union law the State may act in the capacity of public authority or in the capacity of an economic actor. As is discussed in the previous chapter, certain activities of the State are considered to be non-economic because there is no market for the goods or services supplied. This is particularly the case where the State has exclusive competence in the regulatory sphere, such as the issue of licences or the prerogative to issue passports or identity cards for its citizens. Those functions of the State are usually within the responsibility of the public authorities.

On the other hand, the State usually gets involved in economic activities by means of public undertakings. In *AAMS,* the Court of Justice held that "*the State may act either by exercising public powers or by carrying on economic activities of an industrial or commercial nature by offering goods and services on the market*."[345] The distinguishing criteria between these two essential roles of the State- as a public authority or a public undertaking- should be sought in the commercial or industrial nature of the activity pursued. As a result, it is necessary, in each case, to consider the activities exercised by the State and to determine the category to which those activities belong.

In the past, most sectors of the economy were dominated by national, regional or local monopolies where the State was involved in economic activities through public undertakings. Such public sectors have been opened to competition partly or fully in the Member States mainly due to the Commission's and the Court's enforcement of the competition provisions of the Treaty. Moreover, technological development has gradually made it feasible for private enterprises to offer goods and services which so far had only

[345] Case C-118/85 Re *the Amministrazione Autonoma dei Monopoli di Stato (AAMS): Commission v Italy* [1987] ECR 2621, para.7.

been offered by State monopolies or public undertakings. As a consequence, it becomes very important for the Member States to ensure that the competition rules contained in the Treaty are 'fairly and effectively applied' in these sectors.[346] Therefore, publicly owned commercial undertaking must be separated from the public administration which exercises the public authority.[347]

Unlike Articles 101 and 102 TFEU, which make a general reference to the notion of 'undertaking', Article 106 refers to certain categories of undertakings, the first of which is public undertakings. The term of 'public undertaking' is not defined in the Treaty. Nevertheless, it is a Union concept,[348] which means that Article 106(1) would be deprived of its effect if Member States were free to choose their own conception of 'public undertaking'.

In one of its judgements the Court held that "*public undertakings are undertakings for whose actions States must take special responsibility by reason of their influence they may exert over such actions.*"[349] Similarly a public undertaking can be defined as an undertaking which is owned by the State or with which the State has strong contractual, financial or structural links.

A corresponding official definition in the EU legislation can be found in the Commission Directive on the transparency of financial relations between Member States and public undertakings- so called Transparency Directive. For the purpose of the Transparency Directive, the meaning of public undertakings is as follows: "*Public undertaking means any undertaking over which the public authorities may exercise directly*

[346] Commission Directive 2006/111/EC of 16 of November 2006 amending on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (Transparency Directive), O.J. L 318, 17/11/2006, pp.17-25.
[347] Morten P. Broberg and Niels Fenger, "National Organisation of Regulatory Powers and Community Competition Law", **E.C.L.R.,** Vol. 16, No. 6, 1995, p.367-375.
[348] See the opinion of AG Reischl in Cases 188-190/88 *France, Italy and the UK v Commission (Transparency Directive)* [1982] E.C.R. 2545, para.9
[349] Case C-188/190-88 *France, Italy and the UK v Commission* [1982], ECR 2545, para.12.

or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it."[350]

In other words, public authorities may exercise a dominant influence on the behaviour of public undertakings, as a result either of the rules governing the undertaking or of the manner in which the shareholdings are distributed.[351] The same directive defines 'public authorities' as "*all public authorities, including the State and regional, local and all other territorial authorities*." Thus, all state-owned or state-controlled undertakings and other undertakings which are closely related to the other public authorities are regarded to be public undertakings. The definition given here for the public undertakings is functional as it is based on the activity carried on by the entity concerned. However, the institutional structure of the entity is also important to reveal the dominant influence of the State. Therefore, a public undertaking is an entity which carries out an economic activity and which is controlled by a Member State. For instance, before liberalisation, all postal offices in the Community were public undertakings within the meaning of Article 106(1) TFEU as each Member State had direct or indirect control over their post offices.[352]

As long as they are involved in economic activities, the nature of the services provided by the undertakings is not relevant in their categorisation. The services which they provide could be public services or not. In other words, provision of a public service does not render the service provider 'public undertaking' if it is institutionally private and independent from the State influence.

As the only criterion for distinguishing public undertakings from the public authorities is the economic nature of the activity carried out, the legal status or the governing law of the entity is also irrelevant. On the other hand, in case *Commission v Germany*, the Court held that only a part of the postal activities carried on by a body governed by public law may be regarded as the activities of a public authority in the strict

[350] Ibid. Article 2(1).
[351] See the preamble of the Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communication networks and services, O.J. L 249, 17/09/2002, p. 21.
[352] Case C-320/91 *Procureur de Rot v Corbeau* [1993] ECR I-2533, para.15.

sense of the term.[353] Such a distinction may resemble the exception provided for in Article 45(4) (ex Article 39(4) TEC) of the Treaty concerning free movement of workers, where "*posts which involve direct or indirect participation in the exercise of powers conferred by public law and duties designed to safeguard the general interests of the State or of other public authorities*"[354] are concerned.

The Court clarified its position in its later judgements. In *Sacchi*, it expressly rejected the argument put forward by the Italian and German Governments to the effect that television undertakings are not 'undertakings' within the meaning of the provisions of the Treaty and decided that, even if a Member State, for considerations of public interest, of a non-economic nature, has conferred an exclusive right to conduct radio and television transmissions on one or more establishments, for the performance of their tasks, these establishments "to the extent that this performance comprises *activities of an economic nature*, fall under the provisions referred to in Article [106] relating to public undertakings and undertakings to which Member States grant special or exclusive rights."[355]

In *IGAV v ENCC*, the Court ruled that "*the activities of an institution of a public nature, even if autonomous, fall under the provisions referred to [concerning interference by the Member States with the normal functioning of competition, such as Article 106] and not under Articles [101] and [102], even if its interventions take place in the public interest and are devoid of a commercial character.*"[356] From this ruling AG Mischo, drew the conclusion that the commercial activities of a public body, whether autonomous or not, fall under Articles 101 and 102, specifically referred to in Article 106 TFEU.[357]

Similarly, in *Italy v Commission*, the Court expressly rejected the Italian Government's argument to the effect that "the rule-making activities of a body governed by

[353] Case 107/84 *EC Commission v Germany* [1985] ECR 2655, [1986] 2 CMLR 177, paras. 14-15.
[354] See, in particular, Case 307/84 *Commission v France* [1987] 3 CMLR 555; Case 66/85 *Lawrie-Blum v Land Baden-Württemberg* [1987] 3 CMLR 389.
[355] Case 155/73 *The State v Sacchi* [1974] ECR 409, [1974] 2 CMLR 111, at para.14.
[356] Case 94/74 *Industria Gomma Articola Vari (Igav) v Ente Nazionale per la Cellulosa E per la Carta* [1975] ECR 699, [1976] 2 C.M.L.R. 37, at para.35.
[357] See Opinion of AG Mischo in Case C-118/85 Re *the Amministrazione Autonoma dei Monopoli di Stato (AAMS): Commission v Italy* [1987] ECR 2621.

public law may not be regarded as the activities of an undertaking for the purposes of Article [102]." The Court concluded that "*notwithstanding its status as a national undertaking, BT's activities in operating public telecommunications installations and making them available to users in return for payment charges do indeed constitute activities of an undertaking subject as such to the obligations of Article [102] of the Treaty*."[358]

Consequently, a public authority, including the State itself, may in certain cases also be regarded as a 'public undertaking' when it is involved in an economic activity. According to the functional approach, each activity has therefore to be analysed separately.[359] Even in the absence of a distinct legal personality, the exercise of the economic activity by the public authorities suggests the existence of a public undertaking to which the activity is attributed. However, in this case things become more complicated, which will be discussed in the following sections.[360]

3.2.3.2. The Dominant Influence of Public Authorities

The public undertakings are in a different position than that of private undertakings in the sense that through its public undertakings the State may pursue objectives other than commercial ones.[361] The decisive criterion in deciding whether we are dealing with a public undertaking, rather than an ordinary undertaking, is the 'control' or, in other words, 'dominant influence' exercised over the undertaking by a Member State. In *Commission v Spain,* Advocate General states in his opinion that, "…*it may be inferred from a purposive interpretation that the distinction between public and private undertakings, for the purposes of the Treaty cannot be based merely on the identity of its various shareholders, but depends on the opportunity available to the State to impose*

[358] Case 41/83 *Re British Telecommunications: Italy v E.C. Commission* [1985] 2 CMLR 368, at para. 18.
[359] Case C-118/85 *Commission v Italy* [1987]. Compare also Cases *C-205/03 P. Fenin* [2006] and T-155/04 *Selex* [2006] for a situation where different activities could not be analysed seperately.
[360] See p. 110 for the separate legal personality question and p.146 et. seq. for the conflict of interests issue.
[361] Case C-482/99 *French Republic v Commission (Stardust Marine)* [2002] ECR I-4397, para.39.

specific economic policies other than the pursuit of the greatest financial gain which characterises private business."[362]

The Transparency Directive also explains the dominant influence exerted by the public authorities which makes undertakings 'public' in a specific context. Accordingly, "*a dominant influence on the part of the public authorities shall be presumed when these authorities, directly or indirectly in relation to an undertaking:*

(a) hold the major part of the undertaking's subscribed capital; or

(b) control the majority of the votes attaching to shares issued by the undertakings; or

(c) *can appoint more than half of the members of the undertaking's administrative, managerial or supervisory body*."[363]

The main purpose of this definition is merely to delimit the scope of the Transparency Directive in its application to the relevant undertakings. The Court upheld this definition in a case in which it was challenged by a number of Member States.[364] Subsequent practice of the Commission and the case law of the Court of Justice[365] have implied that this definition is accepted to be the general interpretation of the Treaty applicable where necessary. The Commission applies this test when determining whether a body is a public undertaking within the meaning of Article 106 TFEU.[366] Thus, it can be assumed that at least those undertakings that fulfil the requirements of the Transparency Directive are public undertakings in the sense of Article 106 of the Treaty.[367]

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[362] Opinion of Advocate General in Case C-463/00 *Commission v Spain* [2003] ECR I-4581, para.56.
[363] Transparency Directive, Article 2(2).
[364] Cases 188-190/ *France, Italy and the UK v Commission* [1982] ECR 2545, para.24.
[365] See Case 118/85 *Commision v Italy* [1987] ECR I-2599.
[366] The Community Framework for State Aid in the form of public service compensation of 13 July 2005, DGCOMP/D (2005) 179. See also Commission decision *GSM Spain* [1997] OJ L76/19.
[367] Andreas Bartosch, "Legislative Comment-E.C. Telecommunications Law: The New Draft Directive on the Legal Separation of Networks", **E.C.L.R.,** Vol.19, No.8, 1998, pp. 514-519.

For example, the Court used the above-mentioned criteria in *Stardust Marine* case to determine whether the financial support granted to a company were actually emanated from State resources. The Court stated as follows: *"[T]he documents before the Court show that, on 31 December 1994, the State held about 80% of the shares in Crédit Lyonnais and nearly 100% of its voting rights. Crédit Lyonnais held about 100% of the shares in Altus and the latter owned 97% of those of SBT, the remaining 3% being held by Crédit Lyonnais. In addition, the chairman of Crédit Lyonnais and two thirds of its administrative board were appointed by the State. The chairman of Credit Lyonnais also chaired the administrative board of Altus, the members of which were appointed by the administrative board of Crédit Lyonnais. In those circumstances, it has to be concluded that Crédit Lyonnais, Altus and STB were under the control of the State and had to be regarded as public undertakings.*"[368]

The concept of decisive influence appears closely linked to the concept of 'dominant influence' used in the Transparency Directive to decide whether an undertaking is public. The approach used in the Regulation concerning control of concentrations (Merger Regulation) will therefore be a useful tool in determining whether there is public control under Article 106 of the Treaty. Article 2 of this regulation is as follows;

"*Control shall be constituted by rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking in particular by:*

(a) ownership or the right to use all or part of the assets of an undertaking;

(b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking."[369]

[368] Case C-482/99 *Stardust Marine* [2002] ECR I-4397, paras.32-33.
[369] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), Article 2.

Acquisition of control is deemed to exist by the Merger Regulation when persons or undertakings;

(a) are holders of the rights or entitled to rights under the contracts concerned; or

(b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the rights derived therefrom.[370]

It is also important to point out that apart from the certain exceptions set out in Article 3(5), the Merger Regulation clearly defines control as having the 'possibility of exercising decisive influence' rather than the actual exercise of such influence. There is no reason why the possibility for public authority to exercise dominant influence or control over an entity is not sufficient to render this entity a public undertaking. As a result, the existence of a public undertaking will be determined even if public authority does not appear to actually exercise its influence.

While there are widespread debates over the economic nature, or otherwise, of certain activities pursued in the public sector, public or private nature of an undertaking is more identifiable. For example, the public law status of an undertaking may be a strong indication that it is controlled by the public powers and under the State influence. In this case, State control derives not only from the fact of public ownership but also from the rules which govern them. On the other hand, an undertaking with a private law structure may also be a public undertaking if it is controlled by a public authority.

Nevertheless, privatisation processes has substantially changed the structure of public sectors in the Member States and complicated the existence of public control. This is especially the case for "the golden shares" retained by the States after privatisation in the key sectors of economy regarded to be of strategic importance.

[370] Ibid. Article 3.

3.2.3.3. Separate Legal Personality Question

The legal forms in which the public authorities carry out economic activities vary from one Member State to another and within each Member State and also vary in time, in accordance with the prevailing national legislation and policies. The choice of one form or another does not necessarily reflect objective criteria but is often a function of political or historical considerations or even of simple expediency or convenience of management. In view of the diverse forms of public undertakings in the various Member States and the ramifications of their activities, it is necessary to develop a common concept of 'public undertaking' by paying special attention to its proximity to the Union concept of 'undertaking'.

In EU competition law, it is not necessary for an entity to have a separate legal personality to be an undertaking, which has already been discussed earlier. In many cases the State acts not only as an economic actor or entrepreneur but also as a regulator directly managing the economic activity. When the entity carrying out the economic activity is fully integrated into the State administration, economic and regulatory functions merge under the same legal personality. This situation makes the State influence not just dominant but also direct and exclusive over the entity responsible for the economic activity. In other words, State influence could be exercised even more effectively when the State as a public authority and the State as an undertaking are one and the same legal personality. AG Mischo suggests that this may be the explanation for the reason that certain public bodies are not granted a separate legal personality.[371]

In one of its decisions concerning the Spanish international express courier services, the Commission clearly stated that the Post Office was a body which did not have an independent legal personality but formed part of the general administration of the Spanish State, through the Postal Administration. Nevertheless, inasmuch as the Post

[371] Case C-118/85 Re *the Amministrazione Autonoma dei Monopoli di Stato (AAMS): Commission v Italy* [1987] ECR 2621, para.7.

Office was providing services on the market it is an undertaking within the meaning of Article 86(1) (now Article 102(1) TFEU) of the EEC Treaty.[372]

According to the Court's ruling in *AAMS* the fact that the body is integrated into the State administration does not prevent its being regarded as a public undertaking. In this respect, it is irrelevant whether that entity has or has not, under national law, legal personality separate from that of the State since such references to domestic law may undermine the unity and effectiveness of the Union law.[373] Consequently, it may be concluded that the substantive nature of the activity carried out by the public authority, not the legal form that it takes is relevant when deciding its status under the Union law.

3.2.4. Undertakings Granted Special or Exclusive Rights

3.2.4.1. Exclusive Rights

Exercising public authority is a necessary tool for the Member States to shape and pursue their economic or social policies. It has already been explained that the State may conduct regulatory activities in which it organizes the market in the public interest. In certain circumstances, especially where market forces alone do not result in a satisfactory provision of services, public authorities may entrust operators of certain services with obligations of general interest and where necessary grant them special or exclusive rights. The State can also devise a funding mechanism for the provision of such services.[374]

When the State acts by regulating an economic activity through granting exclusive rights to undertakings this is a State measure subject to Article 106, and in some cases to Article 37 TFEU. If the State carries out the economic activity itself, such activity will be subject to Articles 101 and 102 of the Treaty directly. However, granting exclusive rights to a single undertaking with commercial interests, even when the ultimate goal is the public interest, may distort actual and/or potential competition on the market. Enabling the public

[372] Commission Decision of 1 August 1990, OJ L.233, p.19-23, paras. 5-6.
[373] Case C-118/85 *AAMS* [1987] ECR 2621, paras.8-11.
[374] Communication from the Commission on Services of General Interest in Europe, 2001/C 17/04.

or private undertakings to monopolise the market, exclusive rights constitute the obvious example of competitive advantage which usually could not have been achieved otherwise.

There is no provision in the Treaty which suggests that monopolies are in principle illegal.[375] On the contrary, Article 345 TFEU states that the Treaty shall "*in no way prejudice the rules in Member States governing the system of property ownership*." That also follows from Article 37 of the Treaty which only requires monopolies of a commercial character to be adjusted in order to ensure that there is no discrimination between nationals of Member States. The same could be inferred from Article 106 TFEU under which it is possible to grant exclusive rights as long as they are not incompatible with the other Treaty provisions.

Exclusive rights should be granted by public authorities in circumstances where only one single provider is economically viable. Otherwise, the existence of exclusive rights has the effect of restricting the free movement of goods, the free provision of services and establishment. For instance, new products cannot be marketed; or the monopoly has no incentive to provide different/additional services, to introduce new technologies or to align its prices on costs, etc. as there is no threat of competition from new entrants. Moreover, undertakings with exclusive rights usually have a dominant position in the market since they have a large market share or they own or control essential network infrastructures. As a result, their natural tendency would be to prevent the entry of new competitors.[376] With regard to their effects on trade between Member States, granting special or exclusive rights to one or more undertakings derives from the discretion of the State and inevitably restricts the provision of the services subject to exclusive rights by undertakings to or from the other Member States.

[375] Despite that, the development of case law suggests otherwise, which will be dealt with later when analysing the case law, especially *Corbeau* Case on page 153, et seq.

[376] Damien Geradin, "The Opening of State Monopolies to Competition: Main Issues of the Liberalisation Process" in Damien Geradin (Ed), **The Liberalisation of State Monopolies in the European Union and Beyond**, -23 European Monographs, The Hague: Kluwer Law International, 2000, p. 182.

Where the exclusive rights are granted to public undertakings, Article 106(1) TFEU applies in any event.[377] It is clear that Article 106(1) is applicable when the public undertaking has a structure and legal personality distinct from that of the public authority which grants the exclusive right.[378] However, this provision also applies in cases where a public authority, in addition to its normal regulatory activities, directly carries out economic activities.[379]

It is important to define exclusive rights even where the undertaking is a private one. For the first time, exclusive rights are defined in the Commission Directive 90/388/EEC on competition in the markets for telecommunication services[380] amended by the Commission Directive 94/46/EC with regard to satellite communication.[381] Within the scope of this Directive: *"exclusive rights" means the rights that are granted by a Member State to one undertaking through any legislative, regulatory or administrative instrument, reserving it the right to provide a telecommunications service or undertake an activity within a given geographical area*."[382]

A more general and elaborate definition is given by Buendia Sierra for exclusive rights as follows: "*An exclusive right can be defined as a measure taken by a Member State in the exercise of its functions as a public authority, by which exclusivity is granted through any legal instrument in favour of a single undertaking, public or private, such exclusivity*

[377] See Opinion of AG Stix-Hackl in Case C-34/2001 to C-38/2001 *Enirisorse SpA v Ministerio delle Finanze* [2003] E.C.R I-14243, para.37.
[378] See, for example, the exclusive rights for television broadcasting granted by the Greek republic to Greek public undertaking ERT in Case C-260/89 *ERT* [1991] ECR I-2953, paras. 2-3.
[379] Case C-118/85 *AAMS* [1987] ECR at 2621-2622, paras. 8-11; Case 393/92 *Almelo* [1994] ECR I-1477; Case C-242/95 *GT-Link* [1997] ECR I- 4449, para.29.
[380]Commission Directive 90/388/EEC of 28 June 1990 on competition in the markets for telecommunication services. OJ L 192, 24.07.1990, p. 10-16.
[381] Commission Directive 94/46/EC of 13 October 1994 amending Directive 88/301/EEC and Directive 90/388/EEC in particular with regard to satellite communications. OJ L 268, 19.10.1994, p.15-21.
[382] Commission Directive 90/388/EC is repealed by Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communication networks and services; however the definition of exclusive rights is retained almost the same, the only change being the replacement of "telecommunications service" by "electronic communications service".

being for the exercise of a given economic activity in a given territory for a given period of time."[383]

Exclusive right is granted to reserve the exercise of a certain economic activity to a sole operator. It can be deduced from the definitions submitted above that the only exclusive rights which are subject to Article 106 TFEU are those whose object is the carrying out of an economic activity. Therefore, if a Member State reserves the exclusivity for the exercise of a non-economic activity, such measure of the State shall not come within Article 106 (or Article 37) TFEU. On the other hand, although regulation is a non-economic activity, granting of an exclusive regulatory right to an entity which is economically active in the same sector may constitute an infringement of Article 106(1) TFEU in conjunction with Article 102 TFEU.[384]

For the application of Article 106 TFEU, it is also important to note that exclusive rights should be granted by a *public authority*. Any other rights, such as exclusive distribution rights, licences or royalties granted by a private or public entity (either the State itself or a public undertaking) engaged in economic activities will be subject to Articles 101 or 102 TFEU rather than Article 106 TFEU. The main criteria to distinguish between those two situations is the nature and function of the measure or regulation in question and whether that function is properly to be categorised as an exercise of public authority or a purely economic activity. For example, in *Bodson*, exclusive concessions were granted by French local councils to certain private undertakings for the provision of funeral services. The Court of Justice held that Article 106(1) applied, and not Article 101, because the contracts were concluded by the local councils acting in their capacity as public authorities, not as undertakings.[385]

Reservation of an exclusive right to an undertaking implies that the undertaking which benefits from such right is the only one which can carry out the given activity. It also

[383] Buendia Sierra, p.6.
[384] Case C-18/88 *RTT* [1991] E.C.R. I-5979.
[385] Case 30/87 *Bodson v Pompes Funébres de Regions Libérées SA* [1998] E.C.R. 2749.

implies, logically, that the exercise of the activity in question by all other undertakings is prohibited, at least in the absence of authorisation by the monopolist.[386] Therefore, by exclusive rights, a whole economic branch is monopolised, which leads the competition to be totally abolished.[387] For example, exclusive right to broadcast in a particular territory,[388] to operate employment recruitment services,[389] to operate on a particular route,[390] to supply unloading services at a port[391] or to provide bovine insemination services[392] can be mentioned from the case law.

Member States usually combine the grant of an exclusive right to an undertaking with an absolute prohibition on all other undertakings carrying out the concerned activity.[393] Moreover, administrative or even criminal penalties may be enforced for the breach of monopoly rights.[394] In the absence of such prohibition, the undertaking granted an exclusive right may give licenses to third parties and the exclusive right does not cease to exist because of this practice. The legal form of exclusive rights may vary from one Member State to another as such rights may appear as concessions, franchises, licenses, authorisations etc. Consequently, in each case, it is necessary to analyse the legal provisions or the instruments to determine whether the exclusive rights are genuinely conferred or what the exact scope of the right is. In *Brentjens*, the Court held that the public authorities' decision to make affiliation to sectoral pension fund compulsory involved granting that fund an exclusive right to collect and administer pension contributions.[395]

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[386] Case C-260/89 *Elliniki Radiophonia Tileorassi AE (Ert) v Dimotiki Etairia Pliroforissis (Dep) and Sotirios Kaouvelas (ERT)* [1994] 4 CMLR 540, paras 2-3.
[387] Bartosch, "Legislative Comment-E.C. Telecommunications Law: The New Draft Directive on the Legal Separation of Networks", pp.514-519.
[388] Case 155/73 *Sacchi* [1974] ECR 409, [1974] 2 CMLR 177.
[389] Case C-41/90 *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979, [1993] 4 CMLR 306.
[390] Case 66/86 *Ahmed Saeed* [1989] ECR 803, [1990] 4 CMLR 102.
[391] Case C-179/90 *Merci Convenzionali v Porto di Genova (Merci Convenzionali)* [1991] ECR I-5889, [1994] 4 CMLR 422.
[392] Case C-323/93 *Société Civile Agricole du Centre d'Insemination de la Crespelle (La Crespelle)* [1994] ECR I-5077.
[393] Case C-41/90 *Höfner* [1991] ECR. I-1979, [1993] 4 CMLR 306.
[394] Case C-320/91 *Corbeau* [1993] ECR I-2533; Case C-55/96 *Job Centre* [1997] ECR I-7140.
[395] Joined Cases C-115/97 to C-117/97 *Brentjens* [1999] ECR I-6025.

Similarly, in *Greek Oil Monopoly* judgement the ECJ held such quotas like production quotas or import controls to be exclusive rights.[396]

The concept of exclusive rights implies a sole beneficiary in a certain geographical area, which is usually the whole national territory. Nevertheless, exclusive rights also exist in cases where various undertakings receive the sole right to carry out certain activities but with each one assigned its own exclusive territory. Therefore, the area can be the whole national territory, or part of it. For instance, in *La Crespelle*, the national legislation not only provided for the authorisation of insemination centres in particular areas, but it also provided that each centre should have the exclusive right to serve a defined area. This created a series of exclusive rights and what the Court referred to as a series of contiguous territorially limited monopolies in the national territory.[397] On the other hand, rather strangely, the Court described the three undertakings who were entitled to collect waste for recycling in Copenhagen, as holding 'exclusive rights.'[398] It is mentioned in the decision that the prices were freely decided by the undertakings concerned.[399] This can be considered as a sign that these undertaking are in competition with each other in the same geographical area, Copenhagen region, which makes the rights they were granted 'special' rather than 'exclusive' rights.

3.2.3.2. Special Rights

Until the *Terminal Equipment* case the European institutions, in particular the Commission, used 'exclusive' and 'special' rights interchangeably, not paying much attention to the distinction between these two different concepts. For instance, in the preamble of Council Regulation (EEC) No 1422/78 concerning the granting of certain

[396] Case C-347/88 *Commission of the European Communities v Hellenic Republic (Greek Oil Monopoly)* [1990] ECR-I 4789, para.41.
[397] Case C-323/93 *Société Agricole du Centre d'Insemination de la Crespelle v Cooperative d'Elevage et d'Insemination Artificielle de Département de la Mayenne* [1994] ECR I-5077. See also Case C-179/90 *Merci Convenzionali Porto di Genova SpA v Siderurgica Gabrielli* SpA [1991] ECR I-5889.
[398] Case C-209/98 *Enterpenorforeningens Affals Milijosektion (FFAD) acting for Sydhavnens Sten & Grus ApS v Kobenhavns Kommune* [2000] ECR I-3743, [2001] 2 CMLR 936, para. 54.
[399] ibid, para.71.

special rights to milk producer organizations in the United Kingdom[400] it is submitted that "*a Member State may… be authorized to grant a producer organization the exclusive right to purchase milk produced in the region concerned and the right to equalize the prices paid to producers*." The subsequent case related to the same legislation reveals the similar confusion about these terms for the Advocate General preferred using "exclusive rights" throughout his opinion[401] whereas the Court tried to avoid using both terms specifically in its judgement.[402]

Initially the Commission preferred to remain equivocal, which was clear from the joint definition given for the special and exclusive rights in the Commission Directive 90/388 on competition in the markets for telecommunication services: "*the rights granted by a Member State or a public authority to one or more public or private bodies through any legal, regulatory or administrative instrument reserving them the right to provide a service or undertake an activity…*"[403]

The same approach had already been employed in the directive concerning telephone equipment, which was also based on Article 86(3) TEC (now Article 106(3) TFEU). In *Terminal Equipment* and *Telecommunications Services* Cases,[404] the Court upheld the Commission Directives 88/301/EEC and 90/388/EEC. However, in so far as it relates to special rights, the Directives were declared void by the Court on the grounds that neither the provisions of the Directives nor the preambles thereto specify the type of rights which are actually involved and in what respect the existence of such rights are contrary to the various provisions of the Treaty. The Commission issuing the Directive 94/46 EC amended the former Directives and included the following definition for special rights:

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[400] Council Regulation (EEC) No 1422/78 of 20 June 1978 concerning the granting of certain special rights to milk producer organizations in the United Kingdom [1978] OJ L171/14-18.
[401] Opinion of AG Gulmann in Case C-40/92 *Commission v United Kingdom of Great Britain and Northern Ireland* ECR I-989.
[402] Case C-40/92 *Commission v United Kingdom of Great Britain and Northern Ireland* [1994] ECR I-989.
[403] Commission Directive 90/388/EEC on competition in the markets for telecommunications services [1990] OJ L192/10-16, Article 1(1) and recital 2.
[404] Joined Cases C-271, 281, and 289/90 *Kingdom of Spain, Kingdom of Belgium and Italian Republic v Commission of the European Communities (Telecommunication Services)* [1992] ECR I-5866-5867, paras. 28-32; C-202/88 *French Republic v Commission of the European Communities (Telecommunications Terminal Equipment)* [1991] ECR I-1270, paras. 45-47.

"*special rights means the rights that are granted by a Member State to a limited number of undertakings through any legislative, regulatory or administrative instrument which, within a given geographical area,*

- limits to two or more the number of such undertakings authorised to provide a service or undertake an activity, otherwise than according to objective, proportional and non-discriminatory criteria, or

- designates, otherwise than according to such criteria, several competing undertakings as being authorised to provide a service or undertake an activity, or

- confers on any undertaking or undertakings, otherwise than according to such criteria, legal or regulatory advantages which substantially affect the ability of any other undertaking to provide the same telecommunications service or to undertake the same activity in the same geographical area under substantially equivalent conditions.

This definition is without prejudice to the application of Article 92 [now Article 107]."[405]

The above definition is limited to scope of the directives concerning telecommunications. Nevertheless, there is no reason to assume that it is not applicable in other fields. The remarkable aspect of the definition is that it identifies as 'special rights' those which are granted by the State to a limited number of undertakings determined in a subjective and discretionary manner.[406]

The Court subsequently gave a similar definition in a case concerning the interpretation of special or exclusive rights in certain telecommunications directives. It held that *"....the exclusive or special rights in question must generally be taken to be rights which are granted by the authorities of a Member State to an undertaking or a limited*

[405] Commission Directive 94/46/EC amending Directive 88/301/EEC and Directive 90/388/EEC in particular with regard to satellite communications [1994] OJ L268/15-21.
[406] See the Commission's statement at the hearing in the *Telecommunication Services* case, Cases C-271, 281, and 289/90 *Spain, Belgium and Italy v Commission* [1992] ECR I-5833, quated by AG Jacobs at para.50 of his Opinion.

number of undertakings otherwise than according to objective, proportional and non-discriminatory criteria and which substantially affect the ability of other undertakings to provide or operate telecommunications networks or to provide telecommunications services in the same geographical area under substantially equivalent conditions."[407]

The definition given in the directives envisages three types of special rights, the first of which relates to "limitation" of the right to the certain number of undertakings and the second one refers to "designation" of several competing undertakings. The first and the second types are both related to limitation of the number of undertakings, therefore, can be merged into one type. Indeed, the Commission Directive on Electronic Communications,[408] which repealed the above-mentioned Directive 90/388 and amended the Directive 94/46, inserted second type into the first one as follows, where the rest of the definition remains the same:

(a) designates or limits to two or more the number of such undertakings authorised to provide an electronic telecommunications service or undertake an electronic communications activity, otherwise than according to objective, proportional and non-discriminatory criteria.

The third (or actually the second) type addresses the 'legal or regulatory advantages' conferred on any undertaking or undertakings, which substantially affect the ability of other undertakings to provide the same services in the same geographical area. In all three types of the special rights, the common feature is that they should not be granted to the undertakings "according to objective, proportional and non-discriminatory criteria" by the State.

As is the case for the exclusive rights, special rights should also be granted through any legislative, regulatory or administrative instrument, which can be called as a "State measure" to cover all such instruments, by the State or any other public authority

[407] Case C-302/94 *British Telecommunications v Commission* [1996] E.C.R. I-6417, para.34.
[408] Commission Directive 90/388/EC is repealed by Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communication networks and services, O.J. L 249, 17/09/2002, p. 23.

within a given geographical area. The main difference between exclusive and special rights is that with exclusive rights the exclusivity is granted to an undertaking, whereas with special rights the exclusivity is shared by a limited number of undertakings. Here also, exclusivity entails the prevention of others from carrying out that same activity in the same area. This is clearly revealed in *Ambulanz Glockner*, where the Court suggested that there should be a protection given to one undertaking which may substantially affect the ability of other undertakings to exercise the economic activity in question in the same geographical area under substantially equivalent conditions.[409] As a result, undertakings with special rights may resemble the oligopoly-type of economic structure while the undertaking with exclusive right would constitute a monopoly.

Reservation of special rights to a limited number of undertakings means that the number of undertakings is closed. This aspect of special rights distinguishes them from the other types of admission rights for certain activities to which the access is subject to fulfilment of certain conditions and not free but the number of operators is open. For instance, legal practice is reserved for lawyers but anybody who fulfils the certain requirements under the regulation of his/her respective country can become a lawyer. Therefore, right to a legal practice is not a special right, which is relevant for most regulated practices. In *Banchero*, legislation reserved the retail sale of tobacco to authorised traders and merely laid down the conditions which needed to be met in order to obtain access to the market. In this case Court decided that no exclusive (or special) rights were granted because the rules did not confer on any outlet a particular advantage over its competitors.[410] Similarly in *INNO,* the Court examined whether a legislative provision which allowed manufacturers and importers of certain products to fix compulsory selling prices to customers created either special or exclusive rights. Finally, the Court held that those producers and manufacturers who could qualify for such rights were an indefinite class and did not enjoy special or exclusive rights.[411]

[409] Case C-475/99 *Ambulanz Glockner v Landkreis Sudwestpfalz (Ambulanz Glockner)* [2001] ECR 8089.
[410] Case 387/93 *Banchero* [1995] ECR I-4663.
[411] Case 13/77 *INNO* [1977] E.C.R 2115, para.41.

For the special rights to exist 'state discretion' must be present. According to the Commissions definition special rights 'do not exist' where the number of operators and their identities are determined by the State on the basis of objective, proportional and non-discriminatory criteria. Such criteria are not mentioned in the definition of exclusive rights. This may seem strange and must be analysed in detail.

First of all, according to the definition, State may 'arbitrarily' determine the number of undertakings to be granted special rights. In certain cases such a limitation is a result of the nature of the activity or the physical and/or geographical limitation. Buendia Sierra gives the radio frequencies as an example to this situation. Accordingly, as the radio frequencies are physically limited, limiting the number of operators in such a case probably complies with the "objective, proportional and non-discriminatory" criteria.[412] Therefore, allocation of radio frequencies may not be special rights provided that the requirements of the second step are also fulfilled.

In the second step, the State may arbitrarily choose or designate the undertakings to be granted special rights. If the undertakings are chosen according to 'objective, proportional and non-discriminatory' criteria, then there is no place for the State discretion to play any role and it is not possible to speak about special rights. This aspect of special rights was obvious in two cases concerning the conditions imposed on the respective second operator of GSM radio telephony services in Italy and in Spain. The Commission regarded the grant of a first licence to operate the GSM mobile telephony network as a special right as the operator had not been selected on the basis of objective and non-discriminatory criteria. Moreover, neither Telecom Italia nor Telefonica de Espena was forced to participate in a tender for being granted their mobile telephony licences.[413]

Special rights also occur where State exercises its discretion to grant on an undertaking or undertakings legal or regulatory advantages. Such a State practice confers a

[412] Buendia Sierra, p.67.
[413] Commission Decision of October 4, 1995, O.J. L280/49, para.6 (Italy); Commission Decision of December 18, [1997] O.J. L76/19, para.10 (Spain).

serious competitive advantage to the designated undertaking(s) which makes it very difficult for the other undertakings to engage in any of the relevant activities in the same geographical area and under similar conditions. Special legal or regulatory rights usually maintained by the former State monopolies which have been privatised. As is the case for the other types of special rights mentioned above, the State grants these special rights in an arbitrary way which means without basing its decision on 'objective, proportional and non-discriminatory' criteria.

This solution envisaged by the Commission for the determination of special rights seems problematic. Because according to this definition there is no special rights existing if the State discretion does not play any role either in the limitation of the number or in the selection of the undertakings. Then, how those rights granted to the undertakings according to 'objective, proportional and non-discriminatory' criteria should be called? Perhaps it would be more appropriate if the State discretion remained irrelevant in the categorisation of those rights. State discretion could be taken into account when determining whether such rights were granted in compliance with the Union law, in other words, whether they were legal or not. If this definition is taken as the sole basis of the special rights, as all special rights would entail state discretion, they all become automatically illegal with regard to Union law.[414]

In his opinion in *Ambulanz Glockner*, AG Jacobs expressed his view that while this definition may be used to define the concept of special or exclusive rights in Article 86(1) TEC (now Article 106(1) TFEU), that part requiring that the rights be 'granted otherwise than according to objective, proportional and non-discriminatory criteria' was specially designed to apply the liberalisation process in the telecommunications sector. Therefore, it was not, he said, relevant to the identification of special or exclusive rights for purposes of applying Article 86(1) or (2) TEC (now Article 106 (1) and (2) TFEU).[415]

[414] See for example, Commission's Green Paper where the Commission makes it clear in Annex D that it considers that special and exclusive rights over mobile communications, including the Grant of licences on a *discretionary* basis infringed Article 90 [now Article 106 TFEU] in conjunction with Articles 86 [now 102 TFEU] and 59 [now 56 TFEU].
[415] Opinion of AG Jacobs in Case C-475/99 *Ambulanz Glockner* [2001] ECR 8089, paras.88-89.

Following the path opened by the Advocate General, the Court of Justice held that a system, under which provision of patient transport services was effectively reserved to particular organisations by the operation of a system of refusing permits to potential competitors on the basis that to grant them could have adverse effects on the operation and profitability of the public ambulance system, amounted to the grant of special or exclusive right. The Court concluded that it was sufficient that protection was being conferred by a legislative measure on a limited number of undertakings which could substantially affect the ability of other undertakings to exercise the economic activity in question in the same geographical area under substantially equivalent conditions.[416]

3.3. Application of Competition Rules in Conjunction with Article 106(1)

3.3.1. Prohibited State Conduct under Article 106(1)

3.3.1.1. Enacting or Maintaining in Force

In the case of public undertakings and undertakings with special or exclusive rights, Article 106(1) prevents Member States from enacting or maintaining in force any measure that deprives the Treaty provisions of their effectiveness especially with regard to competition. Enactment of a measure means adopting or bringing into effect a new law, regulation or any kind of State measure and it is clearly about a new State action, which has not existed before.

On the other hand, the obligation on the Member States not to 'maintain in force' requires Member States to review their previously enacted measures, which may not have breached the Treaty rules when they were enacted but this is not the case any longer. Thus Article 106(1) provides for an obligation for the Member States to keep their monopolies under constant review. It is repeatedly stated by the Court in several judgements that in most cases not the law or regulation itself granting an exclusive right to an undertaking but

[416] Case C-475/99 *Ambulanz Glockner* [2001] ECR 8089, para.24.

the manner in which the monopoly organised or exercised may be contrary to the Treaty rules.[417]

In some cases where the measures are in breach of the competition rules, the judgements suggest that the very fact of granting monopoly rights may itself be a measure violating Article 106(1). In *Terminal Equipment* case France claimed, *inter alia*, that Article 106 TFEU (then Article 86 TEC) did not allow the Commission to interfere with the granting of special or exclusive rights by Member States because Article 106(1) presupposed the existence of special or exclusive rights so the granting of such rights could not itself constitute a 'measure' within the Article.[418] The Court held that even though Article 106(1) presupposed the existence of undertakings which had certain special rights, it did not follow that all the special or exclusive rights were compatible with the Treaty and that depended on different rules, to which Article 106(1) referred.[419] For the original Member States this obligation under Article 106(1) has existed since 1 January 1957. As regards new Member States, this provision is fully applicable from the moment of accession unless the Act of Accession in question provides for a transitional period.

