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Editorial - Competition: Efficiency and Other Things

*Okeoghene Odudu**

In a memorable essay Richard Hofstadter considers the motivating force behind competition law in the US and identifies three possibilities:

> 'The first were economic; the classical model of competition confirmed the belief that the maximum of economic efficiency would be produced by competition … The second class of goal was political; the antitrust principle was intended to block private accumulations of power and protect democratic government. The third was social and moral; the competitive process was believed to be a kind of disciplinary machinery for the development of character, and the competitiveness of the people—the fundamental stimulus to national morale—was believed to be in need of protection.'[1]

Hofstadter considered the 'antitrust movement' to have been motivated by the second and third goals: competition law existed to do many things. However, Robert Bork famously asks whether 'the antitrust judge to be guided by one value or several?'[2] He then went on to articulate why an antitrust judge is to be guided by a single value and why that single value ought to be efficiency.[3] In *GlaxoSmithKline*, the Court of First Instance sided with Bork, both in relation to the pursuit of a single value and in the choice of the value pursued, when it states that the purpose of European Union competition law 'is to prevent undertakings, by restricting competition between themselves or with third parties, from reducing *the welfare of the final consumer* of the products in question'.[4] This choice would mark the end of the 'modernisation' of the Union's competition rules.[5]

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* Herchel Smith Lecturer, Faculty of Law, University of Cambridge.

1 Hofstadter, 'What Happened to the Antitrust Movement' in Sullivan (ed), *The Political Economy of the Sherman Act : The First One Hundred Years*, Oxford University Press, 1991, 20-31, 23-24.

2 Bork, *The Antitrust Paradox: A Policy at War with Itself,* Free Press, 1993, 50

3 Bork, *The Antitrust Paradox: A Policy at War with Itself,* Free Press, 1993, 72-89

4 Case T-168/01 *Glaxosmithkline Services Unlimited, Formerly Glaxo Wellcome Plc v Commission* [2006] ECR II 2969, para 118, emphasis added, citing Joined Cases T-213 & 214/01 *Österreichische Postsparkasse and Bank für Arbeit und Wirtschaft v Commission* [2006] ECR II-0000, para 115; Case 8/72 *Consten and Grundig v Commission* [1972] ECR 977, p 493; and Case 28/77 *Tepea v Commission* [1978] ECR 1391, para 56.

5 Other milestones can be seen in the Commission's Article 81(3) Guidelines, paragraph 33; DG Competition Discussion Paper on Article 82 EC, paragraph 4; Commission, Article 81(3) Guidelines, paragraph 13; Commission, Vertical Guidelines, paragraph 7. Respectively, OECD (2003), pages 3, 4 and 12 and UNCTAD (1995), page 6. See also, Ehlermann (1998), pages ix, 323, 347 and 354; UNCTAD's submission to OECD (2003), page 4. see for example: Green Paper on Vertical Restraints in EC Competition Policy Com (96) 721 Final [1997] 4 CMLR 519, [54], [65], [82], [85], [293]-[300]; Guidelines on Vertical Restraints, OJ 2000, C291/1, para 8-11; White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC

That an end-point in modernisation has been reached in which competition law does not challenge efficient outcomes, even when contrary to prevailing public ideology, leaves unanswered the challenge of what is to be done about the other things with which European Union competition law has historically been concerned.[6] Reviewing *GlaxoSmithKline*, the Court of Justice rejected the position of the Court of First Instance, finding that 'neither the wording of Article 81(1) EC nor the case-law lend support to such a position'.[7] The Court went on to report that:

> 'there is nothing in Article 81 EC to indicate that only those agreements which deprive consumers of certain advantages may have an anti-competitive object. … [Union competition law] aims to protect not only the interests of competitors or of consumers, but also the structure of the market and, in so doing, competition as such. … it is not necessary that final consumers be deprived of the advantages of effective competition in terms of supply or price'.[8]

Given the importance and implications of this debate, in April 2009 CLaSF held a workshop to consider the place of the non-efficiency objectives in competition law: an ASCOLA Conference taking place in May 2010 will also consider the issue.[9] It is thus timely for these essays on the role of non-efficiency objectives in Union competition law to be published. The essays in this volume consider the extent to which competition law accommodates or excludes consideration of things other than efficiency. When non-efficiency values are concerned there seem to be two options. The first is to immunize the activity achieving a non-efficiency objective from competition law control. Whether the pursuit of a non-efficiency objective excludes the application of Union competition law is a theme pursued by van de Gronden when he considers the ability of Member States to intervene in healthcare markets to protect and promote the value of universal coverage. He finds that the Court waxes and wanes between exclusion of universal healthcare provision from the scope of Union competition law, and inclusion within the scope but capable of exemption based on the incompatibility of competition and public service provision. When the method of intervention is state subsidy it is possible for the healthcare regulator and regulatory

Treaty Commission Programme No 99/027, OJ 1999, C132/1; and, Peeperkorn 'The Economics of Verticals' June EC Competition Policy Newsletter (1998), 10-17. Implications of the evolution of thought from an idea that 'antitrust is for competition to the notion that antitrust is for efficiency' are considered in Fox 'The Efficiency Paradox' in Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust*, Oxford University Press, 2008, 77-101.

6 For one such challenge see, Townley, *Article 81 EC and Public Policy*, Hart, 2009 .

7 Para 62.

8 Para 63. See also Joined Cases C-468/06 to C-478/06 *Sot. Lelos kai Sia EE and Others v. GlaxoSmithKline*, paragraph 65.

9 For previous considerations see Bouterse, *Competition and Integration: What Goals Count? EEC Competition Law and Goals of Industrial, Monetary, and Cultural Policy*, Kluwer Law and Taxation, 1994, Elzinga 'The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?' 125 U Pa L Rev (1977), 1191-1213, Schwartz, 'Justice and Other Non-Economic Goals of Antitrust' 127 U Pa L Rev (1979), 1076-1081, Ehlermann and Laudati (eds), *European Competition Law Annual 1997: The Objectives of Competition Policy*, Hart Publishing, 1998, and Monti, 'Article 81 EC and Public Policy' (2002) 39 CML Rev 1057-1099.

regime to be excluded from Union competition law on the basis that the market operates on the principle of solidarity. State aid rules are also inapplicable when the subsidy merely compensates an undertaking for the performance of a public service obligation. The value of universal service is one of the other things we are required to consider in competition law and policy. Efficiency is shown not to be everything. However, Dan Wilsher considers problems that arise when competition law scrutiny is wholly excluded because of a concern with other things, in his case, environmentally sustainable energy production. First, Community measures fall outside the scope of the competition rules since neither the Community nor its institutions constitute 'undertakings'. However, the evidence is that measures thus far adopted by the Community are at least ineffective and likely counterproductive. Subjecting the measures to the type of efficiency analysis the Treaty state aid rules require would have enabled a more efficient regime to be developed. Further, Wilsher is concerned that competition law immunity for specific actors charged with meeting particular values, such as environmentally sustainable energy production, creates the risk of interest-group lobbying and regulatory capture; paradoxically preventing the most effective pursuit of the objective for which immunity was initially conferred.

As an alternative to immunizing activity achieving a non-efficiency objective from competition law control, a second approach is to develop justifications within competition law that take account of non-efficiency concerns. Such an approach is not without problems: as van de Gronden observes, such an approach gives the Union a role in determining how those in a sphere may operate in order to benefit from competition law justification, even when the sphere is expressly outwith the competence of the Union. However, Hans Vedder considers a broad scope of application to, and review of, non-efficiency objectives through the mechanism of justification is a justifiable approach. As Oles Andriychuk seek to demonstrate with the use of parenthesis analysis, competition is not as a utilitarian instrument, but must be seen deontologically as an intrinsic feature of a liberal democracy. And it is the function of competition law in a liberal democracy Vedder has in mind, viewing competition law as a mechanism by which administrative action may be reviewed and thus providing an important check against regulatory capture, neocorporatism and protectionism. Such an approach addresses the concerns raised by Wilsher. However, whilst various justifications must be made available to ensure that values other than efficiency are respected, Vedder argues that the discipline of competition is all too easily avoided by the mere mention of non-efficiency goals: the intensity of review is insufficiency rigorous and non-efficiency values are given too much weight (ultimately, to the detriment of the extra-efficiency goals, as they are inefficiently pursued). Vedder focuses on environmental values when he identifies a low intensity of review. A more rigorous review of the need to curtail competition law is identified by Szymon Gebski, arguing that the value of financial stability in the banking sector, despite Member State attempts, has not resulted in competition law immunity for state subsidies. Instead, whilst falling within the scope of the state aid rules, Article 87(3)(b) EC has been used to ensure that the value of a stable financial sector is preserved. Thus, this value is subject to the judicial review that Vedder considers appropriate and at an appropriate intensity. This raises the possibility of a different intensity of review for different non-efficiency values, in addition to the different approaches that may be taken in relation to non-efficiency vales (i.e., exclusion from the scope or justification).

Whilst the authors identify the consideration of non-efficiency values, though not explicit, it seems that the argument for immunity or claim of justification is not being claimed in relation to pure private conduct. This is particularly so in Vedder and van de Gronden: the former seeking judicial review, the latter seeking state immunity of the particular values at stake. Both Wilsher and Gebski are also concern with state action. Yet it is not surprising that states are subject to more, different, or higher standards than pure market participants and the role of non-efficiency values absent state involvement is less than clear. An example is seek in Floris Vogelaar's consideration of the extent to which the value of freedom to choose contractual partners is recognised, protected, or challenged by competition law. This private value is subject to increasing scrutiny under competition, even when efficiency is not impaired. Thus values other than efficiency, such as the need to prevent accretions of private power, may motivate competition law intervention, just as they may motivate competition law immunity. The ability to challenge conduct with no detrimental impact on efficiency leaves us exactly where we started, questioning the very purpose of the antitrust enterprise. It is thus abundantly clear that in antitrust, as elsewhere, we are far from the end of history. The contributions show a vitality in the idea that 'we can enhance efficiency and economic welfare (and other goals as well)'.[10] The battle for the soul of antitrust may be won, but the war is far from over.[11]

Note From the Editors

The papers in this Issue of the Review were prepared before the Lisbon Treaty came into force, but published shortly thereafter. All of the papers are therefore 'pre-Lisbon'. The competition provisions in the new Treaty on the Functioning of the European Union are textually unchanged from their precursor provisions in the EC Treaty. They are however renumbered with, for example, Art 81 EC becoming Art 101 TFEU. The main textual change in competition terms is that the reference to 'undistorted' competition that formerly appeared in Article 3(g) EC, now appears in a Protocol to the Treaty.

[10] Fox, 'The Efficiency Paradox' in Pitofsky (ed), *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust*, Oxford University Press, 2008, 77-101, 80, bold emphasis added, italics in original, citations omitted.

[11] Fox, 'The Battle for the Soul of Antitrust' (1987) 75 Cal L Rev 917-923.

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Financing Health Care in EU Law: Do the European State Aid Rules Write Out an Effective Prescription for Integrating Competition Law with Health Care?

*Johan W van de Gronden**

Many Member States have taken measures in order to finance their health care systems. However, it cannot be ruled that these measure run counter the European state aid rules, which could have adverse effects on health care. Therefore, the central question of the present paper is whether the ECJ's and CFI's case law and the measures taken by the Commission accommodate health care concerns in the application of the Articles 87-89 EC (Articles 107-107 TFEU). In this context the health care competences of the Member States are of great interest, because by balancing the health care and competition concerns the Community institutions could develop an approach that respects these competences. This article starts by exploring which health care concerns should play a role in applying the Community state aid rules. It will be argued that universal coverage is an important issue in the EU law approach towards health care. Hence, it will be examined to what extent concerns of universal coverage play a role in the application of the European State aid rules. Firstly, the concept of undertaking, which is the 'gate' to the state aid rules, will be explored. Subsequently, attention will be paid to Articles 87-89 EC.

1. INTRODUCTION

Article 152(5) of the EC Treaty (hereafter EC) provides that the organisation and delivery of health care is considered to be the responsibility of the Member States. In the Treaty of Lisbon this point of departure is reinforced because it is stressed that the responsibilities of the Member States include 'the management of health services and medical care and the allocation of the resources assigned to them'.[1] However, the policy measures taken by the Member States in the field of health care must comply with the basic Treaty provisions on competition law. Member States may still intervene in health care markets in order to guarantee access to health care for all. Financial instruments such as subsidies play a significant role in this respect. Here the EC state aid rules, laid down in Articles 87-89 EC, come into play.[2]

Article 87(1) EC prohibits Member States from distorting competition on the Common Market by giving state aid to undertakings. So, the fair chance exits that national

* Professor of European Law at Radboud University Nijmegen, The Netherlands. With special thanks to Ms A Looijestijn-Clearie for her invaluable comments. The author would like to stress that he bears the sole responsibility for the contents of this article.

1 See the new wording of para 7 of the Article 168 Treaty on the Functioning of the EU. Moreover, this paragraph states that not only the Member States competences for 'the organisation and delivery of health services and medical care', but also 'the definition of their health policy' must be respected.

2 The Treaty of Lisbon has renamed the EC treaty the Treaty on the Functioning of the European Union. The state aid rules are contained in Articles 107-109 of this treaty. As so far all important case law has been based on the old numbers of the EC Treaty, this contribution refers to these provisions.

measures financing health care activities may come under fire from the Community regime on state aid. Hence, the question arises whether this regime interferes with the Member States' competence to organise their health care systems. It goes without saying that the answer to this question largely depends on the case law of the Community courts (ECJ and CFI) and the (policy) measures taken by the Commission. Consequently, it should be examined whether these Community institutions integrate health care objectives into the application of the state aid rules. Are these non-competition goals relevant for European state aid law, which forms an integral part of the competition system of the EU?

The central question of the present paper is, therefore, whether the ECJ's and CFI's case law and the measures taken by the Commission accommodate health care concerns in the application of the Articles 87-89 EC. In this context the health care competences of the Member States are of great interest, because by balancing the health care and competition concerns the Community institutions could develop an approach that respects these competences.

This article starts by exploring which health care concerns should play a role in applying the Community state aid rules. Subsequently, the application of the state aid rules will be explored. This article ends by drawing some conclusions.

2. HEALTH CARE CONCERNS IN THE EU: THE VALUE OF UNIVERSAL COVERAGE

In the EU health care systems differ from Member State to Member State. Nonetheless, it has been argued in legal doctrine that national health care systems in the EU can be divided into two main categories: National Health Services (NHS) and Social Insurance Systems.[3] Member States like the United Kingdom and Spain have introduced a NHS. Such a system is financed by taxes and operates according to a benefit-in-kind-system. At the heart of Social Insurance Systems is compulsory insurance. This implies that all citizens, or particular groups of person, are obliged to be affiliated with a health insurer; such as a sickness fund. In the Netherlands a market-oriented Social Insurance system is in place;[4] all inhabitants of the Netherlands have the obligation to conclude agreements with private insurance companies. Accordingly, the managing bodies are private insurers in the Dutch health care system, but they have to provide health insurance according to principles of open enrolment and private insurers are the managing bodies (with regard to the basic health care scheme).

It is apparent from the foregoing that there is no such thing as a coherent set of principles of EU health law. However, it must be noted that the systems do have one particular value in common. An important point is that every citizen should have access

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3 See for instance TK Hervey and JV McHale, *'Health Law and the European Union'*, Cambridge 2004, p 21.

4 The Dutch health care system was introduced by the Zorgverzekeringswet (Health Insurance Act). See for a short description of this Act: GJ Hamilton, 'A new Private Universal Health Insurance in the Netherlands' in: A den Exter, *Competitive Social Health Insurance Yearbook 2004*, Rotterdam, 2005, p 8 *et seq*.

to necessary health care. Hence, universal coverage is an important issue in the health care systems of the EU Member States. It should be noted that in its case law the ECJ has acknowledged as well that universal coverage is of great importance. In *Smits-Peerbooms*, for example, it was accepted that a Member State must be entitled to plan a network of hospitals covering its whole territory since 'the survival of the population' is dependent on such a network.[5] Apparently, a balanced medical and hospital service open to all must be ensured.[6]

In the light of this case law it was surprising that in 2006 the Council adopted a Communication on common values and principles in the health care systems of the Member States and noted that universality was such a shared value:[7] no-one should be barred access to health care and access for all must be ensured.[8] In its Health Strategy adopted in 2007 the Commission stressed the importance of universal coverage.[9] Furthermore, Article 35 of the Charter of the Fundamental Rights of the European Union provides that 'everyone has the right of access to preventive health care and the right to benefit from medical treatment under the conditions established by national laws and practices'. Consequently, universal coverage is regarded as an important value in European law and is defined as allowing access for all to the necessary health care benefits. It goes without saying that it differs from Member State to Member State which benefits are deemed to be necessary, but it is beyond doubt that all Member States share the value that all their inhabitants are entitled to a minimum level of health care benefits.[10] Although the definition of these benefits is open to debate, universal coverage as such is not called into question.

Subsidising, funding and financially supporting health care are powerful tools for Member States to guarantee universal coverage. This value may be put under pressure if these tools are found to infringe Article 87 EC. Therefore, it could be argued that health care interests are accommodated in the application of the European state aid rules where the objective of universal coverage is integrated into the way the Community Courts and the Commission deal with the Treaty provisions on state aid. Moreover, taking into account this objective would contribute to respecting the health care powers of the Member States. After all, their national authorities remain competent to financially intervene on health markets in order to guarantee access for all to the necessary benefits. This would also be in line with the new provision on the Member States' health care competences inserted by the Treaty of Lisbon, which inter

5 Case C-157/99 *Smits en Peerbooms*, [2001] ECR I-5473, para 74. See also C-385/99 *Müller-Fauré* [2003] ECR I-4509, paras 79 and 80 and C-372/04 *Watts* [2006] ECR I-4325, para 111.

6 *Smits-Peerbooms*, ibid, para 73. See also *Müller-Fauré,* ibid, para 67 and *Watts*, ibid, para 104.

7 The Council Conclusions on Common values and principles in European Union Health Systems, OJ 2006, C156/1.

8 Ibid.

9 White Paper, 'Together for Health: A Strategic Approach for the EU 2008-2013' COM (2007) 630 final, p 3.

10 C.f. AP van der Mei, *Free Movement of Persons within the European Community. Cross-Border Access to Public Benefits*, Oxford, 2003, pp 4 & 5.

alia provides that the responsibilities of the national authorities shall include the allocation of the resources assigned to health services.

Below, it is examined to what extent concerns of universal coverage play a role in the application of the European State aid rules. Firstly, the concept of undertaking, which is the 'gate' to the state aid rules, will be explored. Subsequently, attention will be paid to Articles 87-89 EC.

3. THE CONCEPT OF UNDERTAKING IN HEALTH CARE: ARE THE EUROPEAN STATE AID RULES APPLICABLE TO HEALTH CARE OPERATORS?

It is settled case law that every entity engaged in economic activities is an undertaking within the meaning of EC competition law.[11] In European competition law the concept of undertaking is one of the key jurisdictional tools: it delineates the scope of these rules.[12] How does the ECJ apply this definition to health care cases? This contribution addresses this question by making a distinction between bodies managing health care schemes and health care providers.

When it comes to managing bodies, the ECJ scrutinises whether the health care scheme at issue is almost completely based on the principle of solidarity – in the sense of redistribution of wealth[13] – or whether elements of competition are built into this scheme.[14] If the principle of solidarity is predominant, the managing bodies are not engaged in economic activities according to the ECJ and, as a result, are not undertakings.[15]

The approach of scrutinising the design of the scheme at issue is confirmed by case law that does not concern health care systems but other social security schemes.[16] In *Kattner Stahlbau*,[17] for example, the ECJ examined whether the statutory disability insurance scheme at issue was predominantly based on the principle of solidarity and to what extent this scheme was subject to supervision by the State.[18] In contrast, managing bodies do carry out economic activities, and do fall within the scope of competition

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11 See for instance case C-41/90 *Höfner* [1991] ECR I-1979. C.f. also case C-55/96 *Job Center* [1997] ECR I-7119.

12 V Louri, '"Undertaking" as a Jurisdictional Element for the Application of EC Competition Rules', [2002] Legal Issues of Economic Integration 172.

13 A Winterstein, 'Nailing the Jellyfish: Social Security and Competition Law' [1999] ECLR 330.

14 Cf. E Szyszczak, 'State Intervention and the Internal Market', in: T Tridimas and P Nebbia, *European Union Law for the Twenty-First Century. Volume 2: Internal Market and Free Movement Community Policies*, Oxford, 2004, pp 232 and 233.

15 See e.g. joined cases C-159/91 and C-160/91, *Poucet and Pistre* [1993] ECR I-637, joined cases C-264/01, C-306/01, C-351/01 and C-355/01, *AOK et al.*, [2004] ECR I-2493; case T-319/99, *FENIN* [2003] ECR I-357; and, Case C-205/03P, *FENIN* [2006] ECR I-6295.

16 See e.g. paras 38-46 of Case C-218/00 *Cisal*, [2002] ECR I- 691.

17 Case C-350/07, *Kattner Stahlbau v Maschinenbau- und Metall- Berufsgenossenschaft*, 5 March 2009, n.y.r.

18 At para 43. State supervision must ensure that bodies managing the schemes concerned observe the principle of solidarity.

law, if the national legislature has opted for a (balanced) mix of solidarity and market forces in designing the health care scheme concerned.[19]

What role does universal coverage play in this case law? In the *FENIN* cases,[20] the Community courts ruled that the (Spanish) NHS bodies were not undertakings, as they were funded from social security contributions and other State funding and provided services free of charge to affiliated persons on the basis of universal coverage.[21] This reasoning shows that solidarity and universal coverage are interlinked in health care cases; as in these types of cases solidarity not only leads to the redistribution of wealth but also amounts to the transfer of financial resources from healthy persons to unhealthy persons. At the end of the day, this is a matter of universal coverage, as access for all to health care benefits is ensured. Consequently, concerns of universal coverage do play a role in the ECJ's case law on the concept of undertaking.