3.3.1.2. State Measure

Article 106(1) imposes an obligation on Member States, which requires that a Member State shall neither enact nor maintain in force any *measure* contrary to the rules contained in the Treaty. The concept of 'measure' also appears in Article 4(3) TEU which obliges Member States to fulfil their Treaty obligations and not to jeopardize Treaty objectives. Article 34 (ex Article 28 TEC) prohibits, *inter alia*, measures having an equivalent effect to quantitative restrictions on imports between Member States.

[417] See Case C-155/73 *Sacchi* [1974] ECR 409; Case C-260/89 *ERT* [1974] 4 CMLR 540.
[418] Case C-202/88 *France v Commission* [1991] ECR I-1223.
[419] Ibid., para.22.

A measure can be defined as "*any kind of positive action, whether general or specific, binding or non-binding*."[420] In a Directive concerning the abolition of measures which have an effect equivalent to quantitative restrictions the Commission defined measures as "*laws, administrative provisions, administrative practices, and all instruments issued from a public authority, including recommendations*."[421] Article 4(3) TEU and 34 TFEU have also been interpreted very widely with regard to the concept of measure which they refer to. For example, in *Buy Irish* case the Irish Government took a number of steps to encourage the public to buy local goods, which were considered by the Court as contrary to Article 28 TEC (now Article 34 TFEU).[422] In this case, the Court held that 'measures' do not have to have a binding effect.[423]

Similarly, within the meaning of Article 106(1) TFEU, "*it includes not only laws and regulations, but all forms of administrative practices, recommendations and agreements or decisions of Member States, so long as they affect a public undertaking or an undertaking given special or exclusive rights.*"[424] For instance, in *Dusseldorp,* the relevant measure was a Long Term Plan whereby a Member State required undertakings to deliver their waste for recovery to a national undertaking on which it has conferred an exclusive right.[425]In *Ambulanz Glockner,* the relevant measure was a law which entitled an administrative district to refuse to authorise others who wished to provide ambulance services.[426] In *Port of Rodby,* the Commission found a refusal to grant access to ferry terminal services as a State measure.[427]

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[420] Claus-Dieter Ehlermann, "Managing monopolies: the role of the state in controlling market dominance in the European Community" **E.C.L.R.**, Vol.14, No. 2, 1993, 61-69.
[421] Directive 70/50 on the abolition of measures which have an effect equivalent to quantitative restrictions on imports and are not covered by other provisions [1970] OJ Spec. Ed. 17.
[422] Case 289/81 *Commission v Ireland* [1982] ECR I-1223, para.55.
[423] Ibid., para.28.
[424] David Vaughan, Sarah Lee, Brian Kennelly and Philip Riches, **EU Competition Law: General Principles**, Richmond: Richmond Law and Taxes- EU Competition Law Library, 2006, p.174.
[425] Case C-203/96 *Chemishe Afvalstoffen Dusseldorp BV and Others v Minister van Volkshuisvesting, Ruimtelijke Ordening en Milieubeheer (Dusseldorp)* [1998] 3 CMLR 873, para.61.
[426] Case C-475/99 *Ambulanz Glockner* [2001] ECR 8089.
[427] Commission Decision (*Port of Rodby),* [1994] OJ L55/52.

For a State measure to exist, such a measure should emanate from a positive State action, which can take the form of any legislative, regulatory or administrative instrument through which the State utilise its public authority or *imperium*. However, it is not necessary that the measure is an outcome of a direct exercise of its regulatory powers by the State. Measures of local or municipal authorities are also included within Article 106(1). In one of the cases before the Court of Justice the measure in question was a municipal regulation adopted in Copenhagen, establishing a system for waste recovery and limiting those who could process the waste to a specific number.[428]

As is the case with most Community concepts, not the legal form that the action takes but the function is important in order to distinguish State measures subject to Article 106(1) from the measures of an economic nature taken by a public undertaking and subject to Article 101 of the Treaty. Buendia Sierra explains it clearly that if the object and effect is regulating the market it is State measure of regulatory nature and the State acts as a public authority. On the other hand, if the measure is directly related to an economic activity, it will be assumed that the State acts as an economic actor.[429]

Usually, when the measure aims at organising the market in the light of public interest considerations it consists in a State measure that may breach Article 106(1) unless it is justified by Article 106(2). Such measures may grant an exclusive right to a private undertaking or to a public undertaking. In two *GSM* cases the Commission held that the rules which made the grant of mobile licences subject to fees which were not also payable by the sole existing licence holder were measures contrary to Article 106.[430] Similarly in *Connect Austria*, national legislation under which additional frequencies could be allocated to a public undertaking in a dominant position without the imposition of a separate fee,

[428] Case C-209/98 *Enterpenorforeningens Affals Milijosektion (FFAD) acting for Sydhavnens Sten & Grus ApS v Kobenhavns Kommune* [2000] ECR I-5197.
[429] Buendia Sierra, p.14.
[430] Commission Decisions (*GSM Italy)* [1995] OJ L280/49 and (*GSM Spain)* [1997] OJ L76/19.

whereas the new entrant to the market had to pay a fee for its licence to use those frequencies, was a State measure which could breach Article 106(1).[431]

In other cases, when the grant of exclusivity by a State entity does not aim to organise the market with public interest considerations in mind, it usually consists in a simple act of commercial practice which could equally well be carried out by a private undertaking. For example, in one of its decisions the Commission did not consider the agreement concluded between a shipping conference and the administrative body as a measure because each party could terminate the agreement subject to due notice and exceptions could be granted only with the agreement of both parties.[432] Such agreements are subject to Article 101 rather than Article 106 TFEU.

3.3.1.3. State Responsibility under Article 106(1)

Article 106 of the Treaty seeks to reconcile the pursuit of free movement rules and fair competition with the protection of public services performed by the State monopolies. As mentioned earlier, Article 106 has frequently been used in conjunction with other Articles of the Treaty, such as Article 18 (non-discrimination on grounds of nationality), Articles 34 to 36 (free movement of goods), Article 45 (free movement of workers), Articles 49 to 51 (freedom of establishment), Article 56 (freedom to provide services) and Article 101 (restrictive practices) or 102 (abuse of dominant position) TFEU in order to fulfil this function.

Public undertakings and undertakings granted special or exclusive rights engage in conducts which have an effect on the intra-Community trade in goods or services, they may be found in breach of Articles 34 or 56 without any need of referring to Article 106 and 102. However, Article 106 has particular relevance to the competition provisions and especially Article 102, because public undertakings and undertakings granted special or exclusive rights frequently hold a dominant position, which could be abused very easily.

[431] Case C-462/89 *Connect Austria Gesellschaft fur Telekommunikation GmbH v Telekom Control Kommission and Mobilkom Austria* [2003] ECR I-5197, para.87.
[432] Commission Decision *(Cewal)* 39/82/EEC O.J.1993, L.34/20, recitals 24-70.

Particularly for the liberalised markets to become competitive, it is essential to prevent such abuses through the application of competition rules.[433] As a consequence, the liberalisation of regulated sectors has been most dramatically achieved by means of the combined application of Articles 106 and 102 TFEU.

As is stated previously, while Article 101 and 102 are directed at undertakings, 106(1) TFEU requires Member States to abstain from adopting or maintaining in force measures susceptible to eliminate the effects of these provisions.[434] In other words, Article 106(1) is designed to prevent Member States from depriving the Treaty rules of their effectiveness through the measures they adopt in respect of public undertakings or through measures which enables private undertakings to escape the constraints of the competition provisions. However, when Article 106(1) is applied in combination with competition provisions their substantive content and logic is altered, which does not occur when Article 106(1) is applied with Treaty provisions directed at Member States. Buendia Sierra suggests that when Article 106(1) is combined with Article 101 and 102, the original scope is extended to cover not only the behaviour of undertakings but also State measures.[435] For example in *RTT*, the Court states as follows: "*Article 86 [now Article 102 TFEU] applies only to anti-competitive conduct engaged in by undertakings on their own initiative…not to measures adopted by States. As regards measures adopted by States, it is Article 90(1) [now Article 106(1) TFEU] that applies. Under that provision, Member States must not, by laws, regulations or administrative measures, put public undertakings, to which they grant special or exclusive rights in a position which the said undertakings could not themselves attain by their own conduct without infringing Article 86 [now Article 102 TFEU]*."[436]

Although the Court has a tendency to referring to both Articles 101 and 102 TFEU, suggesting a parallel between these two provisions, its case law reveals an obvious difference in application to State measures of Article 101, on the one hand, and Article 102

[433] Damien Geradin, opcit.
[434] Case 13/77 *INNO* [1977] E.C.R. 2115.
[435] Buendia Sierra, p. 149.
[436] Case C-18/88 *RTT* [1991] ECR I-5979 para.18.

on the other. In practice, the Court has rarely found that Article 101 applies to a State measure in the absence of infringement of this provision by undertakings in the sector concerned. However, it applies Article 102 where there is no effective abuse by undertakings of a dominant position, but where a State measure produces the same effects as such abuse. Secondly, the Court applies Article 101 in conjunction with Article 3(1)(b) TFEU and Article 4(3) TEU whereas; the Court prefers applying Article 102 together with Article 106 to challenge State monopolies.

The Text of Article 102 is as follows:

"*Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.*

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) *making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations, which by their nature or according to commercial usage, have no connection with subject of such contracts*."

A Member State may infringe Article 106(1) by requiring a legal monopolist to behave abusively, in the sense of Article 102, for example by imposing unfair or discriminatory prices, limiting production, applying dissimilar conditions to equivalent transactions with other trading parties. In addition, it is clear from the case law of the EU

Courts that Article 102 also prohibits dominant undertakings from engaging anti-competitive conduct which reinforces their position and excludes actual or potential competitors from the market.[437]

In order for Article 106(1) is applied in combination with Article 102 the conditions of both provisions should be fulfilled. On the other hand, the existence of an infringement by a Member State of Article 106(1) in combination with Article 102 does not necessarily exclude the possibility that the same facts could lead to a parallel infringement of Article 102 by undertakings. The responsibility of undertakings under Article 102 is only excluded where the behaviour in question has been imposed on them by the authorities but not if the State has limited itself to inducing or favouring such behaviour.

3.3.2. Conditions for Application

3.3.2.1. Dominant Position

Dominant position is a legal concept which is of central importance in the application of Article 106(1) in conjunction with Article 102. In *United Brands*, the Court gave the following definition of dominant position, which has been repeated in the subsequent cases: "*The dominant position referred in this Article relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.*" [438]

Undertakings benefiting from exclusive rights usually enjoy a dominant position in their respective Member States. Nevertheless, exclusive rights do not necessarily correspond to a dominant position. Whether dominant position exists within the meaning of Article 102 depends on the facts. In other words, the mere presence of exclusive or special

[437] See Case 6/72 *Europemballage Corp and Continental Can Co Inc. v Commission (Continental Can)* [1973] ECR 215, [1973] CMLR 199.
[438] Case 27/76 *United Brands Co and United Brands Continental BV v Commission (United Brands)* [1978] ECR 207, [1978] 1 CMLR 429, para.65.

rights does not imply the existence of a dominant position, although it is very likely in most cases. For a dominant position to exist the undertaking should have a considerable market power on the relevant market. In this respect, market power is defined by Hawk as "*the power to raise prices by restricting output without significant loss of sales-i.e., the power to fix prices or exclude competition*."[439]

Therefore, it is necessary to define the relevant market and to evaluate the market power of the undertaking concerned in the light of the exclusive or special rights and other factors indicating dominance. In *United Brands* the ECJ held that a dominant position derives from a combination of several factors which, taken separately, are not necessarily determinative.[440] The way in which dominance is derived from a combination of these factors in addition to market share is explained by the Court of Justice in some of the leading cases on Article 102.[441] This was also affirmed by the Court in *Bodson* where it held as follows: "*While the existence of such a dominant position is a question of factual assessment for the national court, it is appropriate for it to base its appraisal on the following criteri[on]: The size of the market share held by the group which is shielded from any competition at all as a result of the exclusive concession*…"[442] The undertaking's ability to influence market conditions, its turnover relative to the size of the market, its control of the means of access to end users, its access to financial resources, and its experience in providing products and services in the market can be the other factors to be taken into account.[443]

The purpose of defining the relevant market is to identify those products and services that are such close substitutes for one another that they operate as a competitive

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[439] Barry E. Hawk, **United States, Common Market and International Antitrust: A Comparative Guide**, 2nd ed., New York: Aspen Law & Business, 1990, p.788.
[440] Case 27/76 *United Brands* [1978] ECR 207, [1978] 1 CMLR 429.
[441] For example, Case 85/76 *Hoffmann-La Roche & Co AG v Commission (Hoffmann-La Roche)* [1979] ECR 461, [1979] 3 CMLR 211, paras.48-49; Case 322/81 *Nederlandsche Banden-Industrie Michelin v Commission (Michelin)* [1983] ECR 3461, [1985] 1 CMLR 282, paras.53-61; Case C-53/92 P *Hilti v Commission* [1994] ECR I-667, [1994] 4 CMLR 614.
[442] Case 30/87 *Bodson* [1989] CMLR 984, para.29.
[443] Klaus W. Grewlich, "Cyberspace: Sector Specific Regulation and Competition Rules in European Telecommunications", **C.M.L.Rev**.,Vol. 36, 1999, pp. 937-969.

constraint on the behaviour of the suppliers of those respective products and services.[444] Demand substitutability, supply substitutability and potential competition are the main elements to be analysed in defining the relevant market.

A relevant market may be affected by State regulation. Legislation may, for example, define a statutory market. Such regulation may mean no substitutes are permitted for a particular product or service, which gives the undertaking a considerable market power, in other words, a legal monopoly. Regulatory measures which grants to a particular undertaking a legal monopoly in the form of an exclusive right constitute the obvious barriers to entry. The Commission and the Court have frequently held such measures to be factors indicating dominance.[445]

The fact that the undertaking's market power or its dominant position has been created by the State regulation is no defence to an action based on Article 106(1) in combination with Article 102 unless the exception laid down in Article 106(2) applies. For example, in *Télémarketing,* the Court held that: "*An undertaking occupies a dominant position for the purposes of Article 86 [now Article 102 TFEU] where it enjoys a position of economic strength…The fact that the absence of competition or its restriction on the relevant market is brought about or encouraged by provisions laid down by law in no way precludes the application of Article 86 [now Article 102 TFEU]*."[446] This statement of the Court means that when the required provisions of Article 102 are fulfilled, the existence of the legal monopoly does not constitute an obstacle for its application.

The doctrine established in *Bodson* and *Télémarketing* is sometimes ignored by the Commission and by the Court itself. The tendency of automatically identifying special or exclusive rights with dominant position without detailed economic analysis is reflected in *Höfner*, where the Court states that: "*It must be remembered, first, that an undertaking*

[444] Jones and Sufrin, p.298.
[445] E.g., Cases C241-242/91 P *RTE & ITP v Comission (Magill*) [1995] ECR I-743, [1995] 4 CMLR 718; Case 226/84 *British Leyland v Commission* [1986] ECR 3263, [1987] 1 CMLR 185; *Sealink/B&Holyhead: Interim Measures* [1992] 5 CMLR 255.
[446] Case C-311/84 *Centre belge d'études de marché –Télémarketing (CBEM) v SA Compagnie luxembourgeoise de télédiffusion (CLT) and Information publicité Benelux (IPB) (Télémarketing)* [1985] ECR 3275, para.16.

vested with a legal monopoly may be regarded as occupying a dominant position within the meaning of Article 86 [now Article 102 TFEU] of the Treaty."[447] However, this approach can be interpreted as a rebuttable presumption, which could be proved to be otherwise with sufficient economic data.

3.3.2.2. Substantial Part of the Internal Market

For the joint application of Article 102, it is required that the dominant position should be held 'within the internal market[448] or in a substantial part of it'. The purpose of this requirement is to exclude from the Article's scope purely local monopolies in which there is no interest of the European Union because there will be no or mere negligible effect on the interstate trade.

A 'substantial part' does not simply mean substantial in geographic terms. In *Suiker Unie* the Court held that *"[f]or the purpose of determining whether a specific territory is large enough to amount to a 'substantial part of the common market" within the meaning of Article [102] of the Treaty the pattern and volume of the production and consumption of the said product as well as the habits and economic opportunities of vendors and purchasers must be considered*."[449]

This requirement does not create any particular problems in the application of Article 106(1) in combination with Article 102 TFEU. The Court usually considers that the territory of a Member State may amount to 'a substantial part' of the Common Market.[450] As a consequence, exclusive or special rights which cover the whole territory of a Member State will fulfil this requirement.

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[447] Case C-41/90 *Höfner* [1991] ECR I-2018, para.28.
[448] In the text of the former Article 82 it was referred to as "common market".
[449] Cases 40-8, 50, 54-6, 111, 113, and 114/73 *Coöperatieve Vereniging 'Suiker Unie' UA v Commission* [1975] ECR 1663, [1976] 1 CMLR 295, para.371.
[450] Case C-41/90 *Höfner* [1991] ECR I-2018, para.28; Case C-260/89 *ERT [*1991] ECR I-2961, para.31; Case C-18/88 *Régie des télégraphes et des telephones v GB-Inno-BM SA (RTT)* [1991] ECR I-5979, para.17; Case C-320/91 *Criminal proceedings against Paul Corbeau (Corbeau)* [1993] ECR I-2567, para.41.

Sometimes, what constitutes a 'substantial part' of the internal market depends on the nature of the market concerned. In such cases, exclusive or special rights covering a more limited area may still be caught. For example, there have been certain transport cases in which very small areas have been found to be substantial. In *Merci Convenzionali* and *Corsica Ferries* the Court reached the conclusion that, taking into account the volume of traffic and the importance of this for imports and exports in Italy, the Genoa dock market constituted on its own 'a substantial part of the common market.'[451] It is also the case with many airports in the Community, in the light of their sheer size and volume of international traffic.[452]

When there is considerable number of exclusive or special rights of limited territorial scope but which together cover the whole territory of a Member State, this can also be considered a dominant position over a substantial part of the internal market. It is the situation in *La Crespelle*, in which exclusive rights granted to a large number of operators in France for the artificial insemination of the cattle were in question. The Court held that "*a contiguous series of monopolies within a Member State that covered the whole of the territory of that State represented a substantial part of the common market*."[453] The Commission adopted the same criteria in its *Portuguese Airports* decision. Moreover in this case, unlike in *La Crespelle*, the monopolies were all under the control of the same entity.[454]

It is important to bear in mind that as the EU is enlarged the concept of 'substantial part' may alter, with the internal market getting broader. While the internal market gets larger it is becomes less probable to find a dominant position in a substantial part of it. What constituted a 'substantial part' of the internal market in the European Community with 6, 9 or 15 Member States may not be considered as a substantial part any longer in the

[451] Case C-179/90 *Merci Convenzionali Porto di Genova SpA v Siderurgica Gabrielli SpA (Merci Convenzionali)* [1991] ECR I-5889, [1994] 4 CMLR 422, para. 15; Case C-266/96 *Cosica Ferries France SA v Gruppo Antichi Ormeggiatori del Porto di Genoa Coop (Corsica Ferries)* [1998] ECR I-3949, [1998] 5 CMLR 402, para.38.
[452] For example, see Commission Decision about the pricing policy of Olympic Airways, [1985] OJ L46/51; [1985] 1 CMLR 730.
[453] Case C-323/93 *La Crespelle* [1994] ECR I-5104, para.17.
[454] Commission Decision *(Portuguese Airports)*, [1999] OJ L69/31, [1999] 5 CMLR 103.

European Union with 27 Member States. However, it is difficult to think of any situation when a whole territory of a Member State covered by an exclusive or special right is not found to be a substantial part of the internal market.

3.3.2.3. Effect on Trade between Member States

Article 106(1) in combination with Article 102 TFEU applies only if the abuse of a dominant position affects trade between Member States. This requirement is all about the jurisdictional division between the Union and national law. The Court has declared on numerous occasions that the purpose of this criterion is to "*define the boundary between the areas respectively covered by Community law and the law of the Member States*."[455] The institutions of the European Union have no competence over abusive conduct of undertakings if its effect is confined to one Member State only.[456]

The effect on trade should be appreciable and how such a conduct may appreciably affect trade between Member States is explained in the Guidelines issued by the Commission.[457] For the effect on trade to be appreciable it must be possible to foresee with a sufficient degree of probability on the basis of a set of objective factors of law and of fact that the conduct in question may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States.[458] Therefore, the effect does not have to actually exist and potential effect would be sufficient to be caught by the Article. In *Höfner* the Court held that *"[a] potential effect of that kind on trade between Member States arises in particular where executive recruitment by private companies may extend to the nationals or to the territory of other Member States*."[459] It is then sufficient that there is

[455] See eg. Joined Cases C 56 and 58/64 *Consten and Grundig v European Commission* [1966] E.C.R. 299 at 341.
[456] Case 22/78 *Hugin v Commission* [1979] ECR 1869, [1970] 3 CMLR 345.
[457] Guidelines on the effect of on trade concept contained in Articles 81 [now 101 TFEU] and 82 [now 102 TFEU] of the Treaty [2004] OJ C101/81, para.13.
[458] Case 56/65 *Société La Technique Miniére Ulm v Maschinenbau* [1966] ECR 235, [1996] CMLR 357
[459] Case C-41/90 *Höfner* [1991] ECR I-2018, para.28.

a possibility that foreign competitors might decide to enter the respective market, or that such a demand might come into existence.[460]

In the light of the case law of the Court of Justice,[461] the Commission Guidelines expresses that *"[t]he concept of "trade" is not limited to traditional exchange of goods and services across border. It is a wider concept, covering all cross-border economic activities, including the services of public undertakings. This interpretation is consistent with the fundamental objective of the Treaty to promote free movement of goods, services, persons and capital.*"[462]

A conduct will be found to affect trade if it interferes with the pattern of trade between Member States. This means that the condition is fulfilled if the conduct in question alters the normal flow or pattern of trade, or causes trade to develop differently from the way it would have developed in the absence of the conduct.[463] It was the case in *Merci Convenzionali*, where the port activities have an obvious effect on the import and export of goods.[464] Similarly, in *RTT* the State measure in question was capable of affecting the import of telephone equipment.[465]

An abusive conduct may also be found to affect trade if it is liable to interfere with the structure of competition in the internal market.[466] The structure of the market will be altered if the abusive behaviour of the dominant undertaking eliminates or threatens to eliminate competitors operating within the Union, by forcing them to leave the market.[467] According to the Guidelines, "*[c]onduct that forms part of an overall strategy pursued by*

[460] See eg. Case C-62/86 *Chemie B.V. v European Commission* [1991] ECR I-3359 at 3374, [1993] 5 CMLR 215.
[461] See for example, Case 172/80 *Züchner v Bayerische Vereinsbank* [1971] ECR 2021, [1982] 1 CMLR 313, para.18; Case C-309/99 *Wouters* [2002] ECR I-1577, [2002] 4 CMLR 913; Case C-41/90 *Höfner* [1991] ECR I-2018.
[462] Guidelines on the effect of on trade concept contained in Articles 81 [now 101] and 82 [now 102] of the Treaty [2004] OJ C101/81, para.19.
[463] Case C-71/74 *Frubo v European Commission* [1975] ECR 563, [1975] 2 CMLR 123; Case C-322/81 *Michelin* [1983] ECR 3461; [1985] 1 CMLR 282.
[464] Case C-179/90 *Merci Convenzionali* [1991] ECR I-5929, para.20.
[465] Case C-18/88 *RTT* [1991] ECR I-5982, para.27.
[466] For an argument that 'a distortion of competition structures' is not in itself sufficient to fulfill the 'effect on interstate' criterion please see Richard Burnley, " Interstate Trade Revisited- The Jurisdictional Criterion for Articles 81 and 82 EC", **E.C.L.R**., Vol. 23, No.5, 2002, pp. 217-226.
[467] Case 6 and 7/73 *Istituto Chemioterapico Italiano SpA and Commercial Solvents Corp. v Commission* [1974] ECR 223, [1974] 1 CMLR 309.

the dominant undertaking must be assessed in terms of its overall impact. Where a dominant undertaking adopts various practices in pursuit of the same aim, for instance practices aim at eliminating or foreclosing competitors…it is sufficient that at least one of these practices is capable of affecting trade between Member States."[468]

It is also important to point out that unlike the rules relating to the free movement of goods, services or persons, the competition rules can be invoked by nationals of a Member State against undertakings and public authorities of the same Member State. For example, in *Corbeau*,[469] the proceedings were started by a Belgian national who questioned the compatibility of the postal monopoly of his country with Article 106(1) in combination with Article 102. Thus, the 'effect on trade' is an objective criterion which does not limit the rights of nationals of Member States where the undertaking whose abusive behaviour in question is located.

3.3.2.4. Abusive Conduct

Article 102 does not prohibit the dominant position itself but only an abuse of it. The text of the Article does not contain any definition as to the meaning of 'abuse'; however, it sets out a list of abusive conducts which is not exhaustive.[470] The concept of abuse within the context of Article 102 has been widely interpreted by the Commission and the Courts of the European Union. Thus, different forms of abuse are possible as well as refusal to access which is very common with the dominant firms holding exclusive rights.

Article 102 refers to conducts of undertakings which may directly affect the market and detrimental to production or sales, to purchasers or consumers. Such behaviours are called as 'exploitative abuses' due to the fact that they represent the ways in which market power is exploited by the dominant undertaking.[471] On the other hand, 'anti-competitive' conducts which exclude competitors, strengthen the dominant position and

[468] Guidelines on the effect of on trade concept contained in Articles 81 [now 101] and 82 [now 102] of the Treaty [2004] OJ C101/81, para.17.
[469] Case C-320/91 *Corbeau* [1993] ECR I-2533.
[470] Case 6/72 *Continental Can* [1973] ECR 215, [1973] CMLR 199, para.26.
[471] Jones and Sufrin, p.280.

weaken the competition on the market are also prohibited.[472] In *Hoffmann- La Roche,* the Court defined the concept from this perspective as follows:

"*The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to the methods different from those which condition normal competition in products or services on the basis of transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition*."[473]

Examples for anti-competitive abuse have been revealed in several cases. In *RTT* the Court held that an abuse within the meaning of Article 82 TEC (now 102 TFEU) was committed where, without any objective necessity, an undertaking holding a dominant position on a particular market reserves itself an ancillary activity which might be carried out by another undertaking as part of its activities on a neighbouring but separate market, with the possibility of eliminating all competition from such undertaking.[474] This was also the case in *CBEM*.[475]

A dominant undertaking may abuse its position by engaging in conduct which is acceptable when carried out by its competitors, which are not in a dominant position on the market, and irrespective of any intention to commit abuse. This is because an undertaking holding a dominant position has a special responsibility, as recognised by the Court in its several judgements, towards the competitive process on the market that it dominates. For the first time the Court expressed this idea in *Michelin* as follows: "*A finding that an undertaking has a dominant position is not in itself a recrimination but simply means that,*

[472] The distinction is used in many textbooks: see for example Richard Whish, **Competition Law**, 6th ed., Oxford: Oxford University Press, 2009, pp. 672-753.
[473] Case 85/76 *Hoffmann-La Roche* [1979] ECR 461, [1979] 3 CMLR 211, para.91. The definition was repeated slightly in different words in Case 322/81 *Michelin* [1983] ECR 3461, [1985] 1 CMLR 282, para.70.
[474] Case C-18/88 *RTT* [1991] ECR I-5981, para. 18.
[475] Case 311/84 *Centre Belgé d'Etudes du Marché- Télémarketing (CBEM) v compagnieLuxembourgeoise de Télédiffusion SA (CLT) and Information Publicile Benelux SA* [1985] ECR 3261, [1986] CMLR 558.

irrespective of the reasons for which it has a dominant position, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition on the market."[476]

For example, predatory pricing or predation, which means charging of a price below a certain level of cost that is profitable, is regarded to be abuse under specific circumstances. Although lower prices are generally good for consumers in the short term, predation has immediate detrimental effects on competitors and consumers will also be adversely affected in the long term. It is because the dominant firm can use predation as a means to increase its market power by eliminating its actual or potential competitors from the market. After the elimination of competitors, the dominant firm can recoup or recover the losses it incurred by charging higher prices.[477] Despite its rare occurrence, predation is an important issue in the recently liberalised sectors where cross-subsidisation is available for the incumbent undertaking which is a former monopolist.[478]

It would appear to be the case that this special responsibility becomes greater, so that a finding of abuse becomes more likely, where the undertaking in question is not merely dominant, but rather "*enjoys a position of dominance approaching a monopoly*."[479] In particular, undertakings which enjoy a legal monopoly as a result of exclusive or special rights that they are holding have even greater special responsibility than that of a dominant undertaking with a lesser degree of market power. In one of its decisions the Commission indicated that the actual scope of the dominant firm's special responsibility must be considered in relation to the degree of dominance held by the firm and the characteristics of the market which may affect the competitive situation.[480] In other words, it must be

[476] Case 322/81 *Michelin* [1983] ECR 3461, [1985] 1 CMLR 282, para.57. See also Case T-228/97 *Irish Sugar plc. v Commission* [1999] 5 CMLR 1300 para.112 and Case T-65/89 *BPB Industries plc v Commission* [1993] ECR II-385; [1993] 5 CMLR 32, para.67.
[477] See eg. Case C-62/86 *Akzo* [1991] ECR I-3359; Case C-333/94 P *Tetra Pak II* [1996] ECR I-6007.
[478] Leigh Hancher and José-Luis Buendia Sierra, "Cross Subsidisation and EC Law", **C.M.L.Rev**.,Vol. 33, 1998, pp. 901-945.
[479] Opinion of AG Fennelly in Cases C-395 and 396 P, *Compagnie Maritime Belge Transport SA v Commission (Compagnie Maritime Belge)* [2000] ECR I-1365, [2000] 4 CMLR 1076, para.136.
[480] Commission Decision (*Deutsche Post AG: Interception of Cross-Border Mail),* [2001] OJ L 331/40, [2002] 4 CMLR 598. See also Commission Decision (*World Cup 1998),* [2000] OJ L5/55, para.85.

assessed in the light of the specific circumstances of each case showing that competition has been weakened. [481] Accordingly, when the firm has a higher degree of dominance, like monopoly, on the relevant market it is more probable that its conduct will be considered an abuse. Therefore, 'special responsibility' has particular importance in the implementation of Article 106(1) combined with Article 102 TFEU.

In practice, however, when Article 106(1) is applied in combination with Article 102, the Commission and the Court of Justice do not require the actual infringement of Article 102. In many cases, all that is required is that such abusive conduct is capable of taking place as a consequence of State intervention. As will be analysed in the development of the case law later, the Court of Justice prefers to be focused more on the effect of the State measure rather than the actual or potential existence of abusive behaviour. This approach might be considered in line with the doctrine applied by the Court in *Continental Can* when it applied Article 102 to prevent a merger which was found by the Court to constitute a threat to the competitive process and structure of the market.[482]

The issue of whether the application of Articles 106(1) and 102 actually requires abusive behaviour to take place was examined by the Court of Justice, again, in *RTT*. This case concerned the exclusive right for the type-approval of telephone equipment. This exclusive right was granted by the Belgian legislation to the public undertaking, Regie des Télégraphes et des Téléphones (RTT). The same undertaking was also imported and marketed telephone equipment, in competition with the other undertakings. RTT defended that for there to be an infringement of Articles 106(1) and 102 there had to be actual abusive behaviour and the possibility of future abuse was not sufficient. The Court rejecting the RTT's argument held that it was sufficient to show either that abuse would be liable to occur as a result of the State measure or that the measure in question may produce similar effects to those which would be produced by a hypothetical case of abuse.[483]

[481] Cases C-395 and 396 P *Compagnie Maritime Belge* [2000] ECR I-1365, [2000] 4 CMLR 1076, para.114.
[482] Case 6/72 *Continental Can* [1973] ECR 215, [1973] CMLR 199.
[483] Case C-18/88 *RTT* [1991] ECR I-5981, paras.23-24.

3.3.3. Development of the Case Law

3.3.3.1. Initial Steps

Hancher explains that the case law on Article 106 of the Treaty as "*at first sight opaque, if not erratic*."[484] Ross also described the Court's jurisprudence as "*a long line of complex and at times abstruse case law, with difficulties being encountered in relation to virtually all its aspects*."[485]

Sacchi[486] is one of the earliest cases in which the application of competition rules to State bodies was challenged and the contested national measure was a grant of exclusive rights to a company controlled by a State holding in the TV industry. In this case the Court confirmed that the competition rules were applicable to private and State controlled bodies. Providing a general interpretation of Article 86 (now Article 106 TFEU) of the Treaty, the Court held that this provision is permission rather than a prohibition. Therefore, Article 106 is directed at the Member States allowing them to grant exclusive rights. Accordingly, for the establishment of unlawfulness of a State measure it was required to prove not merely the existence of the State monopoly but the specific exercise of the monopolistic power in an arbitrary way and the actual effects of this exercise on trade between Member States.[487]

The Court made some clarifications regarding the principle which was established in *Sacchi* in its later rulings. In *Terminal Equipment*, [488] France challenged the Telecommunications Terminal Equipment Directive (88/301), *inter alia*, on the grounds that the Commission had no competence to adopt it on the basis of Article 86(3) (now Article 106(3) TFEU). France claimed that Article 86 (now Article 106 TFEU) did not allow the Commission to interfere with the granting of special or exclusive rights by

[484] Leigh Hancher, "Community State and Market" in Paul Craig and Grainne de Burca (Eds), **The Evolution of EU Law,** Oxford: Oxford University Press, 1999, p. 727.
[485] Malcolm Ross, "Article 16 EC and Services of General Interest: From Derogation to Obligation?", **E.L.Rev.**, Vol.25, 2000, pp.22, 23.
[486] Case 155/73 *Sacchi* [1974] ECR 409.
[487] Ibid.,para.17. The Court noted unfair charges or conditions imposed on the users of its services, discrimination between commercial operators or national products on the one hand, and those of other Member States on the other, as regards access to television advertising.
[488] Case 202/88 *France v Commission (Terminal Equipment)* [1991] ECR I-1223.

Member States because Article 86(1) presupposed the existence of special or exclusive rights so the granting of such rights could not itself constitute a 'measure' within the Article. The Court held that "*even though that Article presupposes the existence of undertakings which have certain special or exclusive rights, it does not follow that all the special or exclusive rights are necessarily compatible with the Treaty*." [489] The compatibility of such rights with the Treaty depends on different rules referred in Article 106 TFEU.

The ruling in *Terminal Equipment* shows that Member States have not retained complete sovereignty with regard to the creation of legal monopolies. This fact is more clearly confirmed in *Corbeau* [490] later. Therefore, Member States must not disregard competition rules and strike the balance between such rules and Article 106 TFEU when granting special and exclusive rights. However, the precise point at which the balance is to be struck is less clear and the way in which the case law has been developed is very important.[491]

3.3.3.2. Turning Point: *Höfner* and Demand Limitation Doctrine

Höfner[492] is regarded to be the turning point in the Court's attitude towards public monopolies. In this case a dispute arose between a company and the recruitment consultants it had employed to find it a sales director. In a dispute about fees the company claimed that the contract between the parties was void as it infringed the German law on the promotion of employment. This legislation conferred on the Federal Office for Employment, the exclusive right to put prospective employees and employers in contact with one another. Nevertheless, to some extent, the Federal Office for Employment tolerated the existence and activities of independent recruitment consultants and it appeared that it was unable, on its own, to meet the demand for executive recruitment.

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[489] Ibid., para.22.
[490] Case C-320/91 *Corbeau* [1993] ECR I-2533 [1995] 4 CMLR 621.
[491] David Edward and Mark Hoskins, "Art.90: Deregulation and EC Law- Reflections Arising from the XVII FIDE Conference", Vol. 32, **C.M.L.Rev.**, 1995, p.160.
[492] Case C-41/90 *Höfner* [1991] ECR I-1979, [1993] 4 CMLR 306.

The questions referred by the German Court raised the issue of whether there was an abuse of a dominant position involved and whether Article 106(1) was infringed by the exclusive rights. As to ruling, first, the Court reiterated the principal that the simple fact of creating a dominant position by granting an exclusive right within the meaning of Article 106 was not as such incompatible with Article 102. However, a "*Member State is in breach of the prohibition contained in those two provisions only if the undertaking in question, merely by exercising the exclusive right granted to it, cannot avoid abusing its dominant position*."[493]

The Court found that by granting an exclusive right to an undertaking for recruitment activities, the Member State created a situation in which the provision of a service was limited because the undertaking with the exclusive right was manifestly not in a position to satisfy the demand prevailing on the market. Such limitation of the service offered to customers constituted an abuse under Article 102(b) TFEU. In order to be more precise in explaining why the Member State was in breach of Article 106(1) in conjunction with Article 102 TFEU, the Court enumerated the following conditions:

"- *the exclusive right extends to executive recruitment activities;*

- *the public employment agency is manifestly incapable of satisfying demand prevailing on the market for such activities;*

- *the actual pursuit of those activities by private recruitment consultants is rendered impossible by the maintenance in force of a statutory provision under which such activities are prohibited and non-observance of that prohibition renders the contracts concerned void;*

- *the activities in question may extend to the nationals or to the territory of other Member States*."[494]

[493] Ibid., para.29
[494] Ibid., para.34.

The Court of Justice applied the above-mentioned conditions in two subsequent cases, namely, *Giovanni Carrara*[495] and *Job Centre*[496] both of which are about the public employment offices holding monopoly over employment in Italy.

The Court's precise judgement in *Höfner* provides a useful guidance on the applicability of the competition rules of the Treaty to the activities of public undertakings and the undertakings with exclusive rights which operate on the market pursuant to such rights granted by the Member States. Here, the Court established the principal that "*any measure adopted by a Member State which maintains in force a statutory provision that creates a situation in which public employment agency cannot avoid infringing Article [102] is incompatible with the rules of the Treaty*."[497] This means that Member States will not be able to hide behind the legal protection conferred to legal monopolies when the monopoly is not being efficient enough to meet demands of the market. The same approach had previously been adopted by the Commission in two Decisions concerning postal services in the Netherlands and Spain.[498]

While Buendia Sierra describes this approach as "demand limitation doctrine",[499] Edward and Hoskin call it as a "limited sovereignty" approach. According to these authors, under "limited sovereignty" approach, the Member States are free to grant legal monopolies provided that the operation of the monopoly does not have the necessary consequence of contravening the competition rules of the Treaty, which is clearly illustrated in *Höfner*.[500]

Gyselen observed that in *Höfner* the Court extended the notion of abuse of a dominant position to such a point that the granting of exclusive rights and the abusive exercise of those rights virtually coincide. He argues, therefore, that this case cannot be

[495] Case C-258/98 *Criminal Proceedings against Giovanni Carra and others* [2000] ECR I-4217.
[496] Case C-55/96 *Job Centre* [1997] ECR I-7119.
[497] Ibid., para. 27. Emphasis added.
[498] Commission Decision (EEC) 90/16 concerning the provision in the Netherlands of express delivery services *(Courier Postal Services- The Netherlands)* [1990] OJ L10/50, paras.14-15; Commission Decision (EEC) 90/456 concerning the provision in Spain of international courier services *(Courier Postal Services-Spain)* [1990] OJ L233/22, para.11.
[499] Buendia Sierra, p.163.
[500] Edward and Hoskins, pp.164-167.

seen as a turning point on its own facts.[501] However, the subsequent case law has revealed that the Court, starting with *Höfner*, has an intention to develop a normative rule.

The Court reached a similar result in *Merci Convenzionali*.[502] In this case Merci had an exclusive right given by the Italian law to organise the loading, unloading, and other handling of goods within the Port of Genoa through a dock-work company. There was a delay in unloading Siderurgica's ship, caused in particular by the dock-work company's workers being on strike. The exclusive rights meant that the vessel's crew was not able to work themselves. Siderurgica demanded compensation for the damage it suffered due to the delay and the reimbursement of the charges it had paid to Merci, which it claimed were unfair given the service it had received, or rather, not received. The Tribunale di Genoa made an Article 267 TFEU reference, asking, *inter alia*, whether Article 106(1) in conjunction with Article 102 precluded the Italian rules.

First, the Court referred to both *Höfner* and *ERT* together stating that a Member State was in breach of the prohibitions contained in Article 106(1) and 102 of the Treaty if the undertaking in question, merely by exercising the exclusive rights granted to it, *cannot avoid abusing its dominant position* or when such rights *are liable to create a situation* in which that undertaking is induced to commit such abuses.[503]

Then the Court evaluated the circumstances described by the national court. Accordingly, the Court found out that "*the undertakings enjoying exclusive rights in accordance with the national procedures laid down by the national rules in question are, as a result, induced either to demand payment for services which have not been requested, to charge disproportionate prices, to refuse to have recourse to modern technology, which involves an increase in the cost of the operations and a prolongation of the time required for their performance, or to grant price reductions to certain consumers and at the same*

[501] Luc Gyselen, "Anti-Competitive State Measures Under the EC Treaty: Towards a Substantive Legality Standard", **E.L.Rev.**, Checklist, 1993, p.77.
[502] Case C-179/90 *Merci Convenzionali* [1991] ECR I-5889 [1994] 4 CMLR 422.
[503] Ibid., para.17. Emphasis added.

time to offset such reductions by an increase in the charges to other consumers."[504] Under these circumstances the Court ruled that the Member State had created a situation contrary to Article 102.

Different from the case in *Höfner,* in *Merci Convenzionali* there were various, serious and repeated abuses committed and limiting of markets to the prejudice of the consumers was only one of them but probably the most serious one. In fact, inefficiency of the undertakings to provide the necessary services on time caused the proceedings for this case to be started. The Court did not explain the causal link between the exclusive right and the abusive behaviour clearly. It may be the reason that the existence of such abuses was so obviously contrary to Article 102 in itself that the Court did not feel it necessary.

Although the Court repeated the principal established in *Sacchi*[505] that the simple fact of creating a dominant position is not as such incompatible with Article 102 TFEU, the question remains as to what kind of exclusive rights will induce or lead the undertakings to committing abuses is not very clear. Jones and Sufrin indicates that *any* dominant position enables the undertaking to behave in ways which would not be feasible in a more competitive market, but the existence of statutory monopoly puts an undertaking in an even stronger position.[506] Therefore, it is for the Member States themselves to assess the implications of the exclusive rights that they grant to undertakings under the case law of the Courts and directives issued by the Commission.

3.3.3.3. Conflict of Interest and Extension of the Dominant Position

In *ERT*[507] and the subsequent similar-type of cases like *RTT* and *Ambulanz Glöckner* the Court adopted a different approach from the one it adopted in *Höfner*. *ERT* is about a preliminary ruling where the Thessaloniki Regional Court referred to the Court under Article 267 TFEU various questions concerning the position of the Greek redio and

[504] Ibid., para.19.
[505] C-155/73 *Sacchi* [1974] ECR 409.
[506] Jones and Sufrin, p.81.
[507] Case C-260/89 *ERT* [1991] ECR I-2925, [1994] 4 CMLR 540.

television undertaking (ERT) to which the Greek government had granted exclusive rights with regard to the original broadcasting and retransmitting of programmes in Greece. Greek law prohibited any person from engaging in activities for which ERT had an exclusive right without ERT's authorisation. The Mayor of Thessaloniki and a municipal company, DEP, set up a television station and began broadcast television programmes. ERT sought an injunction and the seizure of the new station's technical equipment.

The Court, referring to *Sacchi*, repeated the principal that nothing in the Treaty prevents Member States, for considerations of a non-economic nature relating to the public interest, from removing radio and television broadcasts from the field of competition by conferring on one or more establishments an exclusive right to carry out them. Nevertheless, it follows from Article 106(2) and 102 of the Treaty that the manner in which the monopoly is organised or exercised may infringe the rules of the Treaty, in particular those relating, *inter alia*, to the rules on competition.[508] This means that *the manner in which the monopoly is organised* may infringe the competition rules by depriving them from their effectiveness within the meaning of Article 106(2) TFEU.

Basing its reasoning on the specific circumstances of the case, the Court concluded that Article 106(1) of the Treaty "*prohibits the granting of exclusive right to transmit and an exclusive right to retransmit television broadcasts to a single undertaking, where those rights are liable to create a situation in which that undertaking is led to infringe Article 102 by virtue a discriminatory broadcasting policy which favours its own programmes*."[509] This is different from the situation in *Höfner* where the infringement was unavoidable. In this case, the accumulation of rights in the hands of the monopolist did not result in an unavoidable infringement of Article 102. Instead the granting of such rights to a single undertaking created a situation where the monopolist was led to infringe Article 102 TFEU because it would inevitably discriminate in favour of retransmitting its own programmes rather than anyone else's.

[508] Ibid., paras.10-11.
[509] Ibid., para.38. Emphasis added.

Another important case belonging to this group is *RTT*.[510] Under Belgian Law, Regie des Télégraphes et des Téléphones (RTT) held a monopoly over the establishment and operation of the public telecommunications network. The law also provided that only equipment supplied by RTT or approved by it could be connected to its network. GB-INNO sold in its shops telephones which had not been approved by RTT. RTT brought proceedings in the commercial court for an order that GB-INNO should not sell telephones without informing the purchasers that they were not approved. The commercial court asked the Court, *inter alia*, whether Article 3(f), 86 (now Article 102 TFEU), and 90 EEC (now Article 106 TFEU) precluded a Member State from granting to the company operating the public telecommunications network the power to lay down the technical standards for telephone equipment and to check that economic operators meet those standards when it is competing with those operators on the market for terminals. In order to establish this RTT had been given authority to indict persons and undertakings who violated the regulations, as laid down by RTT, by making connections to the network.

First, the Court found that there was an infringement of Article 86 (now Article 102 TFEU) of the Treaty. Because the undertaking holding a monopoly in the market for establishment and operation of the network, without any objective necessity, reserved to itself a neighbouring but separate market, which was the market for importation, marketing, commissioning and maintenance of equipment for connection to said network, thereby eliminating all competition from other undertakings. Since such extension of the dominant position of the undertaking to which the State had granted exclusive rights resulted from a State measure this constituted an infringement of Article 90(1) (now Article 106(1) TFEU) in conjunction with Article 86 EEC (now 102 TFEU).[511]

The Court based its decision on the reasoning that a system of undistorted competition can be guaranteed only if *equality of opportunity* is secured as between the various economic operators. However, according to the Court, to entrust an undertaking

[510] Case C-18/88 *RTT* [1991] ECR I-5973.
[511] Ibid., paras. 19-21.

which markets terminal equipment with the task of drawing up the specifications for such equipment, monitoring their application and granting type-approval is against this principal. Because the granting of such rights to the undertaking will amount to conferring upon it the power to determine at will which terminal equipment may be connected to the public network, and thereby placing that undertaking at an obvious advantage over its competitors.[512] In this respect, *RTT* resembles the case in *ERT* where the accumulation of rights resulted in the conflict of interests.[513]

Instead of emphasising the 'conflict of interests' aspect of the case, the Court of Justice took a slightly different approach from *ERT*. Referring to the *Télémarketing* case,[514] the Court mentioned the 'extension of the dominant position'. Although there was no suggestion of an actual abuse of the dominant position, the Court considered that the real problem in *RTT* was the extension of the monopoly position from one market to another without any necessity. According to this approach, the grant to an undertaking, which is already dominant in one market, of exclusive right in another neighbouring but distinct market, is contrary to Articles 106(1) and 102 TFEU. This doctrine has played a key role in liberalisation process, since the Commission has also employed the doctrine in its liberalisation activities.

Moreover, this case is important because of the clear statement that State measures should not bundle regulatory functions with the commercial activities. In other words, it is a requirement for a healthy competition structure that the national civil services must be organised in such a way that the public authority and the commercial activities are separated.[515] Otherwise, such State measures will infringe Article 106(1) in conjunction with Article 102.

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[512] Ibid., para. 25.
[513] Case C-260-89 *ERT* [1991] ECR I-2925, [1994] 4 CMLR 540.
[514] Case 311/84 *Télémarketing* [1985] ECR 3261, para.27.
[515] Morten P. Broberg and Niels Fenger, "National Organisation of regulatory powers and Community competition law", **E.C.L.R.** 1995, vol. 16(6), 346-373.

The Court applied this doctrine again in *Telecommunications Services*, which is the case about the directive on telecommunications services, saying that: "*The Court has held that the mere fact of creating a dominant position by granting exclusive rights within the meaning of Article 90(1) [now Article 106(1) TFEU] of the Treaty is not as such incompatible with Article 86 [now Article 102 TFEU]…However, the Court also held that the extension of the monopoly on the establishment and operation of the telephone network to the market in telephone equipment, without any objective justification, was prohibited as such by Article 86 [now Article 102 TFEU] where that extension resulted from a State measure, thus leading to the elimination of competition…The same conclusion necessarily follows where the monopoly on establishment and operation extends to the market in telecommunications services*."[516]

In *Telecommunications Services*, the Court clearly stated that the extension of a dominant position which occurs through the grant to a monopolist of a second exclusive right for the carrying out of different, although connected, activities is contrary to Articles 106(1) and 102 of the Treaty unless there is objective justification. Actual abuse does not need to have occurred.

The Court had to deal with a similar situation in *Silvano Raso*, where a dockers company was granted a monopoly over the supply of temporary labour to authorised port operators although it competed with them in the market for port services. The Court stated that the company would have a conflict of interest and that is "*because merely exercising its monopoly will enable it to distort in its favour the equal conditions of competition between the various operators on the market in dock-work services*."[517] As a consequence, the Court concluded that "*the company in question is led to abuse its monopoly by imposing*

[516] Joined Cases C-271, 281 and 289/90 *Kingdom of Spain, Kingdom of Belgium and Italian Republic v Commission of the European Communities (Telecommunications Services)* [1992] ECR I-5868, paras. 35-36.
[517] Case C-163/96 *Criminal Proceedings against Silvano Raso and others (Silvano Raso)* [1998] ECR I-5973, para.29.

on its competitors in the dock-work market unduly high costs for the supply of labour or by supplying them with labour less suited to the work to be done."[518]

The Court applied a similar approach in *Ambulanz Glöckner*,[519] which is another more recent case which has significance from several different perspectives. This case is about the provision of public ambulance services in Germany. National legislation, which was governing such services, distinguished between emergency transport and non-emergency patient transport. Emergency transport service in the Land of Rheinland-Phalz was entrusted to two medical aid organisations which also ran a non-emergency service. Ambulanz Glöckner had previously also provided a non-emergency service. However, when it applied to the relevant public authority for a renewal of its permit, the two medical aid organisations objected, claiming that competition on the non-emergency market would affect their ability to provide the emergency service. As a result, the public authority refused to give a permit.

The Court referring to *RTT*, stated that an abuse within the meaning of Article 82 TEC (now Article 102 TFEU) would be committed where, without any objective necessity, an undertaking holding a dominant position on a particular market reserves to itself an ancillary activity which could be carried out by another undertaking as part of its activities on a neighbouring but a separate market, with the possibility of eliminating all competition from that undertaking.

The main problem was that the application of the federal legislation in question involved a prior consultation of the medical aid organisations in respect of any application for authorisation to provide non-emergency patient transport services submitted by an independent operator. This legislation gave an advantage to those organisations, which already had an exclusive right on the urgent transport services, by also allowing them to provide non-emergency services exclusively. Therefore, the Court concluded that the application of such legislation had the effect of limiting markets to the prejudice of

[518] Ibid., para. 30.
[519] Case C-475/99 *Ambulanz Glöckner* [2001] ECR I-8089 [2002] 4 CMLR 726.

consumers within the meaning of Article 82(b) (now Article 106(b) TFEU) of the Treaty, by reserving to those medical aid organisations an ancillary transport activity which could be carried on by independent operators.[520] Limiting of markets to the prejudice of consumers resembles the reasoning in *Höfner* and the demand limitation doctrine.

3.3.3.4. Final Destination: *Corbeau*

In *Corbeau,*[521] Belgian Law conferred a monopoly on the Belgian Post Office, the Regie des Postes, in respect of the collection, carriage and delivery of various forms of correspondence throughout the Kingdom. Criminal sanctions were imposed for infringing the monopoly. Paul Courbeau, a Belgian citizen, established his own postal service within a limited geographic area, namely in Liége, whereby personal collection would be made from the sender's premises and the delivery made before noon next day in the same area, although deliveries outside the area were made by putting the items in the ordinary post. Corbeau was prosecuted for infringing the Post Office's monopoly. The Liége court referred questions to the Court of Justice with regard to the compatibility of the post office monopoly with Articles 85, 86, and 90 EEC (now Articles 101, 102 and 106 TFEU) of the Treaty. In this respect the local court asked, *inter alia,* whether the monopoly should be modified to comply with Article 90(1) (now Article 106(1) TFEU).

The Court repeated its well-established mantra that the mere grant of exclusive rights not in itself being incompatible with the Treaty but the Member States are not to adopt or maintain in force provisions which may deprive Article 90 EEC (now 106 TFEU) of its effectiveness. The Court did not make any further explanation as to the reasons why the Belgian legislation was in breach of Article 90(1) in conjunction with Article 86 but instead referred to Article 90(2) EEC (now Article 106(2) TFEU) to lay down the conditions in which such exclusive rights could be justified in similar circumstances.[522]

[520] Ibid., paras.42-43.
[521] Case C-320/91 *Corbeau* [1993] ECR I-2533, [1995] 4 CMLR 621.
[522] Ibid. paras. 11-14.

Corbeau is the first case that the Court actually found the very existence of national rules conferring a dominant position on an undertaking to be unacceptable unless the rights at issue can be justified under Article 106(2). Until this case the Court had continually stated that the mere creation of a dominant position through the grant of exclusive rights was not in itself illegal. As is clear from the facts of the case, neither the postal monopoly had actively abused a dominant position, nor the Member State led or induced the undertaking to do that, for example by illegally extending an existing monopoly into new markets or through the accumulation of additional exclusive rights. In other words, despite its statement to the contrary, the Court considered that the mere grant of exclusive right, itself, was in breach of Article 106(1) in conjunction with Article 102 TFEU.

Hancher considers that the abuse, if any, lay in the failure on the part of the Member State to respond the changes in the relevant market, especially in the demand side, by refining the scope of the initial right.[523] Indeed, as the AG Tesauro had pointed out in his Opinion, the market had been the subject of significant developments in the sense that demand for 'added value' services by certain types of consumer, including personal collection, tracing and tracking had grown rapidly. At the time when the monopoly to provide basic postal services was conferred on national postal administrations in the majority of Member States demand for such value-added services simply did not exist.[524] However, market situation had altered fundamentally with the passage of time and the Member State had not adjusted the scope of exclusive right to these changes. Thus inaction could be considered a violation of Article 106(1) TFEU. If this interpretation is correct, then the ruling represents a significant extension of the Court's jurisprudence on the *effet utile* of the Treaty's competition rules to situations where the development of competition is restricted because the market itself has changed, and not necessarily as a result of any independent action on the part of either the Member State or the statutory monopoly.[525]

[523] Leigh Hancher, "Casenote on *Corbeau*", **C.M.L.Rev.**, Vol. 31, 1994, pp.105-111.
[524] Opinion of AG Tesauro in Case C-320/91 *Corbeau* [1993] ECR I-2533, [1995] 4 CMLR 621, para. 15.
[525] Hancher, "Casenote on *Corbeau*", opcit.

Edward and Hoskins submit that the Court applied the 'limited competition' approach, which starts from the presumption that the restriction of competition inherent in legal monopolies is illegal. The underlying rationale for this approach is that the creation of a legal monopoly will necessarily produce restrictive effects on competition so that such monopolies should be permitted only where there is a particular justification for their existence. As a result, the creation of legal monopolies must a) be justified by a legitimate national objective and b) satisfy the principle of proportionality, that is, the consequent restriction of competition must not exceed what is necessary to attain the objective.[526]

AG Tesauro pointed out the same issue in his Opinion by stating that: "*Provisions extending the scope of an exclusive right are not by their nature different from provisions establishing an exclusive right. They both eliminate, in a given sector, the possibility of the free exercise of economic activity and hence of competition. They may therefore be examined in the light of Article 90 and 86 [now Articles 106 and 102 TFEU]. And in both cases what is essential to check is whether or not the provisions in question are objectively justified*."[527]

If we transpose these arguments to the facts in *Corbeau*, it may be stated that the statutory monopoly inherent in the basic service cannot be eliminated without prejudicing the essential function of the universal service, namely to offer to the public as a whole throughout national territory a means of person-to-person communication of average quality at an equalized price affordable by all. This is the justification for the maintenance of the exclusive right to provide basic postal services. Therefore, the monopoly must be retained only for the basic postal services. However, the same cannot be said for services 'which are objectively different from the basic services and which show, as compared with the latter, a specific added value.'[528]

[526] Edward and Hoskins, opcit.
[527] Opinion of AG Tesauro in Case C-320/91 *Corbeau* [1993] ECR I-2533, [1995] 4 CMLR 621, para. 14.
[528] Ibid., para. 18.

The Court could have reached the same result by simply applying the existing case law. As the Commission had suggested, the case might be solved by applying the 'extension of the dominant position doctrine' because the public undertaking which had an exclusive right over the provision of basic postal services, had extended this right over the value added services by the help of the State measure. The Commission also referred to the demand limitation doctrine in *Höfner* as a possible legal basis for finding of an infringement. Instead the Court, sharing the opinion of AG Tesauro, took an innovative step to go as far as saying that the creation of legal monopoly through the grant of exclusive right must be based on objective justification, right from the beginning.

This ruling in *Corbeau* has had an important role to play in the liberalisation of the postal sector. It should be evaluated on its own merits, taking into account of the specific features of the postal market at the time of the judgement. Some authors suggest that with *Corbeau* the burden of proof is reversed because the exclusive rights are considered not to be *prima facie* legal, but to be *prima facie* illegal unless they are justified or fulfil the criteria in Article 106(2). [529] However, the Court's subsequent judgements proved otherwise.

3.3.3.5. Back to the Beginning: *La Crespelle*

La Crespelle[530] is about the exclusive right conferred by the French law on certain bovine insemination centres to provide insemination services over a particular area. In this respect, each insemination centre needed an authorisation to operate and had an exclusive right to serve in a defined area. Those undertakings constituted a contiguous series of monopolies territorially limited but together covering an entire territory of a Member State. Farmers were free to choose the centres they preferred. They also had a right to request a centre to use semen from a particular production centre, either national or foreign, although

[529] Jonathan Faull and Ali Nikpay, **The EC Law of Competition**, Oxford: Oxford University Press, 1999, para. 5.76.
[530] Case C-323/93 *Société Civile Agricole du Centre d'Inséminataion de la Crespelle v Coopérative d'Elevage et d'Insemination Artificielle de Département de la Mayenne (La Crespelle)* [1994] ECR I-5077.

the additional cost would have to be met by the farmer making the request. It was alleged that the centres charged excessive prices for their services.

The Court, again, repeated that the mere grant of an exclusive right within the meaning of Article 90(1) EEC (now Article 106 TFEU) was not as such incompatible with Article 86 (now Article 102 TFEU) of the Treaty. Then the Court, quoting *Höfner*, said that a "*Member State contravenes the prohibitions contained in those provisions only if, in merely exercising the exclusive right granted to it, the undertaking in question cannot avoid abusing its dominant position*."[531]

The Court continue its examination with the question whether allegedly high price charged by this undertaking in return for the insemination services was the direct consequence of the national law. The Court found out, in this regard, that the national law merely allowed insemination centres to require farmers who requested the centres to provide them with semen from other production centres to pay the additional costs entailed by that choice. Although the national law left to insemination centres the task of calculating those costs, such a provision did not lead the centres to charge disproportionate and thereby abuse their dominant position.[532] As a result the national measure in question was not in breach of Article 90(1) (now Article 106(1) TFEU) in conjunction with Article 86 (now Article 102 TFEU).

La Crespelle reveals an important change in the direction of the case law. Until this judgement it was assumed that if a monopoly facilitated the possibility of abuse that was sufficient to constitute 'leading' the undertaking to abuse its dominant position. For example, in *Merci Convenzionali*, when faced by various abusive practices, including charging excessive prices, the Court immediately found that these abusive practices were the direct result of the monopoly, without giving any further reason. It is also against the Court's previous approach that actual- and in some cases even potential- existence of abuse is not required for the infringement to occur. It seems that the Court rejected the doctrine of

[531] Ibid.,para.18.
[532] Ibid.,paras. 20-21.

automatic abuse established in *Corbeau*. Following *La Crespelle*, it cannot be argued that all exclusive rights are *prima facie* contrary to Articles 106(1) and 102.

The Court applied the same approach in *Corsica Ferries*,[533] where it held that the grant of the exclusive right to offer compulsory piloting services in a port was not in itself an infringement of Article 90(1) (now Article 106 TFEU) but the approval of the discriminatory tariffs, which were contrary to Article 86(c) EEC (now Article 102(c) TFEU), was an infringement.

With the subsequent judgments like *La Crespelle* or *Corsica Ferries* the Court seems to have retreated from its approach in *Corbeau*. In these cases and the following ones, the Court continued to repeat the principle that the creation of a dominant position through the grant of exclusive rights within the meaning of Article 106(1) TFEU is not in itself incompatible with Article 102 TFEU, but will become so if the rights make an abuse unavoidable, or if they create a situation whereby the undertaking, merely by exercising its rights, is led to commit an abuse.

In this respect *Albany*[534] is another judgement in which the Court applied the demand limitation doctrine again. This case is about a Dutch pension system in which, at the request of the representatives of employers and employees in a particular sector of the economy, affiliation to a sectoral pension fund was made compulsory by law for all undertakings in that sector. The aim of this legislation was to provide a pension supplementary to the basic State pension. Several undertakings brought proceedings in the Dutch courts challenging the compulsory affiliation regime on the grounds that they provided equivalent supplementary pension scheme themselves. The Dutch Courts referred to the Court of Justice the question, *inter alia*, whether the exclusive rights conferred on the sectoral pension funds infringed the Treaty.

[533] Case C-18/93 *Corsica Ferries* [1994] ECR I-1783.
[534] Cases C- 67/96 *Albany* [1999] ECR I-5751, [2000] 4 CMLR 446.

Albany alleged that the pension benefits from the Fund in question did not match the needs of the undertakings; the benefits were too low, were not linked to wages and, consequently, were generally not adequate. As a reply, the Court repeated that the granting of exclusive rights was not contrary to the Treaty unless merely by exercising the right the undertaking was led to commit abuse or unless an abuse was unavoidable. The Court also accepted that the undertakings which wished to provide their workers with a pension scheme superior to the one offered by the Fund were not able to do so and the resulting restriction of competition drove directly from the exclusive right conferred on the sectoral pension fund. However, the Court did not proceed to consider whether the undertaking was put in such a position which led it to commit abuse, but instead turned to see whether the justification under Article 106(2) applied.[535]

Another case concerning the exclusive rights in the postal sector is worth mentioning here. The *Deutsche Post*[536] is about the German post office, Deutsche Post, which is a State monopoly with the exclusive right to collect, carry and to deliver certain categories of mail in Germany and the obligation arising from the Universal Postal Convention (UPC). In this case the Court, first, referred to *Corbeau*. Repeating the wording of Article 86(1) (now Article 106(1) TFEU), the Court stated that this provision should be read together with Article 86(2) TEC (now Article 106(2) TFEU). In this regard, the Court found that for the postal services of the Member States, performance of the obligations flowing from the UPC was a service of general interest within the meaning of Article 86(2) (now Article 106(2) TFEU). Significantly, the Court considered that the right of Deutsche Post to treat international items of mail as internal post, under the specific circumstances,[537] created a situation where Deutsche Post might be led, to the detriment of consumers, to abuse its dominant position resulting from the exclusive right granted to it to forward and deliver those to the relevant addressees. Therefore, it was necessary to examine the extent

[535] Ibid., paras. 94-98
[536] C-148/97 *Deutsche Post AG v Gesellschaft für Zahlungssysteme mbH (GZS) and Citicorp Kartenservice GmbH* [2000] ECR I-825, [2000] 4 CMLR 838.
[537] At the time of the proceedings, the rate for international mail was lower in another Member State than the internal rate in Germany.

to which exercise of such a right was necessary to enable Deutsche Post to perform its task of general interest, within the meaning of Article 86(2) (now Article 106(2) TFEU), pursuant to the obligations flowing from the UPC and in particular, to operate under economically acceptable conditions.[538]

3.3.4. Making Sense of the Case Law

It is very difficult to make a sensible categorisation of the case law regarding the application of Article 106(1) in conjunction with Article 102 TFEU. In order to make the analysis of the case law easier the cases have been categorised according to the effects of the State measure that was challenged. Therefore, the cases were analysed within two main categories such as, the demand limitation and conflict of interest or extension of the dominant position. However, it is important to note that these categories are not closed. In other words, some cases can be involved in both categories and some cases may not belong to either of them.

Regarding the demand limitation, the Court found, in cases like *Höfner* and *Merci Convenzionali*, that undertakings granted exclusive rights might be unable to operate efficiently and incapable of meeting the demand in the reserved sector. Such situations usually correspond to a violation of Article 102(b) through 'limiting production, markets or technical development to the prejudice of consumers'. According to the Court, a Member State is in breach of the prohibitions contained in Article 106(1) and 102 of the Treaty if the undertaking in question, merely by exercising the exclusive rights granted to it, *cannot avoid abusing its dominant position* or when such rights are *liable to create a situation* in which that undertaking is induced to commit such abuses.

In some cases cumulation of rights granted to a single undertaking may cause conflict of interests and also unjustified extension of its dominant position. The Court had to deal with such situations especially in postal, telecommunications and broadcasting

[538] C-148/97 *Deutsche Post AG v Gesellschaft für Zahlungssysteme mbH (GZS) and Citicorp Kartenservice GmbH* [2000] ECR I-825, [2000] 4 CMLR 838, paras.40-49.

cases. In *ERT* and *RTT*, their exclusive rights enabled these undertakings to extend their monopolies into separate but neighbouring markets without any justification. Cumulation of rights may enable the undertakings to impose high or discriminatory prices on the services that they provide to their customers and their competitors. This situation frequently arises in cases where the undertakings hold exclusive rights over the essential facilities or transport infrastructures, like sea-ports, which was the case in *Silvano Raso* and *Merci Convenzionali*. In such cases the Court held that the mere fact of creating a dominant position by granting exclusive rights within the meaning of Article 106(1) of the Treaty is not as such incompatible with Article 102 TFEU. However, according to the Court, it was prohibited by Article 102 in conjunction with Article 106(1) when the dominant position was extended by a State measure leading to the elimination of competition. Cumulation of rights may also cause the limitation of markets to the prejudice of consumers, which was the case in *Ambulance Glöckner* and such borderline cases can be evaluated under both categories.

On the other hand, the case law regarding the application of competition rules in conjunction with Article 106(1) has not been settled yet. In *Albany* and *Corbeau*, the Court concentrated on the application of the derogatory provision within Article 106(2) TFEU rather than making an extensive analysis as to the nature of the abusive conduct under Article 106(1) and 102 TFEU. The Court's judgement is particularly striking in *Corbeau*, in which the mere grant of exclusive right was found to be a violation of Article 106(1) in conjunction with Article 102 TFEU. Following this judgement, the dominant opinion in the academic circles was that *Corbeau* constituted the final step in the evolution of the case law in this field. However, with *La Crespelle* and the subsequent judgements of the Court proved otherwise. Therefore, it can be concluded that the case law is still evolving but it is, nevertheless possible to predict the outcome of the cases on the basis of the principles developed by the Court of Justice.

3.4. Application of Article 106(2) as a Derogation from the Competition Rules

3.4.1. The Scope and Purpose of Article 106(2)

3.4.1.1. Overview

The social dimension of the EU provisions envisages a mechanism to ensure that the non-commercial elements of public services are protected. In this respect, Article 106(2) of the Treaty provides a limited derogation from the rules of the Treaty with regard to the activities of undertakings entrusted by the State with certain obligations. Public service obligations are generally entrusted to State monopolies in exchange for their special or exclusive rights.[539] According to Article 106(2) TFEU, the Treaty rules shall apply to two types of undertakings, i.e. revenue producing monopolies and those entrusted with the services of general economic interest, only in so far as that does not obstruct the performance of their tasks. It is subject to the condition that the exception should not affect trade to an extent contrary to the interests of the Union.

Unlike Article 106(1), Article 106(2) is addressed to undertakings themselves and not to Member States, although Member States are also able to rely on Article 106(2) and these two provisions may be applied together. As is the case with Article 106(1), Article 106(2) TFEU also makes a special reference to competition rules. In this respect, Article 106(2) is particularly important in relation to the application of Article 102 because there is no other exemption or derogation in the Treaty applicable to this provision. In other words, Article 106(2) is the only defence available for the abuse of dominant position within the meaning of Article 102 TFEU. Therefore, Article 106(2) plays a key role in protecting State activities where public services, or to be more specific, services of general economic interest are at stake.

In *France v Commission*, the Court expressed its view that the purpose of Article 90 EEC (now Article 106(2) TFEU) was to "*reconcile the Member States' interest in using*

[539] Geradin, p.181.

certain undertakings, in particular in the public sector, as an instrument of economic or fiscal policy with the Community's interest in ensuring compliance with the rules on competition and the preservation of the unity of the Common Market."[540] Similarly in *Italy v Commission*, the Court stated that "*Article 86(2) [now Article 106(2) TFEU] is to safeguard the tasks which a Member State sees fit to entrust to a specific body*."[541]

The interpretation of Article 106(2) has produced certain difficulties and a complex case law. For example, there have been doubts as to the meaning of services of general economic interest or when particular undertakings meet the qualifying requirements of being entrusted with such services. Another important issue is about the appropriate test to apply to determine whether these undertakings' tasks are 'obstructed' by the application of normal Treaty rules.

3.4.1.2. Article 106(2) and its Relation with Article 14

Before the Amsterdam Treaty, consideration of services of general economic interest was largely confined to the competition law and application of the derogation in Article 106(2). Amsterdam Treaty introduced Article 16 (now Article 14 TFEU) as a reference to the role of services of general economic interest, within the meaning of Article 106(2). The provision under Article 16 (now Article 14 TFEU) recognised the fundamental character of the values underpinning such services and the need for Community to take into account their function in devising and implementing all its policies, placing it among the principles of the Treaty. However, with the insertion of Article 16 (now Article 14 TFEU) into the "Principles" part of the EC Treaty many questions as to the legal status, significance and regulation of such services were raised. Being recognised as a fundamental principle, the respect for services of general economic interest has further enhanced through

[540] Case C-202/88 *France v Commission* [1991] ECR I-1223; [1992] 5 CMLR 552.
[541] Case 41/87 *Italy v Commission* [1984] ECR 873; [1985] 2 CMLR 368, para.30.

the recognition of access to such services as one of the fundamental rights of the EU in Article 36 of the Charter of Fundamental Rights of the Union.[542]

In the new Treaty on the Functioning of the European Union (TFEU) this provision has remained in the Part I-Principles and Title II-Provisions Having General Application. The text of Article 14 is as follows:

"*Without prejudice to Article 4 of the Treaty on European Union or to Articles 93, 106 and 107 of this Treaty, and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Union and the Member States, each within their respective powers and within the scope of application of the Treaties, shall take care that such services operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfil their missions. The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services*."

As its location in the Treaty suggests, services of general economic interest are considered as a key element in the European model of society. In this respect, Article 14 confirms their place among the shared values of the Union and their role in promoting social and territorial cohesion. It also stresses the joint responsibility of the Union and the Member States and establishes a legal basis for the EU to take action.[543]

Article 14 TFEU does not indicate which services are of general economic interest but indirectly identifies an essential characteristic of these services. On its own, the statement in Article 14 TFEU does not really clarify the concept of services of general economic interest but it is understood that for political and social reasons they are made

[542] Charter of Fundamental Rights of the European Union OJ C 364/1, 18/12/2000.
[543] Communication of the Commission on services of general interest, including social services of general interest: a new European commitment, COM(2007) 725, p.3.

available to all citizens in all regions of a Member State.[544] In this sense, such services promote social and territorial cohesion. However, neither Article 14 TFEU, nor Article 36 of the Charter provides any further guidance on how to balance the operation of competitive markets and the provision of services of general interest.

The question is whether, or to what extent, Article 14 and 106(2) TFEU can be legitimately invoked by a Member State to limit the application of competition rules. Even though the former Article 16 (now Article 14 TFEU) was inserted more than a decade ago by the Treaty of Amsterdam, there is still no consensus as to how it may be interpreted and applied in practice. The answer to this question lingers between the legal and political spheres.[545] In fact, it appears not to have played any role in Commission's decisions or Court's rulings since it came into force. However, with the attachment of the Protocol on Services of General Interest to the Lisbon Treaty, the competences and roles of the Member States in the protection of such services have been more clarified.

3.4.2. Undertakings Entrusted with the Operation of Services of General Economic Interest

3.4.2.1. The Notion of Services of General Economic Interest and the Related Concepts

Article 106(2) TFEU does not define services of general economic interest (SGEI) but it only lays down conditions for the exemption from competition and State aid rules. This is because, in principle, Member States are primarily responsible for defining what they regard as services of general economic interest on the basis of specific features of the activities. In the so-called energy cases[546] of the 1990s, the Court held that Member States "*cannot be precluded, when defining the services of general economic interest which they*

[544] Phedon Nicolaides, "Competition and Services of General Economic Interest in the EU: Reconciling Economics and Law", **State Aid Law Qarterly (EStAL)**, Vol.2, 2003, p.185.
[545] Antonio F. Bavasso, "Public Service Broadcasting and State Aid Rules: Between a Rock and Hard Place", **E.L.Rev**., Vol. 27, No. 3, 2002, pp. 340-350.
[546] Case C-157/94 *Commission v Netherlands* [1997] ECR I-5699, [1998] 2 CMLR 373; Case C-158/94 *Commission v Italy* [1997] ECR I-5798, [1998] 2 CMLR 373; Case C-159/94 *Commission v France* [1997] ECR I-5815.

entrust to undertakings, from taking account of objectives pertaining to their national policy or from endeavouring to attain them by means of obligations and constraints which they impose on such undertakings."[547]

The definition of such services by the Member States can only be subject to control by the Union institutions for manifest error. According to the CFI, *"[t]hat prerogative of the Member State concerning the definition of SGEIs is confirmed by the absence of any competence specially attributed to the Commission and by the absence of a precise and complete definition of the concept of SGEI in Community law.*" [548] Nevertheless, Faull and Nikpay believe that 'services of general economic interest' is "*a Community law concept that more or less corresponds with the notion of public services that exist in some Member States*."[549] Moreover, Member States do not have an unfettered power to determine the status of SGEI. In this respect, a Member State is required to establish "*certain minimum criteria common to every SGEI mission within the meaning of the EC Treaty, as explained in the case law, and to demonstrate that those criteria are indeed satisfied in the particular case. These are, notably, the presence of an act of the public authority entrusting the operators in question with an SGEI mission and the universal and compulsory nature of that mission*."[550]

In general terms, services of general economic interest (SGEI) can be described as commercial services of general economic utility, on which the public authorities therefore impose specific public-service obligations within the meaning of Article 106 of the Treaty.[551] From competition law point of view an alternative definition is given by Sauter as follows: "*Services of general economic interest (SGEI) are an EU legal category that provides an exception to the competition rules for the pursuit of legitimate public interest*

[547] Case C-157/94 *Commission v Netherlands* [1997] ECR I-5699, para.40.
[548] Case T-289/03 *British United Provident Association Ltd* (*BUPA) and others v Commission of the European Communities* [2008] ECR II-81, para.166.
[549] Faull and Nikpay, p.313.
[550] Case T-289/03 *BUPA* [2008] ECR II-81, para.172.
[551] http://europa.eu/scadplus/glossary/services_general_economic_interest_en.htm (as of 24.11.2010).

goal by private undertakings."[552] Transport, energy and communication services are the main examples for such services. SGEI are therefore services which belong to the market, but to which other, 'non-market' values are applied.[553]

Services of general interest (SGI), which is also called as 'general interest services', is a wider concept concerning services considered to be in the general interest by the public authorities and accordingly subjected to specific public-service obligations. Therefore, it is essentially the responsibility of public authorities, at the relevant level to decide on the nature and scope of SGI. The scope and organisation of these services differ from one Member State to another according to their histories and cultures of State intervention. They usually cover a broad range of activities, from the large network industries such as energy, telecommunications, transport, audiovisual broadcasting and postal services to education, water supply, waste management, health and social services.[554]

Different from SGEI, SGI include both economic (e.g. energy and communications) and non-economic services (e.g. compulsory education, social protection) and also obligations of the State (e.g. security and justice).[555] Article 106 of the Treaty does not apply to non-economic services and State obligations. Public authorities can decide to carry out the services themselves or they can decide to entrust them to other entities, which can be public or private, and can either act for profit or not for profit. The Protocol on Services of General Interest, which entered into force as an Annex to the Lisbon Treaty, brought this concept into the primary EU law for the first time, as the former Treaty only referred to the services of general economic interest.

'Public services' is not a technical term in the EU law and it usually used to refer services whose delivery is generally considered to be in the public interest and which may be either regulated, provided or financed by the State. Although the Commission tries to

[552] Wolf Sauter, "Services of General Economic Interest and Universal Service in EU Law", **E.L.Rev.**, Vol.33, No.2, 2008, pp.167-193.
[553] Jones and Sufrin, opcit., p.538.
[554] Commission Communication on services on general interest, including social services of general interest: a new European commitment, COM (2007) 725, p.3.
[555] http://europa.eu/scadplus/glossary/general_interest_services_en.htm (as of 24.11.2010).

avoid using this term, it is often appeared in the case law. The concept of public service has two layers in which it embraces both bodies providing services and the general-interest services they provide. Public service obligations may be imposed by the public authorities on the body providing a service in order to ensure that certain public interest objectives are met (e.g. airlines, road or rail carriers, energy producers). The concept of the public service and the concept of the public sector, including the civil service, are often, wrongly, confused. Actually, they differ, in terms of function, status, ownership and clientele.[556]

Universal service obligation is a key accompaniment to liberalisation of certain sectors such as telecommunications in the European Union. The Commission has attempted to reduce the tension between liberalisation and provision of public services through the development of 'universal service' concept.[557] In this respect, universal service is defined as the minimum set of services of specified quality to which all users and consumers have access in the light of specific national conditions and at an affordable price.[558] The definition and guarantee of universal service ensures that the continuous accessibility and quality of established services is maintained for all users and consumers during the process of passing from monopoly provision to openly competitive markets. It is particularly relevant to the provision of basic postal and telecommunications services, as well as utilities. In the White Paper, the Commission refers to the 'universal service' as a dynamic concept. Accordingly, "*it ensures that general interest requirements can take account of political, social, economic and technological developments and it allows these requirements, where necessary, to be regularly adjusted to the citizens' evolving needs*."[559] In this respect, universal service obligations are very important in the application of Article 106(2) to SGEI.