In sum, it may be argued that it depends on the national design of health care schemes whether managing bodies fall within the ambit of EC competition law. The main argument is related to the principle of solidarity but universal coverage is of interest as well;[22] since providing access to all may be regarded as an expression of solidarity, as the Community Courts did in the *FENIN* cases. In essence, the Community courts draw from the will of the national legislator when deciding whether competition law should be applicable or not; the test deployed by the ECJ may be referred to as a 'concrete test'. This implies that the powers of the Member States are respected: if they are not willing to introduce (a substantive amount of) competition elements in the design of a health care system, competition rules, including the Treaty provisions on state aid, are not applicable.

In contrast, in cases where health care providers, like doctors and hospitals, are involved the ECJ has developed a different approach to the question of whether these entities fall within the scope of the concept of undertaking. It simply departs from the assumption that health care is (usually) provided for economic consideration and that, as a result, doctors and other health care providers are engaged in economic activities.[23] In *Pavlov*, for example, the ECJ was of the opinion that medical specialists are engaged in economic activities (in their capacity as self-employed economic operators) because they provide services for remuneration.[24] Like in *Pavlov*, the ECJ found in *Ambulanz*

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19 See, for example, Case C-244/94, *FFSA* [1995] ECR I-4015; Case C-67/96, *Albany* [1999] ECR I-5751, Joined Cases C-115/97, C-116/97 and C-117/97 *Brentjens* [1999] ECR I-6025 and Case C-219/97, *Drijvende bokken* [1999] ECR I-6121.

20 See Case T-319/99, *FENIN* [2003] ECR II-357 and Case C-205/03P, *FENIN* [2006] ECR I-6295.

21 See para 39 of the CFI judgment in Case T-319/99, *FENIN* [2003] ECR II-357.

22 Cf. Winterstein, op cit, n 13, p 330.

23 See Joined Cases C-180-184/98, *Pavlov* [2000] ECR I-6451 and case C-475/99, *Ambulanz Glöckner* [2001] ECR I-8089.

24 See point 76 of *Pavlov*, ibid.

Glöckner that the medical aid organizations concerned were undertakings because they provided services for economic consideration.[25]

Remarkably, in these cases the ECJ does not examine the concrete legal framework applicable to the health care providers concerned. It merely records that health care services may be offered to end users via market mechanisms. By doing so, the ECJ deals with the definition of economic activities and health care providers in a rather abstract way. Therefore, the test applied to these providers may be regarded as an abstract test.

Consequently, the ECJ almost automatically regards health care providers as undertakings within the meaning of European competition law. In other words, these providers cannot escape from the competition rules. As a result, concerns of universal coverage do not play a role in the ECJ's case law on the concept of undertaking and to health care providers.

In the light of the foregoing, it has to be concluded that, in its case law, the ECJ makes a distinction between managing bodies (such as National Health Care authorities and sickness funds) and health care providers.[26] It appears from the analysis of this case law that the ECJ uses the concept of undertaking as flexible jurisdictional tool to exclude solidarity-based health care systems from the ambit of European competition law, when it comes to managing bodies.[27] Conversely, the role of this tool is neglected if the competition rules are applied to health care providers. Therefore, in this contribution separate sections deal with managing bodies and providers below. But first, the main features of the state aid provisions of the EC Treaty are outlined.

4. THE EUROPEAN STATE AID RULES: GENERAL REMARKS

Pursuant to Article 87(1) EC Member States are not allowed to grant state aid to undertakings that distorts competition on the Common Market and influences intra-Community trade. However, in European state aid law things are not as black and white as they appear. The fact is that the Commission has the power to approve national state aid measures on the basis of Article 87(3) EC. For example, according sub para (c) of this Treaty provision national aid measures facilitating 'the development of certain economic activities or of certain economic areas' may be allowed. Furthermore, Article 86(2) EC, which deals with Services of General Economic Interest (hereafter SGEI), provides for an exemption from the prohibition laid down in Article 87(1) EC. The Commission has the power to approve state aid measures because these measures fulfil the conditions of Article 86(2) EC. Evidently, national state measures will only benefit from these exemptions if they are notified by the

[25] See point 20 of *Ambulanz Glöckner*, op cit, n 23.

[26] See also JW van de Gronden, 'Purchasing health care: economic activity or Service of General (Economic) Interest' [2004] ECLR 84-86.

[27] Cf. also V Louri, op cit, n 12, p 174, and E Szyszczak, 'Modernising Healthcare: Pilgrimage for the Holy Grail?' in M Krajewski, U Neergaard and JW van de Gronden, *The Changing Legal Framework for Services of General Interest in Europe. Between Competition and Solidarity*, The Hague, 2009, p 21.

Member States to the Commission. In the absence of notification, the Commission has the authority to order repayment of the aid concerned.[28] Domestic courts are even obliged to apply the standstill provision of Article 88(3) EC, which implies that they must also order the recovery of illegal state aid granted by the Member States' competent authorities.[29] It goes without saying that the standstill provision could lead - at least potentially - to far-reaching legal problems with regard to financing mechanisms concerning general interest policies. In a worst case scenario many enterprises entrusted with special tasks related to goals of public interest are faced with actions of repayment and, as a result, with deficits on their budgets.

In this regard, it must be noted that the ECJ has developed a special approach towards state aid and issues of general interest built upon the concept of SGEI. In *Altmark*,[30] it held that compensatory measures for the execution for Public Service Obligations (hereafter PSO) do not constitute state aid, provided that the following conditions are met: (1) the undertaking in question is charged with the execution of a PSO, (2) the parameters of the amount of the compensation are established in an objective and transparent way (3) the compensation does not go beyond what is necessary, and (4) in the case that the public contract concerned is not subject to a public procurement procedure, the amount of the compensation is determined on the basis of the expenses a well-run undertaking would have incurred. Compensation measures that comply with these criteria are not regarded as state aid in the sense of Article 87 (1) EC. A major advantage of the approach developed in *Altmark* is, therefore, that these benefits do not need to be notified to the Commission.

It may be argued that by delivering its judgment in *Altmark* the ECJ has developed a jurisdictional approach to state aid. After all, financial measures that fulfil the conditions outlined in this ruling are simply not caught by the prohibition laid down in Article 87(1) EC. Moreover, the reasons that may lead to the non-applicability of this prohibition are - to some extent - related to concerns of universal coverage. After all, in many circumstances the aim of PSO is to enable particular operators to provide services to all at affordable rates.[31] However, the jurisdictional approach in *Altmark* does not offer the Member States carte blanche as the conditions set by the ECJ in this ruling must be fulfilled. The public authorities of the Member State must make the estimation whether PSO benefits do meet these conditions. If so, they do not have to initiate a notification procedure. What is more, in cases where the legality of compensation measures is at stake, it may be argued before domestic courts that these measures are justified in the light of the *Altmark* criteria and, as a consequence, must not be recovered by the enterprise entrusted with the execution of PSO. Hence, the

[28] Article 14 of Regulation 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ 1999, L83/1.

[29] See e.g. case C-39/94, *La Poste*, [1996] ECR I-3547.

[30] Case C-280/00, *Altmark*, [2003] ECR I-7747.

[31] Cf. W Sauter, 'Services of general economic interest and universal service in EU law' (2008) 33(2) ELRev 167.

Altmark approach is capable of solving enormous legal problems that may result from the standstill provision laid down in Article 88(3) EC.

The *Altmark* approach could be of great interest for health care, as universal coverage plays a major role in this sector. However, much depends on how the Community courts interpret the *Altmark* criteria. If they depart from a strict reading of the *Altmark* judgment many national compensation measures will be found incompatible with Article 87(1) EC. As a consequence, the proper execution of many PSOs will be put at risk due to the standstill provision of Article 88(3) EC. Conversely, a flexible interpretation of the *Altmark* criteria will prevent these problems from occurring. How do the Community courts and the Commission deal with this matter in health care? This question is addressed in the following sections.

5. STATE AID AND MANAGING BODIES IN HEALTH CARE

It may be expected that the question of whether a particular health care operator is entrusted with a special task is crucial in the decisions taken with regard to the financing of health care. After all, the first *Altmark* conditions concerns the charge of the execution of a PSO. The analysis of these decisions carried out below will show whether this is the case. Given the different 'undertaking tests' applied by the ECJ to managing bodies and health care providers, the role that *Altmark* plays in health care will be explored in separate sections, as already mentioned. This section deals with financing mechanisms for special tasks entrusted to managing bodies.[32]

5.1. State aid and state oriented health care systems

To start with, it is important to examine whether the European state aid rules are applicable. Above, it was pointed out that according to the jurisdictional approach developed by the ECJ with regard to the concept of undertaking health care schemes, in which the principle of solidarity is predominant, do not amount to economic activities. Consequently, benefits granted by public authorities to bodies managing these schemes do not fall within the ambit of Article 87(1) EC, which implies that these benefits do not need to be notified to the Commission.

Remarkably, it is apparent from the *AOK* judgement[33] that the ECJ quite easily assumes that health care systems are mainly based on the solidarity principle. In this case the ECJ decided that German sickness funds were not undertakings by referring to the following three reasons. Firstly, the insured persons are only entitled to benefits that are fixed by the State (obligatory benefits).[34] Apparently, the German health care system does not allow for competition on the benefits that sickness funds offer to affiliated

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32 This section focuses on financial advantages granted to managing bodies such as health insurers. Therefore, it does not deal with premium reductions that public health insurers grant in order to support enterprises (facing fierce competition on the internal market). This issue is discussed in E Mossialos, M McKee, W Palm, B Karl and F Marhold, *'EU law and the Social Character of Health Care'*, Brussels, 2002, p. 184-186.

33 Joined cases C-264/01, C-306/01, C-351/01 and C-355/01, *AOK et al.*, [2004] ECR I-2493.

34 Ibid, para 45-65.

persons. Secondly, the German sickness funds are non-profit organisations. Amazingly, the ECJ did consider the condition of profit making irrelevant in FFSA,[35] this condition has made a 'come back' in the *AOK* judgment. Thirdly, the German sickness funds are engaged in a system of risk equalisation. Under such a system sickness funds with less healthy persons are compensated for the costs incurred because of these persons by funds with more healthy persons.

In this writer's view Member States can escape from the applicability of the EC state aid rules by introducing state oriented interventions in their health care schemes. As in *Poucet* and *Pistre*,[36] the ECJ is of the opinion in *AOK* that obligatory benefits indicate solidarity and the absence of economic activities. In this respect it is of interest that such benefits do not bear relation to the amount of the contributions paid by the affiliated persons. Hence, if the objective of universal coverage is achieved by fixing the level of benefits in national legislation, the managing bodies concerned are not undertakings and financial support granted to them falls outside the scope of the Treaty provisions on state aid.

Remarkably, in the view of the ECJ, the fact that the German sickness funds were engaged in some price competition did not call into question the finding that these funds are not undertakings. Hence, it may be concluded that many state oriented health care systems - especially those that do not leave room for competition on benefits due to their obligatory nature - are not affected by Articles 87-89 EC. This conclusion is endorsed by the outcome of the *FENIN* cases. Here, both the CFI and ECJ ruled that the managing bodies of the Spanish National Health Service were not engaged in economic activities, as these bodies are obliged to provide health care free of charge. Above, it was pointed out that concerns of universal coverage were closely related to the principle of solidarity in this case. In *FENIN*, the Community courts even held that the purchase activities of the managing bodies of the Spanish National Health Service did not fall within the scope of EC competition law, since their subsequent use (i.e. granting benefits to affiliated persons free of charge) was not of an economic nature. This means that funding granted to these managing bodies does not fall within the scope of the European State Aid rules and, as a result, there is no need to set up a system of separate accounting for purchase activities, but financial support given to the business partners of the managing bodies, i.e. the health care providers, does have to comply with Articles 87-89 EC.

From the foregoing it is apparent that a health care system that is almost only based on the principle of solidarity does - completely - escape from the EC rules on state aid (and competition), as even purchase activities of its managing bodies are also not of an economic nature. It must, however, be noted that this conclusion holds true in so far as - apart from their task to provide basic health care services - these managing bodies do not offer additional commercial health care policies.

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35 Para 21 of Case C-244/94, *FFSA* [1995] ECR I-4015.

36 Para 18 of *Poucet and Pistre*, op cit, n 15.

5.2. State aid and market oriented health care systems

Articles 87-89 EC only come into play when a Member State has introduced a health care scheme based on a mix of solidarity and competition. To what extent do the Community Institutions accommodate concerns of universal coverage in their review of national financial measures in the light of the European state aid rules? For the purpose of answering this question the Zorgverzekerinsgwet and *BUPA* cases are of relevance. These cases are discussed below.

5.2.1. The *Zorgverzekeringswet* case

In the EU the most striking example of a 'mixed solidarity and competition based health care system' is the Dutch Health Insurance Act (hereafter: Zorgverzekeringswet). Under the Dutch system private insurance companies are the managing bodies of the basic health care scheme. They are allowed to be for-profit and, accordingly, it may be assumed that they are undertakings. This conclusion is endorsed by the Commission in its decision concerning state aids granted in the health care system introduced by the *Zorgverzekeringswet*.[37] In the view of the Commission, the most important element regarding the concept of undertaking was that the Dutch insurance companies were allowed to aim for-profit. By stressing the fact that that Dutch health care schemes were administered by for-profit insurers, the Commission built on the ECJ's finding in *AOK* that profit making should be regarded as a significant condition for applying the concept of undertaking. Furthermore, it was taken into consideration that the Dutch health insurance companies were able to influence the rates of the contributions and to determine the level of benefits granted to insured persons. In the Dutch health care system there is room for competition on benefits, which is an important argument for considering entities as undertakings.

Consequently, the flows of funds of the Dutch health care system must comply with the Community rules on state aid. Like the German sickness funds, Dutch private insurers are obliged to be engaged in a risk equalisation scheme. This scheme was managed by a state body and, as a result, payments made within the framework of that scheme amounted to state aids. In the view of the Commission those payments fall within the scope of the prohibition laid down in Article 87(1) EC. In its decision in *Zorgverzekeringswet* the Commission argued that the Dutch risk equalisation scheme did not benefit from the *Altmark* approach, because the fourth condition (costs of a well-run company) was not fulfilled.[38] It was put forward that all insurance companies are entitled to a similar amount of compensation irrespective of the fact whether they operate in an efficient or inefficient way. The Commission contended that the Dutch risk equalisation scheme aimed at tackling all problems of risks and not at compensating costs. As a consequence of the Commission's approach it may be argued that a compensation scheme directed at an open group of operators usually fails to

[37] Decision of the Commission of 22 December 2005 on the introduction of a risk equalisation system in the Dutch Health Insurance, N541/2004 and N542/2004 – C (2005) 1329 fin.

[38] Section 3.4.1 of the Commission decision in *Zorgverzekeringswet*, ibid.

meet the fourth *Altmark* condition. After all, it is hardly possible for the competent health care authorities of the Member States to set up general compensation schemes that take due account of the individual costs of efficient companies.

The strict reading by the Commission of the fourth *Altmark* condition leads to the non-applicability of the jurisdictional approach developed in this case. Due to the competition elements introduced in the design of the Dutch health care system the jurisdictional approach developed in relation to the concept of undertaking cannot be of any help. This system also does not benefit from the jurisdictional approach of *Altmark*. An important consequence of this is that due to the standstill provision such general schemes must be notified to the Commission before they can be put into operation. This enables the Commission to regulate and monitor national compensatory measures taken by Member States in the framework of health care systems based on a mix of solidarity and competition. One could, therefore, argue that in the Dutch health care system competition is not only regulated by national public authorities (entrusted with this task by the Dutch legislator) but also by the European Commission. All the same, the Commission approved the Dutch risk equalisation scheme, since it went on by reviewing this scheme in the light of Article 86(2) EC. In its view all health insurance companies were entrusted with a SGEI mission in spite of the lack of an official and explicit act of entrustment. The special task was derived from general obligations imposed upon the insurers by the Dutch Health Insurance Act. The obligations related to open enrolment, community rating, benefits granted to insured persons, and supervision mechanisms amount to the entrustment of SGEI within the meaning of Article 86(2) EC. As far as the writer of this contribution is aware, this is the first time that a Community institution derives a SGEI mission from the wording of obligations of a general nature. This is remarkable since it is common ground that such a mission should be entrusted by an explicit positive act.[39] Above, it was noted that it may be expected that explicit entrustment should be an important element of consideration. It turns out that this is not the case with the present Commission decision. In any event, the Commission contended that the risk equalisation scheme was necessary in order to solve problems of adverse selection. Such a scheme removes incentives for health insurers to direct their commercial and market strategies at healthy people ('low risks') and to develop policies aiming at preventing unhealthy people ('high risks') from enrolling.[40] Hence, at the stage of justification, i.e. in applying Article 86(2) EC, the Commission was prepared to justify the Dutch risk equalisation scheme. It is clear that a decisive argument for this justification was the objective of universal

[39] On this elementary matter, see, for example, A Jones & B Sufrin, *EC Competition Law*, 3rd ed, Oxford, 2008, p 653 and R Whish, *Competition Law*, 6th Ed, Oxford, 2009, p 234. See also para 22 of the Communication from the Commission, Services of General Interest in Europe, OJ 2001, C17/4, and Commission Staff Working Document. 'Frequently asked questions in relation with Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, and of the Community Framework for State aid in the form of public service compensation', SEC(2007) 1516, p 21.

[40] See section 4.2.2.1 of the Commission decision in *Zorgverzekeringswet*.

coverage. After all, the aim of the risk equalisation scheme at stake was to insure all inhabitants of the Netherlands: not only healthy persons but also unhealthy persons should get access to the necessary benefits.

The taking into account the objective of universal coverage at the justification stage has a price. This is apparent from the way in which the Commission carried out the proportionality test. In its view the payments made in the framework of the Dutch risk equalisation scheme were proportionate. An important consideration was that the scheme concerned was based on *ex ante* correction (the costs of the insurance companies having 'high risks' are compensated in advance) and *ex post* correction was only possible in limited circumstances. It should be noted that *ex ante* equalisation leaves more room for competition than *ex post* equalisation, since compensation paid in advance does not cover all costs, whereas the point of departure of compensation paid afterwards is coverage of all expenses incurred by the health care insurers involved. Implicitly, in *Zorgverzekeringswet* the Commission gave the signal that *ex ante* equalisation is preferred to *ex post* equalisation. Hence, it cannot be excluded that the Dutch government will face difficulties from the Commission, if it decides to change the correction mechanisms of the risk equalisation scheme and to go for an *ex post* system. By assessing the measure concerned at the justification stage the Commission had the power to influence core elements of the Dutch health care system. On the one hand, it respected the health care competence of the Dutch government by interpreting Article 86(2) EC extensively but on the other hand it has the power to influence significant features of the Dutch system. It is not clear from the outset to what extent this is in line with Article 152(5) EC that stipulates that the organisation and delivery of health care belong to the competences of the Member States.

The decision of the Commission was challenged by a Dutch insurance company, *Azivo*.[41] Unfortunately, the case was removed from the register of the CFI, and as a result, the Community courts did not have the opportunity to assess whether the Commission's approach towards the *Altmark* judgement is correct. In this regard, it is a pity that the Dutch government did not bring the *Zorgverzekeringswet* case before the CFI. It could have called into question the Commission's position that the flow of funds resulting from the risk equalisation scheme constitutes state aid within the meaning of Article 87(1) EC. An interesting line of reasoning would have been that the Commission applied the fourth *Altmark* condition (the costs of a well-run company) too strictly. This is a question of principal, since the consequence of the Commission's approach is, as already pointed out above, that general compensation schemes cannot benefit from the *Altmark* judgement. If the Commission's point of view is not correct, these schemes could escape from the applicability of the state aid rules and, as a result, from the state aid control by the Commission.

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41 Case T-84/06, OJ 2006, C108/27.

5.2.2. The *BUPA* case

Although, the Community courts did not review the Commission's decision in Zorgverzekeringswet, the CFI did deliver its judgement in a similar case: *British United Provident Association* (hereafter: *BUPA*).[42] At issue was an Irish risk equalisation scheme that was approved by the Commission. The Commission's decision was adopted before the ECJ delivered its *Altmark* judgement and was, therefore, based on its (now out-dated) *Ferring* ruling.[43] The criteria of the latter were vague and unclear, which compelled the CFI to review the Irish compensation mechanisms in the light of the *Altmark* conditions. Hence, the CFI was confronted with the question of the applicability of the concept of PSO in health care. What was the CFI's stance towards PSO and risk equalisation?

At first, the remarkable differences between the Irish and the Dutch risk equalisation schemes must be outlined for a good understanding of the decision taken by the CFI in BUPA. In Ireland a system based on private insurance operates alongside a tax-financed public health care system.[44] It is an alternative system of coverage for private medical treatment. So Irish inhabitants may opt for a public or a private scheme. Like the Dutch system, private insurance companies have to comply with obligations such as open enrolment and community rating. On top of that they are obliged to participate in a risk equalisation scheme. However, unlike the scheme at stake in *Zorverzekeringswet*, the Irish mechanisms amounted to *ex post* compensation.[45] As compensation paid afterwards is based on the coverage of actual costs, it tends to reduce incentives to compete.[46]

In sum, the Dutch and Irish schemes are different in two respects. Firstly, the private Irish insurance companies provide alternative cover to that provided by public health insurance system, whereas the Dutch private insurers are the only managing bodies. Secondly, the Irish risk equalisation scheme is based on *ex post* compensation and the Dutch scheme (mainly) on *ex ante* compensation.

In the light of these differences, it is striking that in the view of the CFI the Irish equalisation scheme did meet all *Altmark* conditions. The CFI started off by putting forward that the Member States' public authorities have a wide margin of appreciation in entrusting undertakings with special tasks. Community institutions are only entitled to examine whether these authorities make manifest errors when designating PSO. Given this point of departure it is not a surprise that in the view of the CFI all the *Altmark* condition were fulfilled in BUPA. The liberal approach of the CFI may be illustrated by discussing the CFI's considerations with regard to the fourth *Altmark* condition, which played such an important role in *Zorgverzekeringswet*. It was stated that

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[42] Case T-289/03, *British United Provident Association* [2008] ECR II-81.

[43] Case C-53/00, *Ferring* [2001] ECR I-9067.

[44] Case comment on *BUPA* by W Sauter, (2009) 46(1) CMLRev 269, p 273.

[45] Para 33 of BUPA, op cit, n 42.

[46] See Sauter, op cit n 44, p 275.

this condition could not be applied strictly in the present case.[47] The reason for this differentiating approach was that the Irish scheme is neutral with respect to the costs. Its point of departure is the issue of the additional costs associated with negative risk profiles. As long as the equalisation does not lead to 'offsetting any costs that might result from inefficiency' on the part of the private insurers subject to scheme concerned, the fourth *Altmark* condition is not disregarded.[48] The CFI's conclusion was that the Commission's decision did not disrespect the reformulated *Altmark* condition and that, therefore, the payments made in the framework of the Irish scheme at stake did not constitute state aid.

It is clear from the outset that the CFI preferred to apply a jurisdictional approach by relying upon a lenient reading of the *Altmark* conditions. In its view bodies managing a health care scheme based on both competition and solidarity elements may benefit from the jurisdictional approach of *Altmark*. As a result, the health care competences of the Member States are respected more than under the review carried out by the Commission in *Zorgverzekeringswet*. It cannot be ruled out that the CFI was inspired by the wording of Article 152(2) EC that aims at safeguarding these national competences. In the light of the foregoing, one cannot not help thinking that the Dutch government missed an opportunity by not challenging the Commission's decision in *Zorgverzekeringswet*. The CFI has given the Member States considerable leeway to regulate PSO in health care[49] and –by doing so– narrowed down the Commission's possibilities to intervene on the basis of the European state aid rules. Under the *BUPA* approach, of the CFI, many compensation measures do not amount to state aid and do not need to be notified to the Commission. If the Commission's *Zorgverzekeringswet* decision was annulled, the Dutch health care regulations on competition and risk equalization would not have been subjected to the Commission's supervision.

It should be noted that the Commission's decision in *Zorgverzekeringswet* and the CFI judgement in *BUPA* also have a lot in common. It has been pointed out that the Commission derived a SGEI mission from the wording of general obligations laid down in national legislation. In *BUPA* the CFI followed the same method. It argued

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[47] By doing so, the CFI moderated the fourth *Altmark* condition. In legal doctrine, it was put forward that the fourth condition was hard to fulfill, as it is difficult to ascertain what a reasonable profit is. See e.g. A Biondi, 'The financing of Services of General Econonic Interest' in T. Tridimas and P. Nebbia, *European Union Law for the Twenty-First Century. Volume 2: Internal Market and Free Movement Community Policies*, Oxford, 2004, p 270; p 46 of the study 'Internal market and Health Care: a new balance?' conducted in 2006 by Université Libre de Bruxelles in collaboration with the Katholieke Universiteit Leuven on the request of Rudy Demotte, Minister of Public health and Social affairs, Belgium; M Krajewski, 'Providing Legal Clarity and Securing Policy Space for Public Services through a Legal Framework for Services of General Economic Interest: Squaring the Circle?' (2008) European Public Law 390; and, V Hatzopoulos, 'Services of General Interest in Healthcare: An Exercise in Deconstruction?' in U Neergaard, R Nielsen and LM Roseberry, *Integrating Welfare Functions into EU law-From Rome to Lisbon*, DJØF Publishing, Copenhagen, 2009, p 233. Apparently, in *BUPA* the CFI contradicted this point of view.

[48] Para 249 of *BUPA*, op cit, n 42.

[49] Cf. W Sauter and H Schepel, *State and Market in European Union Law. The Public and Private Spheres of the Internal Market before EU Courts*, Cambridge, 2009, p 191, footnote 191.

that in providing medical health insurance services the private insurers operating in Ireland had to comply with obligations such as community rating, open enrolment, lifetime cover and minimum benefits. In the view of the CFI these obligations amount to the entrustment of special tasks.[50] Remarkably, the CFI even accepted as common ground the notion that the concept of PSO corresponds to that of SGEI under Article 86(2) EC and stated that 'it does not differ from that referred to in Article 86(2) EC.'[51] Hence, the CFI's point of view on PSO sheds additional light on SGEI missions. It may be argued that, like the Commission, the CFI is of the opinion that SGEI missions may be derived from general obligations and that in *BUPA* the concept of SGEI is broadened. A consequence of the method deployed in *BUPA* is that an open group of operators may be entrusted with a SGEI mission. The Commission's point of view that all insurance companies could be entrusted with SGEI is supported by the *BUPA* case. This is an important conclusion for the health care sector, as in this sector an open group of operators is supposed to realise objectives of general interest.

It is clear that the rationale of deriving SGEI missions from general obligations is the objective of universal coverage. The aim of the Irish system was to provide access to health care benefits to all. However, the necessity for this was not as compelling as in the Dutch system, since the inhabitants of Ireland had the possibility to take out insurance either from the statutory scheme or from the supplementary scheme that was subject of review in BUPA. Hence, since the statutory scheme provided a fallback option, it could be questioned whether universal coverage would be put under pressure without financing the private insurance companies involved. The CFI's judgment does not shed any light on this matter and, as a result, the way it dealt with PSO in *BUPA* is ambiguous. This does not contribute to the proper understanding of the concept of PSO in health care. The question arises whether SGEI missions or PSO still need to be derived from explicit official acts or whether general obligations related to public interest issues suffice. If the latter is the case, many health care operators are entrusted with SGEI missions and PSO and can be financially supported by state bodies, which may have adverse effects on competition. Whereas the Commission has developed a rather strict approach, the CFI seems to open the door to several kinds of competition distorting measures by considerably extending the scope of the concepts of SGEI missions and of PSO. However, in its recent judgment in a case concerning state aid granted in Italy, the CFI has demonstrated that that there are some limits to its flexible approach by holding that a SGEI cannot be derived from the mere fact that the undertakings concerned pursue activities in the public economic interest.[52] The problem was that the Italian law at issue did not contain any definition of a specific measure or any obligation related to a special task. Moreover, it was not made clear at all which public service obligations were involved. So, merely claiming that the public

[50] Para 182 of *BUPA*, op cit, n 42.

[51] Paras 161 & 162 of *BUPA*, op cit, n 42.

[52] Para 113 of Case T-222/04, *Italy v Commission*, 11 June 2009, n.y.r.

interest is involved without putting forward any substantiated evidence will not help Member States to escape from the European state aid rules.

Of further importance is the *TV2/Danmark* ruling.[53] In this case the CFI also derived a SGEI mission from general obligations laid down in the Danish media legislation. Hence, the approach developed in *TV2/Danmark* is comparable to the method used in *BUPA*. Conversely, it must be pointed out that in *TV2/Danmark* only one operator was entrusted with a special task, as this case concerned activities carried out by a broadcasting company. In the broadcasting sector, public authorities usually entrust SGEI missions to a limited number of operators. In any event, in *TV2/Danmark* the CFI confirmed its rather lenient (and to a certain extent confusing) approach towards SGEI missions deployed in BUPA.

6. STATE AID AND HEALTH CARE PROVIDERS

In section 4 it was pointed out that the ECJ easily assumes that health care providers are engaged in economic activities and should be regarded as undertakings. As a result, financial benefits granted to health care providers constitute state aid within the meaning of Article 87(1) EC. Member States are, therefore, obliged to assess all financial support given to hospitals, physicians etc, in the light of this provision irrespective of the fact that the applicable legal framework is predominantly based on concerns of solidarity and universal coverage. If they fail to do so, they risk that – on the basis of the stand still provision laid down in Article 88(3) EC – national courts or the Commission will order recovery of aids paid to these providers.

How can national public authorities responsible for financing health care providers deal with the problems resulting from the EC rules on state aid? In this writer's view, two approaches are possible. In the first place, they could consider notifying state aid measures to the Commission before putting them into practice. However, it is clear that such a notification process is time-consuming. Moreover, notification procedures give the Commission the opportunity to influence the organisation and financing of national health care systems, by, for example, obliging national health care authorities to introduce market elements into their financial support schemes. It goes without saying that this will not be much appreciated by many national health care authorities. In the second place Member States may argue that the EC state aid rules are not applicable to the financial support given to health care providers. For example, it could be put forward that providers such as hospitals operate on nationally oriented markets, which means that intra-Community trade is not influenced. It is apparent from the *Pearle* judgement[54] that state aid measures that do not have any effect on the trade between Member States, do not fall within the ambit of Article 87(1) EC and are, as a consequence, not subject to the notification obligation laid down in Article 88(3) EC. This line of reasoning could also lead to a jurisdictional approach; the main argument is

[53] Joined Cases T-309, 317, 329 & 336/04 *TV2/Danmark v Commission*, [2008] ECR II-2935.

[54] Case C-345/02, *Pearle* [2004] ECR I-7139.

that the prohibition laid down in Article 87(1) EC is not applicable due of the lack of an effect on intra-Community trade. Another possibility is to argue that the financial advantages compensate the execution of PSO and do not fall within the ambit of Article 87(1) EC because these advantages fulfil the *Altmark* conditions. It is clear from the outset that this line of reasoning is based on the jurisdictional approach developed in *Altmark*. Below, both defences (the absence of any effect on intra-Community trade and the *Altmark* approach) will be discussed.

6.1. Aids granted to hospitals and intra-Community trade

It is risky to assume that the trade between Member States is not influenced. Since 1998, the ECJ has delivered judgments on the free movement provisions of the EC Treaty and cross-border health care.[55] It has held that the competent authorities of a Member State may not make non-hospital care received in other Member States subject to prior authorisation.[56] In contrast, prior authorisation schemes may be applied to hospital treatments that patients undergo in other Member States.[57] However, if patients cannot be treated in domestic hospitals without undue delay, the competent authorities are not entitled to refuse treatment abroad and are obliged to reimburse the costs related to this treatment. Hence, the EC free movement rules are capable of opening up national health care markets and of inducing dynamic cross-border developments on these markets. These effects may be even reinforced by the Draft directive on patient mobility.[58] The Commission published this draft on July 2, 2008 and it may be regarded as a follow-up to the ECJ's case law on cross-border health care. The proposed directive *inter alia* aims at codifying the well-known judgments on hospital treatment in other Member States. But by doing so, it alters the approach developed by the ECJ. Pursuant to Article 8 of the proposed Directive Member States are allowed to provide for a system of prior authorization for reimbursement of the costs of hospital care in other Member States. However, the following conditions must be fulfilled: first, the costs of the treatment concerned must be covered by the national social security system at issue; second, the aim of the prior authorization scheme must

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[55] See e.g. Case C-158/96, *Kohll* [1998] ECR I-1931; Case C-120/95, *Decker* [1998] ECR I-1831; Case C-157/99, *Smits en Peerbooms* [2001] ECR I-5473; Case C-385/99, *Müller-Fauré* [2003] ECR I-4509; and, Case C-372/04, *Watts* [2006] ECR I-4325. See for a general discussion of this case law for example: V Hatzopoulos, 'Killing national Health and Insurance systems but healing patients? The European market for health care services after the Judgments of the ECJ in *Vanbraekel* and *Peerbooms*', (2002) CMLRev 683-729; AP Mei, 'Cross-Border Access to Health Care within the European Union: Recent Developments in Law and Policy', (2003) European Journal of Health Law 369-380; A Dawes, 'Bonjour Herr Doctor: National Healthcare Systems, the Internal Market and Cross-border Medical Care within the European Union', (2006) Legal Issues of Economic Integration 167-182 and JW van de Gronden, 'Cross-Border Health Care in the EU and the Organization of the National Health Care Systems of the Member States: The Dynamics resulting from the European Court of Justice's Decisions on Free Movement and Competition Law', 26(3) Wisconsin International Law Journal (2008-2009), 713 *et seq*.

[56] See e.g. paras 93-98 of *Müller-Fauré*, ibid.

[57] See e.g. paras 72-108 of *Smits-Peerbooms*, op cit, n 55; paras 76-92 of *Müller-Fauré,* ibid, and paras 106-123 of *Watts*, op cit, n 55.

[58] Draft Directive on the Application of Patients' Rights in Cross-Border Health Care, COM (2008) 414 final.

be addressing the outflow of patients and preventing the serious undermining of interests such as the financial balance of the national social security systems. At first sight, the second condition seems to be in line with the settled case law of the ECJ. However, the ECJ has never required that Member States should prove that the proper functioning of their hospital systems is undermined by the (possible) outflow of patients. It simply presupposed the serious undermining of these systems as soon as patients seek treatment abroad (provided that they can be treated without undue delay in domestic hospitals). If adopted in its present form, the draft Directive on patient mobility will limit the competences of the Member States considerably,[59] as they are only allowed to refuse reimbursement of the costs of hospital care undergone abroad in highly exceptional circumstances.[60] In essence, the Commission confirms this point of view in its Communication accompanying the draft directive, by stating 'that the additional costs of treatment arising from these proposals are not likely to be such as to undermine the sustainability or planning of health systems overall. This is because citizens are only entitled to be reimbursed for health care that they were entitled to at home, so Member States only have to pay for health care that they would have had to pay for in any case.'[61] As a result, the Draft patient Directive contains a high threshold for introducing a prior authorisation scheme.[62] In the course of 2009, the European Parliament discussed the Commission's proposal for a Directive on patient mobility. Numerous amendments were added to the text[63] but the requirements regarding the threshold for introducing prior authorisation schemes were not considerably changed. According to the amendments of the European Parliament the Member States must show that 'the absence of prior authorisation could seriously undermine or be likely to undermine' the proper functioning of their hospital care systems.[64] However, at the meeting of 8 and 9 June 2009 the Council did not manage to clinch a deal on the draft Directive.[65] One of the issues to be addressed by the EU Presidency of the second half of 2009 (Sweden) concerns the matter of prior authorisation schemes.[66] So, it may be

[59] JW van de Gronden, 'Cross-Border Health Care in the EU and the Organization of the National Health Care Systems of the Member States: The Dynamics resulting from the European Court of Justice's Decisions on Free Movement and Competition Law', op cit, n 55, p 736.

[60] See also W Sauter, 'The Proposed Patients' Rights Directive and the Reform of (Cross-Border) Healthcare in the European Union' (2009) Legal Issues of Economic Integration' 125 and JW van de Gronden, 'Hervormingen in een dienstbaar Europa. Over diensten, uitdagingen en Europees recht (inaugural address)', Deventer, 2008, pp 50 and 51.

[61] Communication from the Commission, A Community framework on the application of patients' rights in cross-border healthcare, COM(2008) 415 final, p 9.

[62] Section 2.1 of R Baeten, 'The proposal for a directive on patients' rights in cross-border health care' in C Degryse, 'Social developments in the European Union 2008', Brussels, 2009.

[63] European Parliament legislative resolution of 23 April 2009 on the proposal for a directive of the European Parliament and of the Council on the application of patients' rights in cross-border healthcare (COM(2008)0414 – C6-0257/2008 – 2008/0142(COD) (codecision procedure – first reading), A6-0233/2009.

[64] See Amendment 76.

[65] See the Press Release of the 2947th Council meeting, 9721/09 (Presse 124).

[66] Ibid, p 15.

expected that the final version of the Directive on patient mobility will give the Member States more leeway in regulating hospital care than the current draft does.

In sum, it cannot be excluded that the proposed Directive on patient mobility will stimulate cross-border hospital care. As a result, national health care markets will increasingly become interlinked. Hence, financial benefits granted by national health care authorities to hospitals are more likely to affect intra-Community trade than one would expect. It is clear from the outset that the present case law of the ECJ on cross-border health care is already capable of removing obstacles to the free movement of hospital services and of introducing a level playing field for hospital care on the Internal Market in the EU. Due to the dynamics resulting from the current developments regarding cross-border health care Member States may not assume too easily that state aids granted to hospitals do not affect intra-Community trade and, therefore, do not fall within the scope of Article 87(1) EC.

All in all, arguing that intra-Community trade is affected is not very helpful for accommodating concerns of universal coverage in the application of the European rules on state aid. After all, the term 'intra-Community trade' is of an objective nature and, therefore, does not leave much room for taking these concerns into account.

6.2. Aids granted to hospitals and PSO

However, Member States may also argue that financial benefits granted to hospitals do not need to be notified by referring to the *Altmark* approach. They could put forward that, like bodies managing health care schemes, hospitals are charged with the execution of PSO. It should be noted that relying upon the *Altmark* approach will only be successful, if hospitals are entrusted with a SGEI mission. Consequently, the competent health care authorities of the Member States must take policy measures that assign special tasks to hospitals. Preferably, it should be made clear in national legislation or in decisions taken by public authorities that the hospitals that receive financial support provide SGEI (or are entrusted with the execution of PSO).

In this regard it must be noted that in 2005 the Commission adopted a decision governing state aid and PSO.[67] This decision concerns compensations that do not benefit from the *Altmark* approach (because one or more conditions outlined in this ruling are not fulfilled). Apart from small public service obligation undertakings,[68] social housing enterprises and companies operating in air and maritime transport, the 2005 decision is applicable to hospitals. Aids granted to these undertakings are exempted from the notification obligation laid down in Article 88(3) EC. So, at first sight this decision is capable of ensuring universal coverage, since it even justifies financial

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

[68] Small public service obligation undertakings are companies with an average annual turnover less than 100 million during the two financial years preceding that in which the service of general economic interest was assigned, which receive annual compensation for the service in question of less than EUR 30 million.

support that does not pass the *Altmark* test. The aim of the Commission is to give Member States more leeway to finance hospital care at the justification stage. However, the decision – in essence – repeats the conditions formulated in *Altmark* by *inter alia* stipulating that the task must be entrusted by way of one or more official acts of public authorities and that the amount of the transfer of money may not exceed what is necessary for the performance of the special task concerned. The decision further specifies the way the special task must be entrusted and how the amount of the compensation must be determined. The rules laid down in the decision are very detailed and strict. In the light of the above-mentioned CFI judgments (such as *BUPA* and *TV2*) the question arises as to whether the Commission's decision on public service obligation has any added value.

The CFI interprets the *Altmark* conditions less strictly than the Commission does. The chance exists that financial benefits granted to hospitals (and other 'public service companies') that meet the requirements set out in the decision also do not constitute state aid within the meaning of Article 87(1) EC because they are also in accordance with the *Altmark* conditions. Hence, the 2005 decision does not extend the possibilities of the Member States to ensure universal coverage at the justification stage; rather it further muddles the concept of SGEI missions.

This is worrying; as opportunistic health care operators may be tempted to engage in litigation in order to challenge financial support given to hospitals. Telling is the case that resulted from a complaint that the private hospital company, Asklepios, lodged with the Commission on 20 January 2003. It was of the opinion that Germany granted illegal state aid to public hospitals. Subsequently, in 2004 it started proceedings before the CFI as the Commission had not taken an official decision with regard to its complaint yet. The Commission argued that the issues raised in this complaint were sufficiently addressed in its (here-above mentioned) 2005 decision on public service compensations. This point of view was rejected by the CFI as the 2005 decision only lays down abstract criteria and does not, by itself, constitute a definition of the Commission on the specific complaint lodged by Asklepios.[69] However, given the complexity of the case concerned (the German system of financing public hospitals) it could not be argued in the view of the CFI that the Commission was obliged to take a decision within one year.[70] So, there was no undue delay and the appeal of *Asklepios* was rejected. In sum, at the end of the day the CFI did not review the core elements of the 2005 decision. At time of the writing of this contribution, the follow up to the *Asklepios* case was unclear. The *Asklepios* cases shows that health care operators, such as private hospitals, do not shy away from starting procedures in order to challenge state interventions, by which Member State finance fundamental health care services. This may put the proper functioning of the national health care systems under pressure. In this regard it should be noted that some Dutch hospitals contend that Belgian hospitals are able to offer services to Dutch insured persons at low tariffs because the Belgian

[69] Para 77 of Case T-167/04, *Asklepios Klinken v Commission* [2007] ECR II-2379.

[70] Paras 82-91, ibid.

hospital infrastructure is financed at 40% by the Belgian Federal Ministry of Health.[71] So, it may be tempting for Dutch hospitals to challenge one of the core financial interventions of the Belgian health care system.

In 2005 the Commission also published a Community framework for state aid in the form of public service compensation.[72] In principle, this framework is applicable to all sectors governed by the EC Treaty. In this framework, the Commission stipulates under which conditions it is willing to approve public service compensation on the basis of Article 86(2) EC. They are guidelines regarding the exercise of the competence of the Commission to exempt national state aid measures from the prohibition laid down in Article 87(1) EC. The framework provides that a SGEI mission must be entrusted to the undertaking concerned by way of one or more official acts taken by a state body of a Member State. Furthermore, the amount of compensation may not exceed what is necessary to cover the costs connected with the execution of the SGEI mission concerned. Member States must also provide for checking mechanisms to ensure that there has been no over-compensation. In rather general words the Commission sets out how it will use its powers under the state aid regime in SGEI cases. Like the 2005 Decision, the added value of the Framework to the *Altmark* ruling may be called into question. Consequently, the framework does not shed sufficient light on the role that universal coverage cover may play at the justification stage.

In November 2007 the Commission launched its new single market strategy.[73] One of the documents accompanying this strategy addresses state aid - the 'frequently asked questions on state aid and public service obligations' (hereafter "FAQ").[74] It aims at clarifying the *Altmark* approach. Fortunately, this document provides some important and clear remarks on the way the 2005 Decision of the Commission should be interpreted. It is stressed that, unlike the *Altmark* ruling, the Decision does not require the definition of the amount of the compensation through a public procurement procedure or by comparison with the costs of a well run company. It is sufficient that the compensation is not higher than the net costs connected with the execution of the PSO (no overcompensation). Furthermore, it is stated that the SGEI mission may be described by broad definitions. In this respect, however, it is important that the entrustment allows the correct allocation of costs between SGEI and non-SGEI activities. If it is difficult to estimate all costs, the public authorities of the MS are allowed to apply an *ex post* correction or to update the act of entrustment. It suffices that the act of entrustment includes the basis for the future calculation of the compensation.