SGI and SGEI are different from ordinary services in that public authorities consider that they need to be provided even where the market may not have sufficient

[556] http://europa.eu/scadplus/glossary/public_service_en.htm (as of 24.11.2010).
[557] Geradin, opcit.
[558] Commission Communication on Services of General Interest, OJ C 2001, 17/04, para.39.
[559] White Paper of 12.5.2004, COM (2004) 374, Annex I, para.51.

incentives to provide them. This does not exclude the fact that most basic services, such as food, clothing or shelter could be best provided by market forces. On the other hand, if the public authorities consider that certain services are in the general interest and market forces are inefficient or insufficient in the provision of such services, they can lay down a number of specific service provisions to meet these needs in the form of service of general interest.

As is explained in the first chapter, in principle, internal market and competition rules do not apply to non-economic activities and therefore have no impact on SGI to the extent to which these services constitute non-economic activities. Therefore, Article 106 does not apply if such services are considered to be of non-economic nature. Member States have several options for ensuring the provision of services of general economic interest. For example, they can open up the market to competition, impose public service obligations or confer exclusive or special rights to a single operator or a limited number of operators, with or without provision of funding.

3.4.2.2. Undertakings Operating Services of General Economic Interest

SGEI fall within the scope of competition and State aid rules because they are economic in nature. As a result, although the perceived special features of SGEI set them apart from other economic services, operators of SGEI are undertakings which engage in economic activities. The definition of undertaking was discussed in the previous sections and it has no special meaning here.

As mentioned earlier, as long as there is economic activity, the legal status of the undertaking in its national law is irrelevant. By the same token, there is no need for public ownership to provide SGEI. The Treaty itself is neutral as to private or public ownership of enterprises on the basis of Article 345 TFEU. This means that EU cannot prevent public authorities from owning undertakings nor can it prevent State owned undertakings from competing on the market. In this respect, Article 106(2) applies irrespective of legal status

or public ownership. Thus, what matters is the nature of the services provided rather than the nature of the provider.[560]

3.4.3. Revenue Producing Monopolies

This is a reference to undertakings which exploit their exclusive rights to raise revenue for the State.[561] Thus, a revenue producing monopoly can be defined "*as an undertaking that has been given an exclusive right solely for the purpose of creating revenue for a Member State*."[562] In other words, they are monopolies created by the State with the simple objective of obtaining revenues for the State rather than offering a service of general economic interest. Accordingly, this category includes the undertakings to which a public authority has granted exclusive rights in order to obtain revenue for the State. For example, tobacco and alcohol monopolies that exist in some Member States can be regarded as revenue producing monopolies. Usually, these undertakings are public undertakings whose profits will belong to their owner, the State. However, it is possible to have a situation where the State, through a form of contracting out or another similar legal device, transfers the exclusive right to a private undertaking in exchange of which it receives funds.[563] Both cases are examples of revenue producing monopolies within the meaning of Article 106(2).

These undertakings may also constitute monopolies subject to the rules laid down in Article 37 TFEU. Article 37 is located among the free movement of goods provisions, but the Court has stated that this provision aims to eliminate distortions of competition in the Union as well as discrimination against the products and trade of other Member States. As the relation of this provision with Article 106 and the probable application of Article 106(2) to the undertakings within Article 37 have been discussed earlier, it will not be repeated here. However, in the light of the case law developed in this field, it appears that

[560] Nicolaides, "Competition and Services of General Economic Interest in the EU: Reconciling Economics and Law", opcit.
[561] Jones and Sufrin, p. 569.
[562] Ivo Van Bael, **Competition Law of the European Community**, the Hague: Kluwer Law International, 2005, p. 1013.
[563] Buendia Sierra, p.287.

only public interests of non-economic nature may justify the creation of such monopolies under Article 37 TFEU. In this regard, in *Franzen,* which concerns Swedish public monopoly on the sale of alcoholic beverages, the Court held that State monopolies' structures and fees must be both proportionate to the public interest being pursued and must employ the method that is the least restrictive to intra-Community trade.[564]

Although their importance seems to be diminishing throughout Europe, establishment and maintenance of such monopolies may be due to various reasons. A monopoly which is established in order to provide citizens with a service of general economic interest can also be an important source of income for the State. Although both reasons co-exist in many cases, States naturally tend to justify the monopoly on public service rather than revenue producing grounds. This is because relying on the former category is easier vis-à-vis the Commission and the public. As a result, the concept of 'revenue producing monopoly' is hardly mentioned in the case law.[565]

3.4.4. Conditions for Application

3.4.4.1. Entrustment

The application of Article 106(2) requires from Member States the respect to the certain basic conditions which have been developed in the case law of the Court and described by the Commission. Among these conditions, a clear mandate must be assigned by the competent public authority to the service provider regarding the operation of the service in question. This condition has become more significant following the *Altmark*[566] ruling with regard to the application of State aid rules to the services of general economic interest. Therefore, Member States must ensure that such adoption of acts of entrustment is effectively made for all such services.

[564] Case C-189/95 *Criminal Proceedings against Harry Franzen* [1997] ECR I-5909, para.75.
[565] Ibid.
[566] Case C-280/00 *Altmark Trans GmbH and Regierungsprasidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH (Altmark)* [2003] ECR I-7747.

In every case, for the exception provided for by Article 106(2) to apply, the public service mission needs to be clearly defined and must be explicitly entrusted through an act of public authority.[567] The public service mission entails certain tasks assigned to an undertaking by a positive act conferring on it certain functions or by granting it a concession. This assignment should be made by way of one or more acts, the form of which is determined by the Member State concerned.[568] Therefore, merely tolerating, approving, or endorsing the undertaking's activities is not sufficient to determine the proper existence of entrustment.[569]

This obligation is necessary to ensure legal certainty as well as transparency vis-à-vis the citizens and is indispensable for the Commission to carry out its proportionality assessment. According to the Commission, the Member States' approval of the Eurocheques system did not mean that Article 106(2) applied to the banks concerned.[570] In another decision the Commission found that an authors' rights society was not within Article 106(2) merely because it was subject to obligations imposed on all monopolies by national law.[571] In *Dusseldorp,* AG Jacobs submitted that an undertaking is entrusted with a service where certain obligations are imposed on it by the State in the general economic interest.[572]

3.4.4.2. Operation of Services of General Economic Interest

The full application of the Treaty rules may produce results which are incompatible with the pursuit of the specific missions of general interest assigned to these services. These situations are addressed by Article 106(2) as interpreted by the case law of

[567] Case C-159/94 *Commission v France (EDF)* [1997] ECR I-5815.
[568] Preamble of the Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, para.70.
[569] Jones and Suffrin, p.569.
[570] Commission Decision, (*Uniform Eurocheques)* [1985] OJ L35/43, [1985] 3 CMLR 434.
[571] Commission Decision, (*GEMA)* [1971] OJ L134/15.
[572] Opinion of AG Jacobs in Case C-203/96 *Chemische Afvalstoffen Dusseldorp BV v Minister van Volkshuisvesting, Ruimtelijke Ordening en Milieubeheer* [1998] ECR-I-4075, [1998] 3 CMLR 873, para.103.

the Court of Justice.[573] It is relatively easy to deal with SGEI when they are regulated at the EU level. In case of large network industries which have a European-wide dimension, such as telecommunications, electricity, gas, transport and postal services, the services are regulated by a specific EU legislative framework.[574] For example, certain aspects of public broadcasting now are governed by the new Audiovisual Media Services Directive.[575] In the preamble of this Directive it is stated as follows: "*Audiovisual media services are as much cultural services as they are economic services. Their growing importance for societies, democracy- in particular by ensuring freedom of information, diversity of opinion and media pluralism- education, and culture justifies the application of specific rules to these services*."[576] Other services of general economic interest which are not governed by specific EU legislation, such as those in the area of waste management, water supply or waste water treatment, are subject to Union rules like public procurement, environmental and consumer protection. In secondary law, the pursuit of public interest objectives by services of general economic interest is also taken into account in the Services Directive.[577]

The Court's case law, the Commission's Communications and Papers, and the secondary legislation provides a useful assistance to determine what type of services can be classified as SGEI. Although it is left to the Member States' discretion to define what they regard as SGEI on the basis of specific features of the activities, the Court held that 'services of general economic interest' is a Community concept and must be uniformly applied by the Member States.[578] The uniform application of the concept can only be ensured if there are uniform standards adopted by the Member States throughout the EU for such services, which is the task to be handled by the Union institutions.

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[573] See for example, Case C-320/91 *Corbeau* [1993] ECR I-2533; Case C-393/02 *Almelo* [1994] ECR I-1477; Joined Cases C-157/94 to C-160/94 *Commission v Netherlands* [1997] ECR I-5699, *Commission v Italy* [1997] ECR I-5789, *Commission v France* [1997] ECR I-5815, and *Commission v Spain* [1997] ECR I-5851.
[574] Communication of the Commission on Services of General Interest, p.4.
[575] Directive 2010/13/EU of the European Parliament and of the Council of March 10 2010 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services (Audiovisual Media Services Directive).
[576] Ibid, preamble, para.5.
[577] Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, in particular, Article 17.
[578] Case 10/71 *Ministére Public of Luxembourg v Muller* [1971] ECR 723, paras.14-15.

The reason for assignment of the operation of SGEI to undertakings is often that operation of such services needs to be undertaken in the public interest but might not be undertaken, usually for economic reasons, if they were to be left to the private sector.[579] In the case law, some of the services that the Court of Justice has accepted as SGEI are as follows; the administration of major motorways,[580] mooring services in ports,[581] the operation of the electricity supply network,[582] the operation of non-economically viable air routes,[583] the operation of the basic postal services,[584] the performance of the obligations flowing from the Universal Postal Convention,[585] the treatment of waste,[586] sectoral supplementary pension funds,[587] provision of ambulance services.[588]

Although the Court has expanded the concept of SGEI beyond the basic utilities, the Court stated in several cases that the provisions of Article 106(2) constituted an exception to the general rules of the Treaty and therefore must be narrowly construed. As a consequence, in *BRT v SABAM* [589] and *GVL v Commission*[590] the Court found that the collection of authors' royalties was concerned with the management of private interests, although they might be placed under public supervision. Despite the well-developed case law in this field, it is not always easy to determine which services can be regarded as SGEI or which services cannot. For example, in *Merci Convenzionali*, AG Gerven stated that the management of a port is an activity of general economic interest, whereas carrying out or organising the dock work is not. He suggested that if the latter activities were considered to be of general economic interest, then almost all economic activities would fall within this

[579] Opinion of AG Jacobs in Case C-203/96 *Dusseldorp* [1998] ECR-I-4075, [1998] 3 CMLR 873, para.105.
[580] Case 10/71 *Ministére Public of Luxembourg v Muller* [1971] ECR 723
[581] Case C-266/96 *Corsica Ferries France SA v Gruppo Antichi Ormeggiatori del Porto di Genova (Corsica Ferries)* [1998] ECR I-3949, [1998] 5 CMLR 402.
[582] Case C-393/92 *Gemeente Almelo (Almelo)* [1994] ECR I-1477; Case C-157/94 *Commission v Netherlands (Electricity Imports)* [1997] ECR I-5699.
[583] Case C-66/86 *Ahmed Saeed* [1989] ECR 803, [1990] 4 CMLR 102.
[584] Case C-320/91 *Corbeau* [1993] ECR I-2533, [1995] 4 CMLR 621.
[585] Joined Cases C-147 to C-148/97 *Deutsche Post AG v Gesellschaft für Zahlungssysteme mbH (GZS) and Citicorp Kartenservice GmbH* [2000] ECR I-825, [2000] 4 CMLR 838.
[586] Case C-203/96 *Dusseldorp* [1998] ECR I-4075, [1998] 3 CMLR 873.
[587] Case C-67/96 *Albany* [1999] ECR I-5751, [2000] 4 CMLR 446.
[588] Case C-475/99 *Ambulanz Glöckner* [2001] ECR I-8089, [2002] 4 CMLR 726.
[589] Case 127/73 *Belgische Radio en Televisie & Société Belge des Auters, Compositeurs et Editeurs v SV SABAM & NV Fonior* [1974] ECR 51.
[590] Case 7/82 *Gesellschaft zur Verwertung von Leistungsschutzrechten mbH v Commission* [1983] ECR 483.

concept. According to AG Gerven, the decisive question is whether or not the services are of direct benefit to the society as a whole.[591] The Court, without any explanation, did not accept that the undertakings carrying out dock-work, including loading, unloading, transhipment and storage of goods in a port, to be entrusted with a service of general economic interest.[592] The Court usually accepts the existence of SGEI when they are rendered on behalf of all users throughout the territory of a Member State and irrespective of specific situations or the degree of economic viability of each individual operation.[593]

3.4.4.3. Obstruction of Performance or Proportionality Test

Since SGEI are economic in nature they are, in principle, fully subject to Treaty rules, including the rules on free movements, competition and State aids. The full application of these rules to SGEI may threaten the legitimate public interests in the provision of SGEI. On the other hand, public interests and the dynamics of free market economy are not always or necessarily in conflict with each other. This is because opening up services to competition frequently leads to lower prices and greater range of choice for consumers.[594] Therefore, it is essential to provide SGEI with the least disturbance to the competitive markets while observing the public interest. In other words, the concept of SGEI offers a reasonable solution to this dilemma, since proportionate restrictions on competition can be imposed for the benefit of undertakings charged with SGEI to the extent necessary to perform their public service tasks.

According to Article 106(2), if the application of competition or State aid rules obstructs the performance, in law or in fact, of the particular tasks assigned to the undertakings, these services may benefit from a derogation from these rules, provided that certain conditions are satisfied. In respect of State aids, for example, the proportionality of compensation provided to undertakings entrusted with the operation of those services is one of these conditions. In this respect, Article 106(2) suggests a threshold which provides that

[591] Opinion of AG Gerven in Case C-179/90 *Merci Convenzionali* [1991] ECR I-5009, para.27.
[592] Case C-179/90 *Merci Convenzionali* [1991] ECR I-5009, para.28.
[593] See for example, Case C-320/91 *Corbeau* [1993] ECR I-2533, para.15.
[594] Sauter, opcit.

whenever its application has the potential to obstruct the provision of SGEI, a State measure under consideration will have to be justified, and only to the degree necessary for the national provision of SGEI. Anything beyond what is strictly necessary may be considered as illegal aid. By the same token, the Court accepts the grant of special or exclusive rights to the extent that they are justified by public interests and proportionate to the objectives pursued.[595] Therefore, in cases regarding the operation of SGEI, the main question is whether non-compliance with the Treaty rules is essential to the fulfilment of the entrusted tasks and the proportionality should be assessed. Sauter's analysis distinguishes two types of proportionality relevant to SGEI: the 'mild' test of manifestly disproportionate and the 'strict' test of least restrictive means, application being dependent upon whether pre-emption has occurred in the forms of a Community norm occupying the field.[596]

In the early cases the Court was very strict about the 'obstruction of the performance' criteria. In *Höfner,* the Court accepted that the Bundesanstalt had been entrusted with SGEI but stated that such an undertaking remained subject to the competition rules 'unless and to the extent to which it is shown that their application is *incompatible* with the discharge of its duties'.[597] In *Merci Convenzionali*, the Court held that even if the services of general interest had been involved it would not have been necessary for the undertaking to infringe the Treaty rules.[598] Since Article 106(2) provides for a derogation from the normal application of competition rules, it is for the undertaking which relies on this provision to prove that the 'obstruction of performance' condition is satisfied. In this parallel, in *British Telecom*, the Court said that Italy had failed to establish that compliance by BT with the competition rules would obstruct it in carrying out its tasks.[599]

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[595] See for example, Case C-70/95 *Sodemare* [1997] ECR-3395; Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-9141.
[596] Wolf Sauter, opcit., p.176.
[597] Case C-41/90 *Höfner* [1991] ECR I-1979, [1993] 4 CMLR 306, para.24.
[598] Case C- C-179/90 *Merci Convenzionali* [1991] ECR I-5009, [1994] 4 CMLR 422.
[599] Case 41/83 *Italy v Commission (British Telecom)* [1985] ECR 873 [1985] 2 CMLR 368.

Similarly in *RTT*, the Court did not accept that the undertaking entrusted with the public telephone network also needed power to lay down the standards for telephone equipment and to check rival equipment suppliers' compliance with them.[600]

The Court shifted its approach towards a proportionality test in *Corbeau*. According to the Court, the question was the extent to which a restriction on competition or even the exclusion of all competition from other operators is necessary in order to allow the undertaking with exclusive right to perform its task of general interest under 'economically acceptable conditions'.[601] The Court answered the question in the way that the obligation on the part of the undertaking entrusted with that task to perform its services in conditions of economic equilibrium presupposes that it will be possible to offset less profitable sectors against the profitable sectors.[602] Therefore, it justifies a restriction of competition from individual undertakings where the economically profitable sectors are concerned. The Court based its reasoning on the fact that to authorise individual undertakings to compete with the undertaking holding exclusive rights would make it possible for them to concentrate on the economically profitable operations and to offer more advantageous tariffs.[603] This is because individual undertakings are not bound for economic reasons to offset losses in the unprofitable sectors against profits in the more profitable sectors. However, the exclusion of competition is not justified as regards specific services dissociable from the service of general interest which meet special needs of economic operators and which call for certain additional services not offered by the traditional postal service.[604]

In *Commission v Netherlands*, the Court was more explicit as to the meaning of 'obstruction of the performance' and the proportionality condition. In this case the Court stated that it is not necessary, in order for the conditions for the application of Article 106(2) to be fulfilled, that the financial balance or economic viability of the undertaking

[600] Case C-18/88 *RTT* [1991] ECR I-5973.
[601] Case C-320/91 *Corbeau* [1993] ECR I-2533, para.16.
[602] It means cross-subsidy is allowed for these undertakings to maintain their economic equilibrium.
[603] This is called in the doctrin as 'cherry picking' or 'cream-skimming'.
[604] Case C-320/91 *Corbeau* [1993] ECR I-2533, paras.17 to 19.

entrusted with the operation of SGEI should be threatened. It is sufficient that, in the absence of the rights at issue, it would not be possible for the undertaking to perform the particular tasks entrusted to it, defined by reference to the obligations and constraints to which it is subject.[605] The Court added that it is incumbent on the Member State which invokes Article 106(2) to demonstrate that the conditions of that provision are met. However, that burden of proof cannot be so extensive as to require the Member State to prove that no other conceivable measure could enable those tasks to be performed under the same conditions in the event of elimination of the contested measures.[606]

In *Almelo*, the undertaking in question was given the task of ensuring the supply of electricity in part of a national territory. As a reply to questions referred by the national court, the Court said that restrictions on competition from other economic operators must be allowed in so far as they are necessary in order to enable the undertaking entrusted with such a task of general interest to perform it. In that regard, it is necessary to take into consideration the economic conditions in which the undertaking operates, in particular the costs which it has to bear and the legislation, particularly concerning the environment, to which it is subject.[607] According to Ross, the judgement "*clearly indicated that the availability of the derogation was to be measured by a balancing exercise based upon competing priorities rather than inhibiting that choice by insisting upon narrow economic test to be satisfied before the normal market rules can be disapplied*."[608]

The Court's approach in *Dusseldorp* was less flexible and it reminded of its previous rulings. The case was about a monopoly over waste incineration. In this case, the Court ruled that even if the task could constitute a task of general economic interest it was for the Dutch Government to show to the satisfaction of the national court that the objective could not be achieved by other means. The Court also stated that Article 106(2) could apply

[605] Case C-157/94 *Commission v Netherlands (Electricity Imports)* [1997] ECR I-5699, para.52.
[606] Ibid.,para.58.
[607] Case C-393/92 *Almelo* [1994] ECR I-1477, paras.46 and 49.
[608] Ross, p.25.

only if it is shown that without the contested measure the undertaking could not carry out its entrusted task.[609]

Corsica Ferries is another important case which is about an Italian law that obliges ships from other Member States to use the services of local mooring companies who held exclusive concessions in each port. There were three aspects of abuse alleged in this case. The first one was the grant of exclusive rights to local mooring groups, preventing shipping companies from using their own staff to carry out mooring operations. The second one is the excessive nature of the price of the service, which had no relation to the actual cost of the service provided. The third one was the fixing of tariffs that varied from port to port for equivalent services.[610] The local mooring companies submitted, *inter alia*, that the tariffs included a component corresponding to the additional cost of providing a universal service and the services provided were not equal; therefore, they were justified by the characteristics of the service and the need to ensure universal coverage.

In *Corsica Ferries*, the Court ruled that it was not incompatible with Article 102 TFEU and Article 106(1) TFEU to include in the price of the service a component designed to cover the cost of maintaining the universal service. However, it should correspond to the supplementary costs occasioned by the special characteristics of that service. It is also compatible with the said Articles to lay down different tariffs for that service on the basis of the particular characteristics of each port. Consequently, since the mooring companies were entrusted with the services of general economic interest within the meaning of Article 106(2) and the other conditions of this provision were satisfied, legislation such as that at issue did not constitute an infringement of Article 102 TFEU of the Treaty.[611] Interestingly, the Court's ruling was straightforward. It did not explain how it reached these conclusions or whether the restrictions on competition were proportional to the public service objectives pursued. Moreover, the Court did not analyse whether the excessive charges actually corresponded the cost of the additional public service obligations.

[609] Case C-203/96 *Dusseldorp* [1998] ECR I-4075, [1998] 3 CMLR 873, para.67.
[610] Case C-266/96 *Corsica Ferries* [1998] ECR I-3949, [1985] 5 CMLR 402, para.37.
[611] ibid.,para.46-47.

The Court's judgement is quite precise and clear in *Albany*, which concerns the Dutch regime of compulsory affiliation to sectoral pension scheme. According to the Court, it is not necessary, in order for the conditions for the application of Article 90(2) TEC (now Article 106(2) TFEU) to be fulfilled, that the financial balance or economic viability of the undertaking entrusted with the SGEI should be threatened. "*It is sufficient that, in the absence of the right at issue, it would not be possible for the undertaking to perform the particular tasks entrusted to it, defined by reference to the obligations and constraints to which it is subject…or that maintenance of those rights is necessary to enable the holder of them to perform the tasks of general economic interest which have been assigned to it under economically acceptable conditions*."[612]

On the other hand, the CFI draws the bottom line in *Air Inter*, which is about the Commission's challenge to the granting of exclusive rights on two internal French air routes to Air Inter. In this case, the CFI stated that the application of competition rules could be excluded only in as much as they 'obstructed' performance of the tasks entrusted to the undertaking. "*Since that condition must be interpreted strictly, it was not sufficient for such performance to be simply hindered or made more difficult*." [613] It was for the undertaking granted with exclusive right to establish any obstruction of its tasks.

3.4.4.4. No Effect on Trade against the Interests of the Union

Article 106(2) includes a further condition that 'the development of trade must not be affected to such an extent as would be contrary to the interests of the Union.' This is similar to the provision in Article 36 TFEU that the derogation from the free movement provisions should not be 'a means of arbitrary discrimination or a disguised restriction on trade between Member States.'

Unlike the provision in Article 36 TFEU, the last condition of Article 106(2) has been considered to be a further proportionality requirement. This is because if there is no

[612] Case C-67/96 *Albany* [1999] ECR I-5751, para.107.
[613] Case T-260/94 *Air Inter v Commission* [1997] ECR II-997, [1997] 5 CMLR 851, para.138.

effect on trade between Member States, the Articles 101 and 102 will not apply in the first place. Therefore, when the other conditions of Article 106(2) are fulfilled the effect on trade between the Member States is almost inevitable. In one of its Decisions, the Commission stated that the undertaking with a statutory monopoly over the general letter mail in Belgium had infringed Article 102 TFEU by operating a tying policy in order to exclude competitors from the neighbouring business-to-business market. The Commission added that the sealing off of a national market would have impeded trade to an extent contrary to the Community Interest.[614]

3.5. Application of Article 106(2) as a Derogation from State Aid Rules

3.5.1. Purpose of State Aid Regulation and Legal Framework

State aid or subsidy[615] is one of the most significant forms of State intervention into the economic sphere. Governments have always granted State aids for various reasons, in various forms and producing various effects. They include direct money transfers, grants, loans and State guarantees, as well as indirect forms of financial assistance to struggling undertakings or potentially successful ones. As a result, this type of State intervention not only interacts with the flow of goods or services but also with the conduct of economic operators including the recipients and their competitors.[616] Under certain conditions, they may distort competitive process.

On the one hand, State aids can be used as a form of protectionism, to benefit national producers, to give them competitive advantages and to avoid necessary structural adaptation.[617] They can also be used to export the difficulties faced by domestic industry to competing undertakings in other Member States. The adverse effects of a State aid are not necessarily felt by the undertakings established in other Member States alone. Undertakings established in the State granting the aid may also find themselves victims of unfair,

[614] Commission Decision (*De Post-La Poste*), [2002] OJ L61/32.
[615] Subsidy is the equivalent term of State aid in the WTO (World Trade Organisation) Law.
[616] Rubini, p.41.
[617] Commission's Twelveth Report on Competition Policy, para. 158.

subsidised competition and the whole economy of a State may suffer from the inefficient allocation of resources. The resulting distortion of competition would inevitably provoke a rapid retaliatory escalation in the amount of aids granted by other Member States, undermining the Common Market and distorting trade in a manner incompatible with the fundamental principles of the Treaty.[618]

On the other hand, governments do not usually grant State aids without any justifiable reason. In this respect, State aids are one of the preferred tools to remedy market failures and to improve society's welfare. They become even more crucial especially at the extraordinary times of environmental problems, natural disasters, wars or financial crisis, like the very recent one. Therefore, the State aids may be beneficial as long as they are well-regulated.

When regulating State aids, the aim of the Treaty, "*is to prevent trade between Member States from being affected by advantages granted by public authorities which in various forms, distorts or threaten to distort competition by favouring certain undertakings or certain products*."[619] Indeed, Member States would not have accepted a prohibition on customs duties or quotas and other equivalent measures if their effect had substantially been replaced by State aids.

The State aid rules in the Treaty are located under Title VII 'Common Rules on Competition, Taxation and Approximation of Laws', Chapter 1 'Rules on Competition' and Section 2 'Aids Granted by States' between Articles 107-109. The text of Article 107 TFEU (ex Article 87 TEC) is as follows:

1. Save as otherwise provided in the Treaties, 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 shall, in so far as it affects trade between Member States, be incompatible with the internal market.

[618] Fiona C. Cownie, "State Aids in the Eighties", **E.L.Rev.**, Vol. 11, No. 4, 1986, pp. 247-267.
[619] Case 173/73 *Italy v Commission* [1974] ECR 709, para.26; Case C-387/92 *Banco Exterior de Espana* [1997] ECR I-877 para.12.

2. The following shall be compatible with the internal market:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

(b) aid to make good the damage caused by natural disasters or exceptional occurrences;

(c) aid granted to the economy of certain areas of the Federal Republic of Germany, insofar as such aid is required in order to compensate for the economic disadvantages caused by the division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.

3. The following may be considered to be compatible with the internal market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of structural, economic and social situation;

(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;

(e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

The Commission enjoys substantial discretion, first in determining whether a particular measure involves an element of State aid within the meaning of Article 107(1) and secondly in deciding whether any of the main categories of exemptions, as laid down in Article 107(3), apply to the State aid measure in question. In order to determine whether a State measure in question is compatible with the internal market under Article 107(3), the Commission must rely on complex economic, social, regional and sectoral assessments. Under Article 108(3) the aid in question should not be granted until it has been notified to and approved by the Commission. This is an absolute prohibition which is directly enforceable in the national courts.

3.5.2. Definition of State Aid and Conditions of Applicability

Article 107(1) prohibits 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 insofar as it affects trade between Member States. However, the Treaty contains no express definition of the concept of subsidy or aid referred to under Article 107(1).

In one of the earlier cases in this field, the Court held that "*a subsidy is normally defined as a payment in cash or in kind made in support of an undertaking other than the payment by the purchaser or consumer for the goods or services which it produces*."[620] According to the Court, aid is a very similar concept but it is especially devised for a particular objective which cannot be achieved without outside help. Then the Court made the following statement which has been repeated in many judgements since then: "*The concept of aid is nevertheless wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in the strict meaning of the word, are similar*

[620] Case 30/59 *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community* [1961] ECR 1, p.19.

in character and have the same effect." [621] Therefore, the notion of State aid has a very wide scope in the EU.

It is a well established jurisprudence that Article 107(1) of the Treaty does not distinguish between State interventions by reference to their causes or objectives but defines them by reference to their effects.[622] Hence, the actual form of the measure, the intention of the State or the public authority, the expectations of the recipient are deemed to be irrelevant.[623] The relevance of the causes or aims of State measures falls to be appraised only in the context of determining –pursuant to Article 107(3) of the Treaty-whether such measures are compatible with the Common Market.[624] It follows that the concept of aid is an objective one, the sole test being whether a State measure confers an advantage on one or more particular undertakings.[625]

Fundamental questions appear to remain open for each of the conditions laid down in Article 107(1). Even on the number of conditions contained in this provision, there does not seem to be a consensus yet. According to some commentators, the provision under Article 107(1) includes mainly three conditions[626] for the existence of State aid, whereas for some others it includes four.[627] However, the jurisprudence of the Court of Justice suggests the following test consisting of five components:[628]

(i) there should be a benefit or advantage (advantage)

(ii) which is granted by the State or through State resources;

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[621] Ibid. See also Case C-387/92 *Banco Exterior de Espana* [1997] ECR I-877 para.13.
[622] Case C-241/94 *France v Commission* [1996] ECR I-4551, paras. 19-20.
[623] Leigh Hancher, "Towards a New Definition of State Aid under European Law: Is there a New Concept of State Aid Emerging?, **European State Aid Law Quarterly (EStAL)**, Vol.3, 2003, p. 365.
[624] Case C-169/95 *Spain v Commission* [1997] ECR I-135, para 18 and Case C-355/95 *P TWD v Commision* [1997] ECR I-2549, para.26.
[625] Case T-67/94 *Ladbroke Racing Ltd. v Commission* [1998] ECR II-00001, para.52.
[626] Conor O. Quigley, "The Notion of a State Aid in the EEC", **E.L.Rev**., Vol.13, 1988, pp. 242-256.
[627] Malcolm Ross, "State Aids and National Courts: Definitions and Other Problems- A Case of Premature Emancipation?", **C.M.L.Rev**., Vol.37, 2000, p. 410. See also Bartlomiej Kurcz and Dimitri Vallindas, "Can General Measures be …Selective? Some Thoughts on the Interpretation of a State Aid Definition", **C.M.L.Rev.**, Vol.45, 2008, p. 160.
[628] See Opinion of AG Jacobs in Case C-256/97 *Déménagements-Manutention Transport (DTM)* [1999] ECR I-3913, [1999] 3 CMLR 1.

(iii) which favours certain undertakings over others; (selectivity)

(vi) which distorts or threatens to distort competition;

(v) which is capable of affecting trade between Member States.

The last two components of Article 107(1) TFEU are usually met with relative ease, given that the Court has consistently held that the Commission must only provide a sufficiently reasoned case as to why the aid in question can potentially affect trade.[629]

3.5.2.1. Advantage

In order for a State aid to exist, the measure in question must confer a benefit or an economic advantage on a certain undertaking or a class of undertakings. If the measure benefited only, for example, employees or consumers who are clearly not involved in any economic activity, there could be no State aid. To assess whether a measure constitutes aid, it must therefore be determined whether the undertaking receives an economic advantage which it would not have obtained under normal market conditions. 'Normal market conditions' is the key concept on which the private investor test has been developed.

In classical cases of State aid, such as grants or interest-free loans, the advantage factor is obvious, so that this condition was generally neglected or not given much consideration in the past. With the development of 'private investor' principle, the advantage condition received more importance. This principle of private investor[630] or operator [631] was originally developed by the Commission for determining whether investment by the State in the capital of an undertaking constitutes aid within the meaning

[629] Case C-301/87 *France v Commission* [1990] ECR I-307.
[630] This is also called as 'market investor', 'market economy investor' or 'market creditor' principle. See for example, Kelyn Bacon "The concept of state aid: The Developing Jurisprudence in the European and UK Courts", **E.C.L.R.**, Vol. 24(2), 2003, p.54-61.
[631] AG Leger stated that 'private operator' is more appropriate than 'private investor' because it can cover not only investments in the strict sense but also the other kinds of State measures to which this criterion applies. Opinion of AG Leger in Case C-280/00 *Altmark*, para. 15.

of Article 107(1).[632] Accordingly, no aid is involved when the action of the State is in line with the hypothetical behaviour of a rational, profit-driven investor, operating under normal market conditions. This is also in line with the principle that public and private sectors are to be treated equally. Given that it is based on the advantage condition, there will be no advantage granted to the undertakings when the State acts as a market operator seeking profits.[633]

The Court adopted this criterion in its case law and applied it to other kinds of State measures.[634] In order to assess whether a measure contains an element of aid, the Court thus examines whether a private investor of comparable size to the public bodies would have carried out the operation in question under the same conditions, having regard in particular to the information available and the foreseeable developments at the date of the measure adopted. For example, it was stated that where a public bank mobilises its resources to carry out an operation which a private bank would have carried out in the same circumstances, that operation cannot constitute State aid.[635] It was also held in the case law that "*in order to examine whether or not the State has adopted the conduct of a prudent investor operating in a market economy, it is necessary to place oneself in the context of the period during which the financial support measures were taken in order to assess the economic rationality of the State's conduct and thus to refrain from any assessment based on a later situation*."[636]

The Court applies this criterion where the State intervention is of economic nature. A typical case is that of a capital injection. A State or State-financed capital injection cannot be regarded as State aid where a 'private investor operating under normal market

[632] Communication to the Member States concerning public authorities' holdings in company capital, Bulletin EC-9-1984, point. 3.5.1.
[633] Adinda Sinnaeve, "State Financing of Public Services: The Court's Dilemma in the Altmark Case", **EStAL**, Vol. 3, 2003, p.352.
[634] See e.g. Case C-234/84 *Belgium Commission* [1986] ECR 2263; Case 40/85 *Belgium v Commission* [1986] ECR 2321. See also Commission Communication to the Member States on the application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector, OJ 1993 C307, p.3, point 11.
[635] Case T-123/97 *Salomon v Commission* [1999] ECR II-2925, paras.68-69.
[636] Case 482/99 *Stardust Marine* [2002] ECR I-4397 para.71.

conditions' would have made the investment.[637] Similarly, where the State offers to undertakings loans and other financial facilities on preferential terms, the Court compares the terms offered by the State with the likely terms of a 'private creditor' or private operator' asking whether such operator[638] "*would have entered into the transaction in question on the same terms and, if not, on which conditions he could have entered into the transaction*."[639] In these situations the 'private investor' criterion is applicable because the conduct of the State is capable of being adopted, at least in principle, by a private operator acting with a view to operate.[640] Application of this criterion is justified by the principle of equal treatment between the public and private sectors.[641] Accordingly, intervention by the State should not be subject to stricter rules than those applicable to private undertakings.

On the other hand, the criterion of private investor is not applicable where the State intervention has no economic character. That is the case where the public authorities pay a subsidy directly to an undertaking,[642] grant an exemption from tax,[643] or agree to a reduction in social security contributions.[644] This is because the test involves comparing the position of the State with that of a private entity. This means that this criterion is not relevant where the State is acting not as a market participant but in the exercise of its sovereign or public functions. In such cases there will be no private investor comparable to State as no private entity has the power, ability or reason to conduct similar operations. Therefore, in such cases, the focus will be on the selectivity criterion to determine whether the measure confers an advantage on a certain undertaking or group of undertakings for a State aid to exist.[645] The Court confirmed this principle in *Spain v Commission*. In this case the Court held that for the purpose of applying the private investor criterion "*a distinction*

[637] Case C-303/88 *Italy v Commission (ENI/Lanerossi)* [1991] ECR I-1433, [1993] 2 CMLR 1, paras.20-24; Case C-305/89 *Italy v Commission (Alfa Romeo)* [1991] ECR I-1603, paras.19-20.
[638] Case C-342/96 *Spain v Commission* [1999] ECR I-2459, [2000] 2 CMLR 415, para.41.
[639] Case T-16/96 *Cityflyer Express v Commission* [1998] ECR II-757, [1998] 2 CMLR 537, para.51.
[640] Opinion of AG Leger in Case C-280/00 *Altmark*, para.21.
[641] Case C-303/88 *Eni/Lanerossi* [1991] ECR I-1433, para.20; Case C-261/89 *Italy v Commission* [1991] ECR I-4437, para.15.
[642] Case C-310/85 *Deufil v Commission* [1987] ECR 901, para.8.
[643] Case C-387/92 *Banco Exterior de Espana* [1994] ECR I-877, para.14; Case 6/97 *Italy v Commission* [1999] ECR I-2981, para.16.
[644] Case C-75/97 *Belgium v Commission* [1999] ECR I-3671.
[645] See Opinion of AG Fenelly in Case C-390/98 *Banks v Coal Authority* [2001] ECR I-6117, paras-18-20.

must be drawn between the obligations which the State must assume as owner of the share capital of a company and its obligations as a public authority."[646]

3.5.2.2. Transfer of State Resources

For advantages to be capable of being categorised as aid within the meaning of Article 107(1) of the Treaty they must be granted directly or indirectly through State resources.[647] The condition of 'aid granted through State resources' serves to preclude circumvention of the State aid rules through decentralised or privatised distribution of aid. Whenever an aid granted either directly by the State or indirectly through State resources it must be the result of an action of the Member State concerned and should be imputable to the public authorities.[648] 'Public authorities' as a term includes the central government and its ministries or departments, regional and local governments or councils and municipalities.[649]

Article 107(1) of the Treaty covers all the financial means by which the public authorities may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector. Thus, even if the sums corresponding to the measure in question are not permanently held by the Treasury, the fact that they constantly remain under public control, and therefore available to the competent national authorities, is sufficient for them to be categorised as State resources.[650]

According to 'effects based approach' adopted by the Union institutions, it makes no difference whether the aid is granted directly by the State or by public or private bodies established or appointed by it to administer the aid. It is due to the fact that in applying Article 107 TFEU regard must primarily be had to the effects of the aid on the undertakings

[646] Case C-42/93 *Spain v Commission* [1994] ECR I-4175, para.13.
[647] See Joined Cases C-72/91 and C-73/91 *Sloman Neptün v Bodo Ziesemer (Sloman Neptün*) [1993] ECR I-887, para.19; Case C-189/91 *Kirsmammer –Hack v Sidal* [1993] ECR I-6185, para.16; Joined Cases C-52/97 to C-54/97 *Viscido and Others v Ente Poste Italiane (Viscido)* ECR I-2629, para.13; Case C-200/97 *Ecotrade v Altiformi e Ferriere di Servola* [1998] ECR I-7907, para.35.
[648] See Opinion of AG Jacobs in Case C-482/99 *Stardust Marine* [2002] ECR I-4397, para.54.
[649] Antonis Metaxas, "Selectivity of Asymmetrical Tax Measures and Distortion of Competition in the Telecoms Sector", **EStAL**, Vol.4, 2010, p.771.
[650] Case C-33/98 *P France v Ladbroke Racing and Commission* [2000] 3271, para.50.

or products favoured by it and not to the status of the institutions entrusted with the distribution and administration of the aid. Thus it renders the public, private or mixed public-private status of the institutions who manage the resources in question to be irrelevant. A State measure adopted by a public authority and favouring certain undertakings or products may still be an aid if it is wholly or partially financed by contributions imposed by public authority and levied on the undertakings concerned.