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71 V Hatzopoulos, op cit, n 47, p 244.

72 Community framework of the Commission for State aid in the form of public service compensation, OJ 2005, C297/4 .

73 See the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - A single market for 21st century Europe, COM(2007) 725 final. See for further information the next Internet site: http://ec.europa.eu/internal_market/strategy/index_en.htm

74 Frequently asked questions on state aid and public service obligations, 20 November 2007, SEC (2007) 1516.

The FAQ sheds more light on the interpretation of the Decision on public service obligations. However, due to the loose application of the *Altmark* conditions by the CFI, it remains unclear whether national compensatory measures falling within the scope of the FAQ would also benefit from the *Altmark* approach. In this regard, it should be noted that in *BUPA* the CFI also moderated the fourth *Almark* condition (costs of a well run company), like the Commission did in its FAQ in 2007.

All in all, the Community rules governing national compensation measures regarding hospitals are in limbo, as the approaches developed on the EU level contradict each other. Consequently, relying on the *Altmark* approach in order to justify financial benefits granted to hospitals is a dangerous matter. After all, financial advantages that turn out not to be in line with the *Altmark* conditions, must be recovered. It goes without saying that this would put the proper functioning of the hospital network of Member States under enormous pressure.

Member States can, therefore, only avoid legal problems, by notifying their compensatory hospital measures to the Commission. A good example of this approach is the Irish case on financial support and hospitals.[75] The Irish government had introduced a system of capital allowances for investors in hospitals. The Commission not only contended that the Irish government complied with the standstill obligation by notifying this scheme[76] but also put forward that the Irish system concerned did not influence intra-Community trade as it mainly served the local hospital market (where a clear undercapacity existed).[77] However, the author of this paper cannot help thinking that the notification of the Irish system of capital allowances is exceptional and that the vast majority of the financial advantages granted to hospitals has never been made subject to notification procedures. It is to be hoped that despite the lack of clarity of the Community rules on public service compensations these financial advantages do meet the *Altmark* conditions.

7. CONCLUSIONS

The driving force behind the CFI and the Commission decisions on the application of the European State Aid rules to health care cases is universal coverage. The point of departure for this application is the *Altmark* approach that is based on the concept PSO, which is closely related to the need to provide universal coverage. In cases like *BUPA* and *Zorgverzekeringswet* this concept and the notion of SGEI missions have inspired the CFI and the Commission to take due account of health care interests and the competences of the Member States to organise and finance health care. In legal doctrine it is even argued that *BUPA* is a potential step forwards reworking the

75 Decision of the Commission of 27 February 2002, State aid No 543/2001 Ireland-Capital Allowances for Hospitals.

76 Para 23, ibid.

77 Para 20, ibid.

Community model of competition to include elements of solidarity.[78] The concepts of SGEI and PSO can play an important role in health care.[79] Hence, health care concerns are integrated into the way the CFI and the Commission apply Articles 87-89 EC. However, it must be noted that so far the ECJ has not delivered a judgment that clearly settled disputes resulting from tensions between health care objectives and state aid.

Is the EU approach towards health care and state aid fully satisfactory? It could be argued that the jurisdictional approach of the concept undertaking is relatively well developed. This concept gives the Community Courts enough possibilities to accommodate concerns of universal coverage (in relation to solidarity) in the application of the State Aid rules. In contrast, there is one major issue: the simple approach of the concept undertaking towards healthcare providers is not consequent. Hospitals and other providers operating in a solidarity based (legal) framework are undertakings and financial support granted to them must be notified, whereas financial benefits given to managing bodies that administer the schemes of the framework concerned are not subject to the European state aid rules. However, this inconsequent approach will not interfere with the objective of universal coverage, as long as the managing bodies concerned are not engaged in economic activities. Member States may grant financial resources to managing bodies in order to ensure that all patients have access to the necessary health care benefits. Subsequently, the managing bodies concerned purchase health care services from hospitals and other providers for their affiliated persons. As the flow of funds from the managing bodies to the health care providers are payments for the services provided to the affiliated persons, this flow does not amount to state aid within the meaning of Article 87 EC. As result, the objective of universal coverage is achieved without violating the Treaty provisions on state aid.

Unlike the case law on the concept of undertaking, the application of the jurisdictional *Altmark* approach to health care cases is confusing and ambiguous. The Commission departs from a strict reading of the *Altmark* conditions, whereas the CFI has adopted a lenient approach. So, in EU law there is no coherent view on how to apply the *Altmark* conditions in health care cases. This lack of coherence is not in line with the point of departure formulated by the ECJ in free movement cases such as *Hartlauer*, *Apothekerkammer des Saarlandes* and *Commission v Germany*. In these cases, the ECJ argued that Member States have a considerable margin of appreciation in organising national health care as long as their national legislation attempts to realise the health care objectives that are at play in a consistent and systematic manner.[80] Unfortunately, Member States cannot be sure that financial interventions that are based on a consistent

[78] M Ross, 'A Healthy Approach to Services of General Economic Interest? The BUPA Judgment of the Court of First Instance' (2009) 34 ELRev 140.

[79] See in this respect also A Cygan, 'Public Health Care in the European Union: Still a Service of General Interest?' (2008) 57 ICLQ 555.

[80] See paras 48-71 of Case C-169/07, *Hartlauer*, 10 March 2009, n.y.r., paras 19 and 27-60 of Joined Cases C-171/07 and C-172/02, *Apothekerkammer des Saarlandes and others*, 19 May 2009, n.y.r., and paras 46-63 of Case C-141/07, *Commission v Germany* [2008] ECR I-6935.

and systematic design will be found in accordance with Articles 87-89 EC. After all, the Community rules on state aid and health care are themselves not consistent and systematic.

It is necessary that the approaches of the CFI and the Commission are reconciled. In this writer's view, a weak point in the reasoning of the CFI is that SGEI missions and PSO may be derived from general obligations laid down in national legislation. As a result, Member States may be tempted to give financial support to all kinds of health care operators without articulating the special tasks concerned. As this may distort competition, the CFI should consider formulating stricter conditions with regard to the condition of entrustment of a SGEI mission (and a PSO). Hopefully, in future judgments the ECJ will again stress the necessity of a clear and transparent entrustment of such a mission, as soon as it is confronted with a case on state aid and health care. The advantage of such a decision would be that Member States are obliged to develop an articulated state aid policy regarding SGEI/PSO and health care. After all, not all health care services amount to SGEI/PSO. National laws that merely oblige enterprises to respect certain conditions but that do not impose any duty upon them, cannot amount to the entrustment of a special task.

On its part, the Commission could consider not interpreting the fourth *Altmark* condition in a dogmatic way but taking into account the specific health care context. This would imply that as long as the national compensatory measures do not lead to offsetting costs resulting from inefficiency, the fourth *Altmark* criterion is met. Under such an approach the Member States would have more leeway in financing their health care systems - which is in line with Article 152(5) EC - whereas considerable competition distortions are not likely to occur since funding inefficient health care operators is not allowed. By stressing the point that national measures may not lead to compensation of inefficient undertakings (and by not requiring that only cost-efficient companies may benefit from these measures), the Community institutions would give room to the Member States to build in their health care schemes concerns related to the quality of the services provided to patients (apart from efficiency objectives).[81] It goes without saying that such an approach would foster access for all to high quality care.

In any event, as long as the Community institutions put forward differing views as to how the concepts of SGEI and PSO should be interpreted, the compatibility of national financing health care measures (aiming at realising universal coverage) with Community law is at stake. It could be argued that Member States that have opted for a market oriented health care system are 'punished' for this choice, as they are disconcerted by the differing views put forward by the Community institutions and do not know to what extent they are allowed to make use of financial interventions. Moreover, even Member States that have not opted for such a system have to face uncertainty, since financial support given to health care providers such as hospitals falls within the ambit of Articles 87-89 EC.

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[81] Cf. R van den Esschert, 'Valt het risicovereveningssysteem daadwerkelijk onder de reikwijdte van het staatssteunverbod van artikel 87 lid 1 EG?', Master Thesis, Nijmegen 2009, p 86.

It is time that action is taken at EU level in order to clarify the concepts of SGEI and PSO in relation to national financial health care interventions The Commission will evaluate its *Altmark* package.[82] An important aspect of this review should be how to integrate the CFI's views with the Commission's opinion. It could be considered laying down a mitigated interpretation of the fourth *Altmark* condition (the requirement of the well-run company) in the revised *Altmark* package but holding on to the requirement of the explicit entrustment of a SGEI mission (or a PSO).

Additionally, Member States should consider anticipating the importance of this requirement, which implies that they must designate SGEI missions and PSO in a clear and transparent way. So, it is also time that action is taken at the Member States' level. Member States should also contribute to the development of the concepts of SGEI and PSO in health care. They have to point out which health care services their inhabitants should have access to.[83] National legislators should define precisely the public interests involved because the concepts of SGEI and PSO are limited to what is necessary (principle of proportionality).[84] This implies, at least in this writer's view, that national legislation must clearly specify which health care services fulfil an essential function in modern society.[85] This could entail a change in the settled practice of how health care is regulated in (some) Member States. National legislators are forced to decide in advance which health care services have to be provided in a market-oriented setting and which services must be sheltered from market-driven forces. It is inevitable that this will lead to Europeanization of some significant aspects of the national health care organisation of the Member States. After all, national legislatures should model national health laws in line with the special features of SGEI and PSO.[86] But the other side of the coin is that the Member States will remain competent to finance particular health care services without intervention on the part of the Commission.

To conclude, universal coverage is at the heart of the way the European State Aid rules deal with health care. The approaches developed at EU level take concerns related to universal coverage into account. But these approaches suffer from disease and must, therefore, be cured in order to prevent health care systems suffering from bad health.

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[82] Pursuant to Article 19 of the 2005 decision on state aid and SGEI the Commission must undertake an impact assessment with regard to the *Altmark* package by 19 December 2009 at the latest.

[83] Hatzopoulos points out that Community law may give rise to a shift from defining the scope of a health care system to defining health care services of general interest. See V Hatzopoulos, op cit, n 47, pp 241 & 251.

[84] W Sauter, 'Services of general economic interest and universal service in EU law' (2008) 33 ELRev 193.

[85] See JW van de Gronden and JJM Sluijs, De betekenis van het EG-Verdrag voor het reguleren van de zorgmarkt (The consequences of the EC Treaty for regulating health care markets), Preliminary report for the Dutch Health law Association (Vereniging voor Gezondheidsrecht), The Hague, 2009, pp 180 and 181.

[86] See also V Hatzopoulos, 'Financing National Health Care in a Transnational Environment: The Impact of the European Community Internal Market', 26(3) Wisconsin International Law Journal 788, (2008-2009).

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Reducing Carbon Emissions in the Electricity Sector: a Challenge for Competition Policy Too? An Analysis of Experience to Date and Some Suggestions for the Future

*Daniel Wilsher**

DG Competition has persistently advocated externality pricing (through measures like the Emissions Trading Scheme and tradable green certificates) over subsidies to renewable energy suppliers to tackle carbon emissions. The evidence thus far is that these shadow market methods, as implemented to date within the EU, have not incentivised large scale investment away from fossil fuels but rather have bestowed anti-competitive windfall profits on incumbents. On the other hand, DG Competition has been hostile to national price supports for renewable energy on the basis that they are distorting subsidies. There is evidence which suggests however that these feed-in tariffs provide more and cheaper renewable power than shadow market tools. The EU's 2020 ambitious target of obtaining 20% of all energy (not just electricity) from renewables means that most new and replacement grid capacity will have to be sourced from renewables, nuclear or clean coal. However the recent Renewables Directive largely entrenches the fragmentation of the EU renewable energy market arising from the existence of separate national support schemes. In *Preusseneleketra* the European Court of Justice ruled that feed-in tariffs were not state aid and so DG Competition has limited legal powers to shape Member State policy in this area. Given the sunk costs involved, some form of long-term price security for renewables (along with nuclear and clean coal) is essential. This will require much greater state involvement in energy markets and the liberalisation trend will be reversed.

1. Introduction and Overview: The Interconnections Between Competition Policy and Carbon Emissions

The relationship between EU competition law and the growth of low-carbon electricity is a complex one. At first sight, the role of competition policy is to deliver electricity at the lowest cost to consumers without close regard to environmental side-effects. Carbon emissions are in principle the responsibility of other agencies. Thus, whilst DG Environment was developing the Emissions Trading Scheme ('ETS') to deal with carbon emissions, DG Competition and DG Energy were pursuing a liberalising agenda for the energy sector to lower prices for consumers. It is a primary argument of this paper that there are close connections between the two policy areas and that these need to be better understood in order to promote both emissions reduction and the welfare of consumers. As we shall see below, the design and execution of the ETS provided huge subsidies to traditional power generators (using fossil fuels) that were highly anti-competitive and should have attracted competition concerns. Furthermore,

* Senior Lecturer in Law, City University, London. The author would like to thank Dr Angus Johnston of Cambridge University for his helpful discussion and guidance, Dr Anthony White for his inspiration and Professor Dieter Helm for his writings.

the liberalisation agenda in energy markets drove firms to compete on short-run costs of production by switching between different carbon-intensive production methods rather than investing in renewables. Both EU environmental and competition policy have however promoted the use of market instruments that seek to use short-run costs (including volatile spot energy, carbon permits and tradable green certificates for renewable energy producers) to influence investment behaviour. In fact, in the context of persistent market power, energy producers have largely passed on the (low) carbon price or simply switched between different, more or less, carbon-intensive fuels depending upon prevailing relative prices. As a result, large-scale renewable investment has not been stimulated by these innovative market-based systems. The causes are complex but the price volatility and degree of political and technical risk appears to be too great to tempt investors into the market on the scale required.[1] Rather, large-scale renewables have emerged in Member States providing long-term feed-in tariffs paid for by suppliers and ultimately consumers.

Turning to the future, the extremely ambitious target set by the EU of producing 20% of energy (not simply electricity) from renewable sources by 2020 will require unprecedented investment to generate 35%-40% renewable electricity. If the target is met, the 'liberalised' EU electricity market will actually be based on a patchwork of national renewable schemes. There are obvious dangers of protectionism and market distortion in this. Purely national schemes for renewables cannot be reconciled with free movement of goods or competition in a liberalised electricity market. The influence of EU competition policy over national renewable schemes was however rebuffed by the landmark European Court of Justice judgment in *PreussenElektra*.[2] The recent Renewables Directive[3] does little to integrate the respective national schemes. We thus have the odd prospect of the key driver of the EU electricity markets in the years ahead being distinctly hostile to the single market. Electricity markets are likely to remain or become even more partitioned along national lines. This represents a great challenge for competition policy in the EU. DG Competition and Energy need to urgently find new ways to reconcile liberalisation, emissions reduction and financial support for renewables. This paper will explore the relationship between competition policy and carbon emissions to date and suggest what this means for future policy-making in this field.

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1 There are a number of studies comparing short-term market-based incentives as against long-term incentives. See C Mitchell and D Bauknecht et al, 'Quotas versus Subsidies – Risk Reduction, Efficiency and Effectiveness – a Comparison of the Renewable Obligation and the German Feed-In Law' (2006) 34(3) Energy Policy 297-305.

2 Case C-379/98 *PreussenElektra AG v Schleswag AG* [2001] ECR I-2099.

3 Directive 2009/28/EC of the European Parliament and of the Council on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, OJ 2009, L140/16.

2. REDUCING EMISSIONS AND ELECTRICITY MARKETS: FOR PRESENT OR FUTURE CONSUMERS?

To reduce carbon emissions energy must be produced from low or non-carbon sources. In the field of electricity generation, the potential for reduction in emissions is still large in Europe because of the widepread use of coal, gas and oil alongside low carbon alternatives such as wind, wave, solar, biomass, nuclear and hydro-power. There has been wide consensus that the role of government in this should primarily be to create market conditions that send the 'right' price signals to investors, producers and consumers to make this switch to low carbon electricity as soon as possible. The pattern of long-term investment in plant, transmission networks and research and development needs to shift urgently if European and global targets are to be met.

An appropriate regulatory regime within the electricity sector needs to ensure that either 'dirty' producers are no longer able to compete without paying for the costs of their pollution and/or that 'clean' producers are able to charge more than the market electricity price for their positive contribution to environmental protection. The issue can therefore be located within the traditional economic framework of 'externalities' (to price pollution of the environment) and 'subsidies' (for protection of the environment). The aim should be to ensure that there is a rapid move to a low-carbon electricity industry which is achieved at lowest cost to industry, taxpayers and ultimately *future* consumers. Because of the ability of markets to price effectively and deliver innovation, both DG Energy and DG Competition have consistently favoured market-based approaches to reducing carbon emissions over state determined subsidies.[4]

The issue is complicated however by the intensive liberalisation programme in the EU electricity markets. DG Energy at the Commission has sought to create a single market in electricity and gas with a view to reducing prices and improving service for *present* consumers. This well-advanced programme was begun long before the decarbonisation objective emerged in EU policy-making. The structures and incentives created by the liberalised market were designed by DG Energy largely from an internal market perspective without much consideration of environmental issues. This was partly based upon a belief that an EU-wide carbon tax was imminent which would begin to tackle the emissions issue by fiscal rather than regulatory means.[5] The failure to create a single EU energy tax has led to rising emissions as market liberalisation has driven down prices for electricity derived from fossil fuels. There is now an uneasy relationship between the liberalisation agenda and that of carbon reduction which mirrors a conflict between the interests of present and future consumers. This sense of conflict is

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[4] European Commission (1996) Green Paper for a Community Strategy – Energy for the Future: Renewable Sources of Energy, COM (96) 576, 19 November at pp 34-5. The Commission noted the importance of aiming for a Community system of tradable green certificates which would set a market price for carbon and remove the distortions inherent in national renewable schemes. The paper suggests an EU energy tax as the most desirable system for internalising costs of carbon emissions.

[5] European Commission (1996) Green Paper for a Community Strategy – Energy for the Future: Renewable Sources of Energy, COM (96) 576, 19 November, p 13.

however becoming less significant for two reasons. First, current economic analysis suggests that early investment will lead to huge savings for consumers in the medium and long-term.[6] Second, given the near-consensus on the need to tackle climate change urgently and the plethora of measures and targets for increasing renewable energy output, present consumers are inevitably going to face higher costs. Increasingly the real debate will be around how best to achieve the necessary cuts in emissions in the most competitive manner possible.

3. COMPETITION POLICY AND EMISSIONS REDUCTION: THE STORY SO FAR

It is clear that the primary goal of competition policy is to promote the welfare of consumers. This said, the growing importance of climate change to EU policymakers suggests that competition policy should also consider what kinds of regulatory policies might promote the most efficient (from the point of view of consumers) shift to a low carbon economy. If the market structures and incentives are wrong then consumers may end up paying much more for their renewable energy than would otherwise be the case. This is no longer a marginal part of the energy market and will come to form the bulk of energy supplied in years ahead. We can assess the history of competition policy in relation to carbon emissions by looking at three key areas: the lack of effectiveness of the Emissions Trading Scheme ('ETS') to properly price carbon externalities, the free allocation of ETS permits to fossil fuel producers and the issue of national subsidies for renewables.

3.1. The Externalities Approach and the ETS: a Failure to Incentivise Low Carbon Electricity

The economics of carbon reduction are in principle relatively simple. If we think carbon dioxide is an externality then we need to find a 'price' to put on this to stop firms undercutting through pricing below their true costs (including environmental costs). Thereafter the firms can compete on the basis of efficiency and innovation. DG Competition has consistently favoured this approach as expressed in its recent 2008 Guidelines on state aid for environmental purposes where it locates the issue very much in the competition context saying where 'undertakings can avoid bearing the full cost of the environmental harm arising from their activities … the market fails to allocate resources in an efficient manner'.[7] The Commission suggests that 'these negative externalities can be tackled by ensuring that the polluter pays for its pollution

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[6] One difficulty however is that of the time-frame over which the costs of transition are assessed. The Stern report made a persuasive case that high capital investment now will yield the lowest-cost solution in the long-term. To this extent however the maximization of *current* consumer welfare, the traditional role of competition policy, is inconsistent with environmental protection (and *future* consumer welfare). This leads to the question of what kind of model of competition is appropriate in order to maximize emissions reduction. The relevant time-frame may need to be sufficiently long to take account of long-term cost savings to future consumers through early deployment of capital. N Stern, *The Economics of Climate Change*, 2007, Cambridge University Press.

[7] European Commission (2008) Community Guidelines on State Aid for Environmental Protection, OJ 2008, C82/1, Recital 7.

… [f]ull implementation of the PPP [polluter pays principle] would thus lead to correction of the market failure'.[8] In most cases the state does not have to set prices, outputs or calculate subsidies but only find a measure of environmental cost and set a tax accordingly or allow a carbon market to do so. The Commission guidelines do recognise however that the PPP may in practice be impractical if the cost of pollution is hard to calculate or because imposing the full cost may lead to a sudden price shock. In these narrow cases, a subsidy may be appropriate but the guidelines emphasize that this must only occur where both (a) a higher level of environmental protection can be achieved than by the externality approach and (b) the positive environmental effects outweigh the negative effects in terms of distortion of competition.[9] It is clear then, from DG Competition's perspective that '[t]he PPP remains the main rule and State aid is in fact a second-best option'.[10]

This approach is emphasized by the European Emissions Trading System[11] which in principle moves the electricity market towards the internalisation of carbon costs by placing a limit on emissions and requiring firms to hold permits to emit. Emissions above their permitted levels must be paid for by buying extra permits. The ETS Directive was introduced in 2005 at such speed that it did not suggest that it would be well-conceived from a competition perspective.[12] Member States did not wish to burden their industries with heavy costs and so they ensured that 95% of permits had to be given away free according to previous emission patterns ('grandfathering'). They were also able to bargain with the Commission over their overall level of emissions through National Allocation Plans. There was further discretion in allocating the permits between firms depending upon the type of fuel employed and also depending upon how long they had been in the market. The price of emissions permits has been volatile and eventually fell very low when it became clear that too many permits were issued. The impact of the price signal from carbon permits was intermittent and weak so that energy companies did not invest heavily in renewables based upon it. More commonly, companies simply switched between different fossil-fuel sources and different plants depending upon the relative price of carbon, gas and coal. Carbon pricing did not stimulate competition between generators to develop more clean technology or even to install existing technology.[13] This was partly a result of the particular design of the scheme but it illustrates how grave the difficulties with the PPP method can be in practice. DG Competition's favoured method of delivering

[8] Recital 8.

[9] Rectital 6.

[10] Recital 24.

[11] Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC.

[12] For a detailed assessment of the first phase see J Sepibus, 'The European emission trading scheme put to the test of state aid rules,' NCCR trade regulation, Working Paper No. 2007/34, September 2007.

[13] R Betz and M Sato, 'Emissions trading: lessons learnt from the 1st phase of the EU ETS and prospects for the 2nd phase' (2006) 6(4) Climate Policy 351-359.

reductions in environmental externalities has not proved very effective in reshaping competition in the electricity sector so far. Amendments to the ETS (discussed below) will begin to correct some of these problems but not all of them, particularly the volatility of the carbon price which is a major source of uncertainty for investors.

Interestingly, the idea that the ETS is a kind of PPP scheme that aims to protect competition by internalising the 'externalities' of higher emitting producers has been rejected by the recent Grand Chamber ECJ decision in *Arcelor*.[14] Here steel firms challenged their inclusion in the ETS when large-scale chemical companies also producing emissions were excluded. They argued they were suffering discrimination by being included because there were areas of the market in which their products were in competition with chemical producers. The Commission accepted that the ETS should be interpreted as being designed to create a level playing field as between industrial competitors by internalising emissions costs but argued that on the facts there was no competition between the two sectors and therefore no discrimination. In an important ruling, the ECJ rejected the Commission's interpretation of the nature of the ETS scheme. It held that similar emissions levels rendered the firms 'similar' - not the degree of competition between them.[15] It was thus prima facie discriminatory to exclude from the ETS industries with similar emissions levels to that of the steel industry. There was no need for competition between industries to bring them under the ETS as, according to the Court, the aim of the scheme was to reduce emissions, not to eliminate unfair competition. Whilst the Court accepted that competition to reduce emissions most cheaply was the logic driving the ETS, this competition did not have to occur between industrial competitors. The ECJ thought of the competition as of the 'virtual' kind, occurring in the carbon-permit market such that those companies which found it cheaper to reduce emissions would be able to sell permits to those for whom reductions were more expensive. The *Arcelor* approach to the ETS suggests that EC competition law may not be invoked by renewable energy producers who complain of unfair treatment where competitors with high carbon emissions are given free permits under the ETS. We now turn to discuss this issue in more detail.

3.2. The ETS as State Aid: the free allocation of permits to traditional power generators and windfall profits

The problem of volatile and low carbon prices failing to stimulate investment in renewables has been noted. Worse still, from a competition perspective, is the fact that economic research has shown that the price of carbon under the ETS has also been added to retail prices by emitters - in many cases without loss of market share. This large element of pass-on arose from the low level of competition in the energy markets which remained dominated by large national monopolies.[16] The fact that the ETS

[14] Case C-127/07 *Societe Arcelor Atlantique et Lorraine and Others v Premier Ministre, Ministre de l'Ecologie et due Developpement durable, Ministre de l'Economie, des Finances et de l'Industrie* [2008] ECR I-9895.

[15] Para 36.

[16] The liberalisation of access to the grid and distribution networks clearly has a role to play. Increased competition from new entrants (including renewables producers) might prevent this 'pass-on'. Hitherto

produced windfall gains for electricity producers using fossil fuels has attracted critical comment as to why DG Competition did not pursue state aid investigations into the matter.[17]

The idea that emissions permits were state aids was actually proposed by the Commission in relation to a *national* scheme in the *Dutch NOx* case in 2004.[18] The argument was accepted in principle but ultimately rejected on the facts by the Court of First Instance. The case concerned a national emissions trading scheme that was introduced by the Netherlands to meet its EU target for reducing nitrous oxide emissions. 250 large plants across a range of types of producer were chosen to participate. The scheme was notified to the Commission which concluded that the tradable nature of the permits meant they were state aids because they were given away by the state rather than sold. The Dutch government challenged this assessment before the Court of First Instance. The CFI made several important findings. It held first that the permits had a tradable value and were a transfer of state resources. Importantly they rejected the argument that because the overall scheme imposed additional new costs of emission abatement upon firms it could not be a state aid. They thus analysed the free permits separately from the rest of the scheme. However the CFI found that because the scheme covered a wide range of different types of firm the transfer of resources was not selective in such a way as to distort competition. The firms were chosen only by reference to the level of their emissions. There were no competing firms in identical factual and legal situations not covered by the scheme. Other firms were in fact not subject to abatement obligations and so the CFI found they could not be said to have been disadvantaged because they did not have to bear the costs of abatement felt by firms in the scheme.[19]

Although not decisive, this ruling suggests that attempts to challenge the EU ETS on the basis that the free allocation of permits represents state aid will fail. The ETS covers a wide range of sectors and its basic reference point is the 'installation' which is defined by size of emissions. This fits with what the ECJ decided in *Arcelor* that the scheme looks at the level of emissions from plants not particular industries. It does not therefore appear to 'select' in such a way as to benefit particular competitors. This is a serious problem from the perspective of no-carbon producers who are not covered by the emissions trading scheme or any other scheme. They are therefore not in a similar

however low carbon prices, lack of grid access and other market access barriers have prevented effective competition from renewables or other producers.

17 A Johnston, 'Free Allocation of allowances under the EU Emissions Trading Scheme-legal issues' [2006] 6 Climate Policy 115-136.

18 Case T-233/04 *Kingdom of Netherlands and Federal Republic of Germany v Commission* [2008] ECR II-591.

19 This argument is open to a number of objections the most obvious of which is that the permits could be sold on the open market for more than the cost of abatement. Thus the firms receiving them actually could make profits from their sale which firms not given permits could not. See J Sepibus, 'The European emission trading scheme put to the test of state aid rules,' NCCR trade regulation, Working Paper No. 2007/34, September 2007, 10-13.

position legally and factually. At first sight, they cannot therefore argue that there has been a selective advantage given to fossil fuel producers.

The argument against this conclusion stems from the pass-through evidence which suggests that fossil fuel producers with sufficient market power actually received windfalls from free permits. This indicates that giving free permits to polluters allowed them to increase their profitability by continuing to pollute and passing on the opportunity costs of not having sold their free permit.[20] This result stems from economic theory.[21] This suggests that firms exercise a choice about whether to sell the free permits or use them; by using them they lose the revenue they would have gained from selling the permits. This is an opportunity cost and was added to the price of the electricity produced. The fact that they were competing with low-carbon producers and gained an advantage from being placed in the trading scheme suggests that the issue of state aid is quite significant. The decisions in *Dutch NOx* and *Arcelor* fail to recognise this aspect to the problem because they focus solely upon the emissions constraints imposed upon the participants in any scheme. In fact, giving free permits to firms with market power appears to give them supra-normal profits as compared to the non-emitting firms/installations in competition with them. This also sends the wrong incentive signal to firms - to continue with fossil fuel inputs. It is strongly arguable that DG Competition should have begun enforcement action to challenge the free allocation of permits where this facilitated incumbent firms taking windfall profits. Until full auctioning of permits begins the distortion of competition (and consequent consumer harm) remains in place.

The more straightforward case of individual fossil fuel generating firms which are included in the ETS challenging particularly generous permit allocations to rivals also under the ETS have all failed on the ground of lack of standing. The leading case is that in *EnBW Energie Baden-Wurttemberg v Commission*.[22] It is clearly more easily arguable when both firms are in the ETS that relatively abundant free permits to one give a selective advantage over a rival given fewer permits. This would overcome the objection of the CFI in the *Dutch NOx* case as to the appropriate comparator being a firm also subject to emissions restrictions. The Commission has not however chosen to take any action against Member States on this basis so far but it seems a clear legal argument in principle.

The fact that the ETS in its first phase led to higher prices and windfall profits for polluting companies has been widely recognised if not the arguable violation of EU

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[20] K Neuhoff and M Grubb, 'Allocation and Competitiveness in the EU Emissions Trading Scheme: Policy Overview,' (2006) 6(1) Climate Policy 7-30. J Sijm, K Neuhoff, C Yihsu, 'Cost Pass Through and Windfall Profits in the Power Sector,' (2006) 6 Climate Policy 49-72.

[21] P Krugman, R Wells And K Grady, *Economics* (2008, Worth, New York) at 7.

[22] Case T-387/04, [2007] ECR II-1195. The court held that the Commission decision did not directly concern the applicant. The Member State had discretion as to which rules to adopt under its National Allocation Plan. The Commission decision is only one of guidance which the Member State need not act upon. The challenge should therefore be to the Member State not the Commission. See also Case T-130/06 *Drax Power and Others v Commission* [2007] ECR II-67 and Case T-489/04 *U.S. Steel Kosice v Commission* [2007] ECR II-127.

state aid rules this entailed. The forthcoming phase III requires full auctioning of permits to the electricity companies.[23] This should stop the windfall profits. There is however still a possibility of producers offsetting a large proportion of their emissions externally under the Certified Emissions Reduction ('CER') scheme set up under the Clean Development Mechansim of the United Nations Framework Convention on Climate Change.[24] This may lead to a lower carbon price under the ETS and also provide very cheap offsets for fossil fuel producers. The experience with the ETS under Phases I and II suggests that the competition authorities should be looking very closely at the operation of the carbon markets and the allocation of permits in the years ahead. Carbon pricing and allocation of permits and offsets should become a central concern of DG Competition and DG Energy in order to create genuine pressure to internalise the cost of emissions.[25] Emissions reductions schemes should be closely monitored to remove perverse incentives that may be anti-competitive. Above all, the establishment of a stable carbon price floor (effectively a tax) should be a clear policy goal for the EU electricity market.

3.2. Subsidies for renewable energy: the hostility and ultimate exclusion of EC competition policy

The gap between market prices for carbon emitting energy and renewables remains significant, although much depends upon the spot prices for oil, coal and gas. Since 1990, Germany has pioneered 'feed-in tariffs' to bridge this gap.[26] This allowed higher prices to be guaranteed to renewable energy producers which covered all the extra costs of production plus a return on capital. The state simply set a long-term price – usually over 20 years – and required power distributors to pay this to producers. Eventually the growth of the scheme was costly enough to attract criticism from the large German utilities and DG Competition under state aid rules.[27] The Commission favoured a quota scheme linked to tradable green certificates.[28] This would require renewable producers

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[23] Directive 2009/29 of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community.

[24] See above Article 11a.

[25] See the hitherto very benign view taken by the Commission of trading schemes where it says that so long as 'the global amounts of permits granted … is lower than the global expected needs…the overall effect on the level of environmental protection will be positive'. As to state aid, it says merely that no 'over allocation of allowances can be justified and provision must be made to avoid undue barriers to entry'. European Commission (2008) Community Guidelines on State Aid for Environmental Protection, OJ 2008, C82/1, 1.5.11. This fails to provide strong or clear limitations upon the allocation of free permits.

[26] The German schemes varied over time and initially began as a guaranteed payment of 90% of the retail price for electricity. This was later varied to a fixed price differentiated by technology with wind prices being much lower than solar.

[27] For an excellent history of the German schemes and the Commission's hostility see V Lauber and L Metz, 'Three Decades of Renewable Electricity Policies in Germany' (2004) 15(4) Energy and Environment 599-623.

[28] See European Commission (2001) 'Community Guidelines on State aid for environmental protection' OJ 2001, C037, 03/02/2001 for the old guidelines which were replaced in 2008.

to sell their energy to the distributors at wholesale prices but receive the prevailing green certificate price on top. Feed-in tariffs committed the cardinal sin of state aid law by apparently giving 'operating aid' rather than more limited investment support. DG Competition gradually lost patience with the German schemes and intervened to support a legal challenge brought in Germany that was referred to the European Court. The challenge had great political significance because it pitted apparent free-market liberalism against a left/green alliance committed to state intervention in the context of environmental protection.[29]

In a landmark decision in *PreussenElektra* the European Court ruled against the Commission holding that such price guarantees as were offered by the German system were not state aids at all.[30] This followed the logic of earlier cases on state aids which required *state* resources to flow to the sector aided in order for this to be caught by Art 87.[31] Regulation of the market per se, even by setting prices paid to generators of renewables by distributors, was not state aid because the funds did not come from the state treasury. Whilst controversial, this gave the feed-in tariff model a safe harbour free from the opposition of DG Competition and it was adopted in many Member States over the green certificate system. It is clear that it has since been used as a powerful tool of industrial policy to promote the development of new industrial sectors that have generated employment and exports. The model has been widely viewed as successful by giving investors and purchasers of renewable generating technology price certainty over the long-term, leading to lower capital costs. This has expanded the market (which is unlimited) and reduced unit costs to approaching competitive levels in some instances.[32]

DG competition remains suspicious of such schemes despite the growing evidence that they appear to lead to greater deployment of renewables at lower cost. This resistance is not surprising as feed-in tariffs conflict with central assumptions of EU competition and liberalisation policy; setting prices is seen as likely to reduce pressure on both costs and innovation, leading to consumer welfare losses compared to other models. Furthermore, the schemes are entirely national; they do not reward foreign renewable energy and so appear directly discriminatory and in breach of the fundamentals of the single market. DG Competition has therefore (despite *PreussenElektra*) continued to review each feed-in scheme on the basis that they are in fact subsidies or barriers to trade which may be justified only on a case-by-case basis if they meet the rules of

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29 See D Toke and V Lauber, 'Anglo-Saxon and German approaches to neoliberalism and environmental policy: the case of financing renewable energy' (2007) 38(4) *Geoform* 677-682.

30 Case C-379/98 *PreussenElektra AG v Schleswag AG* [2001] ECR I-2099.

31 See C-72/91 & 73/91 *Slomm Neptun v Bodo Ziesemer* [1993] ECR I-887.

32 See A Johnston, A Kavali, K Neuhoff, (2007) 'Take-or-Pay Contracts for Renewables Deployment' (2007) Cambridge Working Papers in Economics No. 0723. See also C Mitchell and D Bauknecht, et al, 'Quotas versus Subsidies – Risk Reduction, Efficiency and Effectiveness – a Comparison of the Renewable Obligation and the German Feed-In Law' [2006] 34(3) Energy Policy 297-305. There are difficulties in drawing any general conclusions about competitiveness because much depends on prevailing fossil fuel prices, carbon permits, demand for renewables components and weather conditions at different sites.

proportionality. Interestingly the recent 2008 guidelines on state aid in environmental cases have tightly drawn rules on aid for renewable energy. These permit state aid up to 100% of investment costs but only where the aid was bid for in a transparent auction.[33] For operating aid, they also suggest tradable green certificate systems are compatible with state aid rules. Importantly, direct financial payments can only be made until the plant has been fully depreciated. The guidelines do not mention feed-in tariffs at all which remain outside the competition framework altogether despite providing what looks very much like operating aid on a long-term basis. Of course this may be DG Competition simply acknowledging the *PreussenElektra* holding that such schemes are outside the scope of Article 87 EC Treaty. Nevertheless, with the widespread adoption of such schemes across the Member States, DG Competition is in a parallel universe operating guidelines that do not have any relationship with what is actually happening in the Member States. When renewable energy was only a fraction of the total this was less significant; with the 2020 target however renewables are set to dominate the future of electricity production.

DG Competition urgently needs to come in from the cold here and rethink the approach to renewables. The best means would be to recognise that market mechanisms such as green certificates appear to be ineffective in present conditions (particularly with the ETS not providing a stable floor carbon price and with fossil fuel price volatility). DG Competition should endorse the long-term price certainty of the feed-in schemes but give guidelines which encourage Member States to follow more competitive approaches. One example is the use of competitive auction systems whereby the state invites tenders for low-carbon energy on long-term contracts. The auctions would have to be differentiated by technology to encourage more costly infant industries. This would give investors long-term pay-back without the state having to 'guess' the level of subsidy as under the feed-in system.[34] Such an approach is however inconsistent with an energy liberalisation policy that seeks to remove the state from the whole process of buying and selling electricity. The state will have to begin to take a more active role in commissioning energy in order to meet renewable targets at competitive prices and develop new technologies. Along with energy security concerns, this points towards a move back towards more state involvement (even planning) within the electricity market.

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[33] See Guidelines on State Aid for Environmental Protection at 3.1.6.1

[34] In fact, the UK adopted such an approach for several years which appears to have been successful in driving down prices but failed to call-forth significant wind capacity. The reasons for this failure are complex. See C Mitchell and P Connor, 'Renewable Energy Policy in the UK 1990-2003' (2004) 32(18) Energy Policy 1935-1947 and L Butler and K Neuhoff, 'Comparison of feed-in fariff, quota and auction methods to support wind power deployment' (2004) Cambridge Working Papers in Economics 0503. This does not mean however that differently devised schemes cannot be made to deliver capacity.

4. THE LIBERALISATION OF ELECTRICITY MARKETS: THE PROBLEM OF INTEGRATING RENEWABLES

The other key aspect of competition policy impacting upon emissions has been energy market liberalisation. Looking back to the early days of energy liberalisation it is clear that DG Energy was unduly optimistic about the prospects for renewable energy in a liberalised market.[35] Driven by a belief that wind power was about to become competitive and that an EU energy tax was imminent, the assumption was that renewables would benefit from the opening up of markets to new players.[36] There was however recognition that renewables perhaps still suffered from modestly higher costs and might remain uncompetitive for a time. This risk could increase with lower prices after liberalisation. The main tool to support renewables would be the possibility of a premium on top of the wholesale electricity price to reflect the environmental benefits of renewable power.[37] This would not however remove the exposure of renewables to the volatile nature of wholesale prices.

With these assumptions about competitiveness and energy taxes, the Commission vastly underestimated the financial support needed to reach ambitious targets for the growth of renewable energy from 14.3% to 23.5%.[38] Rather it believed that consumers would soon choose the cheapest energy from a range of sources, including renewables that would be competitively priced.[39]

This is not the place to provide a detailed review of the workings of the electricity market reforms.[40] The main point is to consider the principal effects of the new legal structures as regards lowering carbon emissions. The first Electricity Directive attempted to open up generation to competition without discrimination in favour of incumbents. In principle this would allow new renewable energy producers, along with other competitors, to enter the market having previously been legally excluded by authorisation schemes. There was also one specific provision made allowing Member States to give preference to the dispatch of renewables but not how this was to be

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35 For a survey of the evolution of Commission thinking see V Lauber (2005) 'The Politics of European Union Policy on Support Schemes for Electricty from Renewable Energy Sources' available at www.wind-works/lauber (at 22 September 2009).

36 European Commission (1996) Green Paper for a Community Strategy – Energy for the Future: Renewable Sources of Energy, COM (96) 576, 19 November, 13.

37 European Commission (1997) Energy for the Future: Renewable Sources of Energy. White Paper for a Community Strategy and Action Plan, COM (97) 599 final, 26 November 1997.

38 1997 White Paper 28-31. It estimates that only about 300 million per year would be required between 1998-2010 across the whole EU.

39 European Commission (1999) Working Paper: Electricity from Renewable Energy Sources and the internal electricity market, SEC (1999) 470, 13 April.

40 For a good summary see T Jamsasb and M Pollitt, 'Electricity Market Reform in the European Union: Review of Progress toward Liberalization and Integration,' (2005) Working Paper 05-003, Centre for Energy and Environmental Policy Research.

achieved in a manner consistent with competition law.[41] The second Electricity Directive[42] modified the first in ways that attempted again to improve access to the market for competitors. The principal method was unbundling vertically integrated network operators in terms of legal form. There were also better guarantees of grid access. The specific reference to renewables was limited but the increased power of Member States to intervene in the market to protect security of supply allowed them to give priority to renewables.[43]

There remain, however, serious barriers for renewables within the liberalised market structure as it stands. In a comprehensive review de Sepibus argues that liberalisation has failed to produce the modernisation of the grid and distribution systems to allow access by large numbers of small and medium sized renewable installations.[44] This would include the installation of 'smart' technology which is able to balance the variability of renewables supply with the shifts in demand. Thus, in conjunction with the failure of the ETS to price emissions adequately, renewables have not been able to benefit from the liberalised market without support from national policies, particularly feed-in tariffs.

During the early phase of liberalisation, the Commission was concerned about the compatibility of national renewable energy support schemes with the rules governing the single market. It thought the schemes should be harmonised because they were 'non-transparent, unstable and unpredictable' and 'a serious barrier to further market penetration'.[45] It was recognised that long-term investor confidence required a stable EU framework that a harmonized scheme would achieve. The Commission was clear however that this should be based upon 'market-based' schemes like renewable energy certificates and tenders rather than national feed-in tariffs set by the state. The latter were understandably seen as costly, damaging to competition and creating barriers to free movement of goods.[46] As discussed above, only energy produced within that

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41 Article 8(3) and Article 11(3) of the Electricity Directive 96/92/EC which allowed but did not require Member States to require system operators to give priority to dispatching installations using renewable energy for reasons of environmental protection.

42 Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ 2003, L176, pp 37-56.

43 Article 3(3).

44 For a detailed analysis see J de Sepibus (May 2008), 'The Liberalisation of the Power Industry in the European Union and its Impact on Climate Change', NCCR trade regulation working paper no. 2008/10, 48-51. The author explains that renewables suffer from the short-term cost pressure because of their capital intensiveness but also the degree of market dominance by traditional fossil fuel producers which still inhibits their access to markets. A further matter is the intermittent nature of renewables which attracts penalty balancing charges not felt by large-scale fossil fuel and nuclear producers under current grid rules.