It follows from the Court's case law that State resources are not involved where the public authorities at no stage enjoy or acquire control over the funds which finance the economic advantage in issue.[651] For example, in *BALM,*[652] it was held that the allocation by the German Government of shares in a tariff quota opened by a Council Regulation did not fall within Article 92 (now Article 107 TFEU) because, since the levy waived was part of the Community's own resources, the financial advantage derived by a trader from receiving a share in the quota was not granted through State resources.

Van Tiggele[653] is one of the earlier cases in which the Court dealt with a State measure fixing minimum retail price for gin. In this case the Court held that, even though the fixing of minimum retail prices with the object of favouring distributors of a product at the expense of the consumer gives the former distinct advantages, it does not constitute an aid because there is no employment of State resources, whether directly or indirectly.

In *Sloman Neptun*, the Court found that a State measure in question did not involve an advantage granted through State resources, since that measure did not "*seek, through its object and general structure, to create an advantage which would constitute an additional burden for the State or for any public or private organs designated or established by the State*."[654] The Court's reasoning in this case is not in compliance with the 'effects based approach' which indicates that "*Article 107(1) does not make any*

[651] Opinion of AG Jacobs in Case 482/99 *Stardust Marine* [2002] ECR I-4397, para.38.
[652] Case 213-215/81 *Norddeutsche Vieh-und-Fleischkontor v BALM* [1982] ECR 3583, paras. 22, 23.
[653] Case 82/77 *Van Tiggele*, [1978] ECR 25.
[654] Joined Cases C-72/91 and C-73/91 *Sloman Neptün* [1993] ECR I-887, para.21.

distinction according to the causes or aims of the aid in question but defines them in relation to their effects."[655]

PreussenElektra[656] is a more recent case, in which the State obliged electricity distribution companies to purchase electricity produced from renewable energy sources, and to do so at prices above the actual market value of the electricity. The Court reached a similar conclusion that there was no State aid as there was no involvement of State resources. This is because the economic advantages provided to the distributors financed exclusively with funds which at no stage came under the control of State. The fact that the purchase obligation imposed by statute, and conferred an undeniable advantage on certain undertakings did not give it the character of aid within the meaning of Article 107(1).[657]

On the other hand, there is considerable case law, according to which it is not necessary to establish in each case that there has been a transfer of State resources for the advantage granted to one or more undertakings to be capable of being regarded as State aid within the meaning of Article 107(1) of the Treaty. For example in one case, the Court stated that a measure by which the public authorities grant to a certain undertaking a tax exemption which, although not involving a transfer of State resources, places the persons to whom the tax exemption applies in a more favourable situation than other taxpayers constitutes State aid within the meaning of Article 107(1) of the Treaty.[658]

The Court also held that State resources within the meaning of Article 107(1) of the Treaty need not necessarily come from the State budget. Where the funds used for a measure are financed through compulsory contributions, such as parafiscal charges, and then distributed according to State legislation they must be regarded as State resources. The situation will not be any different even if they are collected and administered by institutions

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[655] See for example, Case T-106/95 *Fédération Francaise des Sociétés d'Assurance (FFSA) ad Others v Commission* [1997] ECR II-229, para.195.
[656] Case C-379/98 *PreussenElektra AG v Schhleswag AG (PreussenElektra)* [2001] ECR I- 2099.
[657] For a critique of this narrow approach to the State resouces criterion, see Marco Bronckers and Rosalinde van der Vlies, "The European Court's PreussenElektra Judgement: Tensions between EU Principles and National Renewable Energy Initiatives", **E.C.L.R.**, Vol.22, 2001, pp.458-468.
[658] Case C-387/9 *Banco Exterior de Espana v Ayuntamiento de Valencia* [1994] ECR I-877, para.14.

distinct from but, nonetheless, controlled by the public authorities.[659] For example, the Court, pointing out that a benefit does not have to be financed directly by State resources in order to be considered a State aid; stated that it is sufficient if the benefit is decided upon and financed by a public body, implemented subject to the approval of the public authorities, granted in the same way as an ordinary State aid and represented as being part of a package of measures which are accepted to be State aids.[660]

The distinction in Article 107(1) of the Treaty between aid granted by the State and aid granted through State resources serves to bring within the definition of aid not only aid granted directly by the State, but also aid granted by public or private bodies designated or established by the State.[661] The resources of public undertakings are also considered to be State resources where the State is capable, by exercising over such undertakings, of directing the use of their resources to finance specific advantages in favour of other undertakings.

However, the criterion of control of an undertaking is not, purely on its own, sufficient to establish that the conduct of that undertaking is imputable to the State. The imputability of a measure to the State is an additional condition developed by the case law within the context of 'transfer of State resources' to determine whether any State aid exists within the meaning of Article 107(1) of the Treaty.[662] This condition applies particularly when public undertakings are involved in commercial transactions or they form partnerships with private undertakings.

In *Stardust Marine*, the Court held that even if the State is in a position to control a public undertaking and to exercise a dominant influence over its operations, actual exercise of that control in a particular case cannot be presumed.[663] A public undertaking may act

[659] Case C-173/73 *Italy v Commission* [1974] ECR 709, para.33.
[660] Case C-290/83 *France v Commission* [1985] ECR 439, para.20.
[661] Joined Cases C-72/91 and C-73/91 *Sloman Neptün* [1993] ECR I-887, para.19.
[662] Joined Cases C-67/85, 68/85 and 70/85 *Van der Kooy and Others v Commission (Van der Kooy)* [1988] ECR 219, para.35; Case C-303/88 *Italy v Commission* [1991] ECR I-1433, para.11; Case C-305/99 *Italy v Commission* [1991] ECR I-1603, para.13.
[663] Case C-482/99 *French Republic v Commission (Stardust Marine)* [2002] ECR I-4397, para.52.

with more or less independence, according to the degree of autonomy left to it by the State, which might be the situation in a specific case. Therefore, the mere fact that a public undertaking is under State control is not sufficient for measures taken by that undertaking, such as the financial support measures, to be imputed to the State. In this respect, it is also necessary to examine whether the public authorities must be regarded as having been involved, in one way or another, in the adoption of those measures.[664]

The imputability to the State of an aid measure taken by a public undertaking may be inferred from certain indicators arising from the circumstances. Such indicators set out by the Court and AG Jacobs in *Stardust Marine* are as follows:

- the fact that the body in question could not take the contested decision without taking into account the requirements of the public authorities;[665]

- its integration into the structures of public administration;

- the legal status of the undertaking (in the sense of its being subject to public law or ordinary private law);

- the nature of the undertaking's activities and the extent to which the activities were exercised on the market in normal conditions of competition with private operators;[666]

- the intensity of the supervision exercised by the public authorities over the management of the undertaking, and the degree of control which the State has over the public undertaking;[667]

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[664] Ibid.
[665] Joined Cases C-67/85, 68/85 and 70/85 *Van der Kooy* [1988] ECR 219, para.37
[666] In this context AG Jacobs referred to the scale and nature of the measure, in his opinion to Case C-482/99 *Stardust Marine* [2002] ECR I-4397, para, 67.
[667] See for example, Case C-303/88 *Italy v Commission*, paras.11 and 12; Case Case C-305/99 *Italy v Commission*, paras. 13-14.

- any other indicator showing an involvement by the public authorities in the adoption of the measure, or the unlikelihood of their not being involved, having regard to the compass of the measure, its content or the conditions which it contains.[668]

It is also important to bear in mind that the fact that a public undertaking has been constituted in the form of a capital company under ordinary commercial law is not, on its own, sufficient to exclude the possibility of an aid measure taken by such a company being imputable to the State. Despite its autonomy conferred upon it by the legal form, the existence of control and dominant influence exercised over the undertaking by public authorities make the involvement of State resources probable. Therefore, this indicator must be assesed with the other indicators to determine in a given case whether or not the State resources are involved.[669]

3.5.2.3. Selectivity

State aid is defined as advantage in any form whatsoever conferred on a selective basis to undertakings by a Member State. Article 107(1) prohibits State aid favouring certain undertakings or the production of certain goods, that is to say, selective aid.[670] The reference to 'favouring certain undertakings or the production of certain goods' covers both private and public undertakings and all their production, subject to Article 106(2) of the Treaty.[671] Therefore, an advantage granted to entities which are not undertakings and general measures of economic policy open to all enterprises are not covered by Article 107(1) of the Treaty and do not constitute State aid.

The condition of selectivity, as the primary means of differentiating between objectionable State aids and general legislative measures, is of the fundamental importance

[668] These indicators were also endorsed in a recent Decision by EFTA Surveillance Authority on alleged State aid granted by the Icelandic State to investment funds and associated fund management companies connected to the three failed Icelandic banks Glitnir, Kaupthing and Landsbankinn, OJ C292, 28.10.2010, pp.8-22.
[669] Case C-482/99 *Stardust Marine* [2002] ECR I-4397, para.57.
[670] Case C-88/03 *Portugal v Commission* [2006] ECR I-7115, para.52.
[671] Case C-78/76 *Steinike & Weinlig v Germany*, [1977] ECR 595, paras. 17-18.

to the definition of State aid.[672] In this respect, selectivity condition functions as a crucial test which limits the scope of Article 107(1) of the Treaty. Consequently, this condition usually treated first by the EU institutions, even before the assessment of the involvement of State resources or the effect on trade.

State measures can either be general or selective. Only the latter may constitute State aid, provided that all the conditions of Article 107(1) of the Treaty are fulfilled. If measures are not of general application, they can be either materially or regionally selective.[673] General measures are defined as "*those benefitting the entire economy, such as lowering of tax rates or interest rates*." [674] Similarly, "*measures which apply in an all automatic manner across the board to all firms in all economic sectors in a Member State, e.g. nation-wide fiscal charges*"[675] can be regarded to be general measures.

In the case law, although it is possible to find many examples of measures which are considered to be selective;[676] it appears to be very difficult to find any measures directly named by the Court as general and for that reason being outside the scope of Article 107(1).[677] The European Courts and the Commission prefer to indicate what cannot constitute a general measure rather than defining it. For example, in *Spain v Commission* the Court stated that "*the social character of State aid is not sufficient to exclude it outright from being categorised as aid for the purposes of Article 92 [now Article 107 TFEU] of the Treaty*."[678]

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[672] Leigh Hancher, "Towards a New Definition of State Aid under European Law: Is there a New Concept of State Aid Emerging?, **European State Aid Law Quarterly (EStAL)**, Vol.3, 2003, p. 365.
[673] Bartlomiej Kurcz and Dimitri Vallindas, "Can General Measures be …Selective? Some Thoughts on the Interpretation of a State Aid Definition", **C.M.L.Rev**., Vol. 45, 2008, p. 161.
[674] Leigh Hancher, Tom Ottervanger and Piet Jan Slot (eds.), **EC State Aids**, 3rd ed., London: Thomson-Sweet and Maxwell, 2006, p.53.
[675] Christos Golfinopoulos, "Concept of Selectivity in State Aid Definition Following the 'Adria-Wien' judgment: Measures Justified by the Nature or General Scheme of a System", **E.C.L.R.**, Vol.24, 2003, p.544.
[676] See for example, Case C-203/82 *Commission v Italy* [1983] ECR 2525; Case C-241/94 *France v Commission* [1996] ECR I-4551; Case C-148/04 *Unicredito Italiano* [2005] ECR I-11137; Joined Cases C-393/04 and C-41/05 *Air Liquide Industries Belgium* [2006] ECR I-5293.
[677] See for example, Case C-143/99 *Adria Wien Pipeline* [2001] ECR I-8365, para.35; Case C-156/98 *Germany v Commission* [2000] ECR I-6857, para.22.
[678] Case C-342/96 *Spain v Commission* [1999] ECR I-2459, para.22.

Selectivity of a measure is evaluated at the moment when the measure is adopted. Even if a Member State has an intention to extend the measure which is restricted to certain undertakings to its entire economy, making it a general measure, that intention cannot be taken into account to avoid the application of Article 107 TFEU. Otherwise, it would enable the Member States to escape the application of State aid rules simply by declaring its intention to generalize the contested measure in the future.[679]

Commission does not deal with general measures in its State aid practice very often, leaving the more precise interpretation of the notion to the Court of Justice. Nevertheless, it is possible to obtain some assistance from its Notices and Communications as to the meaning of general measures. Accordingly, general measures may include measures of economic or social policy which apply to persons in accordance with objective criteria without regard to the location, sector or undertaking in which the beneficiary is employed.[680] If the measure applies uniformly to all undertakings, e.g. a uniform reduction of corporation tax, then it is general. If some undertakings enjoy an incidental advantage this would appear to be permissible.[681] Direct tax measures that pursue general economic policy objectives by reducing the tax burden related to certain production costs normally do not constitute State aid if they apply without distinction to all firms and to the production of all goods and services.[682]

The Court of Justice usually starts its analysis with a rather broad definition of selectivity. However, the Court often invokes the 'inherent logic of the system' test in order to determine that the measure in question is in fact general in nature despite the fact that it may have differential effects on certain undertakings or categories of undertakings.

[679] Case C-75/97 *Belgium v Commission* [1999] ECR I-3671, paras.41-42.
[680] See for example, the Commission Notice on Co-operation between National Courts and the Commission on State Aid Field [1995] OJ C321/7, para.7.
[681] Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation [1998] OJ C384/3, para.14.
[682] Commission Communication on Towards a More Effective Use of Tax Incentives in Favour of R&D, SEC(2006) 1515/COM/2006/0728 final, point.12.

Provided that the differentiation in question arises from the inherent logic, nature or overall structure of the system, there is no selectivity.[683]

In one of the earlier cases, the Court had to deal with the selectivity issue. In this case, the French Government granted an advantage to French exporters by a preferential rediscount rate. This rate was applied by Banque de France for short and long term credits given for exports to other Member States. Although the main distinction was between exporting companies on the one hand and all other companies on the other, a potentially indefinite number of products could have been exported and no sector was privileged. Despite these circumstances, the Court took the view that the measure was selective. It was because the measure favoured only national exported products, helping them to compete in other Member States.[684]

Another case, *Greece v Commission*[685] concerned aid granted by Greece in the form of interest rebates in respect of exported products. In this case, the Court held that "*…a preferential rediscount rate granted by a Member State only for exports of its own products constitutes an aid within the meaning of Article 92 [now Article 107].*"[686] Similarly, in *Spain v Commission,*[687] the case was about a Spanish law provided for a corporate tax deduction concerning certain export activities, in order to promote international trade by supporting foreign investment. The Court referring to the previous two cases mentioned above, ruled that such a measure could benefit only one category of undertakings, namely undertakings which had export activities and made certain investments, and that such a finding was sufficient to show that it fulfilled the condition of specificity. In this case there was no pre-determined budget allocation, nor a defined

[683] Case C-173/73 *Italy v Commission* [1974] ECR 709, para.33; Case C-148/04 *Unicredito Italiano* [2005] ECR I-11137, para.51.
[684] Joined Cases 6 and 11/69 *Commission v France* [1969] ECR 523, para.20.
[685] Case C-57/86 *Greece v Commission* [1988] ECR 2855.
[686] Ibid., para.8.
[687] Case C-501/00 *Spain v Commission* [2004] ECR I-6717.

number of beneficiaries. It is submitted that it was understandable from the internal market point of view but less so from the selectivity perspective.[688]

The selectivity test established by the European Courts is quite broad. In *CETM* case the CFI stated as follows: "*The fact that the aid is not aimed at one or more specific recipients defined in advance, but that it is subject to a series of objective criteria pursuant to which it may be granted, within the framework of a predetermined overall budget allocation, to an indefinite number of beneficiaries who are not initially individually identified, cannot suffice to call in question the selective nature of the measure and, accordingly, its classification as State aid within the meaning of Article 92(1) [now 107(1)] of the Treaty. At the very most, that circumstance means that the measure in question is not an individual aid*."[689] This statement confirms the conclusions in the previous cases that even a measure which does not distinguish, *prima facie*, between undertakings and is directed at the indefinite number of beneficiaries can be caught by Article 107(1).

In *Italy v Commission*,[690] an Italian law granted aid consisting in a reduction in the social charges pertaining to family allowances for the benefit of the textile and garment-making industry and small crafts. The Court held that the measure in question partially exempted "*undertakings of a particular industrial sector from the financial charges arising from the normal application of the general social security system*."[691] This case shows that any sectoral advantage can be classified as selective, even if the sectors are not, from an economic point of view, in direct competition with each other, but rather in competition with the same sectors from other Member States.[692] However, in a similar case, *Belgium v France*,[693] the Court reached a different conclusion. In this case, a Belgian law granted a reduction in social security contributions for undertakings employing manual workers. The purpose of that measure was to promote the creation of jobs in industrial sectors employing

[688] Kurcz and Vallindas, p. 168.
[689] Case T-55/99 *CETM* [2000] ECR II-3207, para.40.
[690] Case 173/73 *Italy v Commission* [1974] ECR at 709.
[691] Ibid., para. 15.
[692] See also Case C-172/03 *Heiser* [2005] ECR I-1627.
[693] Case C-75/97 *Belgium v Commission* [1999] ECR I-3671.

mostly manual workers earning low wages. The measure appeared to be quite selective. The Court, however, ruled that "*the restriction of the measures in question to manual workers and only to those working time exceeds a certain number of hours is not sufficient to support the conclusion that aid within the meaning of Article 92 [now Article 107] of the Treaty exists*."[694]

In another case, *France v Commission*,[695] the ECJ rejected the qualification of a measure as a general measure due to the discretionary powers vested in the French National Employment Fund. This conclusion was repeated in many subsequent cases.[696] However, the Court held in *Spain v Commission* that discretionary power is not a *sine qua non* condition for establishing the selective characteristic of the measure.[697]

In *Adria-Wien* it was stated that neither the large number of eligible undertakings nor the diversity and size of the sectors to which those undertakings belong provide any grounds for concluding that a State initiative constitutes a general measure of economic policy. However, in the same judgement the Court emphasised that a State measure which benefits all undertakings in a national territory, without distinction, cannot constitute State aid.[698] In *Gemo,*[699] which is a case regarding the provision of a public service, the Court found the measure in question selective, despite the fact that the service of public carcass disposal was free of charge and open to everybody who might need it. It was because the Court regarded the measure as benefitted essentially farmers and slaughterhouses and the result would not have been any different even if the regime in question had also applied to the owners of domestic animals and certain undertakings such as zoos or if certain public undertakings occasionally benefitted from the measure.[700]

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[694] Ibid., para. 28.
[695] Case C-241/94 *France v Commission* [1996] ECR I-4551.
[696] See for example, Case C-256/97 *DM Transport* [1999] ECR I-3913, paras. 28-30; Case C-295/97 *Piaggio* [1999] ECR I-3735, para.39.
[697] Case C-501/00 *Spain v Commission* [2004] ECR I-6717, para.121.
[698] Case C-143/99 *Adria Wien Pipeline* [2001] ECR I-8365, paras. 35-36.
[699] Case C-126/01 *Ministére de l'Economie, des Finances et de l'Industrie v GEMO SA (GEMO)* [2003] ECR I-13769.
[700] Ibid., para.38.

Under the current state of the case law, the dividing line between State aid and general measures of economic policy seems rather obscure.[701] The Court prefers to qualify the measures as general if their selectivity is justified by the nature or overall structure of the system. However, the benchmark to be adopted in each case is not very clear in advance and for the sake of legal certainty more guidance is necessary from the EU institutions. It is also important to point out that if the selectivity test is interpreted very broadly this will result in the over-extension of the State aid rules. As a consequence, all economic policy decisions of the Member States will be brought under the scrutiny of the EU authorities, without any distinction being made between direct interventions in the market and general measures to regulate economic activities.[702] On the other hand, selectivity criterion is easily fulfilled in State aid cases regarding the financing of SGEI as there is usually a single undertaking which is financed to perform its public service obligations.

3.5.2.4. Distortion of Competition

Distortion of competition is one of the most important paradigms in the State aid regulation, especially when it comes to considering the negative effects State aids may have on the functioning of the market. It is because State aids may interfere with the conduct of economic operators, distorting the competitive relationship between the recipient undertakings and their competitors.[703] According to one view, every governmental action which impinges on the economy creates a distortion.[704] Therefore, the idea of distortion rests on the State's interference with the natural market mechanism governing the allocation of resources within the State granting the aid, which results in the subsequent disturbance of the economic relations between Member States.

For a State measure to be caught under Article 107(1) TFEU it must be capable of distorting competition. The test defined by the Commission and the EU Courts to determine

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[701] Connor O. Quigley, "The Notion of a State Aid in the EEC", **E.L.Rev**. Vol. 13, 1988, p. 245.
[702] For a similar view, see Opinion of AG Maduro in Case C-237/04 *Enirisorse* [2006] ECR I-2843, paras.45-46.
[703] Luca Rubini, p. 381.
[704] John H. Jackson, **The World Trading System- Law and Policy of International Economic Relations**, 2nd edn, Cambridge Massachussets: MIT Press, 1997, p.298.

the effect on competition is so broad that any measure that distorts and threatens to distort the conditions of competition between undertakings may fall under the scope of Article 107(1) of the Treaty.[705] In fact, the effects of State aid may be spread across the markets and economies and therefore, control of State aid requires an assessment of these effects, *inter alia* by tracing the distribution of gains and losses caused by the State measure in question.[706]

Since 'distortion of competition' as a condition has been broadly interpreted and applied in the EU law, the approach of the EU institutions is quite strict in conducting such analysis to determine the distortive effects of the State measure. Particularly in the early years, the Commission rejected the autonomy of the requirement of distortion of competition holding that any aid is liable to distort competition and hence it is not necessary to prove the effects.[707] AG Capatorti was of the similar opinion in *Philip Morris*, where he said that, whenever there is a subsidy, a distortion of competition is presumed. In this case, the Court required the strengthening of the position of the recipient undertaking compared with other undertakings competing in intra-Community trade to prove a distortion of competition.[708] In other words, improvement in the competitive position of an undertaking resulting from a State aid generally points to a distortion of competition compared with other competing undertakings not receiving such assistance. Under this standard, any form of financial assistance is capable of strengthening the financial position of the recipient undertaking.

In the traditional line of case law, the Commission is required to provide a statement of reasons of its determination of distortion of competition and effects on trade between Member States but a detailed market analysis is not necessary. In *Wam*, the CFI held that the Commission was not required to define the relevant market, and in particular

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[705] Phedon Nicolaides, Mihalis Kekelekis and Maria Kleis, **State Aid Policy in the European Community: Principles and Practice**, 2nd ed., International Competition Law Series, The Hague: Kluwer Law International, 2008 p.40.
[706] Antonis Metaxas, "Selectivity of Asymmetrical Tax Measures and Distortion of Competition in the Telecoms Sector", **EStAL**, Vol.4, 2010, p.775.
[707] Commission's 1981 Annual Report on Competition Policy, point.176.
[708] Case 730/79 *Philip Morris Holland BV v Commission of the European Communities (Philip Morris)* [1980] ECR 1980, p.2671, paras.11-12.

to determine the market situation, the market shares of beneficiaries, the position of competitors or the trade flows between Member States. Moreover, according to the CFI, it was not necessary for the Commission to assess the impact of the aid on the prices of the recipient, to compare them with those of the competitors, to examine the sales situation of the recipient in a given market or to prove the actual effects of aid on competition.[709] Ironically, the Commission's decision was annulled for inadequate explanation of the alleged distortion of competition by the CFI in the end and the Court of Justice confirmed the annulment of the Commission's decision.[710]

In the light of the case law, the standard of proof for determination of the distortion on competition appears to be relatively low and that almost no evidence is required.[711] In the appeal of the *Wam* decision, AG Sharpston stated that "*what was required was a specific or plausible connection between the grant of aid and alleviation of the burden of costs that the recipient company would have normally had to bear*."[712] As a result, at least at the present stage neither the case law, nor Article 107(1) TFEU requires a quantitative test. Therefore, it applies to direct or indirect, actual or potential effects and since it focuses on effects rather than the intention or purposes of the State measure, it would be difficult for public services to escape being caught by this condition.

3.5.2.5. Effect on Trade between Member States

The conditions of 'distortion of competition' and 'effect on trade between Member States' are usually treated as inextricably linked to each other by the Commission and the Courts. Thus, if the aid is found to distort competition then it will be almost inevitably found to have an effect on trade. The requirement for the effect on trade between Member States is essentially the same as that required by Article 101 and 102 of the Treaty. Where the financial support of the State strengthens the position of an undertaking or a certain

[709] Joined Cases T-304 and 316/04 *Italian Republic and Wam SpA v Commission (Wam)* [2006] ECR II-64, para.64.
[710] Case C-494/06 *P Commission v Italy and Wam* [2009] ECR I- 3639.
[711] Kelyn Bacon, **European Community Law of State Aid**, Oxford: Oxford University Press, 2009, para.2.137.
[712] Opinion of AG Sharpston in Case C-494/06 P *Commission v Italy and Wam* [2009] ECR I- 3639, para.49-50.

category of undertakings vis-à-vis other undertakings competing in intra-Community trade, the aid must be regarded as affecting trade between Member States.[713]

With regard to aids given to the service sector, the effect on trade does not depend on the local or regional character of the service supplied or on the scale of the activity concerned. According to the case law, "*neither the relatively low level of aid nor the relatively modest size of the beneficiary undertaking rules out the possibility of trade between Member States being distorted*."[714] For example, subsidies payable to Dutch service stations located near German border, as a result of the increase in national fuel prices following the rise in excise duties in the Netherlands were found to be affecting trade between Member States. It is due to the fact that their purpose was to mitigate the disparity between the levels of excise duties payable in the Netherlands and the amount of excise duty levied on light oils in Germany.[715] However, in case of Irish hospitals, the Commission did not find that the system of capital allowances aiming at the creation of facilities for public local and relatively small hospitals, serving a local hospital market with clear undercapacity could affect trade between Member States. It is also because they could not attract investment or customers from other Member States.[716]

In practice, when considering the effect on trade between Member States, the Commission looks first at the trade statistics. However, such an examination is not conclusive. Any analysis must take into account the potential competition which could reasonably be expected to affect trade flows. For example, the output of an undertaking which is being kept in business by granting of aid alone may replace trade which would otherwise have taken place.[717] The Court has stressed that it is upon the Commission to

[713] Case 730/79 *Philip Morris* [1980] ECR I-2671, para.11.
[714] Case C-142/87 *Belgium v Commission* [1990] I-959, para.43; Cases C-278/92, C-279/92 and C-280/92 *Spain v Commission* [1994] ECR I-4103, paras.40-42.
[715] Case C-382/99 *Netherlands v Commission* [2002] ECR I-5163.
[716] Commission Decision *(Ireland-capital allowances for hospitals),* N 543 2001, OJ C154, 28.6.2002.
[717] See Commission's 14th Report on Competition Policy, para.201.

identify who the actual or potential competitors are, at least in terms of the sector affected.[718]

State measures are not regarded to be liable to affect trade between Member States when they finance certain local or regional undertakings or the services that they provide, such as swimming pools, leisure centres, créches, cultural centres or hospitals.[719] Moreover, according to the Commission Regulation on de minimis aid,[720] aid not exceeding a ceiling of EUR 200.000 over any period of three years does not affect trade between Member States and does not distort or threaten to distort competition. As regards undertakings active in the road transport sector, this ceiling should be set at EUR 100.000.

3.5.3 Application of Advantage Condition to the Financing of SGEI under Article 106(2)

3.5.3.1. Case Law before *Altmark*

In the application of State aid rules, one of the most fundamental questions is whether- and according to what criteria- a financial advantage granted by the authorities of a Member State to offset the cost of the public service obligations they impose on an undertaking must be classified as State aid within the meaning of Article 107 of the Treaty. Within this framework, the issue of the EU State aid rules applicable to the financing of services of general economic interest or public services has been a subject of controversy among the EU institutions, Advocates Generals of the Court, and in academic world.

Initially, in *ADBHU,*[721] the Court decided not to regard compensations for public service obligations as State aid within the meaning of Article 107(1) of the Treaty. In this case, which was referred by a national court through preliminary ruling, the Court had to answer the question whether indemnities granted to certain companies for the services they

[718] Case C-351/98 *Spain v Commission* [2002] ECR I-803; Case C-372/97 *Italy v Commission* [2004] ECR I-3679.
[719] See Commission Pres Release IP/00/1509 of 21 December 2000.
[720] Commission Regulation 1998/2006 on the application of Articles 87 [now 107] and 88 [now 108] of the Treaty to *de minimis* aid, OJ L379/5.
[721] Case 240/84 *Procurer de la Republique v Association de defense des bruleurs d'huiles usages (ADBHU*) [1985] ECR 531.

performed in collecting and/or disposing of waste oils constituted State aid within the meaning of Article 107(1) of the Treaty. The Court responded that indemnities did not constitute aid within the meaning of Article 107 of the Treaty, but rather consideration for the services performed by the collection or disposal undertakings.[722]

The Commission also adopted the Court's approach in *ADBHU* in its decisions and practices.[723] In the *FFSA* case, the Commission found that the tax exemption, which amounted to 85% reduction in the basis for assessment of local taxes, granted to the French Post constituted a definite financial advantage. However, since it did not exceed what was necessary to ensure the public service, it qualified for the derogation laid down in Article 106(2) of the Treaty. The Commission then concluded that, since the measure was covered by Article 106(2), it did not constitute State aid within the meaning of Article 107(1) of the Treaty.

The CFI did not follow the Commission's approach and ruled that the measure in question constituted State aid as the French post had received an advantage which it would not have obtained under normal market conditions.[724] However, the CFI found that the aid could be compatible with the Common Market under Article 106(2) of the Treaty. Contrary to the Commission, the CFI did not regard Article 106(2) TFEU as precluding the application of Article 107(1) but as an additional basis for the compatibility of the measure in question with the Common Market, similar to the other exceptions provided by Article 107(2) and (3) of the Treaty. The CFI noted that for the derogation under Article 106(2) TFEU to apply, it is not only important that the undertaking in question is involved in the provision of SGEI, but also that the "*application of rules of the Treaty, specifically those of Article 87 [now Article 107 TFEU], must obstruct the performance of the particular tasks assigned to the undertaking and the interests of the Community must not be affected*."[725]

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[722] Ibid., para.18.
[723] See e.g. Commission Decision, (*French Postal case)*, OJ 1995 C 262, para.11. See also the Community Guidelines on maritime transport, OJ 1997 C 205, point.5.
[724] Case T-106/95 *Fédération Francaise des Sociétés d'Assurance (FFSA) v Commission* [1997] ECR II-229.
[725] Ibid., para.173.

FFSA is an important judgement to understand the difference in the approach of the Union institutions to the role that is played by Article 106(2) in the financing of SGEI. In this case, while the Commission held that the assistance granted to ensure performance of SGEI did not constitute State aid, the CFI on the other hand, held that this was a form of State aid that could be justified if it satisfied the requirements of Article 106(2). The CFI's ruling in the *FFSA* was appealed to the Court of Justice, which confirmed the assessment made by the CFI. However, the Court did not make any examination to determine whether the compensation actually conferred an advantage which constituted State aid.[726]

The CIF applied that same reasoning to its latter judgement in *SIC,*[727] which concerned the financing of public television in Portugal. According to the CFI, the yearly grants paid by way of compensation to the public broadcaster constituted a financial advantage and the fact that these advantages were intended to offset the costs of public service obligations had no bearing on their classification as State Aid. This fact might be taken into account for the assessment of the compatibility of the aid with the common market under Article 106(2) of the Treaty. This case was not appealed to the Court of Justice. On the basis of the rulings in *FFSA* and *SIC*, it seems that once an advantage is qualified as aid because of its effects, it can then be considered as justifiable, provided that it aims to cover additional costs of the provision of SGEI.

The following case, *France v Commission*,[728] was about the question whether aid, qualifying for the derogation of Article 106(2) of the Treaty, was subject to the standstill clause of Article 108(3), according to which a Member State may not implement any aid before it is authorised by a Commission decision. The main argument was that even if a compensation for public service obligations constituted State aid, it must have been exempted from the notification rule in Article 108(3). The Court rejected this argument and held that the notification and suspension obligations applied to the aid granted to undertakings entrusted with the operation of SGEI within the meaning of Article 106(2) of

[726] Case C-174/94 P *FFSA and others v Commission* [1998] ECR I-4833.
[727] Case Case T-46/97 *Sociedade Independente de Comunicacao (SIC) v Commission* [2000] ECR II-2125.
[728] Case C-332/98 *France v Commission* [2000] ECR I-4833.

the Treaty. Therefore, such aid had to be notified and could only be implemented after the Commission had taken a decision finding the aid to be compatible with the Common Market. Otherwise, that aid granted to public services in breach of those obligations would constitute illegal aid.[729] Again, the Court did not deal with the question whether compensations constituted State aid directly. Nevertheless, this judgement was generally regarded as, at least, an implicit confirmation of the CFI's rulings in *FFSA* and *SIC*.

In the light of the cases mentioned above, the dominant view among the jurists and academic circles was that all compensations paid by public authorities for the various types of public services had to be considered as State aid and had to be notified to the Commission in accordance with Article 108(3) of the Treaty. Therefore, the Court of Justice's ruling in *Ferring* caused a real surprise and controversy even among the Member States.

Ferring[730] concerned the wholesale distribution of medical products in France. According to the French legislation, a tax contribution was payable by pharmaceutical laboratories on the sale of medicines to pharmacies. The contribution was, however, not levied on sales of medicines made by wholesale distributors. The reasoning was to restore the balance of competition between various distribution channels for medicines which was seen as distorted by the fact that the wholesale distributors were under a public service obligation while pharmaceutical laboratories were not. Ferring, which was a pharmaceutical laboratory, alleged that the tax levied on direct sales of pharmaceutical laboratories was an illegal State aid granted to wholesale distributors.

In *Ferring*, the Court ruled that a tax exemption, which might in principle fall under Article 107(1) of the Treaty, may be regarded as compensation and therefore not State aid provided that it corresponded to the net additional costs incurred by the companies concerned in discharging their public service obligations imposed on them by national

[729] Ibid., paras.27-32.
[730] Case C-53/00 *Ferring v ACOSS (Ferring)* [2001] ECR I-9067.

law.[731] In addition, the Court stated that, provided the tax exemption was equivalent to the additional costs incurred, no real advantage for the purposes of Article 107(1) of the Treaty was provided. The Court analysed the purpose of the measure in question and not its effects despite the effects-based approach developed in the case law. In this way, it excluded the application of Article 107(1) TFEU and applied directly Article 106(2) of the Treaty. Instead of classifying the State measure in question as aid, the Court opted to apply Articles 107(1) and 106(2) in opposite directions.[732] Therefore, the case represents a radical turn in the case law.

The Commission's policy following the *Ferring* judgement was not entirely clear and consistent. While some decisions fully applied the *Ferring* approach, some others concluded that the measure did not qualify as State aid, but left open the possibility to examine nevertheless whether the conditions of Article 106(2) were met. This position inevitably created confusion.[733]

3.5.3.2. Legal Theories Applied by the EU Institutions

The State Aid Approach: According to the State aid approach, State funding granted to an undertaking for the performance of services of general economic interest constitutes State aid within the meaning of Article 107(1), but may be justified under Article 106(2) of the Treaty if the conditions of that derogation are fulfilled and, in particular, if the aid does not exceed the appropriate remuneration for the costs of the service. This approach was first developed by the CFI in *FFSA* and *SIC*, subsequently adopted by the Commission[734] and also defended by AG Leger in his two Opinions in the *Altmark* case.[735] It is based, in particular, on the view that Article 107(1) does not

[731] Ibid.,para.29.
[732] Ivan Draganic, "State Aid or Compensation for Extra Costs: Tuning the Test of Proportionality in EC Competition Law", **EStAL**, Vol. 4, 2006, p. 685.
[733] See Commission Decision of 13.05.2003, Ireland, N 46/2003; Commission Decision of 22.05.2002, UK, N 631/2001. See also the Commission Report of 27 November 2002 on the state of play in the work on the guidelines for State aid and services of general economic interest, point 3 (COM (2002) 636 final).
[734] See e.g. Commission Communication on services of general interest in Europe, OJ 2001 C 17, para.26. Even after *Ferring* the Commission favoured this approach in the *GEMO* case.
[735] Opinions of AG Leger of 19 March 2002 and 14 January 2003 in Case C-280/00 *Altmark* [2003] ECR I-7747.

distinguish between measures of State intervention by reference to their causes or aims but defines them in relation to their effects.[736] Consequently, the fact that certain financial advantages are granted to offset public service obligations merely represents the purpose of aim of the measure in question, but does not impinge on its effects and hence on its objective status as aid.[737]

One of the arguments put forward in favour of the State aid approach was that it was necessary to ensure that Article 106(2) of the Treaty would not be deprived of its effect in the field of State aid.[738] Pursuant to this argument, if compensation did not constitute State aid, its compatibility with the Common Market could not be examined under Article 106(2) of the Treaty, so that this provision would lose its function with regard to State aid. It was also argued in favour of State aid approach that it could preserve Commission's surveillance role in reviewing measures for financing of public services.

Nevertheless, this approach was criticised on the fact that it seems difficult to reconcile with the wording of Article 107(1), which applies only to measures providing economic advantage and distorting or threatening to distort competition. These two conditions of the State aid do not seem to be fulfilled when the amount of compensation does not exceed the amount required for the provision of the public services. AG Leger rejected this argument stating that even though there may not be a net advantage to the recipient, what the Treaty required under Article 107(1) was only a 'gross advantage'.

According to the 'gross advantage' theory, the subsidies or other types of advantages granted by public authorities, on the one hand, and what the recipient has to contribute in return, on the other hand, must be examined separately, in two steps. The obligation of the recipient to contribute, which would be analysed in the second step, is of

[736] Case T-106/95 *FFSA* [1997] ECR II-229, para.195.
[737] Case Case T-46/97 *SIC* [2000] ECR II-2125, para.83. See also Opinion of AG Leger of 19 March 2002 in Case C-280/00 *Altmark* [2003] ECR I-7747 para.77.
[738] Ibid.

no relevance for determining whether the State measure comes under Article 107(1), but only comes into consideration for the examination of the compatibility of the aid.[739]

However, before AG Leger submitted his Opinions in *Altmark*, AG Tizzano in *Ferring* argued that the imposition of an obligation and the provision of compensation for it cannot be considered as separate matters for they are two sides of the same public measure, which is intended as a whole to ensure that public needs are satisfied.[740] Another argument against Leger's 'gross advantage' theory put forward by AG Jacobs in *GEMO* before AG Leger submitted his second Opinion in *Altmark*. According to AG Jacobs, where the public authorities purchase goods or services on the market, there will be State aid only if and to the extent that the remuneration paid exceeds the appropriate market price. In such situations, one would thus only look at the 'net' effect of the State measure. There were no obvious reasons why the analysis should be different in the case of public service obligations, which can be seen as a service to the public purchased by the State.[741]

Another criticism against the State aid theory, usually put forward by the Member States that the notification obligation and in particular the standstill requirement of Article 108(3) might seriously disrupt the provision of public services. In certain circumstances, it may be difficult or even impossible in the general interest of society to wait for prior authorisation by the Commission. This is even less justifiable for compensation measures, which would in any case be authorised by the Commission in the end. As mentioned above, in *France v Commission*,[742] the Court expressly rejected this argument, stating that "*the procedural obligations are the safeguard of the machinery for the review of aid in Community law*."[743]

[739] Opinion of AG Leger of 14 January 2003 in Case C-280/00 *Altmark* [2003] ECR I-7747, para.35-38.
[740] Opinion of AG Tizzano in Case C-53/00 *Ferring* [2001] ECR I-9067, para.61.
[741] Opinion of AG Jacobs in Case C-126/01 *GEMO*, para.115.
[742] Case C-332/98 *France v Commission* [2000] ECR I-4833.
[743] Ibid.,para.32.