45 European Commission (1996) Green Paper for a Community Strategy – Energy for the Future: Renewable Sources of Energy, COM (96) 576, 19 November at 17.

46 European Commission (1999) Working Paper: Electricity from Renewable Energy Sources and the internal electricity market, SEC (1999) 470, 13 April, 16-20. The Commission was relying upon evidence from the UK in which the tender price under the Non-Fossil Fuel Obligation ('NFFO') scheme had come down to apparently near competitive levels for wind energy.

Member State was eligible for feed-in tariffs which appeared to be directly discriminatory. Even after the *PreussenElektra* decision, the Commission could take encouragement from the apparently provisional nature of the court's decision on Article 28 EC. The court had talked about the difficulty of securing mutual recognition for renewable energy from other Member States and the fact that the liberalisation of the electricity market was only work in progress so that some obstacles to trade must remain for the time being.[47] This suggested that national schemes might be vulnerable to attack on Article 28 grounds in the future if a system of mutual recognition for renewable power could be agreed.

The remarkable fact is that despite first being proposed over ten years ago, there has been almost no progress toward integrating the market in renewable support schemes. In 1998, the Parliament proposed an EU-wide feed-in system for renewables that was innovative in proposing a single method of calculating the premium for renewables above the average price in each Member State.[48] Grid operators would have to purchase all certified renewable energy and be compensated by the government if their share was excessive. The important additional element was that the proposal allowed Member States to choose between feed-in per se or tenders for blocks of renewable supply. The proposal effectively endorsed the legality and efficiency of feed-in tariffs despite the strong opposition to them emanating from the Commission as discussed above. In the end the Parliament's suggestion was rejected by the Commission which was seeking to have the feed-in system declared illegal in the *PreussenElektra* case. After that case, the Commission was chastened as national schemes were left apparently untouchable under state aid law. As a result, a much more modest measure, the 'RES Directive'[49] was eventually passed in 2001. This simply required Member States to create objective, transparent and non-discriminatory criteria for designating energy as coming from renewable sources.[50] Energy produced according to these national standards should be given a guarantee of origin ('GO'). Each Member State had to confer mutual recognition upon each other's guarantees.[51] Crucially however there was

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47 See paras 76-81 of the judgment.

48 European Parliament (1998) Report on Network Access for Renewable Energies – Creating a European Directive on the Feeding in of electricity from renewable sources of energy in the European Union. Committee on Research, Technological Development and Energy; rapporteur R. Linkohr. A4-0199/98, PE 224.949.fin, DOC_EN/RR/354/354415, 26 May.

49 Directive 2001/77/EC of the European Parliament and of the Council on the promotion of electricity produced from renewable energy sources in the internal electricity market. The Directive did impose a requirement that the grid operators and distributors 'guarantee the transmission and distribution of electricity produced from renewable sources'. (Article 7(1)) The firms could however impose charges for this service under Member States required them to bear the costs. (Article 7(3))

50 Article 5.

51 This met the concern of the Court of Justice in *PreussenElektra* about the difficulty for Member States in satisfying themselves that imported renewable energy was produced according to appropriate standards. Although it is thus possible the European Court might revisit its conclusion on the Article 28 point in the light of harmonised Community standards requiring mutual recognition, it seems unlikely on political grounds that feed-in tariffs would be found illegal given their centrality to European energy policy on renewables.

no obligation to accept feed-in energy from other Member States or harmonise the substance of national support schemes.[52]

5. The 2008 Renewables Directive: The Rise and Fall of Trading in Renewable Electricity Guarantees of Origin

The most recent stage in reviewing energy liberalisation within the Commission converged with the climate change issue at the European Council in March 2007. This endorsed proposals for a new electricity Directive but also the 2020 targets on renewables. The Commission was then required to join the two issues together in a Strategic Energy Technology Plan ('SET-Plan') in November 2007.[53] This led to a new Proposal for a Decision to meet the 2020 targets which required amendments to the ETS, the RES Directive and a new Directive on Carbon Capture and Storage.[54] The Commission (and DG Energy in particular) had given up the idea of producing a single harmonized model for renewables support across all Member States because of the previous problems. The new RES Directive proposal did however initially include an important measure to require trading in guarantees of origin for renewable energy between both Member States and firms.[55] This would have meant that firms producing renewable energy in one Member State could sell the GOs to firms in other states. The price of GOs would be determined by the market and this might lead to higher production of renewables where it was cheapest to do so and the sale of the resulting GOs to places where it was more expensive to produce green energy. This would have been a significant integration of the renewable energy market (or at the least the GOs arising thereunder). Electricity suppliers could meet targets to surrender a given volume of GOs whilst green energy producers would gain a premium in the form of the sale of the GO. During the drafting debates, a system of tradable GOs was strongly supported by DG Competition on the basis that it would lead to more efficient deployment of renewables.[56]

The proposal for tradable GOs proved highly controversial and was eventually dropped after much lobbying by renewable producers, some large-scale energy consumers and

[52] For a discussion of how to harmonize feed-in tariffs see M Munoz, V Oschmann and JD Tabara, 'Harmonization of Renewable electricity feed-in laws in the European Union' (2007) 35(5) Energy Policy 3104-3114. For a comparison of different support mechanisms in the context of the debate on harmonisation see D Fouquet and TB Johansson, 'European renewable energy policy at crossroads – focus on electricity support mechanisms' (2008) 36(11) Energy Policy 4079-4092.

[53] COM (2007) 723. Adopted by the Council of Ministers on 28 February 2008, 6722/08 (Presse 45).

[54] COM (2008) 30.

[55] Proposal for a Directive of the European Parliament and of the Council on the promotion of the use of energy from renewable sources. COM (2008) 30 final. Articles 6-9. The proposed text did allow Member States to have a system of prior authorisation before permitting transfer of GOs on certain conditions being met.

[56] M Nilsson, IJ Nilsson, K Ericsson, 'Rapid turns in European renewable energy policy: advocacy and framing in the proposal for trading of guarantees of origin' (2008) Fridtjof Nansens Institute Report 9/2008.

Member States with feed-in systems.[57] There were a variety of concerns. Most prominent was the view that national support schemes would be undermined by trading in GOs.[58] This stemmed from the fear that firms with low production costs might simply sell their energy in neighbouring states along with the GOs if the combined price was more attractive than the feed-in tariff in their home Member State. This would have left the home Member State with increasingly expensive and less diverse renewable suppliers which would undermine taxpayer support for the schemes.[59] There was also concern that the system of GOs might simply provide further windfall gains to power producers (as the ETS had) – a view given some credence by the Commission.[60] This was because pricing for GOs might well be set by the most expensive marginal technologies (such as PV-solar). This would result from EU-wide demand for GOs outstripping supply and the market clearing at the most costly marginal prices. Other producers of energy would then simply set their prices to match those of this marginal cost (including the high GO price). The result might lead to higher electricity prices for all consumers than under the feed-in system where the price paid is technology specific.[61]

The demise of the trading of GOs shows that there is wide-spread resistance to any attempt to integrate national feed-in schemes, particularly because they are seen as politically and economically vulnerable in any trading system but also because of concerns that private actors (power firms and traders in instruments) will receive windfalls at the consumers' expense. The political support for national schemes comes from a number of factors including the success of the schemes in generating green energy but also the industrial policy advantages of supporting fledgling components industries supplying the renewable generators.[62] In the longer term the growth of renewables will become central to EU energy markets. The present position is that competition will not take place between power generators because the national support schemes are likely to remain separate. There will however be strong competition in the

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[57] Directive 2009/28/EC of the European Parliament and of the Council on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, OJ 2009, L140/16. See Article 15 which does not on the face of it require or permit the transfer of GOs between persons in different Member States. Member States are given an unfettered discretion to deny feed-in tariffs or other support to firms asking for GOs. Thus they can force firms to choose between feed-in or GO trading in their business models (Article 15(2)).

[58] M Nilsson, IJ Nilsson, K Ericsson, 'The Rise and Fall of GO trading in European renewable energy policy: the role of advocacy and policy framing' (2009) 37(11) Energy Policy 4454-4462.

[59] See K Neuhoff, A Johnston, D Fouquet, M Ragwitz and G Resch, 'The proposed new EU renewables directive: an interpretation,' 6th April 2008. Accessible at Cambridge Electricity Policy Research Group under 'Other Publications.'

[60] European Commission (2008) 'Impact Assessment: Document Accompanying Package of Implementing Measures for EU's Obligations on Climate Change and Renewable Energy for 2020.' Brussels, 23 January, SEC (2008) 85/3 at 12-13.

[61] D Toke, 'The EU Renewable Directive: What is the Fuss about Trading?' (2008) 36 Energy Policy 3001-3008.

[62] M Nilsson, IJ Nilsson, K Ericsson, 'The Rise and Fall of GO trading in European renewable energy policy: the role of advocacy and policy framing' (2009) 37(11) Energy Policy 4454-4462.

generating capacity and services markets with producers using free movement of goods provisions in the Treaty. This should drive innovation in reducing costs for established technology. The experience in Germany, Spain and Denmark so far suggests that feed-in tariffs have not produced ossification in the product markets where there has been strong competition between manufacturers that have congregated in these markets.

6. CONCLUSIONS

The theoretical ideal (in orthodox competition policy terms) of dealing with emissions by internalising externalities has not yet happened and is not likely to do so soon. The modest and volatile carbon price so far seen under the ETS has not stimulated investment in renewables. The scheme has however given windfall profits to dominant generators at the expense of consumers. Over the medium-term the ETS may begin to exert pressure of emissions more effectively although this is still subject of great uncertainty. There are two main potential sources of strong downward pressure on carbon prices: the possibility to buy off-sets under the Certified Emissions Reduction scheme and the large expansion in renewable energy itself.[63] In any event, DG Competition should favour a strong and consistent carbon price (with a floor price) to provide a more transparent price incentive for investment. Furthermore, they should favour short-run competition on a level playing field with companies paying for their pollution. Full auctioning of carbon permits in the electricity sector will begin in principle begin in 2013. It should be seen as a key policy, along with unbundling and grid improvements, for the internal market in electricity. There is still a danger that anti-competitive subsidies will reappear in the form of grants to add carbon capture and storage facilities to fossil fuel plants. Any such aid should be closely scrutinized because it will reduce incentives to invest in alternative energy. Other schemes also have the potential to harm consumers such as the tradable guarantee of origin put forward in the draft Renewables Directive. This might well have led to windfall profits for power producers at the expense of consumers. DG Competition has so far failed to intervene to challenge these side-effects of environmental policy taken at EU level.

By contrast the issue of national subsidies was placed beyond competition scrutiny in *PreussenElektra*. This gave a legal buttress to massive state support for renewables by individual Member States outside the competition law regulatory system. The passing on of the extra costs of a feed-in system to all consumers has allowed renewables to scale up and driven unit prices down. Ironically therefore, perhaps the most effective measure thus far taken to promote environmental protection was subject to strongest attack from the perspective of EU competition policy at DG Competition. This said, the fixing of prices by the state looks very unsatisfactory from a competition policy

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[63] There is no doubt a conflict between the feed-in tariff which 'pays for' emissions reduction and the ETS system which is supposed to do them same. The larger the feed-in market, the lower the carbon price generated by the ETS will fall. The domestic consumers of the Member States are paying (through feed-in tariffs) to reduce emissions at a higher price than that set in the ETS market. The policies are not joined up at all. In an ideal world, the ETS should do most of the work of shifting incentives by being stable and high enough to obviate the need for subsidies from taxpayers and consumers.

angle. The German experience suggests nevertheless that technological competition has been generated but that it requires long-term price 'certainty' for firms engaged in each technology to enter the market. The rejection of the state aid argument by the ECJ in *PreussenElektra* may thus have opened the way towards a new model of competition. This appears to be appropriate for a capital intensive fledgling industry which faces low-marginal cost incumbents with heavy sunk costs.

Despite these benefits, there are obvious problems with the feed-in systems currently in place in that (a) they discriminate against cheaper renewable energy from outside the particular Member State operating the scheme (b) they favour existing technology (c) they rely upon state officials' estimates of the costs of production and innovation, and (d) they are very open to particular interest-group lobbying. DG Competition could thus attempt to engage more fruitfully in this debate by arguing for technology neutral feed-in tariffs that support low-carbon energy and/or tenders by new state renewable purchasing authorities. There could also be a policy to encourage cross-border feed-in tariffs and regional co-operation between schemes. This will be harder to sell to Member States who have been keen to see feed-in tariffs as part of their industrial policy in developing home industries. It will however offer a move away from the uncertainty of spot pricing mechanisms (including the ETS and green certificates) favoured so strongly up to now by the DG Competition and DG Energy in electricity markets.

Thus there remains a serious conflict between the national partitioning of the market in renewables deployment and the creation of a single EU energy market. Support for feed-in tariffs has been closely linked to industrial policy and the development of export industries for components. If the feed-in tariffs borne by one set of taxpayers ultimately fund generation and components industries in other Member States this would be unsustainable. It thus seems unlikely that Member States will allow significant subsidised cross-border trade in renewable energy.[64] There will continue to be discrimination against imported renewable energy. There is already however increasingly vigorous competition in the markets for equipment (both within the EU and from outside) and this should drive down costs of renewable electricity. In the longer term, one can imagine that opinion within Member States will shift from supporting expensive feed-in tariffs to simply buying the cheapest renewable power. As the natural resources used by current technology are distributed differently across Member States (most obviously sun, wind and hydro-power), electricity should ultimately flow from resource 'rich' to resource 'poor' areas within a single market. There is however little prospect of this in the foreseeable future under the current

[64] The renewables directive does however contain provision for Member States (rather than firms) to engage in statistical transfers to each other. See Article 6. Directive 2009/28/EC of the European Parliament and of the Council on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, OJ 2009, L140/16.

market and regulatory conditions. This will rather depend upon more strategic EU and Member State action to commission trans-European grid improvements.[65]

[65] For more details on this see the Strategic Energy Technology Plan COM (2007) 723. Adopted by the Council of Ministers on 28 February 2008, 6722/08 (Presse 45).

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Of Jurisdiction and Justification. Why Competition is Good for 'Non-Economic' Goals, But May Need to be Restricted

*Hans Vedder**

This paper investigates the role that competition law may play in increasing efficiency and ensuring better protection of non-economic objectives. It does so be identifying aspects of jurisdiction and justification in the application of EU competition law, and notably Articles 81, 86 and 87 EC and the useful effect-doctrine (Article 10 in connection with 81 EC), concerning these non-economic objectives concerning environmental protection, media markets and the liberal professions. The underlying thesis is that the application of competition law can expose instances of regulatory capture and thus increase efficiency as well result in a higher level of protection of the non-economic objective.

1. Introduction

In popular political thinking, competition and the so-called non-economic goals are often contrasted or even considered mutually exclusive. We see this in many instances where the Member States or private parties involved argue for a complete disapplication of the competition provisions because application of the competition rules would hamper the attainment of so-called non-economic goals.[1] Article 16 EC, the new Article 14 of the Treaty on the Functioning of the European Union[2] and the Protocol on services of general interest to the Treaty of Lisbon are just three high-profile manifestations of this sentiment on the political level.[3]

These politicians have, however, simultaneously introduced market-based mechanisms in various areas of society. It is, for example, quite common to find market-based mechanisms in the national organisation of health care[4] and the European Community has actively introduced market mechanisms in many environmental protection

* Senior Lecturer in the Department of European and Economic Law, University of Groningen.

1 The outcry by Christine Denys that the judgment in Case C-203/96 *Chemische Afvalstoffen Dusseldorp BV e.a. tegen Minister van Volkshuisvesting, Ruimtelijke Ordening en Milieubeheer* (*Dusseldorp*) [1998] ECR I-4075, may have 'surrendered the environment to the merciless commercial logic of the internal market', C Denys, 'Case Note on Dusseldorp', 1999 *EELR*, p 21–30 at p 30, is just one example of this sentiment. See also the speech by Herbert Ungerer at the 1999 annual IBC Conference, available from: http://ec.europa.eu/competition/speeches/text/sp1999_018_en.html

2 Hereafter abbreviated as TFEU.

3 Protocol on Services of General Economic Interest, OJ 2008, C115/306.

4 In the Netherlands, for example, hospitals are considered to be undertakings and must compete. Government intervention is minimal and agreements and concentrations between hospitals are subject to supervision on the basis of the Netherlands Competition Act, see http://www.nma-org.nl/nederlands/home/Actueel/Themadossiers/Zorg/Index.asp

schemes.[5] Such markets, characterised not only by the presence of market mechanisms, but also by the fact that they serve non-economic objectives (such as environmental protection, adequate health care) are referred to in this paper as 'quasi-markets'. In an ever more complex world where cost-efficiency is increasingly important, these two phenomena – less competition but more markets – may actually result in more inefficiency, neocorporatism and protectionism. EC competition law can play an important role in preventing this.

This paper argues that the first sentiment – asserting that competition is impossible and competition law should not apply at all – is misguided if only because competition law can serve a democratic purpose in the process ensuring the observance of the rule of law. This follows from the observation that many of the (quasi) markets subject to these sentiments are quite complex, subject to market failures and thus need intervention to ensure that they function optimally and in the public interest. The problem, however, is that these interventions rely on information, initiatives and, to a certain extent, self-regulation from the group that is regulated. No matter how competent an authority may be, it will never possess the knowledge of that industry itself and this holds equally true for the legislature. This brings with it the danger of regulatory capture. Such regulatory capture would normally not be open to challenge by a (potential) competitor or consumer before the judiciary in the member states as soon as it would involve an Act of Parliament.[6] EC competition law, however, does allow such private parties to challenge such regulation that is not (completely) in the public interest. Instances of capture resulting in a failure to observe the public interest will inevitably be exposed in an appreciation of the proportionality of a national measure by the judiciary.[7] This, however, requires the case to fall within the scope of EC competition law which has been construed rather extensively by the European Court of Justice,[8] in particular where the competition rules addressed to the Member States are concerned. With regard to the application of competition law to quasi markets, the concepts of an 'undertaking' and 'effect on trade between Member States' constitute the most relevant elements of the scope.[9] As a result, these have generated a significant body of case law. It is argued that the exceptions to such concepts should be construed (more) narrowly so as to enable supervision of such entities on the basis of EC competition law. However, similar reasoning can also be observed where justifications

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5 The Emissions Trading Directive, Directive 2003/87, OJ 2003, L 275/32, concerning greenhouse gases is the most prominent example but other Directives also allow for market-based mechanisms in their implementation by the Member States, see for example, Directive 2001/81 on National Emissions Ceilings (NEC), OJ 2001, L 309/2, and Directive 94/62 on Packaging and Packaging Waste, OJ 1994, L 365/10.

6 *Cf.* J Holmes, 'Fixing The Limits of EC Competition Law: State Action and the Accommodation of the Public Services, (2004) *Current Legal Problems*, pp 149-174, at p 153.

7 It may be noted that this encompasses the European Court of Justice as well as the decentralised Community judges, *i.e.* the national judiciary.

8 Hereafter the Court or ECJ.

9 The concept of an 'aid' is similarly important in the context of Article 87 EC.

for *e.g.* 'services of general economic interest' or 'inherent restrictions' are concerned.[10] These justifications have been the subject of similar activity on the part of the judiciary as well as the Commission.[11]

This judicial activity has not gone unnoticed by the Member States and indeed the branch of EC law that deals with the relations between the market and public authorities[12] is consistently subject to controversy from the part of the Member States. For example, from early case law to more recent cases, the jurisprudence on Article 86 EC still deals with the fundamental question of Member State sovereignty and the appropriate level of EC intervention.[13] Apart from these interventions, through the European judicial system, the Member States have also sought to exercise their powers, as in *Herren der Verträge,* in order to influence competition law through Treaty amendments. The 'French' removal of the 'competition principle' and the 'Dutch' Protocol on Services of General Interest in the Treaty of Lisbon are prominent examples. Apparently, these Member State influences have had an effect on the Court's application of both concepts; relating to jurisdiction as well as those relating to justification.

This paper argues that EC competition law should shift its attention from the jurisdiction to the justification. This, in turn, will force Member States to think more carefully about the objectives of regulatory interventions and self-regulation, as failure to take into account the public interest will consequently be exposed. This places the European judiciary at a central point in the process of observance of the rule of law on a European basis. This judicial activity will be triggered by the involvement of European consumers. These may be final consumers, but also consumers of legislation who wish to shop around for the most convenient regulations and expose overly restrictive or protectionist regulation.

This paper will first analyse the so-called non-economic objectives to see the manner in which these relate to competition and markets (section 2). This will also involve a definition of what are considered to be 'jurisdiction' and 'justification'. It will then examine cases and (national) regulation in environmental markets (section 3), markets

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[10] See also J Holmes, 'Fixing The Limits of EC Competition Law: State Action and the Accomodation of the Public Services', (2004) *Current Legal Problems*, pp 149 - 174, which distinguishes between scope, substance and justification, p 151; T Prosser, *The Limits of Competition Law*, Oxford: Oxford University Press 2005, p 127 and W Sauter & H Schepel, *State and Market in European Union Law*, Cambridge; Cambridge University Press 2009, p 23. This paper integrates the scope and substance issues identified by Holmes, and relates these to a wider concept of jurisdiction, as will be explained below.

[11] E.g. Case C-309/99 *JCJ Wouters, JW Savelbergh and Price Waterhouse Belastingadviseurs BV v Algemene Raad van de Nederlandse Orde van Advocaten*, (Wouters) [2002] ECR I-1577 and Decision 2005/8 *Belgian Architects Fees*, OJ 2005, L4/10. For an overview of cases see http://ec.europa.eu/competition/sectors/professional_services/cases/decisions.html

[12] Article 86, 87 and the *effet utile*-doctrine (Article 10 in connection with 81/82 EC).