AG Leger also found that the procedural obligations were not liable to disturb the functioning of services of general economic interest for several reasons.[744] First of all, procedural obligations did not apply to all State measures including the ones which were not liable to affect trade between Member States. Secondly, for measures coming under Article 107(1) of the Treaty, the Commission was subject to certain time limits. In this respect, the Commission was obliged to carry out a preliminary examination of the aid within two months of its notification.[745] If the Commission had not taken any decision by the expiry of this time limit, the Member State concerned may implement the aid, subject to informing the Commission beforehand.[746]

The Compensation Approach: According to this approach, State financing of public services constitutes aid within the meaning of Article 107(1) of the Treaty only if, an to the extent that, the advantages conferred by the public authorities exceed the cost incurred in discharging public service obligations. In other words, the aid would merely correspond to the difference between the public advantages and the value of the commitments entered into by the recipient. AG Leger called this theory also as 'net definition of aid' or 'real advantage theory' in his Opinion in *Altmark*.[747]

The compensation approach was first adopted by the Court in *ADBHU*. In this case AG Lenz, who delivered his Opinion on 22 November 1984, took the view that as long as the indemnities granted out of public funds did not 'exceed annual uncovered costs actually recorded by the undertaking, taking into account a reasonable profit, no economic advantage within the meaning of Article 107(1) of the Treaty could be present'.[748] AG Lenz, therefore, proposed to exclude what he referred to as mere 'quid pro quo for obligations imposed on certain undertakings in the public interest' not to be caught by the prohibition on State aids. It was the original position of the Commission before the *FFSA* judgement of the CFI.

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[744] Opinion of AG Leger of 14 January 2003 in Case C-280/00 *Altmark* [2003] ECR I-7747, paras.63-64.
[745] See Case 120/73 *Lorenz* [1973] ECR 1471, para.4 and Article 4(5) of the Regulation No 659/1999.
[746] Case 120/73 *Lorenz* [1973] ECR 1471, para.4 and Article 4(6) of the Regulation No 659/1999.
[747] Opinion of AG Leger of 14 January 2003 in Case C-280/00 *Altmark* [2003] ECR I-7747, para.31.
[748] Opinion of AG Lenz in Case 240/84 *ADBHU* [1985] ECR 531.

This approach then explicitly expressed by AG Tizzano and followed by the Court in *Ferring*. In *Ferring*, the Court held that "*provided there is the necessary equivalence between the exemption and the additional costs incurred, wholesale distributors will not be enjoying any real advantage for the purposes of Article 92(1) [now Article 107(1)] of the Treaty, because the only effect of the tax will be to put distributors and laboratories on an equal competitive footing*." [749] In other words, the compensation for the provision of a public service does not confer any real advantage on the companies entrusted with the service. Therefore, the advantage condition of Article 107(1) is not fulfilled.

This theory was mainly criticised on the fact that it seems to deprive Article 106(2) of the Treaty of any role in the State aid field. This is because if the compensation cannot be qualified as State aid, there is no scope for examining whether it complies with the conditions of Article 106(2) of the Treaty. If, on the other hand, the financing exceeds what is necessary, the measure can in any case not be authorised under Article 106(2) of the Treaty since it would infringe the principle of proportionality.

Another criticism against the compensation approach was that it merely looked at the additional costs actually incurred by the fulfilment of the public service obligation, without asking the further question whether the undertaking was performing its tasks in an economically efficient way or not. It was further argued that in the absence of any efficiency criterion the undertaking that wasted resources in fulfilling its public service obligation would have no incentive at all to change into a less wasteful management as the entirety of the additional costs actually incurred would be fully reimbursed.[750]

It was further argued in *Altmark* that the compensation approach was incompatible with Article 93 (ex Article 73 TEC) of the Treaty, concerning the field of transport by land, since it would make this provision inoperative. According to Article 93 TFEU "*aids shall be compatible with this Treaty…if they represent reimbursement for the discharge of*

[749] Case C-53/00 *Ferring* [2001] ECR I-9067, para.27.
[750] Andreas Bartosh, "The 'Net Additional Costs' of Discharging Public Service Obligations", **EStAL.**, Vol.2, 2002, p.189.

certain obligations inherent in the concept of a public service." This seems to confirm that authors of the Treaty regarded the financing of public services in principle as State aid. Under the compensation approach, the application of Article 93 TFEU and the certain Regulations adopted in accordance with this Article would be pointless as the compensation granted to undertakings entrusted with the operation of a public transport service by land would in any case not constitute State aid.[751]

Qui Pro Quo Approach: In the Opinion that he prepared for *GEMO*, AG Jacobs concluded that neither 'State aid' nor 'compensation' approach were satisfactory in all cases with regard to financing of SGEI. He therefore considered a solution which would reconcile both approaches. Under the theory developed by AG Jacobs, the Court should distinguish between two categories of situation. The distinction between both categories would be based on the nature of the link between the financing and the general interest obligations imposed and on how clearly those obligations are defined.

The first category would be the cases where the financing measures are clearly intended as a quid pro quo for clearly defined general interest obligations. In other words, there would be a direct and manifest link between the financing measures and clearly defined public service obligations imposed. The first criterion suggested consists in examining whether there is a 'direct and manifest link' between the State funding and public service obligations. In practice, this amounts to requiring the existence of a public service contract awarded after a public procurement procedure.[752] Similarly, the second criterion suggested consists in 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.[753] For cases falling into that category the compensation approach would apply and if the conditions are fulfilled there would be no State aid.

[751] Opinion of AG Leger of 19 March 2002 in Case C-280/00 *Altmark* [2003] ECR I-7747, para.84; Opinion of AG Jacobs in Case C-126/01 *GEMO*, para.116.
[752] Opinion of AG Jacobs in Case C-126/01 *GEMO*, para.119.
[753] Ibid., para. 120.

The second category would comprise the cases where the link between the State funding and the general interest obligations imposed is not direct and manifest, or where the general interest obligations are not clearly defined. A general tax exemption for public banks could be given as an example for this type of cases. Such cases should be analysed according to the State aid approach.

This approach was designed to avoid the objections raised against the other approaches and offered an alternative to find a compromise solution. However, as AG Jacobs recognised himself, the proposed distinction might not always easy to draw. In practice it seems that both categories would comprise only a few clear-cut cases, while the large majority of cases would fall into a grey zone.[754] Pointing out this problem AG Leger also stated that quid pro quo approach was not capable of guaranteeing sufficient degree of legal certainty. It is due to the fact that it reveals extreme difficulty to know what is covered by the expression 'direct and manifest link'. It is likely to receive widely different interpretations and it would only be possible to define the term on a case by case basis.[755]

AG Leger criticised this approach for introducing elements, such as; the form in which the aid is granted, the legal status of the measure in national law, the reasons or objectives of the measure, into the actual definition of aid. According to him, under those criteria mentioned above, the quid pro quo approach departs from the Court's case law on State aid. He submits that it serves "*defining the aid no longer by reference solely to the effects of the measure, but by reference to criteria of a purely formal or procedural nature*."[756]

3.5.3.3. *Altmark* Judgement and the Conditional Compensation Approach

Altmark concerned a local bus company in Germany, Altmark Trans, which had been issued 18 licences for passenger transport on regional lines. In order to provide its services, Altmark received financial aid from the German State. The issue before the Court

[754] Opinion of AG Jacobs in Case C-126/01 *GEMO*, para.121.
[755] Ibid.,paras.86-87.
[756] Opinion of AG Leger in *Altmark* [2003] ECR I-7747, paras..82-84.

of Justice was whether such aid granted by a Member State to an undertaking entrusted with the provision of SGEI constitutes aid, and as such would be scrutinised as illegal under Article 107(1) of the Treaty.

The Court answered the above mentioned question relying on its previous rulings in *ADBHU* and *Ferring*, without entering into a discussion of the above-mentioned theories which were developed by the Commission and CFI and argued by the Advocates General at length. The Court confirmed that a State measure is not caught by Article 107(1), where it "*must be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations, so that those undertakings do not enjoy a real financial advantage and the measure thus does not have the effect of putting them in a more favourable competitive position than the undertakings competing with them*."[757]

The Court further established four additional conditions, aimed at helping its assessment of compensation to determine whether it is capable of escaping State aid rules of the Treaty. As the Court ruled in *ADBHU* and *Ferring*, the application of Article 107(1) TFEU was procedurally excluded if the compensatory measure in question fulfils the following four criteria and is justified:

First, the recipient undertaking must have public service obligations to discharge and these obligations must be clearly defined. It will be up to the recipient undertaking and national authority to prove that such duty has been sufficiently defined. In this way, the selection process and the financing of SGEI without prior notification can escape classification as State aid as long as it is clearly demonstrated from the start. Therefore, this condition constitutes a positive development towards greater transparency.

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

[757] Case C-280/00 *Altmark Trans GmbH and Regierungsprasidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH and Oberbundesanwalt beim Bundesverwaltungsgericht (Altmark)* [2003] ECR I-7747, para.87.

undertakings. According to the Court, *"[p]ayment by a Member State of compensation for the loss incurred by an undertaking without the parameters of such compensation having been established beforehand, where it turns out after the event that the operation of certain services in connection with the discharge of public service obligations was not economically viable, therefore constitutes State aid within the meaning of Article 97(1) [now Article 107(1) TFEU] of the Treaty*."[758] This condition has the same objective, which is to increase transparency in the financing of SGEI.

Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations. The Court did not clarify the meaning of 'reasonable profit' and it prompts more questions and uncertainties with regard to the calculation of the payment necessary for the performance of SGEI. Without proper guidance on how such profit is to be calculated, there is a danger that Member States might be tempted to use this provision to justify higher levels of compensation than necessary.[759] In this respect, this condition is not sufficiently well-structured to ensure that the financial aid is strictly necessary for the provision of SGEI. Instead this test serves for the purpose that the financial aid does not exceed what is reasonably required for SGEI to effectively compete.[760]

Fourth, where the undertaking 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 Union, 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 the means to be able to meet the 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 main purpose of this

[758] Ibid., para.91.
[759] Noel Travers, "Public Service Obligations and State Aid. Is all Really Clear after Altmark?", **EStAL**, Vol.3, 2003, p.387.
[760] Phedon Nicolaides, "Distortive Effects of Compensatory Aid Measures: A Note on the Economics of the Ferring Judgment", **E.C.L.R.**,Vol. 23, No.6, 2002, p.313.

condition is that if such selection were exercised through a public procurement procedure, the financing would less likely be excessive. It also makes the supervision easier and the selection process more transparent. On the other hand, public procurement may achieve different results, depending on how it is designed.[761] It means that such procedures may not necessarily procure the services at the least costs to the Union. The most difficult part of the condition seems to be how to apply the test described by the Court in the absence of public procurement. Indeed, it is not easy to find a comparable 'typical, well-run and adequately-provided undertaking' within a sector which is not purely commercial or partially reserved. This difficulty has already been confirmed by the Court in *Chronopost* case.[762]

These conditions define in fact the notion of compensation. Only if they are satisfied will State financing for discharging public service obligations constitute a mere compensation, not conferring any advantage, and therefore not fall within Article 107(1) of the Treaty. Conversely, if one or more of the conditions are not complied with, the State measure must be regarded as State aid and the notification obligation and standstill clause of Article 108(3) of the Treaty apply.

3.5.3.4. Implications of *Altmark* and Post-*Altmark* Developments

The Court of Justice rendered three important judgements following its *Altmark* decision and these two judgements revealed significant sings for future development of the case law. One them is *GEMO,*[763] for which AG Jacobs had submitted his Opinion where he introduced 'qui pro quo approach' for the cases related to the financing of SGEI before the Court gave its ruling in *Altmark*. This case concerns the system of financing a public carcass disposal service by a meat purchase tax in France. Under this system, the sums generated by the meat purchase tax were paid into a fund to finance the collection and disposal of animal carcasses and animal material seized in slaughterhouses found unfit for

[761] Paul D. Klemperer, "What Really Matters in Auction Design" **Journal of Economic Perspectives**, Vol.16, No.1, 2002, p.169.
[762] Case C-83/01 *Chronopost SA, La Poste and French Republic v Union française de l'express (Ufex), DHL International, Federal express international (France), and CRIE* [2003] ECR I-6993.
[763] Case C-126/01 *GEMO* [2003] ECR I-13769.

human or animal consumption. This fund was operated by the National Centre for the development of farm structures and the service was regarded to be public service under the State authority.

Gemo was a medium-sized supermarket, which markets meat and meat-based products in France and, in that capacity, was liable to the meat purchase tax. Claiming that the tax was contrary to Union law and State aid rules in particular, Gemo applied to French tax authorities for the reimbursement of the sums paid by the way of that tax. After long legal proceedings, the case was brought before the Court of Justice through preliminary ruling. The Court analysed the case under the usual State aid conditions, including advantage, transfer of State resources, selectivity, and effect on Member States. As regards, advantage the Court held that the service for the collection and disposal of animal carcasses and slaughterhouse waste was provided free of charge, which should normally have been within the responsibility of farmers and slaughterhouses. "*Therefore, intervention by the public authorities intended to relieve farmers and slaughterhouses of that financial burden appears to be an economic advantage liable to distort competition*."[764] As the other conditions of the State aid are also fulfilled, the Court concluded that provision of this service free of charge must be classified as State aid.

Strangely, the Court did make any reference to *Altmark*, or the possible application of Article 106(2) TFEU. The main question in the case was not whether the payments to a private undertaking constituted aid but rather whether an indirect aid was granted to the beneficiaries through free services. The answer to this question could not have been found in *Altmark* criteria because the State's payments to providers of SGEI risk fulfilling all the conditions and thus falling outside Article 107(1) TFEU. The French legislation clearly defined the public service obligation of collection and disposal of animal carcasses and slaughterhouse waste in advance and in an objective and transparent manner. The imposed tax amount did not seem to exceed what is necessary and the public service contracts were

[764] Ibid., para.33.

concluded for five years. In the light of these facts, the Altmark criteria do not appear to be adequate and workable when the Court has to deal with cases like *GEMO*.[765]

Enirisorse[766] is the second case, in which the Court had to deal with, *inter alia*, the question, on whether the allocation to a public undertaking of a proportion of port charges levied in relation to the loading and unloading of goods constituted State aid within Article 87(1) (now Article 107(1) TFEU) of the Treaty. In this case, the Aziende were public economic entities responsible for the management of mechanical loading and unloading equipment, storage areas and other property, real and personal, owned by the State and used for the movement of goods. The Aziende might be authorised to supply other commercial port services, to undertake the managing of equipment and plant not owned by the State and to perform duties entrusted to them by law in other ports forming part of the geographical area of the port in which they had their registered office. Aziende received for its services two thirds of the State's charges on goods loaded and unloaded in, or in transit through several Italian ports.

Using its own manpower and equipment, Enirisorse loaded and unloaded domestic and foreign goods without making use of the services of the Aziende operating in that port. Nevertheless, Enirisorse was required to pay the port charges and it started legal proceedings before the national authorities, arguing that the legislation was contrary to Articles 86 (now Article 102 TFEU) in conjunction with Article 90 (Article 106 TFEU) of the Treaty and constituted State aid.

In this case, the Court applied three out of four conditions of *Altmark*, thus more clarification is needed regarding the fourth condition. As regards the first condition, the Court stated that it was not clear that public-service duties had been entrusted to the Aziende, and still less therefore that such duties had been clearly defined.[767] In this regard, the Court did not provide any further guidance as to what was to be considered as clear and

[765] For a similar view see Ivan Draganic, opcit., p.687.
[766] Joined Cases C-34/01 and C-38/01 *Enirisorse SpA v Ministero delle Finanze* [2003] ECR I-14243.
[767] Ibid., para. 34.

defined in advance and in an objective manner. This is because, as mentioned above, the legal status, public service duties, and the financial means of Aziende were defined in the relevant Italian legislation. Although they appear to be quite clear, objective and transparent parameters in the legislation, the Court disagreed.

Under the second Altmark condition concerning compensation, the Court found that the amount of the port charges paid to the Aziende did not reflect the costs actually incurred by the latter for the purposes of supplying their loading and unloading services, since that amount was linked to the volume of goods transported by all users and shipped to the ports in question. In that way, the amount paid varied with the level of activity in the ports concerned. Such a system did not satisfy the requirement that compensation could not exceed what was necessary to cover all or part of the costs incurred in the discharge of public service obligations. The Court concluded that if a measure concerning the allocation by a Member State of a significant proportion of charges, such as port charges, to a public undertaking was not linked to clearly defined public-service duties and/or if other conditions, such as laid down in *Altmark* were not complied with, that measure must be classified as State aid within the meaning of Article 107(1) of the Treaty in so far as it affected trade between Member States. [768]

After *GEMO* and *Enirisorse*, the Commission took the initiative for some legislative attempts to provide further clarification to the Altmark criteria. For the adoption of the State Aid Action Plan,[769] the Commission issued in July 2005 a package of measures aimed at clarifying and rationalising the current State aid law. Therefore, a Commission Decision, an amended version of the Commission Directive on financial transparency, and a 'Community Framework for State aid in the form of public service compensation' were adopted. This package has made a significant contribution to the simplification of the rules applicable, in accordance with better regulation principles. They also enable the Member States to secure public service missions through an act of entrustment, and to compensate

[768] Ibid., paras.37-39.
[769] Commission's State Aid Action Plan, Brussels, COM(2005) 107, 7.6.2005.

all net costs incurred by the companies charged with such services. However, the Decision and Framework apply only where the four Altmark criteria are not fulfilled and the measure constitutes State aid. Otherwise, if the conditions are not met, the measure cannot be scrutinised under Article 107(1) TFEU and thus the Decision and Framework do not apply.

The third important case in this field is *BUPA,*[770] which arose from the measures adopted in Ireland to open up the market in private medical insurance and the applicants' attempt to overturn the Commission's refusal to classify the Risk Equalisation Scheme as a State aid. The risk equalisation system emerged as a result of the liberalisation process established by the Health Insurance Act and was administered by the Health Insurance Authority. In this respect, the risk equalisation scheme was a device that attempted to counter the threat to the market stability that would arise if insurers were allowed to conduct business on the basis of risk insurance whereby older, less healthy and costlier individuals would find insurance more difficult and expensive to obtain than younger, fitter and, accordingly, cheaper members of the population.

Although 'intergenerational solidarity', which was the case in *Poucet and Pistre*, was not directly used in the legislation, the risk equalisation system in effect pursued this goal by adopting an approach based on community rating. Accordingly, the proposed scheme envisaged that private medical insurers with a risk profile below that of the average risk profile would pay a levy to the Health Insurance Authority. The latter would in turn pay out the insurers with a higher than average risk profile. Therefore the new entrants, such as BUPA, to the health insurance market had to make payments under risk equalisation system as they would normally concentrate on the more profitable side of the market.

The Irish Authorities notified the risk equalisation system to the Commission under Article 88(3) (now Article 108(3) TFEU) and the Commission decided not to raise objections, stating that: "*The risk equalisation system involves payments which are limited*

[770] Case T-289/03 *British United Provident Association Ltd* (*BUPA) and others v Commission of the European Communities* [2008] ECR II-81.

to the minimum necessary to compensate private medical insurers for services of general economic interest obligations and therefore does not involve state aids in the sense of Article 87(1) [now Article 107(1) TFEU] EC."[771] BUPA and BUPA Ireland launched proceedings for annulment of the contested decision before the CFI. In its almost 350 paragraphs long ruling the CFI went into all details of the scheme under attack and, in doing so, based its material assessment on the four criteria as developed in *Altmark.* In this regard, Ross states that in CFI's view, the Altmark criteria overlapped "to a large extent" with those of Article 106(2) TFEU.[772]

Under the Altmark criteria, the first condition was satisfied because of the way in which Ireland had properly exercised its discretion in defining compulsory public service obligations. The applicants' claim that the second condition was not met because of the discretion vested in the Health Insurance Authority and Minister was also rejected by the CFI. Accordingly, the CFI held that this argument confused the decision to commence payments within the risk equalisation system with the calculation of the payments themselves. The point of the second condition was to preclude "…*any abusive recourse to the concept of an SGEI on the part of the Member States*."[773] For the remaining conditions the CFI observed that "*a strict application of the third Altmark condition, which is aimed at a different form of compensation for an SGEI obligation, would not take account of the particular nature of the functioning of the compensation system provided for by the risk equalisation system. On the contrary, such an approach would amount to calling in question as such Ireland's choice to establish such a system, which is completely independent of the receipts and profits of the private medical insurers and which is designed to ensure the proper functioning of a private medical insurance market subject to the private medical insurers' obligations*."[774]

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[771] Commission Decision of 13 May 2003 *(Ireland)*, State aid N 46/2003.
[772] Malcolm Ross, "A Healthy Approach to Services of General Economic Interest? The BUPA Judgment of the Court of First Instance", **E.L.Rev**.,Vol. 34, No.1, 2009, pp.127-140.
[773] Case T-289/03 *BUPA* [2008] ECR II-81, para.214.
[774] Ibid., para. 241.

The judgement is important for two main reasons. First, the CFI concluded that the equalisation scheme satisfied the entirety of the Altmark requirements even though the Commission had based its assessment, as it rendered its decision prior to *Altmark*, on the *Ferring* judgement. Secondly, the ruling in BUPA has revealed that Altmark provides very useful guidance on how to assess national schemes designed to compensate costs linked to the fulfilment of SGEI, but does not fit in each and every case and therefore has to be modified accordingly.[775]

[775] Andreas Bartosh, "Editorial: The Ruling in BUPA-Clarification or Modification of Altmark", EStAL, Vol. 2, 2008, p.211.

4. TURKEY'S OBLIGATIONS UNDER ARTICLE 106 TFEU

4.1. Application of Competition Rules to Public Undertakings and Undertakings with Special or Exclusive Rights

4.1.1. Public Undertakings in Turkish Legal System

4.1.1.1. Historical Background

The State intervention in the economic life has a long history in Turkey. Even in early stages and golden ages of the Ottoman Empire, the State needed to set up institutions to fulfil its own administrative and military needs.[776] On the other hand, public services for the daily needs of the society were usually provided by the non-economic foundations established usually by the members of the Royal Family, high-ranked military persons, and bureaucrats.[777] Most of such foundations lost their efficiency and became redundant with the collapse of the Empire and the Turkish Republic felt the urgent necessity to provide these public services by regulating the economic life and engaging in the economic and industrial activities by itself even before the private initiatives emerged.[778] Therefore, in the Turkish Republic, State funded enterprises have been the result of the State's political, social and economic goals.

In the Turkish legal and economic system public undertakings mainly comprise of 'public economic enterprises (PEE)'. The emergence of PEEs in the Turkish economic life goes back as far as to 1800s, late periods of the Ottoman Empire. For example, Beykoz Military Equipment Factory (1810), Feshane Factory (1835), Bakırköy Factory (1850) and

[776] Dündar Sağlam, **Türkiye'de Kamu İktisadi Teşebbüsleri**, Ankara: Ankara Üniversitesi Siyasal Bilgiler Fakültesi İşletme İktisadı ve Muhasebe Enstitüsü Yayınları, 1967, p.5.
[777] Sıddık Sami Onar, "Türkiye'de İktisadi Devlet Teşekküllerini Doğuran Amiller, Bu Teşeküllerin Hukuki ve İdari Yapılarının ve Şekillerinin Tahlil ve Tenkidi", in **Muammer Raşit Seviğ'e Armağan**, İstanbul Üniversitesi Hukuk Fakültesi Yayınları, 1956, s.4.
[778] Yıldızhan Yayla, **İdare Hukuku**, 1st ed., İstanbul: Beta, 2009, s.85.

Ziraat Bankası (Bank of Agriculture) (1888) are regarded to be the first examples of public economic enterprises in Turkey.[779]

Following these initial examples, Turkiye Sanayi ve Maadin Bankası (Industry and Mining Bank of Turkey) was founded in 1925 and entrusted with the task of operating the industrial entities owned by the State, establishing new ones, operating mines, granting credits to industrialists and miners and conducting banking transactions. However, this Bank failed to fulfil its tasks. Therefore, the industrial enterprises that the Bank was under obligation to govern were transferred to the State Industry Office and the banking operations were transferred to the newly established Turkiye Sanayi ve Kredi Bankası (Industry and Credit Bank of Turkey). Later, these two entities were transferred by the Law No.2262 to Sümerbank which was established in 1933. During the same period the obligation of Osmanlı Bankası to operate the money transactions of the State was granted to the Central Bank which was established in 1930. In 1935 the Institute for Examination and Search of Mines and Etibank for production and distribution of energy were established.[780]

The above-mentioned entities engaged in different economic activities were the first models of PEEs that would be established in the future. For example, Sümerbank was entrusted with certain public service duties, such as to prepare the projects of industrial enterprises established by the State capital and govern them, to join other enterprises and assist them and to train the necessary qualified workers for them. Within this framework, emergence of public economic enterprises is mainly based on social, political and economic reasons. Increasing general welfare level of the society under social justice principles, and providing society with goods and services of certain quality, amount and price constitute examples for social reasons. Protection of national security can be given as an example for political reasons whereas; establishment of enterprises which the private sector is not ready

[779] Turgut Tan, **Ekonomik Kamu Hukuku Dersleri**, Ankara: Turhan Kitabevi, 2010, p. 167.
[780] Ibid.

for, owing to the lack of sufficient human resources or low- profit margins, is an example for economic reasons.[781]

Apart from the exclusive Laws enacted for certain public enterprises, the first legislation governing State owned economic enterprises, including PEEs, was the Law No.3460 which came into force in 1937.[782] This Law aimed to organise enterprises with public capital and to subject them to the common rules regarding the management and supervision. Following this legislation, 1961 Turkish Constitution introduced provisions[783] for the regulation of PEEs and the Law No.440 of 1964[784] was enacted to implement those provisions.

The 1982 Constitution contains various provisions on PEEs. In order to implement these provisions, first, the Decree No.60[785] was adopted by the Board of Ministers but this Decree was approved with several amendments by the Turkish Parliament and public funded enterprises were held subject to the Law No. 2919 of 1983.[786] In a very short term, the State intended to privatise some of the PEEs and for the achievement of this goal the Decree No.233 was adopted.[787] Having been amended several times, this Decree is still in force today.

4.1.1.2. Definition of Public Economic Enterprise

The public economic enterprise is one of the most crucial models of the State intervention to the economic life in Turkey. Public economic enterprise (PEE), as a concept, has not been defined directly in the legislation, although it is mentioned in different Laws, Decrees and Regulations, including the Turkish Constitution. Therefore, there is a tendency in the academic circles to define it on the basis of Article 165 of the

[781] Tevfik Altınok, **Kamu Iktisati Teşekkülleri Sorunları ve Çözüm Yolları**, Ankara: Maliye Bakanlığı Tetkik Kurulu Yayını, Vol. 24, No. 1, 1982, p.7.
[782] Sermayesinin Tamamı Devlet Tarafından Verilmek Suretiyle Kurulan İktisadi Teşeküllerin Teşkilatiyle İdare ve Murakabeleri Hakkında Kanun, No.3460, 17.6.1937.
[783] See, Articles 119, 126 and 127 of 1961 Constitution.
[784] İktisadi Devlet Teşekkülleriyle Müesseseleri ve İştirakleri Hakkında Kanun, No. 440, 12.3.1964.
[785] İktisadi Devlet Teşekkülleri ve Kamu İktisadi Kuruluşları Hakkında Kanun Hükmünde Kararname, No.60, 11.4.1983.
[786] İktisadi Devlet Teşekkülleri ve Kamu İktisadi Kuruluşları Hakkında Kanun, No.2929, 19.10.1983.
[787] Kamu İktisadi Teşebbüsleri Hakkında Kanun Hükmünde Kararname, No.233, 8.6.1984.

Constitution. The list of enterprises captured by this term depends on the scope of the relevant legislation governing certain PEEs.

Article 165 of the 1982 Turkish Constitution contains a provision titled as 'Supervision of Public Economic Enterprises'. This provision states that "the basics of the supervision by the Turkish Parliament of public institutions and their associate partnerships, *the more than half of the capital of which* belongs directly or indirectly to the State is regulated by Law." Being inspired by this provision it is suggested that public economic enterprise, is an entity, more than half of the capital of which belongs to the State or other public authorities and which produce goods and/or services in the economic field.[788]

However, according to the Decree No.233 on Public Economic Enterprises, one of the common features of PEEs is that their whole capital belongs to the State. This is a very narrow interpretation of the PEEs, much narrower than the scope of public undertakings accepted in the EU and even contradictory to Article 165 of the Constitution. Bülbül explains the contradiction between Article 165 and the Decree No.233 on the fact that Article 165 has the title of "Supervision of Public Economic Enterprises" and the provision is located in the first section under the title of "Financial Provisions" within the fourth part titled as "Financial and Economic Provisions" of the Constitution. Therefore, Article 165 does not aim at defining the PEEs but rather setting a rule regarding their supervision.[789]

Nevertheless, it is commonly agreed that not just the PEEs within the meaning of the Decree No. 233 but also the ones in which the State holds more than half of the shares are subject to Parliamentary supervision. This provision conveys that the definition of PEE is broader than the one in the Decree No.233. Supporting this approach, in one of its judgements the Constitutional Court held that although its title refers specifically to PEEs, the scope of the provision is broader to capture all *public institutions* and *their associate*

[788] Tan, p.170. For similar definitions see also, Kemal Gözler, **İdare Hukuku**, 2nd ed., Bursa: Ekin Kitabevi Yayınları, Vol.1, 2003, p.170; H. Ercüment Erdem, **KIT'lerin Tacir Sıfatı**, İzmir: Dokuz Eylül Hukuk Fakültesi Döner Sermaye ve İşletmesi Yayınları, 1992, p.19.
[789] Erdoğan Bülbül, **Kamu İştirakleri-Bir Hukuki Niteleme Denemesi**, 1st ed., İstanbul: Beta, 2004, p.120.

partnerships in which the State directly or indirectly owns more than half of the capital.[790] Similarly, in another judgement, the Constitutional Court ruled that the Funds should also be regarded as *public institutions* within the meaning of Article 165 of the Constitution.[791] In the light of these judgements, it is argued that Parliamentary supervision under Article 165 is not a condition of being a PEE and the PEE is a more common term which is used to address the State's intervention into the economics as a service provider.[792] Bülbül goes one step further to suggest that, even the enterprises in which the State has less than half of the capital can be regarded as PEEs when the other conditions are fulfilled.[793]

Indeed, as is mentioned in the previous chapter, "*public undertakings means any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it*"[794] for the purposes of the EU law. Therefore, for the characterisation of an undertaking as 'public' the most important criterion is the 'dominant influence' of the State or other public authorities over the undertaking in question. First, this dominant influence might arise from the ownership of the undertaking, which means that the State holds the total capital. Secondly, it may also arise from the participation of the State in the capital, which means that the State has less than 100% of the capital. Finally, the dominant influence of the State may arise from the rules governing the undertaking, which means that the undertaking is subject to the rules different from the ones that the ordinary private undertakings are subject to.

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[790] Constitutional Court Judgement of 28.1.1988, E.1987/12, K.1988/3, Resmi Gazete (RG), 07.10.1988, No.19952, Anayasa Mahkemesi Kararları Dergisi (AMKD) No. 24, p.49.
[791] Constitutional Court Judgement of 7.7.1994, E.1994/49, K.1994/45-2, RG 10.9.1994, No.22047, AMKD No.31, Vol.1, p.222. See also Constitutional Court Judgement of 22.12.1994, E.1994/70, K. 1994/65-2, RG 28.1.1995, No.22185; AMKD, No.31, Vol.1, p.385 (about the supervision of Turkish Telecommunications Company -Türk Telekomunikasyon A.Ş.- before its privatisation).
[792] For a similar approach see İhsan Kuntbay, **Türkiye'de Kamu İktisadi Teşeküllerinin Yönetimi**, Ankara: Türkiye ve Ortadoğu Amme İdaresi Enstitüsü Yayınları, 1981, p. 2.
[793] Bülbül, p.125.
[794] Article 2(b) of the Commission Directive of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings, 2006/111/EC OJ L318/17.

According to this definition in the Transparency Directive, a dominant influence on the part of the public authorities is presumed when these authorities, directly or indirectly in relation to an undertaking: *"(i) hold the major part of the undertaking's subscribed capital; or (ii) control the majority of the votes attaching to shares issued by the undertakings; or (iii) can appoint more than half of the members of the undertaking's administrative, managerial or supervisory body*."[795] Taking into account these conditions, it is also possible to make some evaluations for the concept of PEE in the Turkish law.

First, there is no doubt that when the State owns the total capital of an undertaking, this undertaking will be regarded as a public undertaking in both EU and Turkish law. This should be also relevant for the undertakings in which the State holds the majority of the shares. This interpretation is in parallel with Article 165 of the Turkish Constitution and the Law No.3346 which was enacted to implement this provision. Under the Law No.3346 concerning the supervision of PEEs by the Turkish Parliament, the following entities are within the scope of this Law:

- the entities more than half of the subscribed capital of which is hold by the public legal persons,

- other entities more than half of the subscribed capital of which is hold by the above-mentioned entities,

- although not included in the above mentioned entities, the entities subject to special laws, which are entrusted with public authority and obligations mainly to operate public services and which are not among the professional associations of public character,

- Iller Bank.[796]

[795] Ibid.
[796] Iller Bank has a long history of co-operation with local authorities, specifically with municipalities. Lending to infrastructure investments, project development, technical consultancy and transfer of funds from central budget to local administrations are the four bacis functions of the Bank.

The first two categories of entities enumerated above correspond, in respect of their capital structure, to the definition of public undertakings within the Transparency Directive and consequently to the public undertakings stipulated in Article 106 of the TFEU. The third category of entities, however, corresponds exactly to the undertakings entrusted with exclusive or special rights within the meaning of Article 106 TFEU and their public or private character is totally irrelevant when assessing their compatibility with rules of the Treaty.

Secondly, when the State has less than 50% of the capital of an undertaking, it may still be able to exercise a dominant influence over the undertaking. In other words, having less than 50% of the shares does not necessarily mean being the minority in the management and decision making mechanisms of the undertaking. There are some other ways in law to be dominant in the management of a company. For example, according to Article 401 of the Turkish Commercial Code it is possible to attach various privileges to some shares by the Articles of Association. In the joint stock companies, these privileges may appear as privileged shares[797] or privileged participation[798] in the management.

Another mechanism for the State is to hold a 'golden share' for retaining its dominant influence over the management of the undertaking, when the State has lost the majority of shares, especially, during the privatisation process. For example, Law on Telegraph and Telephone No.406 contained such a provision stating that all shares of Türk Telekom can be sold but one privileged share conferring on the State the right to vote cannot be sold. This privileged share, granted to the State the right to approve in matters such as amendment of the Articles of Association, establishment of new companies or participation in the established companies, joining international telecommunications associations, concluding international agreements, transfer of shares effecting the structure

[797] For further information see Reha Poroy, Ünal Tekinalp and Ersin Çamoğlu, **Ortaklıklar ve Kooperatif Hukuku**, 12th ed., Istanbul: Vedat Kitapçılık, 2010, paras.781-807.
[798] For further information see Hasan Pulaşlı, "Anonim Şirketlerde Yönetimde İmtiyaz ve Buna İlişkin Esas Sözleşme Düzenlemelerinin Anlamı ve Etkisi", in **Prof. Dr. Erdoğan Moroğlu'na 65. Yaş Günü Armağanı**, İstanbul: İstanbul Üniversitesi Hukuk Fakültesi Yayınları, 1998, p.563.

of the management board to protect the national interests for economic and security reasons.

Thirdly, when the State holds minority of the shares, or in an extreme case has no share at all, in the capital of an undertaking, the State can still exercise its dominant influence, albeit indirectly, through the rules governing the undertaking. That is the case if the undertaking is subject to public law provisions and effective supervision of the State different from the private undertakings. For example, (public) subsidiaries are defined by the Decree No.233 as 'joint stock companies in which a State economic enterprise, public economic corporation or its associate partnerships hold minimum 15% and maximum 50% of the capital. Obviously, the State has minority shares in this type of undertakings but these undertakings, nevertheless, are subject to the Decree No.233, and also other specific Laws which concerns public sphere. For example, in Article 6 of the Law on Minerals No.3213 of 4.6.1985, public subsidiaries are enumerated among PEEs and other public institutions and administrations which can be granted the right to operate mine if they are authorised by their Laws. It is also possible to find similar provisions mentioning (public) subsidiaries in other Laws, such as Law on Tax Conciliation,[799] Law on Lawyers,[800] which are not applicable to the private undertakings. Constitutional Court also confirmed that they are different from the employers with private legal and natural personality.[801] Basing his arguments on these facts, Bülbül submits that there is no obstacle in the Turkish legislation to regard (public) subsidiaries as PEEs.[802]

In the light of the above-mentioned arguments and in the absence of a specific legal instrument, like the Transparency Directive in the EU law, which exclusively defines and governs public undertakings in the Turkish legal system, the definition of PEE is not a settled issue. Despite its broad scope, the Law No.3346 which was enacted to implement

[799] Article 17 of the Tax Conciliation Law, about the payment of debts by public institutions according to an installment plan.
[800] Article 14 of the Law on Lawyers, about the prohibition imposed on lawyers not to file a case or pursue enforcement against the PEEs and other public institutions that they had worked for in two years starting from their leave.
[801] Constitiutional Court Judgement of 18.2.1992, E.1991/5, K.1992/9, RG 7.5.1992, No.21221; AMKD, No.28, Vol.1, p.143.
[802] Bülbül, p.147.

Article 165 of the Constitution provided for exceptions regarding, especially, the economic enterprises of municipalities and some other entities although they operate using the public funds. In other words, the entities more than half of the capital of which is subscribed by local public administrations, including municipalities, and the entities more than half of the capital of which is subscribed by these entities are held outside the Parliamentary supervision and consequently the definition of PEEs in the strict sense of the meaning. The existing inconsistency in the definition of PEE causes legal controversy as to the legal regime that is applicable to these enterprises. This legal situation also prevents a correct assessment of the State's role in the economy.[803] Although the number of PEEs has been decreased as a result of liberalisation and privatisation process in the recent years, the provisions encouraging corporate structures in the new Law on Municipalities proves that the issue retains its importance.[804]

4.1.1.3. Public Economic Enterprises under the Decree No.233

The Decree No.233 applies to two types of PEEs, state economic enterprises and public economic corporations, their institutions, associate partnerships and subsidiaries. **State Economic Enterprise (SEE)** is a public economic enterprise, the whole capital of which belongs to the State and which is established to operate in the economic field under the commercial principles.[805] State Equipment Office (Devlet Malzeme Ofisi), Meat and Fish Corporation (Et ve Balık Kurumu), Eti Mine Works (Eti Maden İşletmeleri), Mechanical and Chemical Industry Corporation (Makina ve Kimya Endüstrisi Kurumu), TMO (Toprak Masulleri Ofisi), Pit Coal Corporation of Turkey (Türkiye Taş Kömürü Kurumu), Turkish Coal Works Corporation (Türkiye Maden İşletmeleri Kurumu), Turkish Petrolium Corporation (Türkiye Petrolleri Anonim Ortaklığı), Sugar Factories of Turkey Corporation (Türkiye Şeker Fabrikaları A.Ş.), Petroleum Pipeline Corporation (BOTAŞ), Turkish Electricity Corporation (TEDAŞ), Turkish Electricity Generation Incorporation

[803] 1994 Kamu İktisadi Teşebbüsleri Genel Raporu, Başbakanlık Yüksek Denetleme Kurulu yayını, Ankara, 1996, pp. 4 and 13.
[804] Tan, p.173
[805] Article 2(2) of the Decree No.233.