[13] Joined cases 188-190/80, *France, Italy and United Kingdom v Commission* (Transparency Directive) [1982] ECR 2545, and, more recently, Joined Cases T-309, 317, 329/04, *TV 2/Danmark A/S v Commission* (TV 2/Danmark) judgment of 22 October 2008, nyr, paras 101-113.

for the professions (section 4), and media markets (section 5) in order to establish that the European Courts have indeed shifted the focus from jurisdiction to justification. This study will also show that there are benefits arising from the application of the competition rules in terms of the 'non-economic' objectives involved. Finally, the conclusions will reveal that the European judiciary has recently become more reluctant to continue its focus on a serious review of the justification of national measures. This can be characterised as a restriction of the scope of judicial review; a question of jurisdiction relating to the remit for the Member States, the Commission and the judiciary. The ramifications of this restriction of the scope of judicial remit are examined and it will be demonstrated that these are damaging for the (non-economic) goals pursued by the national measures.

2. Markets and Non-Economic Objectives

Many of the so-called non-economic objectives relate to market failures. This in turn refers to situations in which the market does not yield optimal outcomes. The externalities involved in environmental protection and information asymmetries connected with the liberal professions are just two examples. In a nutshell, the external nature of environmental costs means that use of the environment does not translate into costs incurred by the person using the environment. This results in an incentive to overexploit the environment. Similarly, the inability for the average consumer to judge quality in relation to price means that competition on the market for the liberal professions may focus exclusively on price,[14] possibly to the detriment of quality. The solution to overcome this and in turn to ensure efficiently operating markets is for public authorities to regulate such markets.[15]

This response may take several forms, which would relate to the different levels on which decisions on the actual balance between markets and public intervention to promote non-economic objectives are taken. These may be taken at the abstract, legislative, level. More often, however, we see that the legislative level only stipulates the general framework (in a more or less detailed manner) and leaves the application to lower regulatory levels, such as authorities, agencies or (semi)-self regulatory entities.[16] Given the complexity of the markets involved, such regulation may be of a highly technical and very complex nature. Calculating emissions allowances or abatement costs exactly is very difficult, as is finding out precisely how much competition can be allowed in a certain aspect of a liberal profession. This difficulty is overcome more easily by those actors who possess more experience with the activity at hand. In practice this boils down to the regulated entities having better knowledge than the

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[14] As consumers will not be able to judge quality, investing in and competing on quality will not be a distinguishing feature.

[15] It may be noted that this definition would actually encompass nearly all markets, as completely liberal markets are a largely mythical beast.

[16] See, for an example at the European Level, recital 36 of the preamble to Directive 2007/65, the Audiovisual Media Services Directive, OJ 2007, L332/27.

regulator, which in turn increases the risk of regulatory capture.[17] The same probably holds true for complex financial structures used for cross-subsidisation and bottleneck infrastructure logistics.[18] Where regulatory capture occurs, there is no guarantee that regulation enhances either efficiency or the non-economic objectives pertinent to that market, as the regulation basically becomes an agent for rent-seeking by (vested) interests in the market.[19] This risk of regulatory capture may be reduced when the regulatory process employs competition between regulated entities. However, this requires an open and transparent regulatory process in which (contemplated) regulatory decisions clearly state who has submitted the views leading to it, as well as how these views were incorporated in the decision. Moreover, the trialogue relationship between the regulator and two or more regulated entities must be open to judicial review.[20] Competition law provides this starting point for judicial review.

2.1. Competition Law and Quasi-Markets

Traditionally, instances of regulation would, depending on the level on which it takes place, not be open to judicial review or would only be subject to limited judicial review on the basis of general norms of administrative law. As regards the former: whenever regulation takes the form of an Act of Parliament the Constitution of the Netherlands, for example, rules out a judicial review.[21] Concerning the latter, the general principles of administrative law hardly provide the basis for an in-depth review of the effects on competition of a certain regulatory decision.[22]

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17 For a lucid overview of agency or regulatory capture in the US, see: JQ Wilson, *Bureaucracy – what government agencies do and why they do it*, New York: Basic Books 1989, p 72 *et seq*. See furthermore: J-J Lafont & J Tirole, 'The Politics of Government Decision-Making: A Theory of Regulatory Capture', *The Quarterly Journal of Economics*, Vol 106 (4), pp 1089-1127 and GJ Stigler, 'The Theory of Economic Regulation', *Bell Journal of Economics and Management Science*, 1971 Vol 2, pp 3-21.

18 Such as railway capacity allocation schemes, see L Di Pietrantonio & J Pelkmans, *The Economics of EU Railway Reform*, BEEP Briefing No 8, p 16. Available from: http://www.coleurop.be/content/studyprogrammes/eco/publications/BEEPs/BEEP8.pdf.

19 See also J Holmes, 'Fixing The Limits of EC Competition Law: State Action and the Accomodation of the Public Services, (2004) *Current Legal Problems*, pp 149 – 174, who at p. 168 refers to 'their [the undertakings'] own conception of the public interest'.

20 This refers to a trialogue in the sense that regulated entities can be divided into two sides (*e.g.* an incumbent and a newcomer). Of course further distinctions between interests are possible as consumers may intervene and regulated entities may be divided into more than two groups that may have more or less concurrent or antagonistic objectives. For an applied game theory analysis to this bargaining process, see RF Baskerville, 'A Game Theory Approach to Research on Lobbying Activities in Accounting Regulation: Benefits and Issues' (2007)Victoria University Centre for Accounting, Governance and Taxation Research Working Paper No 42. Available at SSRN: http://ssrn.com/abstract=1237738.

21 Article 120 of the Constitution prohibits any review of the legality of Acts of Parliament or Treaties on the basis of the Constitution.

22 For an overview of these principles see: RJGH Seerden (ed), *Administrative Law Of The European Union, Its Member States And The United States*, Antwerp: Intersentia, 2007. For an analysis of the relation between these principles on the member state and European level, see: JH Jans *et a*l., *Europeanisation of Public Law*, Groningen: Europa Law Publishing, 2007.

EC competition law, however, does allow for such an in-depth review. The instruments that make up EC competition law are well-known and for the purpose of this article the focus is on those instruments that concern state intervention in (quasi-)markets. These are the useful effect doctrine (Article 10 in connection with Article 81 EC), Article 86 and Article 87 EC. All three instruments contain elements that relate to the scope, as well as elements that allow for a justification, and both elements have been used to accommodate the non-economic concerns involved in quasi-markets.

The applicability of all three instruments requires an effect on intra-community trade and the involvement of an 'undertaking'. These concepts have been explored in myriad decisions and judgments. It is not the purpose of this article to analyse these cases as such. Rather, this article attempts to relate the decisions on the scope in quasi-markets to the decisions on the justification. A good example of the relation in point can be seen in *Albany*.[23] This case concerned Netherlands regulation of sectoral pension funds. The entity in charge of administering the sectoral funds was found to be engaged in an economic activity and thus qualified as an undertaking. However, the Court also admitted that the rules to which it was subject made it less competitive. According to the Court, this loss of competitiveness was not of a magnitude that would allow the Funds' activities to be declared non-economic in nature, but they could perhaps justify an exclusive right.[24] This clearly demonstrates the link between Article 86(2) EC and the exceptions to the concept of an undertaking. To put it differently: the Court relates jurisdiction to justification.

The useful-effect doctrine has a further jurisdictional element, in that it does not apply to collectively negotiated labour agreements. According to the *Albany*-exception, such agreements are set outside the scope of Article 81 EC on the basis of an interpretation of the EC Treaty as a whole.[25] As far as justifications are concerned, the most obvious justification relates to Article 81(3) and the so-called rule of reason or the exception for inherent restrictions.[26]

Concerning Article 86 EC, the required causal connection between the granting of the exclusive right and the infringement of the EC Treaty, most prominently in the form of abuse of a dominant position, constitutes an element that defines the scope of Article 86(1). This allows the Court to differentiate between various exclusive rights that, at least superficially, show a close resemblance. The striking difference in outcome between *Dusseldorp* and *Sydhavnens* provides a good example of just such

23 Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie (Albany)* [1999] ECR I-5751.

24 Case C-67/97 *Albany* [1999] ECR I-5751, para 86.

25 Case C-67/97 *Albany* [1999] ECR I-5751, paras 52-60. For a critical discussion, see HHB Vedder, *Competition Law and Environmental Protection in Europe: Towards Sustainability?*, Groningen: Europa Law Publishing, 2003, p 126 *et seq.*

26 See Case C-309/99 *J.C.J. Wouters, J.W. Savelbergh en Price Waterhouse Belastingadviseurs BV v Algemene Raad van de Nederlandse Orde van Advocaten (Wouters)* [2002] ECR I-1577, paras 97-110.

differentiation.[27] In both cases, operators challenged exclusive rights that sought to ensure the profitability of a public undertaking charged with waste management obligations. Yet the fate that befell both exclusive rights was widely different even though the operator that started *Sydhavnens* essentially relied on *Dusseldorp*.[28] The justification in Article 86 can be found in the second paragraph, and can result in the non-applicability of the entire EC Treaty if this is necessary to ensure the fulfilment of a service of general economic interest.

The last panel in this triptych consists of Article 87 EC. As far as its scope is concerned, the requirement of an effect on trade between Member States is perhaps construed more widely in the context of this provision compared to the other competition provisions.[29]

Furthermore, exceptions to the scope of Article 87(1) that are likely to be relevant for non-economic objectives can be found in the selectivity requirement,[30] the requirement that state funds must be involved,[31] and finally, the requirement that the aid must result in an advantage for an undertaking. The last requirement refers to what is better known as the *Altmark Trans* exception. Again a justification can be found in Article 87(2) and (3), with the latter being predominantly used.

Apart from these elements of jurisdiction and justification inherent in the legal texts involved, there is a more profound aspect of jurisdiction to the competition law applicable to (quasi)-markets. This, however, requires a characterisation of EC competition law as an instrument dealing with regulatory competition between the Member States.

2.2. EC Competition Law as a Regulatory Instrument on the Regulatory Market

Notably in relation to Article 86, and certainly as regards Article 87 EC, enforcement is primarily within the domain of the Commission. This allows the Commission's position to be characterised as a regulator on the regulatory market, or the market for regulation. A company wishing to become active on the market of a Member State may encounter

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[27] Case C-203/96 *Chemische Afvalstoffen Dusseldorp BV and Others v Minister van Volkshuisvesting, Ruimtelijke Ordening en Milieubeheer (Dusseldorp) [1999] ECR I-4075 and Case C-209/98 Entreprenørforeningens Affalds/Miljøsektion (FFAD) v Københavns Kommune (Sydhavnens)* [2000] ECR I-3743.

[28] Compare the arguments brought forward by Sydhavnens, Case C-209/98 *Sydhavnens* [2000] ECR I-3743, para 72, with the Court's appreciation in *Dusseldorp*, Case C-203/96 *Dusseldorp* [1999] I-4075, para 63.

[29] For one, the Court has never been willing to accept a *de minimis* threshold under which aid would not have an effect on intracommunity trade, *e.g.* Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht* (Altmark) [2003] ECR I-7747, para 77-82 and Case C-206/06 *Essent Netwerk Noord BV supported by Nederlands Elektriciteit Administratiekantoor BV v Aluminium Delfzijl BV, and in the indemnification proceedings Aluminium Delfzijl BV v Staat der Nederlanden and in the indemnification proceedings Essent Netwerk Noord BV v Nederlands Elektriciteit Administratiekantoor BV and Saranne BV* (Essent Netwerk Noord) n.y.r., para 76.

[30] See Case C-143/99 *Adria-Wien Pipeline GmbH, Wietersdorfer & Peggauer Zementwerke GmbH v. Finanzlandesdirektion für Kärnten (Adria Wien)* [2001] ECR I-8375, paras 41-54.

[31] Case C-379/98 *PreussenElektra AG v Schhleswag AG, in the presence of Windpark Reußenköge III GmbH and Land Schleswig-Holstein (PreussenElektra)* [2001] ECR I-2099, paras 58-62.

regulatory barriers to entry. These may be barriers that restrict entry as such, but they may also be barriers that make entry less attractive. A good example of such regulatory barriers to entry can be seen in *BUPA*.[32] Here BUPA, a new entrant on the market, was confronted with a risk equalisation fund that had the practical effect of imposing on BUPA an obligation to transfer funds to the incumbent competitor. This effect was so pervasive that, during the court case, BUPA stated that it would consider ceasing its activities within the Irish market.[33] As part of its attempt to challenge the Commission's decision to approve the risk equalisation fund, BUPA referred to the Netherlands risk equalisation fund that has less restrictive and distorting effects on competition. This demonstrates that BUPA was trying to induce regulatory competition leading to better regulation by creating, as it were, a trialogue between the Commission, the Irish and Netherlands authorities.

EC law can, on a more general level, be characterised as playing a regulatory role in a market for regulatory competition. The provisions on the fundamental freedoms, and in particular the rules on mutual recognition, clearly enable a comparison of different regulatory regimes and will stand in the way of overly restrictive regimes, unless this more restrictive regime is objectively justified.[34] This allows the EC law framework, and the actors playing a role in shaping this framework, to function as the touchstone for challenges to national regulatory regimes.[35] The Commission's central role in various liberalisation processes, both on the legislative and the administrative level, confirm this role for EC law in general and the Commission in particular.[36]

The most important difference between the role of the Commission on the regulatory market and that of a normal regulator on a normal market is, of course, that the Commission is ultimately subject to the very entities it regulates: the Member States. Similarly, the touchstone of EC law is ultimately determined by the *Herren der Verträge*. This means that there is an increased risk of capture, if exercising sovereign rights can actually be likened to regulatory capture. Irrespective of the terminology used, regulatory capture is a powerful explanation for recent developments related to the application of EC competition law to certain quasi-markets.

As the various case studies in the following paragraphs show, the Commission has at times adopted decisions that entail a rather minimal standard for supervision. In these

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32 An overview of the *BUPA* saga is provided in paragraph 6 *infra*.

33 Case T-289/03 *British United Provident Association Ltd (BUPA), BUPA Insurance Ltd and BUPA Ireland Ltd v Commission* (BUPA) n.y.r., para 78. At this moment BUPA Ireland has been taken over by Quinn-healthcare.

34 Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* (Cassis de Dijon) [1979] ERR 649, para 8.

35 See on this role: N Reich, 'Competition Between Legal Orders: A New Paradigm of EC Law?' (1992) 28 *CMLRev,* pp 861-896.

36 *Cf.* the so-called Article 7 procedure, whereby National Regulatory Authorities have to inform the Commission in advance of regulatory measures pursuant to Article 7 of Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the "Framework Directive"), OJ 2002 L 108/33. For an overview of this procedure in practice, see: Commission Communication on Article 7, COM (2007) 401.

cases it is for the European Courts to ensure an adequate standard of review as part of their duty to ensure the observance of the law in the application of the EC Treaty.[37] The rather open character of the norms involved, notably in EC competition law, place the Courts in a particularly important position in that they are able to exert considerable influence not just on EC competition law, but equally on EC competition policy.[38] In this regard, the regulatory role is not ascribed to an institution, such as the Commission or Court of First Instance, but rather to EC competition law (as it may be applied and interpreted by those institutions). As with any regulator, EC competition law may also be captured. It is submitted that this is reflected in the more profound jurisdictional element alluded to above. This is seen clearly in the judgment in *British Aggregates Association*,[39] which concerned an appeal against a judgment of the Court of First Instance[40] in which the British Aggregates Association's appeal against a Commission decision[41] was dismissed. This case started with the Aggregates Levy, which amounts to a tax on virgin aggregates. Among others, secondary aggregates and aggregates that are a by-product are exempted with a view to encouraging their use, thus reducing the environmental impact of virgin aggregate production. The Commission took a particularly favourable view of the Aggregates Levy and decided that it did not constitute State Aid within the meaning of Article 87(1) because it did not constitute a selective advantage. This effectively means that the Commission reduced the scope of Article 87(1) using the more profound jurisdictional element.

The Court of Justice exposes these two (interlinked) aspects of jurisdiction very nicely. Firstly, the Court of First Instance's generous approach to the selectivity criterion, in light of the environmental objectives of the Aggregates Levy as well as the integration principle in Article 6 EC, is found to constitute an error in law.[42] Pivotal to this finding was paragraph 115 of the judgment, in which the Court of First Instance held that "[it] must be emphasised in that regard that it is open to the Member States, which, in the current state of Community law, retain, in the absence of coordination in that field, their powers in relation to environmental policy, to introduce sectoral environmental levies in order to attain those environmental objectives referred to in the preceding paragraph. In particular, the Member States are free, in balancing the various interests involved, to set their priorities as regards the protection of the environment and, as a result, to determine which goods or services they are to decide to subject to an environmental levy. It follows that, in principle, the mere fact that an environmental levy constitutes a specific measure, which extends to certain designated goods or

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37 *Cf.* Article 220 EC.

38 *Cf.* M Monti, *EC Competition Law*, Cambridge: Cambridge University Press 2008, p 43, insofar as the Court's endorsement of Commission policy is concerned. On a more general level, judicial inventions such as the useful effect doctrine are a clear example of court-made competition policy.

39 Case C-487/06 P *British Aggregates Association v. Commission* (British Aggregates Association II), n.y.r.

40 Case T-210/02 *British Aggregates Association v. Commission* (British Aggregates Association I) [2006] ECR II-2789.

41 Decision C(2002) 1478 of 24 April 2004 in Case N 863/01.

42 Case C-487/06 P, *British Aggregates Association II*, paras 79-92.

services, and cannot be seen as part of an overall system of taxation which applies to all similar activities which have a comparable impact on the environment, does not mean that similar activities, which are not subject to the levy, benefit from a selective advantage." This paragraph breathes an amount of deference on the part of the Court of First Instance that is quite inapt within the confines of State Aid supervision. As a response to this the Court of Justice held that "[...] the need to take account of requirements relating to environmental protection, however legitimate, cannot justify the exclusion of selective measures, even specific ones such as environmental levies, from the scope of Article 87(1) EC [...] as account may in any event usefully be taken of the environmental objectives when the compatibility of the State Aid measure with the common market is being assessed pursuant to Article 87(3) EC".[43] Here we see the Court recognising the non-economic objective within the confines of the justification available in Article 87(3), whilst taking it out of the jurisdictional element of selectivity.

The more profound jurisdictional element is addressed explicitly a few paragraphs later in the judgment, where the scope of the judicial review carried out by the Court of First Instance is scrutinised. Here the Association submitted that the Court of First Instance erred in law when it looked only for manifest errors of appraisal, whereas it should have carried out a comprehensive review of the Commission's findings concerning the applicability of Article 87(1) EC.[44] The Court concurs and finds that the Court of First Instance carried out a limited review.[45] According to the Court the "State aid, as defined in the Treaty, is a legal concept which must be interpreted on the basis of objective factors. For that reason, the Community Courts must in principle, having regard both to the specific features of the case before them and to the technical or complex nature of the Commission's assessments, carry out a comprehensive review as to whether a measure falls within the scope of Article 87(1) EC."[46] Since no such technical or complex appraisals were established, a comprehensive review was in order. *British Aggregates Association* shows that both the Commission and the Court of First Instance restricted the scope of their review, thus shifting the focus of their supervision from justification to jurisdiction.

As a result, the UK government's Aggregates Levy needs to be scrutinised in more depth, thus introducing more supervision of this intervention in a (disfunctioning) environmental market. Whilst this can be seen as another legal dam blocking the mainstream of life, it may be observed that the Court indicated the more proper place for environmental concerns may be within the confines of Article 87(3) EC. This would entail an enhanced role for EC competition law as a regulatory instrument on this particular market for regulation.[47]

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43 Case C-487/06 P, *British Aggregates Association II*, para 92.

44 Case C-487/06 P, *British Aggregates Association II*, para 102.

45 Case C-487/06 P, *British Aggregates Association II*, para 110.

46 Case C-487/06 P, *British Aggregates Association II*, para 111.

47 Indeed, the exceptions to the Aggregates Levy's scope appear to have been partly motivated by reasons of competitiveness, which, it is submitted, must be distinguished from the environmental protection reasons.

3. MARKETS FOR ENVIRONMENTAL PROTECTION

The most prominent example of a quasi market fraught with market failures is the market for environmental protection in the form of the EU Emissions Trading Scheme (hereafter: EU ETS). Although there are several environmental markets in existence, the market for greenhouse gas allowance trading is by far the biggest and most developed example. A quick glance at Directive 2003/87 immediately reveals it to be a highly regulated market, with a strong role for national governments and the Commission.[48] Moreover, it is a market with a serious risk of national regulatory capture in that the Member States involved possess an incentive not to impose strict, and thus expensive, emissions reductions standards upon their national industry. This can take place in the National Allocation Plans in which the Member States allocate the starting amount of allowances over the various sectors and undertakings active in the sectors.[49] Emissions trading can only work if there is no over-allocation and the amount of allowances on the market corresponds to the total amount of emissions. In this case ensuing reductions of the amount of allowances will mean the attainment of emissions abatement objectives, as well as the creation of the scarcity all markets need to function. In an environmental market, restrictions of emissions go hand in hand with distortions of competition. This is the primary reason why the necessity to check compatibility of National Allocation Plans with the rules on establishment and State Aids was recognised in the ETS Directive.[50]

The Commission's review of National Allocation Plans, however, was in particular in the first (learning) phase clearly insufficient in that extensive lobbying from industry resulted in over-allocation across the board in many Member States. This type of over-allocation is not particularly damaging from a competition perspective.[51] What is more damaging to competition is an allocation that benefits certain sectors of the industry, or certain companies within a sector.[52] This is what Energie Baden-Württemberg argued as a response to the Commission's approval of the German National Allocation Plan.[53] In a nutshell, EnBW's argued that the German Plan contained a number of elements which entailed a competitive advantage for one of Germany's two largest energy

[48] Directive 2003/87, OJ 2003, L275/32. This Directive envisages so-called National Allocation Plans for the initial allocation of allowances to be drawn up by the Member States (Article 9(1)). However, such NAPs are subject to guidance (Article 9(1)) as well as scrutiny by the Commission (Article 9(1) and (3)).

[49] Interestingly, the ETS Directive only lays down a minimum amount of allowances to be grandfathered, Article 10. This in itself already allows for considerable differences in the costs imposed on industries by NAPs.