(EÜAŞ), Turkish Electricity Transmission Company (TEIAS), General Directorate of Tea Corporations (Çay İşletmeleri Genel Müdürlüğü-ÇAYKUR), General Directorate of Agriculture (Tarım İşletmeleri Genel Müdürlüğü) are among the existing SEEs.

Public Economic Corporation (PEC) is a public economic enterprise, the whole capital of which belongs to the State and which is established to provide basic goods and services of monopolistic nature and the goods and services produced by which are regarded as privileges because of this public service.[806] This type of PEE corresponds to the monopoly undertakings under Article 31 TFEU and the revenue producing undertakings located under Article 106(2) of the Treaty in EU law. At the present, Turkish Railways Corporation (TC Devlet Demir Yolları İşletmesi), Turkish Post and Telegraf Organisation (T.C. Posta ve Telgraf Teşkilatı), State Airports Corporation (Devlet Hava Meydanları İşletmesi), Directorate General of Coastal Safety (Kıyı Emniyeti Genel Müdürlüğü) are the examples for PECs.

According to Article 1(2) of the Decree No.233, this legislation aims to enable SEEs to create more resources for investment by working in compliance with each other and with the national economy in a profit oriented and efficient way on the basis of economic principles. Regarding PECs, it is stated that the Decree aims to provide these entities with necessary facilities which will enable them to conduct their duties and public services in accordance with economic and social necessities under the principle of efficiency.

Decree No.233 subjects both SEEs and PECs to the common rules, bringing them under the common term 'enterprise'. Accordingly, both types of PEEs have public capital, but only SEEs could be established as 'joint stock companies'[807] within the meaning of Turkish Commercial Code. They both have legal personalities and save as otherwise provided in the Decree, they will be subject to private law principles. Therefore, they are excluded from the scope of General Accounting Law and State Procurement Law, and they

[806] Article 2(3) of the Decree No.233.
[807] Article 3 of the Decree No.233.

are not under the supervision of Turkish Court of Auditors. They could be entrusted with special public service obligations by the Board of Ministers, and when they incur loss or become devoid of profit it is reimbursed by the Treasury. They are also free to determine the price tariffs of the goods and services that they produce and/or provide, in accordance with the economic and social needs, under the principle of efficiency.[808] When it deems necessary, the Board of Ministers also determine price of goods or services provided by these enterprises in the public interest.

Institutions are undertakings or group of undertakings, whose capital totally belong to one SEE or PEC under which they operate. According to Article 15(1) of the Decree No.233, SEEs and PECs whose capital totally belong to the State can organise their undertakings as 'institutions'. The institutions produce the products of monopolistic nature within the activity field determined by the objective of their establishment.

Associate Partnerships are the joint stock companies consisting of an undertaking or group of undertakings in which a SEE or a PEC holds more than 50% of the capital.[809] Associate partnerships could be formed when an institution transformed into an associate partnership model; the shares of a SEE or PEC in a subsidiary has been increased above 50% or when a SEE or a PEC has more than 50% of the shares in a newly established company. For example, before the privatisation process started, TEDAŞ had organised distribution of electricity in Turkey through certain distribution companies and its associate partnerships. With regard to the law that the associate partnerships are subject to, determination of prices of the goods or services that they produce, activity fields, obligations and external supervision, the same rules applicable to SEEs, PECs and to the institutions also apply to associate partnerships. Similarly, their assets are regarded to be State goods, and they have the authority to expropriate the necessary real estate and property rights to achieve their aims and to realise their activities.

[808] See Council of State Judgement, 10. Chamber, E. 1989/96 K. 1989/2636, Danıştay Dergisi, No.78-79, p.515.
[809] Article 3(5) of the Decree No.233. For a similar provision see, Article 3(b) of the Law on Encouragement of Savings and Accelaration of Public Investments, No.2983, 29.2.1984.

Subsidiaries are joint stock companies in which a SEE, PEC or its associate partnerships hold minimum 15% and maximum 50% of the capital. It is not possible for more than one SEE or PEC to participate in the same subsidiary. As 15% is the minimum participation rate, it cannot be reduced below this percentage through capital increase. Different from the SEE, PEC or their institutions, associate partnerships and subsidiaries are regarded to be mixed capital enterprises.[810] In order to distinguish them from ordinary subsidiaries subject to Turkish Commercial Code, they can also be referred to as 'public subsidiaries'.

As is mentioned earlier, the definition of PEEs under the Decree No.233 is quite narrow when it is compared to Article 165 of the Constitution and much narrower when it is compared to the definition of public undertakings adopted by the EU institutions. On the other hand, the Decree provides important clues as to the definition and legal status of the PEEs under Turkish legal system.

4.1.1.4. Legal Status of Public Economic Enterprises

Despite the recent privatisation and liberalisation process, the public services which are regarded to be among "the essential and continuing obligations"[811] that should be conducted by the State in compliance with the general administrative principles are still provided by the public entities. These entities include mainly PEEs but also other public entities established by their specific Laws. Being components of the Turkish administrative system, such public entities either have their own legal personalities or they are part of other legal persons[812] as they cannot exist without being part of a legal personality.[813] Although there are some entities without legal personalities in the administrative

[810] Bülbül, p.22.
[811] This expression is found in Article 128 of the Constitutition. See also for e.g. Constitutional Court Decision of 26.06.2002, E.2001/377, K.2002/59, RG 09.11.2002, No: 24931.
[812] Natural persons are not considered to be components of the Administrative System.
[813] Lütfi Duran, **Idare Hukuku Ders Notları**, Istanbul: Istanbul Üniversitesi Hukuk Fakültesi Yayınları, 1975, p.70.

organisation, they are structurally attached or related to another entity with a legal personality.[814]

In Turkish legal system only public legal persons are able to use public authority as distinct from the private legal or natural persons. According to Article 123(1) of the Turkish Constitution, administration within the meaning of public law is governed by Law as a legal instrument.[815] Consequently, according to the second paragraph of the same Article, "[p]ublic legal personality could only be established by Law or on the basis of the authority explicitly granted by Law." Therefore, public legal personality is established by Law as a principle.

Since only public legal persons are able to use public authority, private legal persons, as a principle, cannot be granted public authority. On the other hand, it is submitted that in certain Laws there are some provisions which can be interpreted as conferring the capacity to use public authority on private legal persons and this interpretation has also been supported by some case law.[816] For example, Erkut argues that the private legal persons who provide public services should be considered as a public authority and their services as administrative measures.[817] However, according to the Constitutional Court when there is no specific provision in the Constitution to this effect, conferring public authority on private legal persons by Law is against the Constitution.[818]

The strict approach of the Constitutional Court with regard to the use of public authority by private legal persons could be explained by the general principles concerning 'sovereignty' laid down by the Constitution. Indeed, public authority emerges from the

[814] İl Han Ozay, **Günışığında Yönetim II-Yargısal Korunma**, İstanbul: Oniki Levha Yayınları, 2010, p. 167.
[815] The concept of Law includes Acts as well as Decrees having the same effect as Law, issued by the Board of Ministers in accordance with Article 91 of the Constitution.
[816] See Cem Ayaydın, "Özel Hukuk Kişilerinin Kamu Kudreti Kullanması Sorunu ile 4708 sayılı Yapı Denetimi Hakkında Kanuna İlişkin Anayasa Mahkemesi Kararı Hakkında Düşünceler", in **Yıldızhan Yayla'ya Armağan**, Galatasaray Üniversitesi Yayınları, 2003, p.129. See also, Bahtiyar Akyılmaz, **İdari Usul İlkeleri Işığında İdari İşlemin Yapılış Usulü,** Yetkin Yayınları, 2000, s.37.
[817] Celal Erkut, **İptal Davasının Konusunu Oluşturma Bakımından İdari İşlemin Kimliği**, Ankara: Danıştay Yayınları, 1990, p.61.
[818] See for e.g. Constitutional Court Decision of 11.12.1986, E. 1985/11, K. 1986/29, RG 18.04.1987, No.19435; AMKD, No:22, p.433.

State's sovereignty. Sovereignty is defined as the authority to conduct certain transactions that produce legal results in the legal sphere and Constitution is the superior norm that reveals the limits of the use of this authority.[819] Article 6 of the Constitution is as follows: "*Sovereignty belongs to the Nation without being subject to any condition. Turkish Nation uses this sovereignty by means of the authorised bodies in accordance with the Constitutional principles. The use of sovereignty, under no circumstances, can be left to any body, category or class of people. Nobody can use State authority which does not arise from the Constitution*." Accordingly, sovereignty should be used in accordance with law and Constitution, and the State authorities that are used on behalf of the Nation shall arise from the Constitution.

In the light of the Constitutional principles, public legal personalities can be established by Law which finds its basis in the Constitution. Although PEEs are established by Law and have their own legal personalities, the nature of their legal personalities and their legal status is a matter of dispute among different authorities and academics. According to Onar, although their institutional structures and management procedures are similar to that of private legal personalities and they are subject to private law provisions in their relations with third parties in their daily practices, PEEs should be regarded as public legal persons.[820] Basing his arguments on the wording of Article 126 of the Constitution, Hatemi also thinks that PEEs and, consequently SEEs, should be considered as public legal personalities.[821]

It is important to emphasise that being subject to private or public legal provisions and having a private or public legal personality are different matters. When a legal personality is established by Law, it is usually indicated that the entity in question is "subject to private law" in its specific Law whereas; it is often neglected to indicate whether this legal personality is of public or private nature. According to Bilgen, if an

[819] Erdoğan Teziç, **Anayasa Hukuku**, Istanbul: Beta, 7th ed., 2001, p.99.
[820] Sıddık Sami Onar, p.30. For an opposite view, see Ernst E. Hirsh, **İktisadi Devlet Teşekküllerinin Hukuki Mahiyeti**, Ankara: Hukuk İlmini Yayma Kurumu Konferansları, 1939, p.22.
[821] Hüseyin Hatemi, **Medeni Hukuk Tüzelkişileri**, Vol.1, İstanbul: İstanbul Üniversitesi Hukuk Fakültesi Yayınları, 1979, p.65.

entity providing a public service is established by Law in which it is indicated that the entity is subject to private law, this entity will be regarded as a public legal person as long as it has the authority granted by its establishing Law to conduct administrative actions.[822]

Ozay submits that there is no doubt that SEEs are public legal persons subject to private legal provisions according to their establishing Laws. As a result, some of their activities are supervised by Administrative (Administrative Courts and Council of State) and the others are supervised by Legal Courts (Ordinary Legal Courts and Court of Appeal).[823] Indeed, PEEs are established according to an explicit authority granted by Law, they produce goods or provide services in the public interest and the prices of such goods or services may be determined by the Board of Ministers, members of their management board are assigned by the public authorities, their loss may be compensated from the State budget and they are subject to Parliamentary supervision. Such qualities can only be found in public legal personalities, not in private ones.[824] Regarding their legal status, the Court of Dispute Resolution ruled that PEEs are subject to private law provisions only in their daily business and their relations with third parties. Other fields, especially, the implementation of the legislation concerning their activities and decisions regarding the organisation and practice of their services are of administrative nature and subject to the law of administration.[825]

The Council of State has a decision about the Turkish Central Bank, which supports this approach. Turkish Central Bank was established by the Law No.1211,[826] which states that the bank is established under the title of 'Central Bank of the Republic of Turkey' as a joint stock company having the exclusive right to issue banknotes and other obligations and authorities determined by this Law. The bank will be subject to private law provisions unless otherwise stated in the Law.[827] In this respect the Council of State held

[822] Pertev Bilgen, **İdare Hukuku Dersleri- İdare Hukukuna Giriş**, İstanbul: Filiz Kitabevi, 1996, p.14.
[823] İl Han Özay, "Futbolda 'Özelleştirme", İdare Hukuku ve İlimleri Dergisi, No.1-3, 1990, p. 33.
[824] For a similar view, see Metin Günday, **Idare Hukuku**, 7th ed., Ankara: Imaj Yayincilik, 2003, p.478.
[825] Court of Dispute Resolution Judgement of 14.5.1966, E. 1966/1, K. 1966/15, Danıştay Kararları Dergisi, no.103-105, p.511. For a similar statement see Judgement of 6.11.1974, E. 1971/35, K. 1974/1380, RG 7.1.1975, No.15111, p.5.
[826] This Law was amended by Law No.3985 dated 21.4.1994.
[827] Article 1 of the Law No.1211.

that the cancellation of the rediscount credits provided by taking into security the credit certificates issued by an intermediary bank is within the banking activities of the Turkish Central Bank and therefore the dispute should be resolved according to the private law provisions by the ordinary legal courts.[828] This fact does not affect the public person character of the Turkish Central Bank and if the dispute had been about its exclusive right to issue banknotes it would have been resolved according to public law principles.

The Court of Appeal has adopted the approach that PEEs are public legal persons. In one of its rulings, the Court stated that from Constitutional law point of view the State comprises a part of a whole with its country and nation. Despite that, some public institutions are granted separate legal personality for legal, social and economic reasons and some of them having economic character are held subject to private law.[829] In another decision, the Court of Appeal ruled that Turkish Electricity Corporation is a PEC listed under Decree No.233. Therefore, Turkish Electricity Corporation is a public institution, the total capital of which belongs to the State and which was established to produce goods and services of monopolistic character, without any doubt.[830] In another decision, Plenary Assembly of Court of Appeal stated that PEEs and their associate partnerships have not lost their public identity completely even in their transition to private legal personality during privatisation process.[831] However, Court of Appeal also held that SEEs have the legal personalities of private nature. In one of its decisions, referring to an old judgement dated 1945, the Plenary Assembly of Court of Appeal ruled that PEEs are merchants within the meaning of Turkish Commercial Code, as they operate commercial undertakings. The fact that their capital belongs to the State or the assignment procedure of their managers is

[828] Council of State, 10. Chamber Judgement dated 2.5.1994, E. 1992/4076, K. 1994/1962, Danıştay Kararları Dergisi, No.90, p.1127.
[829] Court of Appeal, 12. Law Chamber dated 23.3.1981, E.1981/598, K. 1981/2936, Yargıtay Kararları Dergisi, Vol.7, No.7, 1981, p.867.
[830] Court of Appeal, 4. Law Chamber dated 6.2.1986, E.1986/277, K. 1986/932, Yargıtay Kararları Dergisi, Vol.2, No.5, 1986, p.654.
[831] Court of Appeal, Plenary Assembly Judgement dated 3.3.2004, E. 2004/9-116, K. 2004/136.

subject to special rules does not confer them a public law character. Therefore, they are private legal persons being subject to private law provisions.[832]

Council of State has adopted a more consistent approach. The judgement dated 1995 by 7. Chamber is particularly important in this regard. In this judgement, the Council of State held that public institutions, although they can be engaged in private undertaking activities, they were established as public legal personalities having their own autonomy, budget and assets under the control of central administrative authority and their activities are generally concerned with the provision of public services. Among these, the ones which were established to engage in economic activities like, industry, mining and agriculture are public economic institutions and they are collected under the umbrella term of public economic enterprise (PEE). [833]

In the light of the case law developed by the Council of State, Court of Appeal, the Court of Dispute Resolution and Constitutional Court and having regard to the different opinions existing in the academic circles, it is clear that the legal status of public economic enterprises is not a settled issue, either. The Council of State's approach seems to be closer to the functional approach adopted by the EU institutions in the sense that nature of the activity is more important than how the legal status of an entity is described in determining the applicable law to a specific activity. This could be adopted as a uniform approach by all the Courts and authorities to increase the legal certainty in this field.

4.1.1.5. Public Economic Enterprises as Undertakings

Irrespective of whether they have separate legal personalities, or whether they are of public or private legal status, PEEs are indisputably engaged in various economic activities. Despite that, it is still not clear whether PEEs can be regarded as 'undertakings' in the Turkish legal system. Different legal authorities, such as High Courts, or

[832] Court of Appeal, Plenary Assembly Judgement of 19.19.2005, E.2005/ 3-560-K.2005/587, Yargıtay Kararları Dergisi, Vol.32, No.1, 2006, p.5.
[833] Council of State, 7. Chamber Judgement of 27.12.1995, E. 1993/5190, K. 1995/5811, Danıştay Kararları Dergisi, No.91, p.618.

administrative bodies define PEEs in a different way according to the area in which the legal status of these enterprises comes into question, which was discussed above. The characterisation of PEEs as undertakings is decisive in determining whether they are subject to the Turkish competition rules.

Article 3 of the Law on the Protection of Competition No.4054 defines the undertaking as "*natural or legal persons who produce, market, and sell goods or services in the market and units which can decide independently and do constitute of an economic whole*." [834] According to the Competition Authority this definition in Law No. 4054 contains one functional and one formal criterion. The so-called functional criterion is about producing or offering goods and services on the market, which corresponds to the definition of 'economic activity' developed by the Court of Justice in its case law in the EU.[835]

The formal criterion about the capability of independent decision making, however, concerns the applicability of the competition rules to an undertaking rather than the definition of undertaking in the EU law. It is also a good example to show why Community institutions do not prefer using formal criterion when defining general concepts like 'undertaking'. Using this formal criterion in the second part of the definition may cause hesitation as to the 'undertaking' character of public enterprises under competition rules. It is very difficult to talk about 'the capability of independent decision making' when the State holds the majority shares of the enterprise, for it means that the enterprise is acting under dominant influence of the State. This problem concerns *prima facie* the SEEs and PECs under the Decree No.233 since their capital 100% belongs to the State. As the imputability of the conduct in breach of competition rules to the undertaking to determine the extent of its liability is a different issue from the characterisation of an entity as an

[834] The definition is taken from the English translation of the Act on the Protection of Competition No.4054 on the official website of the Competition Board (http://www.rekabet.gov.tr as of 11.01.2011).
[835] Case 118/85 *Commission v Italy* [1987] ECR 2599; [1988] 3 CMLR 255, para.7 and Case C-35/96 *Commission v Italy (Customs Agents)* [1998] ECR 1-3851; [1998] 5 CMLR 889, para.36.

undertaking, the formal criterion in the second sentence of the definition does not seem to be in the right place.

As the notion of undertaking under the EU law was explained in the previous Chapter, the details of this notion will not be discussed here any further. However, it is useful to remember the Court's definition of undertaking in *Höfner*, according to which "*the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity or the way in which it is financed*."[836] Moreover, the recent Law on Monitoring and Supervision of State Aids has a wider definition for undertakings. According to Article 2 of this Law, undertakings are "*natural or legal persons who produce, market and sell goods on the market*."[837] If a similar definition had been adopted in the Competition Law No.4054, it would have been easier for the Competition Authority to regard PEEs as undertakings in the meaning of competition rules.

On the other hand, the Competition Board considered ÇAY-KUR (General Directorate of Tea Corporations) as an undertaking within the meaning of Article 3 of the Law on the Protection of Competition. The Competition Board held that according to its Articles of Association published in the Official Gazette, ÇAY-KUR is a PEC whose liability is limited to its capital and subject to private law provisions, save as otherwise stated in the Decree No.233 and its Articles of Association. Having a separate legal personality, ÇAY-KUR is able to produce and sell goods and to decide independently, which make it an undertaking for the purposes of competition law.[838] In the same Decision, the Competition Board regarded General Directorate of Tobacco, Tobacco Products, Salt and Alcohol Corporations (TEKEL) as an undertaking due to its being subject to private law provisions according to the Decree No.233 without any further analysis.

The Competition Board dealt with the definition of undertaking in a more detailed way in its *ASKI* decision. ASKI, (Ankara Water and Sewage Authority) is an entity

[836] Case C-41/90, *Höfner*, para.21.
[837] Services are excluded from the definition of undertaking, as they are held outside the scope of the Law.
[838] Competition Board Decision of 22.6.1999 *(ÇAY-KUR)*, No: 99-31/277-167.

entrusted with the obligation to provide water and sewage services within the borders of Ankara Metropolitan Municipality. This entity has its own separate legal personality and budget. The Turkish Competition Board analysed the legal status of ASKI in a case based on the allegation that ASKI abused its dominant position by imposing high prices on the provision of water and waste-water services.

Repeating the definition of undertaking in Article 3, the Competition Board stated that the Law No.4054 does not define the public enterprises and their scope thereof. However, the public enterprises could have a separate legal personality from the State and could be located in central, regional or local authorities. According to the Board, when the central and local public authorities are themselves engaged in economic activities they can be regarded as 'undertakings' for the economic activities that they pursue, excluding the activities they conduct by using their public authority. Furthermore, it follows from the definition in Article 3 that even the units established within the central and local authorities without any separate legal personality could be regarded as undertakings. Therefore, ASKI which has revenues independent from the municipality and a separate legal personality should be considered as an undertaking.[839]

Although the final outcome of the Board's decisions usually seems to be right and fully in line with the practice of the Community Institutions, it does not easily fit into the definition of undertaking in Article 3 of the Law No.4054 for above mentioned reasons.

4.1.1.6. Application of Competition Rules to Public Undertakings

As is already mentioned in the previous section, public enterprises including PEEs are regarded to be 'undertakings' within the meaning of Article 3 of the Law on the Protection of Competition, as long as they are engaged in economic activity and capable of independent decision making. The Competition Board, albeit hesitantly, usually found the competition rules applicable to the public undertakings. In one of its decisions, the Board held that the sales of PECs to the private sector companies under the Law on the Regulation

[839] Competition Board Decision (*ASKI*) of 13.03.2001, No.01/12/114-29.

of Privatisation Practices and Amendment of Some Laws and Decrees No.4046 are within Article 7 of the Competition Law.[840] Similarly in Etibank decision, the Board stated that the sale of total shares of Etibank Bankacılık A.O by the Presidency of the Privatisation Authority to a private commercial company is an acquisition within the meaning of the Communique Concerning the Mergers and Acquisitions Calling for the Authorisation of the Competition Board No.2010/4. [841]

The Competition Board's Decision regarding Türkiye Şeker Fabrikaları A.Ş, which is a SEE in the form of a joint stock company under the Decree No.233, is quite remarkable for revealing the Board's hesitation to apply competition rules to the PEEs having exclusive rights. In this case, three competing sugar factories in Turkey claimed that Türkiye Şeker Fabrikaları A.Ş had abused its dominant position. The Board held that this enterprise, owing to its high market shares and its exclusive rights granted by law had a dominant position in the relevant market. However, the Board decided that Türkiye Şeker Fabrikaları as a PEE was able to determine freely neither its behaviour nor the purchase price of sugar beet and sale price of sugar on the relevant market. All these factors were determined in the public interest by Laws and Decrees and also by the Primeministry and Ministries which were not undertakings in the meaning of the Competition Law No. 4054. Under these circumstances it was not necessary to analyse whether Türkiye Şeker Fabrikaları had breached Article 6 of the Law by abusing its dominant position.[842]

The decision about the public sugar company is too short to reach a clear conclusion. On the other hand, it is important to note that the Board, albeit its emphasis to the lack of capacity of that enterprise to make an independent decision, did not say that it was not an undertaking. Instead, the Board proceeded to find that the enterprise had a dominant position on the relevant market. However, even if it had abused its dominant position, the competition rules would not have been applicable to this enterprise because the behaviour in question was not attributable to the enterprise but to the State.

[840] Competition Board Decision (*Çinkur*) of 03.12.1997, No.41/264-14.
[841] Competition Board Decision (*Etibank*) of 19.03.1998, No.57/426-54.
[842] Competition Board Decision (*Türkiye Şeker Fabrikaları*) of 13.08.1998, No.78/603-113.

4.1.2. Undertakings with Special or Exclusive Rights in Turkish Legal System

4.1.2.1. General Background

In Turkish legal system, the legal nature of exclusive or special rights is not specifically defined in the legislation. However, such rights could be granted to the public or private undertakings through enacting special Laws or concluding concession agreements. Since the public undertakings are discussed above, here the focus will be on the private undertakings with exclusive or special rights. In this respect, the oldest piece of legislation regarding the provision of public services through concession agreements between private parties and the State goes back to the period of the Ottoman Empire. Relevant Ottoman legislation, 'Law on Concessions related to Public Interest' dated 1910, ratified and enacted by the Parliament of the Turkish Republic in 1932,[843] is still in force today along with more specific legislation. According to this legislation, the concession agreements including provisions as to an exemption from any tax or charges or reimbursement from the general State budget that government finds necessary should be submitted for approval by the Turkish Parliament. It is possible to find the reflection of this provision in the subsequent legislation enacted during the 1980s and 1990s.

The waves of privatisation which occurred in the 1980s paved the way for more liberal economies that necessitated a new approach towards the identification of the roles and duties traditionally attributed to the State. It is against this background that the first Law No. 3096,[844] enacted in 1984, enabled private local or foreign companies to take part in the production, transmission, distribution and commerce of electricity, which was then monopolised by the Turkish Electricity Institution (TEK). Pursuant to Article 3 of this Law, the companies established to provide electricity services can be entrusted by the Board of Ministers upon the proposal of the Ministry of Energy to build up necessary facilities for production, transmission and distribution of electricity in the specific regions identified in

[843] Menafii Umumiyeye Müteallik İmtiyazat Hakkındaki 10 Haziran 1326 tarihli Kanuna Bazı Maddeler Tezyiline ve Bu Kanunun Bazı Maddelerinin İlgasina Dair Kanun dated 25.06.1932, No. 2025.
[844] Türkiye Elektrik Kurumu Dışındaki Kuruluşların Elektrik Üretimi, İletimi, Dağıtımı ve Ticareti ile Görevlendirilmesi Hakkında Kanun dated 4.12.1984, No. 3096.

the implementing regulation. The Ministry of Energy concludes a contract for up to ninety nine years, which is determined, taking the depreciation period of such facilities into account, with the entrusted company in compliance with the decision of the Board of Ministers. In addition to this provision, Article 4 stipulates that the Ministry of Energy may grant a licence to the private companies established exclusively to produce electricity for building up and operating the production facilities. Electricity energy produced in such facilities can be sold to the Turkish Electricity Institution or to the entrusted companies in the region in accordance with the tariff fixed by the Ministry. When fixing the tariff, a necessary income for annual operation and maintenance costs, interest, exchange rate differences (if the rate is not guaranteed before), technical and capital depreciations, other costs and payments, together with reasonable profit distributed amongst the partners, is taken as a base.

Following this sector-specific legislation which still constitutes the legal basis for the public-private cooperation in the electricity infrastructure projects, the second Law No. 3465,[845] which was enacted in 1988, created an opportunity for the private sector to participate in the building up and maintenance of motorways which was then the sole responsibility of the General Directorate of Highways. According to this Law, private companies established in Turkey may be entrusted with building up, maintenance and operation of the motorways (access-controlled highways) and with building up, maintenance and operation of the service facilities for travellers. The contracts can be concluded up to forty nine years and the contract term shall include building up, maintenance and operation of all facilities. At the end of the term, the entire motorway and facilities with their annexes shall be returned automatically to the General Directorate available for use, free from any charges, debts and commitments. Even in this case, the responsibilities of the entrusted firm vis-à-vis the General Directorate shall continue.

[845] Karayolları Genel Müdürlüğü Dışındaki Kuruluşların Erişme Kontrollü Karayolu (Otoyol) Yapımı, Bakımı ve İşletilmesi ile Görevlendirilmesi Hakkinda Kanun dated 28.05.1988, No. 3465.

Another piece of legislation which is worth mentioning here is the Law No.4046[846] which was enacted in 1994 to regulate the privatisation procedures in Turkey. Article 15 of this Law provides that the operation rights of public authorities with general or additional budgets and the sections of their associate entities, which produce goods or provides services and their assets (dams, ponds, motorways, accommodated health facilities, ports etc.) as well as that of PEEs and their institutions, associate partnerships, undertakings and undertaking units may be transferred to private persons through 'granting of operation right' or 'renting out' or 'any similar mechanism' up to 49 years. This provision clearly demonstrates the transition from the traditional approach to the provision of public services by the State or public authorities to the more functional approach involving private entities.

The more concrete applications of public-private partnerships started in 1990s and were developed to a certain extent, despite the constitutional problems which have arisen from time to time. With respect to the provision of natural gas, the Decree No.397,[847] which was enacted in 1990, granted Botaş the exclusive right to import natural gas, including its liquid form. Then, through certain legal arrangements Botaş transferred its natural gas contracts to private sector, and import of liquid natural gas was liberalised. Having established in 1974, Botaş was transformed into a legal status of PEC in 1995 and it was entrusted with the public service obligation to realise high-scale investments in exchange for its exclusive right. Although investments, such as the building up of pipe-lines for high pressured natural gas, the management of such lines and the enrichment of resources were conducted through public-private partnership models under the coordination of Ministry of Energy, Botaş retained its exclusive right in importation and transmission under the Law No.4646.[848]

[846] Özelleştirme Uygulamaları Hakkında Kanun dated 24.11.1994, RG 22124.
[847] Doğal Gaz Kullanımı Hakkında Kanun Hükmünde Kararname dated 9.2.1990, RG 20248.
[848] Doğal Gaz Piyasası Kanunu dated 02.05.2001, RG 24390. For more information see Competition Board Decision dated 14.10.2010, No. 10/65-1372-510.

The Law No.3996,[849] which was enacted in 1994, introduced 'Build-Operate-Transfer' model in order to finance certain projects that require advanced technology and high financial resources. According to the Law, it is a specially developed financial model where the investment capital, including the profit obtained from the operation, is paid to the private undertaking by the public authority or the service receivers by buying the goods or services provided by this undertaking during the term of its operation. The original Article 5 of this Law stipulated that the 'Build-Operate-Transfer' model was based on the contracts concluded between public authorities and private undertakings, which would not constitute any concession and thus which would be subject to private law provisions. However, the Turkish Constitutional Court considered that this model envisaged in this Law was actually based on concession agreements concluded within the realm of public law and cancelled this provision.[850]

Moreover, Law No.4283,[851] which was enacted in 1997, introduced another model so called 'Build-Operate'. The main objective of this Law is to regulate the conditions and procedures of granting licence for the establishment or operation of thermal plants and for energy sale to production companies in compliance with the energy planning and policies of the State through Built-Operate model in which such undertakings will have the ownership of these facilities. Hydroelectric, geothermal, nuclear power stations and other renewable energy sources are not within the scope of this legislation.

4.1.2.2. Public Contracts, Concessions and Public Services

In the Turkish legal system, public services may be provided by the State either through public legal persons having the character of monopolies, excluding private parties (e.g. railway transport) or through public-private partnerships in a field that is open to

[849] Bazı Yatırımların ve Hizmetlerin Yap-İşlet-Devret Modeli Çerçevesinde Yaptırılması Hakkında Kanun dated 13.6.1994, RG 21959.
[850] Constitutional Court Judgement of 28.6.1995, E. 994/771, D. 995/23, RG 24.1.1995, No. 22586, p.37.
[851] Yap-İşlet Modeli ile Elektrik Enerjisi Üretim Tesislerinin Kurulması ve İşletilmesi ile Enerji Satışının Düzenlenmesi Hakkında Kanun dated 16.7.1997, RG 23054.

competition.[852] In the Constitutional tradition, granting exclusive rights to private persons is not a preferable method of provision of public services. Despite that, exclusive or special rights which appear as certain privileges or concessions in the Turkish legal system are granted to the private undertakings usually through concession agreements. Since the Turkish Courts regard concession agreements as belonging to the public realm, such agreements are the certain models of public contracts which have emerged as a result of the expansion in the public service notion and become one of the administrative methods.[853]

It is obvious that public authorities have the capacity of concluding both public and private contracts, although it is not always easy to determine which one is relevant to a specific contract. Generally, the type of the contract to which a public authority is a party is determined by indicating the applicable law or the competent authority for resolving the disputes in the legislation. However, sometimes it may not be possible to understand the type of the contract from the legislative provisions. In such cases it is significant to ascertain the characteristics of the contract by examining the scope and the legal relation formed between the parties of it.

The contract may be considered as a public contract when the legal relation between the parties necessitates a special regulation which is peculiar to the public authority.[854] The jurisprudence developed by the Constitutional Court, Dispute Resolution Court and Council of State lays down certain characteristics which may be used as indicators of a public contract. Accordingly, there is a public contract when one of the parties is a public authority, public interest is the objective and provision of a public service is the scope of the contract and the public authority has superior privileges.[855] Despite the well developed criteria existing in the jurisprudence different methods may apply to determine the type of a contract in each case.

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[852] Y. Yayla, pp.88-96.
[853] Sıddık Sami Onar, **İdare Hukukunun Temel Esasları**, İstanbul: Akgun Basım, 1966, p.1540.
[854] M. Günday, p.169.
[855] Constitutional Court Judgement of 9.12.1994, E.994/42-2, K. 1994/42-2, RG 24.1.1995, no.22181 p.23. Also see Council of State Judgement of 10.29.04.1993, E. 1991/1, K.1993/1752, Danıştay Kararları Dergisi, No.88, p.463.

The Concession contracts, unlike contracts of private law character, while creating certain rights and obligations for both parties, also specify the public service obligations, entrustment conditions and the authorities. The Council of State, in its Opinion on the interpretation of the Law No.3096, stated that if a certain obligation of public service character was entrusted to a private undertaking this would constitute a concession.[856] This legal term was later described by the Constitutional Court as "*the provision of public services by private (natural or legal) persons bearing the investment capital, profit, loss and damages under the supervision and control of the public authority in accordance with a generally long termed public contract*". On the other hand, Law No.4046, defined concession narrowly, although it is only binding within the scope of this legislation, which is the implementation of the privatisation projects. According to Article 15 of the Law, only monopolised activities concerning production of goods and provision of services by the public authorities with general or additional budget and such activities of PEEs in compliance with their founding objectives can be regarded as 'concessions'. It is also emphasised in the same provision that no other activities can be identified as such.

The key notion to understanding what concession or public contract really means is the notion of 'public service'. This term was defined by the Constitutional Court as "*regular and continuing services provided to the society to maintain public use and public interest by the State or the public authorities or under their supervision and control*."[857] Accordingly, the Constitutional Court considered production, transmission and distribution of electricity as well as "building up and maintenance of bridges, tunnels, dams, facilities for drinking and utility water, sewage systems, motorways, sea and air ports to constitute public services. Thus, the Court stated that any agreement, the scope of which was the transfer of foundation or operation of a public service to a private undertaking would be regarded as a 'public service concession contract'. According to the Court, under the Constitutional jurisdiction, not the legislation governing the contract but the nature or quality of it was the determinant factor in identifying the concession contracts. That

[856] Council of State Judgement of 1.9.1992, E. 992/232, K. 992/294, Danıştay Kararları Dergisi, no.87, 1993, p.33.
[857] Constitutional Court Judgement of 28.6.1995, E. 994/71, K. 995/23, RG.24.1.1995, No.22586, p.37.

statement also explains the broad view adopted by the Court which contradicted with that of the Law No.4046 when describing 'concession'. The reason which lied beneath this conservative approach of the Court was the protection of the legal system where all concession contracts were scrutinized and pre-controlled by the Council of State under Article 155(2) of the Constitution.

For the provision of public services by private undertakings, the amendment of Articles 47, 125 and 155 of the Constitution in 1999 may be regarded as a turning point. These amendments have conferred a new dimension to the understanding of public services and their provision to the society. The new provision added to Article 47 of the Constitution states that the types of investments and services which have been conducted or provided by the State or PEEs to be entrusted or transferred to the natural or legal private persons shall be determined by law. This has paved the way for concluding contracts in private law with private undertakings for the provision of public services by enacting specific laws. Additionally, with the amendment of Article 155, the Council of State has been charged with the duty of submitting its opinion on the concession contracts within two months. Having its pre-control authority abolished and being limited within a specific time limit to submit its opinion, the major influence of Council of State over the concession contracts has considerably been weakened.

The change in the constitutional system has triggered the new applications of public-private partnership models through legislative regulations and in certain economic fields even where the local public authorities have significant involvements. For instance, the Laws enacted in 2005, relating to City Special Administrative Authority (Law No. 5302) [858] and Local Administrative Authorities Union (Law No. 5355), [859] and the Municipality Law (No. 5393)[860] have enabled the local governmental organisations to avail themselves of certain public-private partnership models.

[858] İl Özel İdaresi Kanunu dated 22.2.2005, RG 25745.
[859] Mahalli İdare Birlikleri Kanunu dated 26.5.2005, RG 25842.
[860] Belediye Kanunu dated 3.7.2005, RG 25874.

Moreover, the first actual regulation of a public-private partnership model, other than Build-Operate or Build-Operate-Transfer, has been realised through adding a specific provision into the Basic Law on Health Services.[861] Accordingly, the health facilities, establishment of which are deemed necessary by the Supreme Planning Council, may be built on land belonging to the Ministry or Treasury by the natural or legal private persons chosen through a public procurement procedure in compliance with the pre-project prepared and basic standards determined by the Ministry. The facilities are built by such natural or legal persons by renting the land for a limited period of time which shall not exceed forty nine years and in return for a certain payment.

4.1.2.3. Application of Competition Rules to Undertakings with Special or Exclusive Rights

In principle, competition rules are fully applicable to private undertakings having exclusive or special rights. However, it is important to emphasise that granting of exclusive rights to a single undertaking is not the most preferred way in the provision of public services despite the constitutional and legislative developments mentioned above. For instance, the legislation concerning the privatisation of electricity was subject to legal actions many times before the Turkish Courts on the grounds that private monopoly should not be created. In this regard, Constitutional Court stopped[862] the implementation of the Law No.3974 [863] on the privatisation of Turkish Electricity Institute (TEK) and then cancelled it.[864] In the reasoned judgement, the Court held, *inter alia*, that there was no measure to prevent monopolisation or cartelisation in the relevant Law, which was in breach of the Articles 167 and 172 of the Constitution.

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[861] Sağlık Hizmetleri Temel Kanununa Bir Ek Madde Eklenmesi Hakkında Kanun dated 3.7.2005, No.5396, RG 25876.
[862] Constitutional Court Judgement of 11.4.1994, E. 1994/43, K. 1994/42-1.
[863] 1211 Sayılı Türkiye Cumhuriyeti Merkez Bankası Kanunu, 3182 sayılı Bankalar Kanunu, 2983 sayılı Tasarrufların Teşviki ve Kamu Yatırımlarının Hızlandırılması Hakkında Kanun, 2985 sayılı Toplu Konut Kanunu, 7.11.1985 tarihli ve 3238 sayılı Kanun, 2499 Sayılı Sermaye Piyasası Kanununda Değişiklik Yapılması ve 1177 sayılı Tütün Tekeli Kanununun Bazı Maddelerinin Yürürlükten Kaldırılması ve Kamu İktisadi Teşebbüslerinin Özelleştirilmesi Hakkında Kanuna Ek Maddeler Eklenmesine İlişkin Kanun Hükmünde Kararnamenin Değiştirilerek Kabulüne Dair Kanun.
[864] Constitutional Court Judgement of 9.12.1994, E.994/42-2, K. 1994/42-2, RG 24.1.1995, no.22181.

In the light of the Constitutional principles and in compliance with the relevant legal provisions, Competition Authority does not usually hesitate to use its authority regarding the private undertakings with special or exclusive rights. In this respect, the Competition Board's decision upon the application for permission by TEDAŞ under the Regulation on Mergers and Acquisitions 1997/1 to transfer the operation rights of the electricity distribution facilities in 17 provinces of TEDAŞ provides a useful example. In this case, the Competition Board analysed the nature of exclusive rights which were going to be transferred to the private undertakings. According to the Article 8(e) of the Concession Contract to be signed between the Ministry of Energy and the entrusted private undertakings, "*Undertaking shall establish electricity distribution facilities and shall acquire the facilities established or being established by other entities, provided that they have the required conditions, in its assigned area. The trading right of the electricity which shall be bought from the third parties who has the right to sell it shall exclusively belong to the Undertaking*."[865] The Board found that neither the Law No.3096, nor the relevant regulation or the decisions of Board of Ministers and concession contracts contain a provision which grants such an absolute monopoly right to the authorised undertaking.

In TEDAŞ's application, the Competition Board also categorised the exclusive rights which is based on a concession contract, into three categories in respect of the competition law. Accordingly, the first type is that the transferring party leaves production, sale and distribution of the goods or services, which constitute the subject matter of the contract, or use of a right (patent, know-how, etc.) to the other party in a certain region but saves his/her own right and keeps it open to the passive sales from other regions. This is called as 'basic monopoly'. The second type is that the transferring party waves his/her own right of production or sale or use of any other right in the certain region where he/she transfers the exclusive right. This is called as 'strengthened monopoly'. Finally, the third

[865] Competition Board Decision of 16.10.1998, K. 87/693-138, D. D4/1/A.I.-98/4., p. 5.

type is that active and passive sales are prohibited and alternative supply sources are closed. This is called as 'absolute regional monopoly'.[866]

The Competition Board found that the Concession Contract in question gives an absolute regional monopoly to private undertakings. The Board stated that the fact that electricity energy has its own particularities, has strategic importance for the State's economy or there are difficulties to meet the demand does not justify granting an absolute regional monopoly closing the market to the competition to a private undertaking. This meant the continuance of the pre-privatisation situation, although in this situation this exclusive right had been used by the State on behalf of the public. If this exclusive right was transferred to a private undertaking without any change, it would have meant that the competition dimension of privatisation was neglected. It was expected that privatisation should have increased the competition. As a result, the Competition Board decided to approve the acquisition on the condition that the provision granting absolute regional monopoly to private undertakings should be removed from the Concession Contract.[867]

On the other hand, irrespective of the private or public nature of the undertaking in question, the Turkish Competition Authority may not prefer applying competition rules when the exclusive or special rights arise from a specific Law. In this respect, the decision of the Competition Board regarding alleged abuse of a dominant position by Eti Holding A.Ş. is particularly important.

Under Law No.2840[868] and the Law on Minerals No.3213, Eti Holding A.Ş. has an exclusive right to extract, concentrate and refine tincal ores which is a type of boron mineral and to produce boron end products from them and to market them. Since Eti Holding exercises this exclusive right throughout Turkey, it has a dominant position in the relevant market. It was alleged that Eti Holding had abused its dominant position by preventing other undertakings from entering the separate but adjacent market over which it

[866] Ibid., p. 6.
[867] Ibid., p. 8.
[868] Bor Tuzları, Trona ve Asfaltit Madenleri ile Nükleer Enerji Hammaddelerinin İşletilmesi, Linyit ve Demir Sahalarının Bazılarının İadesini Düzenleyen Kanun.

does not hold an exclusive right and by distorting competitive conditions in the same market. The Competition Board stated that Eti Holding is an undertaking within the meaning of competition provisions however; the allegations regarding the abuse of dominant position arise from the use of its exclusive right. Given that actions and transactions based on the implementation of a specific Law is not within the scope of the Law on Protection of Competition, competition provisions are not applicable to this undertaking and investigation shall not be proceeded.[869]

The Competition Board Decision was appealed to the Council of State and the appeal was rejected by the 10th Chamber in 2003,[870] which was upheld by the Plenary Assembly of Council of State in 2005.[871] In the Plenary Assembly Decision, one of the judges held in his dissenting opinion that according to the preamble of Article 2 of the Law on the Protection of Competition, competition rules must be applicable to all undertakings engaged in economic activities, irrespective of their public or private nature. Thus, application of competition rules should not be avoided when a public undertaking abused its exclusive rights conferred on it by Law. Indeed, Article 2 of the Law No.2840 states that the search of boron salt, uranium and torium minerals and their operation is conducted by the State and the licenses granted for these minerals to natural or legal private persons under the Law on Minerals No.6309 are cancelled. However, Article 49 of the subsequent Law on Minerals No.3213 indicates that the search and operation of boron, trona and asphaltit minerals found after entering into force of this Law shall be governed by this Law and the principles regarding their exportation shall be determined by the Board of Ministers.

According to the Law on Minerals No.3213 and the implementing regulations, mining works include search, pre-operation and operation of minerals whereas; operation of the mine covers the extraction of mineral ore and its marketing. The provision in the Law No.2840 with regard to the operation of boron mines by the State excludes the processing

[869] Competition Board Decision of 4.1.2000, Decision No: 00-1/2-2, D. No: D1/2/H.H.Ü-99/2.
[870] Council of State, 10.Chamber Judgement dated 5.2.2003, E. 2001/306, K. 2003/424.
[871] Council of State, Plenary Assembly Judgement dated 16.6.2005, E. 2003/659, K. 2005/2178.

of mineral ore to produce an end product. Therefore, the exclusive right held by Eti Holding only covers the extraction of tincalin, an unprocessed version of boron, and its marketing in Turkey, not the end products borax pentahydrate or borax dekahydrate. Otherwise, the plaintiff company who applied to the Competition Board with the allegations against Eti Holding could not have produced them.

The *Eti Holding* decision of the Competition Authority has been subject to criticism in the academic circles[872] in Turkey and by the European Commission. In the Progress Report of 2001, which was issued by the Commission after *Eti Holding* decision, it is stated that doubts remain as to whether this Authority enjoys the appropriate powers to effectively apply competition law to public undertakings, State monopolies and companies having special rights and the exact competence of that authority therefore needs to be clarified.[873]

Actually this decision constitutes *de facto* extension of the exclusive rights held by Eti Holding over markets separate but adjacent to the one over which the undertaking holds its legal monopoly. As is explained in the previous chapter, granting of exclusive rights to a single undertaking is prohibited under EU law, where those rights are liable to create a situation in which that undertaking is led to infringe Article 102 TFEU, which prohibits abuse of a dominant position, or where the infringement becomes unavoidable. In such cases Article 106 TFEU is applied in conjunction with Article 102 TFEU to condemn the State measure, even if the undertaking has not *actually* abused its dominant position. However, in *Eti Holding* case, the Competition Authority did not even start the investigation against the undertaking.

[872] For the criticism of the decision see, Erol Katırcıoğlu, "Rekabet Kurumu", **Radikal Newspaper** dated 5.1.2002.
[873] Commission's 2001 Regular Report on Turkey's Progress towards Accession, SEC (2001) 1756, Brussels, 13.11.2001, p. 56.

4.1.3. Turkey's Obligations Regarding the Implementation of Competition Rules

In accordance with the provisions of the Additional Protocol based on the Association Agreement concluded between Turkey and the EU in 1963 and the Association Council Decision 1/95[874] and as an accession country to the EU, Turkey is required to have established market rules, including those on competition, which will be fully in line with the EU *acquis*. The *acquis*, for the purposes of the EU law, includes not only the basic Articles 101 and 102 TFEU on competition, but also the present and future secondary legislation, frameworks, guidelines, and other relevant administrative acts in force in the EU as well as the case law of Court of Justice of the European Union.[875] Furthermore, over the whole negotiation period Turkey has to prove a satisfactory track of record on the implementation of the competition policy including State aids.

In the context of the implementation of the Customs Union, Turkey has already complied with most of its obligations regarding the implementation of competition rules. Turkey adopted the Law on the Protection of Competition that complied with Community legislation in December 1994 and incorporated the EU's competition provisions. Following the adoption of the competition law, Turkey established the Competition Authority to be responsible for the enforcement of the Law on the Protection of Competition in May 1997. Since the Authority started its operation in November 1997, it has amended the Law on the Protection of Competition several times, published Communiqués and Guidelines to align Turkish competition legislation with developments in the EU competition law.

In its Progress Reports on Turkey, the Commission found that the Competition Authority was established as a functionally independent body with the necessary administrative structures to allow for the effective implementation of competition rules to the private undertakings and merger control. However, due to incomplete legal alignment,

[874] These documents will be analysed in more detail in respect of the State Aid provisions in the next section.
[875] For more details see Peter Schütterle, "Implementing of the EC State Aid Control- an Accession Criterion", **EStAL**, 2002, p.79.

the Competition Authority does not enjoy the appropriate powers and competence to effectively apply competition rules to public undertakings and undertakings having exclusive and special rights.[876] As a result, considerable difficulties have been experienced in the adjustment of State monopolies.[877] In other words, although the Competition Authority has exclusive competence to enforce competition rules, it has not been able to intervene in the distortions of competition which arise from other legislation containing anti-competitive provisions. Competition Authority's competence over public undertakings and undertakings having exclusive and special rights is, therefore, seriously restricted by such legislation. In order to remedy this situation a comprehensive review of legislation should be initiated.

The Commission also indicated that the Competition Authority should interpret the definition of 'undertaking' in a broader way in cases involving public entities, and more frequently use its *ex officio* competence to apply the competition provisions to the publicly controlled sectors. This is because a large number of specific sectoral laws, in particular on services, do not comply with the Law on the Protection of Competition and *de facto* prevent Competition Authority from enforcing the competition rules. As is mentioned in the previous section, the Competition Authority does not apply competition rules especially when the exclusive or special rights arise from specific legislation. Therefore, the Commission stated that legislative amendments to sectoral regulations, which contradict the Law on the Protection of Competition, in particular legislation granting exclusive and special rights, are necessary in order to ensure the efficient enforcement of competition rules.[878] In this respect, the main responsibility lies with public and legislative authorities to complete the alignment of sectoral legislation with the *acquis* as a matter of priority and Competition Authority should fully be involved in this process.[879] The Competition Authority should be consulted and its remarks concerning drafts of all types of legislation

[876] Commission's 2002 Regular Report on Turkey's Progress towards Accession, SEC (2002) 1412, Brussels, 9.10.2002, p.77.
[877] Commission's 2000 Regular Report on Turkey's Progress towards Accession, 8.10.2000, p.38.
[878] Ibid.
[879] Commission's 2003 Regular Report on Turkey's Progress towards Accession, 2003, p.73.

which may have an impact on competition should be taken into account.[880] In this respect, Turkey's adoption of the guidelines for regulatory impact analysis, in consultation with the Competition Authority, with regard to the impact which any draft laws would have on competition is a very positive development.

The promotion of competition in the privatisation process is also very important and Competition Authority has played an active role in the context of merger control. This is because the entity, which is going to be privatised, usually holds a dominant position in the relevant market. The co-ordination between the Competition Authority and the sectoral regulatory authorities plays a crucial role in the development of privatisation models which ensure a high level of competition in the respective sector in the post-privatisation period.[881] The Competition Authority delivers useful advisory opinions to Privatisation Authority on how to design privatisation tenders before they are launched. For example, the Competition Authority issued opinions on the privatisation tenders of tobacco factories, ports and the Turkish Telecommunications Company (Türk Telekom A.Ş.).

While Turkey has a high level of alignment in the enforcement of competition rules and merger control, there has been no progress towards alignment of the rules concerning public undertakings and undertakings holding exclusive and special rights. This fact has been repeated by the Commission in almost every progress report on Turkey since the very first one issued in 1998, until the very recent one issued in 2010.[882] In this regard, Turkey should prepare specific legislation and/or amend the current legislation concerning public undertakings, including PEEs, to bring them into the same the line with each other to ensure a harmonious application of competition rules to every undertaking. Accordingly, the definition of 'public undertaking', 'exclusive right' and 'special right' should be defined by way of law and be applied by the jurisdictional, administrative and regulatory authorities in the same way.

[880] Commission's 2005 Regular Report on Turkey's Progress towards Accession, SEC (2005), 1426, Brussels, p.69.
[881] Commission's 2004 Regular Report on Turkey's Progress towards Accession, SEC (2004) 1201, Brussels, p. 91.
[882] Commission Staff Working Document, Turkey 2010 Progress Report, SEC (2010) 1327, 9.10.2010, p.55.

4.2. Application of State Aid Rules in Turkey

4.2.1. Legal Framework of State Aids

The Law on the Encouragement of Industry dated 1927 was the first Law concerning the encouragement measures in the Turkish Republic. Following the transition into the planned policy on economic development, the Law No.933 and various other Laws were enacted. Starting with 2002, the encouragement measures were called as 'State aids'. The legislation governing different types of State aids has already been quite diversified. However, in respect of investments, it is particularly important to indicate the Decision on State Aids in Investments [883] by the Board of Ministers, which was based on the Law No. 474 (Article 2), Law No.933 (Article 3/C), Law No.4703 (Article 5), Law No.5520 (Article 32/A), Law No.4706 (Additional Article 3) and Law No.3065 (Article 13 (a),(d)).

The Decision on State Aids in Investments has been adopted to facilitate the compliance of national development plans and annual programmes with the obligations arising from the EU rules and that of other international agreements. The underlined aims of the Decision can be enumerated as follows: Directing the savings to the investments with high additional value; increasing the production and employment; enabling the sustainability of the investments and development; promoting large-scale investments to technology and R&D which will increase the international competitiveness, encouraging direct foreign investments, decreasing regional disparities; supporting investments for environmental protection.[884]

The Decision authorised the Undersecretariat of Treasury to take necessary measures and regulatory actions by considering macro economic policies and economic developments; to determine rules and procedures concerning duties granted to certain institutions; to analyse and conclude issues which are omitted in this Decree; to monitor the investments with regard to their compliance with the conditions determined in the

[883] Decision of Board of Ministers No. 2009/15199 of 14.7.2009; RG.16.7.2009, No.27290.
[884] Ibid., Article 1.

encouragement certificates; to conduct transactions related to encouragement certificates, to cancel them and apply necessary sanctions when it deems necessary. In order to benefit from the State support determined in the Decree, the investment project should be approved and confirmed with the encouragement certificate issued by the Undersecretariat of Treasury.

Encouragement Certificate is a document which contains characteristic values of the investment and allows the recipient to benefit from the State support when the investment is realised in accordance with the approved conditions and values. The type of the State support that the beneficiary will receive is also indicated on the certificate and this document is only granted if the investment is deemed to be useful for Turkey's economy by the Undersecretariat of Treasury.[885] The legal status of the certificate is subject to debates among academics. According to one view it is a public contract as it is concerned with public service obligation and the public authority has discretion to make changes in the project or able to demand additional conditions, which exceeds the limits of private law.[886] However, the dominant view is that approval or decline of the application for certificate on the basis of regulatory measures is a 'bilateral public measure' in which the public authority uses its discretionary powers.[887]

Turkey abolished the State aid scheme to textile and clothing sector at the end of 1995 before the Customs Union entered into force.[888] General overview of the current legislation concerning State aids reveals that State support for investments, employment, agriculture and tourism retains its importance. Within this framework, there are various provisions regarding State aids to support investment and employment, for example, in Law on Encouragement and Employment Amending Certain Laws No.5084; Law on Industrial Regions No.4737; Law concerning the Establishment, Coordination and Duties of Development Agencies No.5449 (Article 4/2) and the Directive concerning Projects and

[885] Communiqué on the Implementation of State Aids in Investments, No.2006/3, Article 3.
[886] Tayfun Akgüner, **Özel Girişim Özgürlüğü ve Yatırımları Teşvik Tedbirleri**, Istanbul, 1979, p. 234.
[887] Turgut Tan, opcit., p.310.
[888] See Regular Report from the Commission on Turkey's Progress Towards Accession, 1998, p.33.

Activities Supported by Development Agencies; Decision by the Board of Ministers on the Implementation of the Law on Establishment of Turkish Investment Support and Promotion Agency.[889] As regards State aid for agriculture, Law on Agriculture No.5488 (Articles 4, 16, 19 and 21) and Law on the Establishment and Duties of Institution for Agriculture and Rural Development No.5648 can be mentioned. Concerning turism and culture, Law on the Encouragement of Turism No.2635 and Law on the Encouragement of Cultural Investments and Initiatives No.5525 contain several provisions regarding State aids. Similar provisions about State aids can be found in the Law on Technology Development Regions No.4691, Law on the Support of Research and Development No.5746; Law No.3332 on the Encouragement of Capital Markets, Spreading Capital on the Base and Measures for Regulating Economy Amending Corporate Tax Law No.5422, Procedural Tax Law No.213 and Banks Law No.3182.

Considering the wide diversity of legislation containing different types of State aid provisions for various reasons, monitoring and control of State aids constitutes a serious problem in Turkey. Moreover, implementation of these provisions by different public authorities like, Ministry of Finance, Undersecretariat of Treasury, Undersecretariat of Customs or Ministry of Agriculture makes the situation more complicated. In the absence of a single authority responsible for carrying out State aid control, systematic assessment of the compatibility of aids with Turkey's obligations under Community acquis or their implications on the competitive market system becomes very difficult. In order to overcome this difficulty and to fulfil her obligations under Community acquis, Turkey adopted the Law on Monitoring and Supervision of State Aids No.6015 establishing a competent authority for this task in 2010.

It is also important to note that the relevant legislation mentioned in this section concerns mainly the undertakings of commercial nature or private undertakings. There is no specific legislation governing the State aid rules applicable to public undertakings or undertakings with exclusive or special rights. Certain provisions with regard to the

[889] Resmi Gazete (RG) dated 17.3.2007, no.26465, p.4.

maintenance of their financial stability by compensating for their public service obligations from the State budget, especially in case of revenue or profit loss, can be found in their legislation establishing and regulating these undertakings, such as the Decree No.233. However, such provisions are not, generally, regarded to be State aid under Turkish law in the strict sense of the meaning as their roles as economic actors and public authorities are tightly interlinked to each other.

4.2.2. State Aid Rules in the Basic Documents between Turkey and the EU

4.2.2.1. Under the Additional Protocol

The approximation of competition and state aid rules is mentioned under the title of 'Competition, Taxation and Approximation of Laws' of the Additional Protocol.[890] According to Article 43 of the Protocol, it is a duty of the Association Council to adopt the conditions and rules for the application of the principles laid down in Articles 85, 86, 90 and 92 (now Articles 101, 102, 106 and 107 TFEU) of the Treaty within six years of the entry into force of the Protocol. During the transitional stage Turkey may be considered as being in the situation specified in paragraph 3(a) of Article 92 (now 107 TFEU) of the Treaty.[891] This provision corresponds to "aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349 TFEU, in view of structural, economic and social situation.

Therefore, aid to promote Turkish economic development will be considered to be compatible with the proper functioning of the Association if such aid does not alter the conditions of trade to an extent inconsistent with the mutual interests of the Contracting Parties. It is also submitted that at the end of the transitional stage, the Council of

[890] Additional Protocol and Financial Protocol signed on 23 November 1970, annexed to the Agreement establishing the Association between the European Economic Community and Turkey and on measures to be taken for their entry into force, OJ L293, 29.12.1972, pp.4-56.
[891] A similar provision can be found in Article 70 of the Stabilisation and Accession Agreement concluded between the EU and Croatia on 19 October 2001 and came into force on 1 February 2005.

Association will, taking into account the economic situation of Turkey, decide whether it is necessary to extend the above-mentioned period.

4.2.2.2. Under the Decision No.1/95 Establishing Customs Union

Similar provisions, in parallel with the Treaty rules on competition and State aids, are stipulated in the Association Council Decision No. 1/95 implementing the final phase of the Customs Union between Turkey and the EU.[892] The key elements of Articles 34 and 35 of the Decision No.1/95, which came into force on 25 December 1995, are still valid for the future harmonisation process. Article 34 of the Decision provides that *"[a]ny aid granted by Member States of the Community or by Turkey through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Community and Turkey, be incompatible with the proper functioning of the Customs Union*." This is the definition of State aid in Article 107(1) of the Treaty. Article 34 also lays down conditions for aids which shall be and may be considered to be compatible with the functioning of the Customs Union and these aids are similar to the ones enumerated in Article 107 of the Treaty. According to the second paragraph of Article 34, the following shall be compatible with the functioning of the Customs Union:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

(b) aid to make good the damage caused by natural disasters or exceptional occurences;

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected after the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division;

[892] Decision No 1/95 of the EC-Turkey Association Council of 22 December 1995 on implementing the final phase of the Customs Union, 96/142/EC.

(*d) for a period of five years from the entry into force of this Decision, aid to promote economic development of Turkey's less developed regions, provided that such aid does not adversely affect trading conditions between the Community and Turkey to an extent contrary to the common interest.*

Under Article 34(3) the following may be considered to be compatible with the functioning of the Customs Union:

(a) in conformity with Article 43(2) of the Additional Protocol, aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;

(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State of the Community and Turkey;

(c) for a period of five years after the entry into force of this Decision, in conformity with Article 43(2) of the Additional Protocol, aids aiming at accomplishing structural adjustment necessitated by the establishment of the Customs Union. The Association Council shall review the application of that clause after the aforesaid period.

(d) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions between the Community and Turkey to an extent contrary to the common interest;

(e) aid to promote culture and heritage conservation where such aid does not adversely affect trading conditions between the Community and Turkey to an extent contrary to the common interest.

(f) such other categories of aid as may be specified by the Association Council.

According to Article 37 of the Decision, the Association Council shall adopt the necessary rules for the implementation of the provisions concerning State aid within two

years following the entry into force of the Customs Union. These rules shall be based upon those already existing in the EU and specify the role of each competition authority. Until these rules are adopted the provisions of the GATT (now WTO) Subsidies Code shall be applied for the implementation of State aid rules.

Under Article 39, before the entry into force of this Decision, Turkey shall adapt all its aids granted to the textile and clothing sector to the rules laid down in the relevant Community frameworks and guidelines under Articles 92 and 93 (now Aricles 107 and 108 TFEU) of the Treaty. Turkey shall also inform the Community of all its aid schemes to this sector. Within two years after the entry into force of this Decision, Turkey shall adapt all aid schemes other than those granted to the textile and clothing sector to the Community State aid rules. If a new scheme is to be adopted, Turkey shall inform the Community as soon as possible of the content of such scheme. In addition, Turkey shall notify the Community in advance of any individual aid to be granted to an enterprise or a group of enterprises that would be notifiable under Community legislation had it been granted by a Member State. Community shall have the right to raise objections against an aid granted by Turkey which it would have deemed unlawful under EC law had it been granted by a Member State. If Turkey does not agree with the Community's opinion, and if the case is not resolved within 30 days, the Community and Turkey shall each have the right to refer the case to arbitration.

With regard to public undertakings and undertakings to which special or exclusive rights have been granted, Article 41 contains the main provision that reveals the Turkey’s obligations in this field. According to this Article, Turkey shall ensure that, the principles of the Treaty, notably Article 90 (now Article 106 TFEU), as well as the principles contained in the secondary legislation and the case-law developed on this basis, are upheld. Turkey has to fulfil this obligation by the end of the first year following the entry into force of the Customs Union. Similarly, pursuant to Article 42, Turkey shall progressively adjust any State monopolies of a commercial character so as to ensure that no discrimination regarding the conditions under which goods are procured and marketed exists between

nationals of the Member States and of Turkey. The adjustment process shall be conducted in accordance with the conditions and the time-table laid down by the Association Council by the end of the second year following the entry into force of this Decision.

4.2.3. Turkey's Obligations Regarding the Implementation of State Aid Rules

Turkey had not fulfilled most of the obligations laid down by the Additional Protocol and the Association Council Decision 1/95 for a long time. Turkey complied with the obligation with regard to adapting all its aid schemes for the textile and clothing sector by notifying the Commission at the end of 1995 that there were no longer any aid schemes in the sector.[893] However, Turkey did not achieve any progress regarding the other aid schemes within two years from the entry into force of the Customs Union as determined by the Association Council Decision 1/95.

In 2000, Turkey communicated to the Commission provisional findings of a study on the definition of regional aid map of Turkey, which was completed in 2002. Turkey also provided information on parts of the policies for granting State aid. In the same year a study was started by the relevant Turkish Ministries in co-operation with the Commission to establish a list of the relevant existing laws. The aim of the study was to start a substantive review with respect to compatibility with the Community *acquis*.[894] However, as there was no single authority responsible for carrying out State aid control by systemically assessing the compatibility of aid awards with the Community *acquis*, these studies did not produce satisfactory results. Indeed, State aid control was under responsibility of different public authorities, such as the Undersecretariat of Treasury and Undersecretariat of Foreign Trade. Therefore, in the absence of an authority responsible for State aid, no enforcement record was available in the sectoral or regional basis.

In order to ensure the fulfilment of obligations arising from the Customs Union, it was required that Turkey should also give special attention to the overall State aid system.

[893] Commission's 1998 Regular Report on Turkey's Progress towards Accession, 1998, p.34.
[894] Commission's 2000 Regular Report on Turkey's Progress towards Accession, 2000, p.39.

In this respect, the increase of transparency through the establishment of an inventory for existing State aid and regular annual reporting following the methodology and the presentation of the Commission's survey on State aid are crucial. However, without establishing a responsible authority for monitoring the aid schemes it is very difficult to make an inventory for existing State aids and increase transparency. Existence of such an authority responsible for State aids is a pre-condition to guarantee an effective application and enforcement of the State aid rules under the Decision 1/95.

In June 2001, the establishment of a functionally independent authority responsible for the enforcement and monitoring of State aid in Turkey was agreed, to be effective as of 1 January 2003. For this purpose an ad-hoc committee was set up within Turkish Government with a view to preparing the setting up of this independent body.[895] Turkey agreed to establish an inventory of State aid and regular annual reporting following the methodology and the presentation of the Commission's survey on State aid after the creation of the State Aid Monitoring Authority. However, this body was not established in 2003 and the legislation regarding its establishment did not come into force until 2010. This fact prevented the proper implementation of competition rules, resulting in potential competition infringements in markets through the allocation of public resources. Besides, the absence of reporting of State aids based on the EC standards reduced the transparency of financial transactions between the State and undertakings.[896]

The Commission repeated that "*Turkey has not adopted the State aid legislation nor set up an operationally independent State aid monitoring authority*"[897] or "*Turkey has not prepared the State aid inventory and has not reported on State schemes as required by the transparency commitments*" [898] in almost each progress reports until 2010. Turkey's reluctance to implement State aid provisions in the Additional Protocol and the Decision 1/95 reveals a striking contrast to the position of Croatia who started accession negotiations

[895] Commission's 2001 Regular Report on Turkey's Progress towards Accession, SEC(2001)1756, Brussels, 2001, p.56
[896] Commission's 2003 Regular Report on Turkey's Progress towards Accession, 2003, p.74.
[897] Commission Staff Working Document of 14.10.2009, Turkey 2009 Progress Report, SEC(2009)1334, p.49.
[898] Commission Staff Working Document of 5.11.2008, Turkey 2008 Progress Report, SEC(2008) 2699, p.46.

with the EU in the same year as Turkey. Croatia adopted the State Aid Law and the Regulation on State Aid, which came into force in April and July 2003 respectively. In addition, Croatia authorised the Competition Agency established under the national Competition Law, to monitor and order the recovery of State aid. That means Croatia took important steps towards fulfilling its obligation regarding the implementation of State aid rules just in two years after concluding Stabilisation and Accession Agreement[899] with the EU in 2001 but before starting the accession negotiations in 2005. Though they are not accession countries, Macedonia enacted State Aid Law and three governmental regulations on notification procedures, which came into force on 1 January 2004, and Albania enacted the Law on State Aid in 2005.[900]

In October 2010, Turkey adopted the Law on Monitoring and Supervision of State Aids.[901] This Law establishes a competent authority for this task, which is supported by an institutional structure within the Undersecretariat of Treasury. Although the Law provides provisions on notification and monitoring of aid schemes in line with Turkey's Customs Union obligations, the services sector is excluded from its scope. In order to be fully compatible with the EU *acquis*, Turkey should also bring services into the scope of this Law and new legal framework and necessary institutions should be established to regulate State aids, particularly, in energy and transport sector. The State Aids Monitoring and Supervision Board, whose establishment had been delayed for a long time, should become operational soon.

Regarding the adjustment of State monopolies to the market economies in compliance with EU law, the transitional period for adjustment foreseen by the Decision 1/95 expired on 1 January 1998 without any improvement. The transformation of TEKEL is a good example to mention in this respect. The regular discussions between Turkey and

[899] OJ L26, 28.1.2005, p.3. Approved by Council and Commission Decision of 13 December 2004 concerning the conclusion of the Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the republic of Croatia, of the other part (2005/40/EC, Euratom), OJ L26, 28.1.2005, p.1.
[900] Peter Schütterle, "State Aid Control in the Western Balkans and Turkey", **EStAL**, Vol.2, 2005, pp.256-257.
[901] Devlet Desteklerinin İzlenmesi ve Denetlenmesi Hakkında Kanun dated 13.10.2010, No.6015, RG 27738 Date: 23.10.2010.

the Community Authorities on adjustment of TEKEL (tobacco, salt and alcohol monopoly) was started in 1996 and lasted until 2006. In 2001, TEKEL was transformed into a SEE but retained its exclusive rights which was criticised by the Commission. In 2003, the regulatory powers of TEKEL were transferred to Tobacco and Alcoholic Beverages Authority. The step-by-step privatisation of TEKEL, which was pointed out in almost each Progress Report proved the difficulty of the task of dismantling the special and exclusive rights of such a State monopoly. However, there is still no specific legislation regulating State aids allocated to the public undertakings and undertakings having special and exclusive rights. Public undertakings providing services are obviously not covered by the recent Law on State aids as the services sector is excluded from its scope. Moreover, there are still no rules ensuring transparency of financial relations between public authorities and public undertakings, such as the Transparency Directive in EU law.

5. CONCLUSION

In this thesis the State's involvement in economic activities on the market place through public undertakings and undertakings having exclusive and special rights, and the application of the competition and State aid rules to these undertakings under the provisions of Article 106 TFEU was analysed. It was submitted that the State may act either by exercising public powers arising from its sovereignty or by carrying out economic activities of an industrial or commercial nature by offering goods and services on the market. State activities will be subject to different rules of the EU Treaties or may totally remain outside the scope of such rules according to their economic or non-economic nature.

The EU competition and State aid rules are only applicable, when there is an economic activity under consideration. Therefore, the question of how to distinguish between economic and non-economic activities has often been raised in the cases dealing with the application of competition and State aid rules to the types of undertakings under Article 106 of the Treaty. The answer to this question requires a case-by-case analysis, since the Court of Justice prefers a functional approach to distinguish economic activities from non-economic ones. There is no specific definition of economic activity in the EU law but it is an EU law concept which constantly evolves as a response to new economic, social and institutional developments that differ from one Member State to another.

The EU competition rules, in its broader meaning, apply to every entity carrying out a service or offering goods on the market, irrespective of its legal status or the way in which it is funded. Therefore, it is irrelevant whether the entity is a public undertaking, private undertaking and association of undertakings or part of the administration of State. According to the case law of the Court of Justice it is the nature of activity and the way in which it is provided, organised or financed which determine whether a certain activity is economic or not. For instance, some services, such as education, health-care, social insurance, etc., can be described as economic or non-economic activities according to the conditions under which they are provided. In order to make this distinction the Court relies

on a set of criteria related to the nature and conditions of the provision of goods and services in question, such as the existence of market, remuneration, risk bearing or profit making for enonomic; regulatory or redistributive nature of the activity for non-economic activities. In practice this means that a single entity may be engaged in both economic and non-economic activities and be subject to competition rules for parts of its activities but not for others.

As a principle, competition rules do not apply to the regulatory activities of State since they are deemed to be of non-economic nature. However, in the light of the case law developed by the Court of Justice on the former Articles 3(f), 5(2) and 85 of the EEC Treaty competition rules may become applicable to the regulatory activities, when the Member State is to; require or encourage the adoption of agreements, decisions, or concerted practices that were contrary to Article 85 (now Article 101 TFEU), or deprive its own legislation of its official character by delegating to private entities the responsibility to make decisions in the economic sphere. This is due to the fact that in such cases, although exceptional, the State is not regarded to be acting in the public interest but in the specific interests of private undertakings. Thus, the State measure in question is actually a cover of private agreements in breach of competition rules. Under the principle of supremacy of Union law and by virtue of Article 3(1)(b) TFEU the State, including national courts, national competition authorities and all other public authorities under the obligation to disapply State measures conflicting with the Union's competition rules. Even the private undertakings can be held liable for complying with such State measures if they are able to act autonomously despite the existence of a State measure in question.

Irrespective of their public or private status and how they are financed, all entities shall be subject to the competition and State aid rules of the Treaty as long as they engage in economic activity. In this respect, there is a well-established case law in the EU as to the the definition and scope of the notion of 'undertaking'. However, Articles 101 and 102 TFEU are only applicable to the undertakings and not to the States themselves. Therefore, these provisions are not able to avoid a much greater risk that competition could be

distorted or restricted by State activity. This is due to the fact that State pursues general economic or social objectives which may not always be compatible with those of the EU. State intervention into the market through public undertakings or through granting exclusive or special rights to undertakings could pose a danger to the uniform application of the Treaty rules throughout the EU. There is no direct provision in the Treaty which prevents Member States to establish public undertakings or to grant exclusive or special rights to the public or private undertakings. However, the Treaty prohibits Member States from adopting measures which deprive the competition rules of their effectiveness.

Within this framework, Article 106(1) of the Treaty indicates that in case of public undertakings and undertakings having special and exclusive rights, Member States shall neither enact nor maintain in force any measure contrary, *inter alia*, to the competition and State aid rules. Under this provision, not merely the granting of exclusive right but the manner in which it is organised may infringe competition rules. It is a settled case law that any measure adopted by a Member State which maintains in force a statutory provision that creates a situation in which an undertaking having an exclusive right cannot avoid infringing Article 102 TFEU or is led to infringe this Article is incompatible with the rules of the Treaty. In specific cases, the granting of exclusive right itself may be condemned under Article 106(1) TFEU in conjunction with Article 102 TFEU even there is no actual or potential abuse of a dominant position by the undertaking in question.

On the other hand, according to Article 106(2) of the Treaty, the undertakings entrusted with the operation of services of general economic interest or having the character of a revenue producing monopoly shall be subject to the rules, *inter alia,* on competition as far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. In the application of this provision to performance and financing of public services, the notion of 'services of general economic interest (SGEI)' plays the key role. Member States are primarily responsible for defining what they regard as SGEI on the basis of the specific features of the activities and this definition can only be subject to control by the Union institutions for manifest error. Article 14 TFEU

represents a statement about the value of SGEI in the EU, whereas the Commission has issued numerous papers and communications which attempt to capture the meaning and significance of SGEI on the European level. The case law of the Court of Justice, which has been developed to a considerable extent since the beginning of 1990s, provides a useful guidance as to the meaning of SGEI, their entrustment to undertakings, their operation by the undertakings and how the application of competition and State aid rules can obstruct the provision of such services. According to the 'obstruction of performance' condition or the 'proportionality test', it is essential to provide SGEI with the least disturbance to the competitive markets while observing the public interest. Consequently, Article 106(2) TFEU can be invoked to disapply EU competition and State aid rules to SGEI, depending upon the degree of intensity with which its proportionality requirements are applied.

Application of Article 106(2) to the financing of public services under the advantage condition of the EU State aid rules has particular importance. Article 107(1) prohibits 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 insofar as it affects trade between Member States. In this sense, in order for a State aid to exist, the measure in question must confer a benefit or an economic advantage on a certain undertaking or a class of undertakings.

In the application of State aid rules, one of the most fundamental questions is whether- and according to what criteria- a financial advantage granted by the authorities of a Member State to offset the cost of the public service obligations they impose on an undertaking must be classified as State aid within the meaning of Article 107 of the Treaty. Within this framework, the issue of the EU State aid rules applicable to the financing of services of general economic interest or public services has been a subject of controversy among the EU institutions, Advocates Generals of the Court, and in academic world.

In the development of the case law, different legal theories and approaches were suggested or adopted. In the end, with its landmark ruling in *Altmark* the Court of Justice

set the standard for a refined compensation approach by establishing four cumulative conditions. These conditions are as follows: 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 compensation is calculated must be established in advance in an objective and transparent manner. Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations. Fourth, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations. In case all these conditions are satisfied, the compensation will not be regarded as State aid, without any obligation to notify it to the Commission.

Subsequent case law of the Court Justice has already proved that it is not possible to apply those four conditions in every single case. In this respect, the ruling in *BUPA* has revealed that *Altmark* provides very useful guidance on how to assess national schemes designed to compensate costs linked to the fulfilment of SGEI, but does not fit in each and every case and therefore has to be modified accordingly. Therefore, despite the clarification in the case law, the extent and circumstances in which compensation for public service obligations constitutes State aid and in what conditions Article 106(2) is applicable remain a lively issue.

Although the main objective of this thesis is to analyse and reach several conclusions as to how the EU competition and State aid rules are applied to the public undertakings and undertakings having special and exclusive rights, and to what extent they can be exempted from the application of such rules when they are entrusted with public service obligations under Article 106 of the Treaty, Turkey's obligations under Article 106 TFEU were also dealt with in the last chapter of this thesis. As an accession country Turkey

has to align its competition law and State aid practices with the EU *acquis* but Turkey's obligations also arise from the Customs Union which has been in force since 1996.

In this respect, Turkey has achieved a certain progress in the alignment of its competition law with the EU legislation, in the narrower sense of the meaning. On the other hand, the Competition Authority's hesitation to apply competition rules to public undertakings and undertakings with special and exclusive rights reveals that it does not enjoy the appropriate powers and competence in this field. In other words, although the Competition Authority has exclusive competence to enforce competition rules, it has not been able to intervene in the distortions of competition which arise from other legislation containing anti-competitive provisions. Competition Auhority's competence over public undertakings and undertakings having exclusive and special rights is, therefore, seriously restricted by such legislation. In order to remedy this situation a comprehensive review of legislation should be initiated.

For effective application of the competition rules, Competition Authority should interpret the definition of 'undertaking' in a broader way in cases involving public entities, and more frequently use its *ex officio* competence to apply the competition provisions to the publicly controlled sectors. The definition in Article 3 of the Law on the Protection of Competition should be amended in accordance with the corresponding definition of undertaking in the EU law and in line with the definition in the new Law on Monitoring and Supervision of State Aids.

While Turkey has a high level of alignment in the enforcement of competition rules and merger control, there has been no progress towards alignment of the rules concerning public undertakings and undertakings holding exclusive and special rights. In this regard, Turkey should prepare specific legislation and/or amend the current legislation concerning public undertakings, including PEEs, to bring them into the same the line with each other to ensure a harmonious application of competition rules to every undertaking. Accordingly, the definition of 'public undertaking', 'exclusive right' and 'special right'

should be defined by way of law and and be applied by the jurisdictional, administrative and regulatory authorities in the same way.

In October 2010, Turkey adopted the Law on Monitoring and Supervision of State Aids. This Law establishes a competent authority for this task, which is supported by an institutional structure within the Undersecretariat of Treasury. Although the Law provides provisions on notification and monitoring of aid schemes in line with Turkey's Customs Union obligations, the services sector is excluded from its scope. In order to be fully compatible with the EU acquis, Turkey should also bring services into the scope of this Law and new legal framework and necessary institutions should be established to regulate State aids, particularly, in energy and transport sector. The State Aids Monitoring and Supervision Board, whose establishment had been delayed for a long time, should become operational soon.

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