[50] Directive 2003/87, Annex III, point 5. See further: Commission Guidance, COM (2003) 830 final, point 47.

[51] However this is not the case where international competition is taken into account. It does of course greatly reduce the environmental effectiveness of the trading scheme.

[52] The exclusion of the aluminium packaging industry from the scope of the EU ETS can be seen as an example of such a distortion on the EU level. See further Case C-127/07 *Société Arcelor Atlantique et Lorraine and Others v. Premier ministre, Ministre de l'Écologie et du Développement durable, Ministre de l'Économie, des Finances et de l'Industrie* (Arcelor), judgment of 16 December 2008, n.y.r.

[53] Order in Case T-387/04 *EnBW Energie Baden-Württemberg v. Commission* (EnBW) [2007] ECR II-1195.

producing undertakings, RWE and E.On.[54] As a result, the Commission's decision to approve the plan was said to be contrary to the Commission's obligation to check whether the plan was compatible with the State Aid provisions.[55] The Court of First Instance did not, however, rule on the substance of this case and declared EnBW's action to be inadmissible. In doing this, the Court also addressed the role of State Aid scrutiny in this procedure. The Court found that the Commission's decision contained only a preliminary appraisal of the State Aid aspects that would not stand in the way of the full State Aid investigation under Article 88(3) and (2) EC or the direct effect of the former provision.[56] As a result, EnBW now has an incentive to start a full State Aid procedure concerning the German National Allocation Plan in order to expose the possible selective over-allocation.

Whether this will be successful, however, remains to be seen in view of the Court of First Instance's judgment in the *Netherlands NOx* case.[57] This case concerned the Commission's appraisal under the State Aid rules of the Netherlands emissions trading scheme for nitrogen oxides.[58] This trading scheme is a so-called dynamic cap or Performance Standard Rate (PSR) trading scheme, whereby there is no absolute cap on emissions allowances (as in the EU ETS) but rather an environmental performance standard (the amount of NOx emitted per amount of energy used) that will decrease annually. An undertaking that increases the environmental performance to a level that exceeds the PSR (*i.e.* emits less NOx per unit of energy than prescribed by the PSR) will get NOx credits to be, for example, banked or sold to less environmentally efficient companies that did not meet the PSR. The Commission concluded that the scheme entailed a State Aid because the NOx credits are intangible assets that were handed out for free. As a result the Netherlands government foregoes revenues that could have been achieved in an auction or other form of sale of the NOx credits. However, the Commission considers the aid compatible with the common market on the basis of Article 87(3)(c) EC.

According to the Netherlands government, the NOx trading scheme did not constitute a State Aid within the meaning of Article 87(1) because it entailed no advantage financed through state resources and because it lacked selectivity. Regarding the former argument, the Court of First Instance sides with the Commission in finding that the tradability of the NOx credits constitutes an advantage. Moreover, by not auctioning or

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54 T-387/04 *EnBW* [2007] ECR II-1195, paras 36, 37.

55 This is also interesting from the regulatory capture perspective in that the Commission admits that it relied on the explanations given by the German authorities, T-387/04 *EnBW* [2007] ECR II-1195, para 43. This relatively uncritical attitude towards arguments put forward by the Member States can be explained by the political pressure on the Commission as well as the strict time-limits that were imposed on the Commission.

56 Case T-387/04 *EnBW* [2007] ECR II-1195, para. 133, 134.

57 Case T-233/04 *Netherlands v. Commission (Netherlands Nox)*, judgment of 10 April 2008, n.y.r.

58 Pursuant to the National Emissions Ceilings (NEC) Directive 2001/81, OJ 2001, L 309/22, the Member States must ensure that certain emissions ceilings are observed. The Netherlands decided that a market based mechanism was necessary to meet these targets efficiently, see explanatory statement for the proposal to this act: TK004-2005, 29766, nr. 3, at p 5 *et seq.*

otherwise selling them to the undertakings, the Netherlands government has foregone income and thus financed this advantage.[59] Whatever may be made of this,[60] the Court's findings concerning selectivity are more interesting for the purpose of this paper. In this connection the Court finds that the measure lacks selectivity because it is limited in its scope to installations with a certain thermal capacity.[61] Moreover, even if the scope would entail a differentiation between those undertakings subject to a PSR and thus able to participate in the trading scheme and those who are out, this differentiation is considered objectively justified by the Court. The fact that those in the scheme are large emitters of NOx, according to the Court, objectively justifies treating them differently on ecological grounds from those outside the scheme's scope. This is hardly sensible from an environmental perspective, as many small emissions will damage the environment just as much as a few large emissions.[62] The result of *Netherlands NOx* is that the trading scheme no longer constitutes State Aid and this in turn results in the disappearance of the reporting obligations that the Commission imposed in its decision ex Article 87(3)(c) EC. While this may *prima facie* seem like a good thing (why would anyone want burdensome reporting duties for something as laudable as environmental protection), second thoughts may be less optimistic. It appears that the Commission had imposed the reporting requirements partly because it doubted the environmental effectiveness of the NOx trading scheme.[63] Just as with *EnBW*, State Aid supervision may very well enhance competition as well as the environmental effectiveness of the scheme.[64]

The combined logic of Netherlands NOx and the Commission's approach to State Aid supervision concerning the National Allocation Plans makes that there is less room for State Aid supervision as a result of the high(er) standard for proving selectivity in combination with the Commission's considerable deference to Member State National Allocation Plans. For the current trading period, that commenced in 2008 and will last until 2012, the scope of State Aid supervision has been significantly reduced to the detriment of both competition and the environment.

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[59] Case T-233/04 *Netherlands NOx* paras 74, 75.

[60] It is submitted that this argument is fundamentally flawed because it is simply impossible to auction such credits in a PSR system, if only because the exact amount of available credits cannot be known in advance. As a result, scarcity cannot be known in advance and this makes it impossible to bid or otherwise come to a price for such credits. This is also why PSR-trading schemes entail a far lower risk of resulting in competitive distortions. Over allocation (selective or not) is simply impossible and a PSR that is too lenient will only detract from the scheme's environmental effectiveness, see further HHB Vedder, 'Annotatie bij Zaak T-233/04', *Nederlands Tijdschrift voor Energierecht* 2008, pp 116-124.

[61] Case T-233/04 *Netherlands NOx* paras 87-96. This is comparable to the reasoning adopted by the Court of Justice in Case C-127/07 *Arcelor* concerning the scope of the EU ETS.

[62] In this regard the reference to *Adria-Wien* is particularly objectionable as this was exactly the case in which the Court of Justice held that from an environmental perspective it is irrelevant whether pollution results from the production of goods or the provision of services, Case C-143/99 *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* (Adria-Wien) [2001] ECR I-8365, para 52.

[63] *Cf.* the penultimate bullet point in paragraph 3.3 of the contested Decision C (2003) 1761 relating to measure N 35/2003.

[64] It may be noted that the Commission has appealed this judgment, OJ 2008, C 223/30, Case C-279/08 P.

The solution to this conundrum has been a radical one. The post 2012 climate change package envisages a new emissions trading directive that entails a much more harmonised regime.[65] For one, National Allocation Plans and their scrutiny by the Commission have been replaced with allocations fixed on the Community level.[66] Furthermore, the Member States' discretion concerning the choice between auctioning and grandfathering is reduced. From a regulatory competition and capture perspective, this is interesting to note. What is more interesting is that this higher degree of harmonisation and the resulting centralisation of decision making was actually the result of the Member States themselves.[67] In a way, they restricted the room for regulatory competition and capture by submitting themselves to a stricter regulatory regime. This obviates the need for State Aid supervision, except for the Commission's supervision of the more traditional State Aids in the form of subsidies etc. Concerning these forms of State Aids, supervision remains strict and takes account of the environmental effectiveness as well.[68] The centralisation of regulation, however, means that the risk of competitive distortions that detract from the environmental effectiveness is similarly centralised.[69] This is reflected in the rules on carbon leakage. Carbon leakage relates to the 'export' of greenhouse gas emissions as a result of the higher carbon price in the EU. This undermines the environmental integrity of the emissions trading directive as well as the competitive position of the EU industry. The logical complement of the centralised and harmonised rules on allocation and auctioning is therefore a centralised regime on carbon leakage.[70] This, however, presupposes that, for example, the exact rules for determining the industries exposed to a significant risk of carbon leakage are sufficiently clear so as to avoid regulatory competition. In this regard, the result of the negotiations does not look that promising. For one, the definition of industries exposed to carbon leakage takes place at NACE-3 level and *where appropriate and where the relevant date are available*, at NACE-4 level.[71] Leaving aside the discretion inherent in making NACE-4 level disaggregation dependent on appropriateness and availability of data, it is submitted that an adequate appraisal of competitive forces requires a market definition, which cannot be equated to a NACE determination.[72] Moreover, the methodology used to determine exposure to carbon leakage is all but clear and free

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[65] Directive 2009/29 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community (Post 2012 ETS Directive), OJ 2009 L 140/63. For a critical discussion of this Directive see S Cló, 'The ETS Reform and Carbon Leakage: Economic Analysis of the New ETS Directive' (April 9, 2009), available at SSRN: http://ssrn.com/abstract=1375544.

[66] Articles 9, 9a and 10 of the Post 2012 ETS Directive.

[67] Given that the December 2008 climate package was actually adopted in the European Council, it can be said that it were the *Herren der Verträge* who decided this.

[68] *Cf.* Commission Guidelines on State Aid for Environmental Protection, OJ 2008, C 82/1, para 6.

[69] See Recital 23 of the Preamble to the Post 2012 ETS Directive.

[70] Recital 24 of the Preamble and Articles 10a, 10b and 10c of the Post 2012 ETS Directive.

[71] Recital 24 of the Preamble of the Post 2012 ETS Directive.

[72] Cf. Case T-27/02 *Kronofrance SA v Commission* (Kronofrance) [2004] ECR II-4177, paras 82-84.

from discretion and thus entails a risk of regulatory competition to the detriment of the environmental effectiveness of the scheme as well as the level playing field.[73]

4. MARKETS FOR THE PROFESSIONS

Liberal professional services are provided on markets similarly fraught with market failures, mostly relating to information asymmetries and positive externalities. Moreover, many governments have allowed for (semi) self-regulation by those professions. This will frequently take the form of the public authorities only laying down the framework of general rules; the members of the profession are then responsible for further elaborating and enforcing these rules. This situation has the potential to result in overly restrictive rules that benefit neither competition nor the consumer.[74] As a result, consumers may complain or members of the profession may want to challenge rules in order to expose overly anticompetitive regulations. Again, EC competition law, and notably the useful effect doctrine, allows these consumers and members of the profession to do exactly that.

The useful effect doctrine was developed in connection with (semi) self-regulation by private parties. Generally this (semi) self-regulation takes the form of a private initiative (self-regulation) that was later formalised or otherwise received a seal of approval by public authorities. Whereas pure self-regulation could fall under Article 81 EC,[75] public authorities' involvement in such semi self-regulation is governed by the useful effect doctrine. Such (semi) self-regulation is particularly prominent in the professions, where governments need to reconcile public tasks with the fact they are administered by private parties operating partly in their own interest. The results are considerable inefficiencies, resulting to a large degree from barriers to entry, tariff regulations and regulation of market conduct.[76] One explanation for these inefficiencies can be regulatory capture. The fact is that a transfer of consumer welfare to the producers and deadweight loss cannot be explained through democratic mechanisms, if only for the simple reason that the number of consumers by far exceeds the number of producers in this market, which would result in the latter having a negligible democratic impact.

The useful effect doctrine and Article 81 EC have been instrumental in discovering such inefficient (semi) self-regulation and separating the chaff from the wheat. Plainly

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73 For a critical analysis of this regime, see S Cló, 'The ETS Reform and Carbon Leakage: Economic Analysis of the New ETS Directive', p 21 *et seq* (April 9, 2009), available at SSRN: http://ssrn.com/abstract=1375544.

74 See also European Parliament Resolution on the follow-up to the report on Competition in Professional Services, adopted 12 October 2006, A6-0272/2006.

75 *Cf.* Belgian Architects Decision, IP/04/800.

76 I Paterson, M Fink, A Ogus, *Economic impact of regulation in the field of liberal professions in different Member States - Regulation of Professional Services*, Vienna: Institute for Advanced Studies, 2003, report for the European Commission. See further: Ch U Schmid (ZERP), *Conveyancing Services Market*, report for the European Commission, both reports are available on the DG-Comp website: http://ec.europa.eu/comm/competition/sectors/professional_services/studies/studies.html

appalling cases such as *CNSD*[77] and *CIF*[78] apart, there have been numerous cases that deal with much less far-going restrictions of competition. These cases have allowed the Court to develop an approach, particularly in the second wave of cases that started from the mid 1990s onwards, which is quite balanced.[79] *Wouters*, for example, deals with a self-regulation by the Netherlands Bar Association which prohibited structural cooperation between members of the bar and accountants.[80] According to the Court, this rule does not go beyond what is reasonable to ensure the proper practice of the legal profession.[81] Again, there is considerable deference on the part of the Court, particularly when the contested rule is put into perspective. Essentially, the rule attempts to protect the advisory nature of the activities of the members of the bar from the supervisory nature of accountancy activities. The judgment indicates the possible pro- and anticompetitive effects of so-called multidisciplinary partnerships and then juxtaposes the independence required of accountant with the partisan nature of the members of the bar. This appears to be like a great many little ducklings all agreeing that they will not be eaten by four foxes because otherwise no one would eat the duckweed, which would be bad for the foxes as well.[82] If one thinks that an abundance of duckweed is something to be avoided, an agreement between four foxes not to eat ducklings would seem more logical or, in legal terms, proportionate. *Arduino*, delivered on the same day as *Wouters*, shows identical reticence on the part of the Court.[83] This case concerned the way in which fees charged by members of the Italian bar were determined. In a nutshell this procedure involved a draft tariff drawn up by a committee consisting of representatives from the bar association. Moreover, this committee was not under any particular duty to take general interests into account.[84] This, however, did not keep the Court from finding the situation compatible with the useful effect doctrine. The Court came to this decision because of the role played by the Minister and Italian courts. The former would have to approve the tariffs[85] and could do so only after having obtained the advice from the Council of State and the Interministerial Committee on Prices. Apart from the fact that the Court does not

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77 Case C-35/96 *Commission v Italy* (CNSD) [1998] ECR I-3851. The semi self-regulation in this case amounted to little more than a government sponsored price fixing cartel.

78 Case C-198/01 *Consorzio Industrie Fiammiferi v. Autoritá Garante della Concorrenza e del Mercato (CIF)* [2003] ECR I-8055.

79 For an overview see: I Forrester, 'Where Law Meets Competition: Is Wouters Like a Cassis de Dijon or a Platypus?' in, CD Ehlermann & I Atanasiu (eds), *European Competition Law Annual 2004*, Oxford: Hart Publishing 2006, p 271 *et seq*.

80 Case C-309/99 *Wouters* [2002] ECR I-1577.

81 Case C-309/99 *Wouters* [2002] ECR I-1577, para 109.

82 In accountancy there are four big firms (*Wouters*, para 91, still refers to the 'big five'), but subsequent mergers have reduced this number to four.

83 Case C-35/99 *Manuele Arduino v Compagnia Assicuratrice RAS SpA (Arduino)* [2002] ECR I-1529.

84 Case C-35/99 *Arduino* [2002] ECR I-1529, paras 37 – 39.

85 The Court infers from this that the 'Minister has the power to have the draft amended by the CNF', para 41. Notice that the Minister cannot amend the draft independently, but rather must rely on the bar association to do so.

address the extent to which these entities actually represent the general interest, it may be noted that their powers are only advisory. In this regard it may be pointed out that the Interministerial Committee on Prices consists of representatives of the various ministries, producers and trade unions, *i.e.* the supply side of the industry.[86] As regards the role of the Italian courts, they settle the tariffs on the basis of the seriousness and number of issues dealt with. Moreover, they could set aside the tariffs in exceptional cases. In sum, the Minister's involvement offers little guarantees for the protection of the general interest and the Court's role may reduce, but certainly does not rule out price fixing effects of the binding tariffs.[87]

Italian lawyers' semi self-regulation continues to generate case law, as *Cipolla*[88] and *Mauri*[89] show. *Mauri* deals with access to the legal profession. This case is the result of Mr Mauri's failure to pass part of the bar exam. He appealed against this decision and, before the administrative judge, he objected to the composition of the examination committee, which consisted of two judges, a law professor and two members of the bar, elected by the bar association. The presence of the latter two could, in theory, allow for the bar exam to be used as a means not only to control the quality but also the quantity of those admitted to the bar.[90] The Court noticed that the members of the bar only made up two fifths of the committee as well as the possibility of an appeal against the decisions of the committee and the possibility for ministerial intervention. As a result, the examination committee was found to have sufficient guarantees to operate in the general interest so as to prevent it from acting only in the interests of the bar association; which seems a sensible decision in light of the facts.

Cipolla, on the other hand, seems more controversial. Again, the Italian lawyers' tariffs were at stake. Unsurprisingly, the judgment in *Cipolla* closely follows that in *Arduino*, with the Court focussing on the procedural guarantees that ensure that the tariffs are in the general interest, and not just in the interest of the bar association that fixes the draft tariff. This mere repetition of *Arduino* may be disappointing, but predictable. More controversial is the Court's appreciation of the tariffs under the free movement rules.[91] Here the Court adopts the ruinous competition doctrine when it states that:[92]

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86 D.Lgs.Lgt. 19 October 1944, n. 347.

87 This situation may be compared to that in ECJ Case 240/82 *Stichting Sigarettenindustrie and others v Commission* [1985] ECR 3831, paras 23-29, where cigarette retailers had reduced the amount of competition that was already reduced as a result of government interference.

88 Joined Cases C-94/04 and C-202/04 *Federico Cipolla v Rosaria Fazari, née Portolese and Stefano Macrino and Claudia Capoparte v Roberto Meloni (Cipolla)* [2006] ECR I-11421.

89 Case C-250/03 *Giorgio Emanuele Mauri v Ministero della Giustizia and Commissione per gli esami di avvocato presso la Corte d'appello di Milano (Mauri)* [2005] ECR I-1267.

90 Case C-250/03 *Mauri* [2005] ECR I-*1267*, para 10.

91 The Court deals with the case on the basis of Article 49 EC. Given the assimilation and convergence between the free movement rules and the competition rules (section 3.1.1), the Court's reasoning concerning Article 49 EC can be *applied mutatis* mutandis to the useful effect doctrine.

92 Joined Cases C-94/04 and C-202/04 *Cipolla* [2006] ECR I-11421, para 67.

Although it is true that a scale imposing minimum fees cannot prevent members of the profession from offering services of mediocre quality, it is conceivable that such a scale does serve to prevent lawyers, in a context such as that of the Italian market which, as indicated in the decision making the reference, is characterised by an extremely large number of lawyers who are enrolled and practising, from being encouraged to compete against each other by possibly offering services at a discount, with the risk of deterioration in the quality of the services provided.

The Court's Grand Chamber essentially states that price competition may be bad for the quality of services provided, but at the same time recognises that minimum fees cannot guarantee good quality services.[93] This level of respect for tariff regulations is quite inappropriate and can possibly be explained from a legal policy perspective.[94] This becomes clear when the Commission's arguments in *Cipolla* are examined. Whereas these arguments remain obscure in the judgment, A-G Poiares-Maduro's opinion sheds more light on the inter-institutional debate underlying this case. The Commission in particular asked for a reconsideration of *Arduino*,[95] amongst others, in light of the opinions of Advocates General Jacobs[96] and Léger[97] who suggest a three-fold test for an exception to the useful effect doctrine. The requirements for such an exception are that (1) the public authorities of the Member State concerned exercise effective control over the content of the agreement; (2) the State measure pursues a legitimate aim in the public interest, and (3) the State measure is proportionate to the aim which it pursues. It may be noted that the current case law as it stands does not include the proportionality test put forward by Jacobs and Léger. As a result the Court is unable to conduct a serious review of the proportionality of the tariff rules. This appears to be the trade-off for relatively more legal certainty, as adopting the proportionality test would invariably open up the debate on the proportionality of the regulation of not just lawyers' tariffs.[98]

5. MEDIA MARKETS

The media also constitutes a sector of the economy that suffers from market failure. At the time of writing, dealing with the issue of positive externalities arising from quality investigative journalism in a democracy is particularly topical in the Netherlands, given that a committee has just advised that a levy on internet access be raised to subsidise

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93 Joined Cases C-94/04 and C-202/04 *Cipolla* [2006] ECR I-11421, paras 85, 86 of the Opinion.

94 M Amorese, 'Cases C-94/04, Cipolla & Macrino: The Emergence of a Political Approach to the Regulation of Professionals in Europe?', (2007) 13 Colum JEL 733.

95 Joined Cases C-94/04 and C-202/04 *Cipolla* [2006] ECR I-11421, para 27 of the Opinion.

96 Opinion in Joined Cases C-180/98 to C-184/98 *Pavlov and Others* [2000] ECR I-6451.

97 Opinion in Case C-35/99 *Arduino* [2002] ECR I-1529.

98 Joined cases C-94/04 and C-202/04 *Cipolla* [2006] ECR I-11421, paras 28 - 30 of the Opinion. For a critical analysis of overly restrictive (semi) self-regulation and its supervision, see J Kwoka, 'The Federal Trade Commission and the professions: a quarter century of accomplishments and some new challenges', [2005] *Antitrust Law Journal*, Vol. 72, 997–1012.

newspapers.[99] On a more general note, we have already observed that, in the US, extensive research has been undertaken into the regulation of broadcasting services.[100] Whereas this research concerns broadcasting regulations and more particularly frequency allocation, current practice in the EU focuses on the public service broadcasting function of the media, and notably the funding of this obligation.[101] Again, the exact definition of the public service remit or the service of general economic interest involved is very much at the centre of the debate. In particular this concerns the situation in which a public service obligation is (partly) subsidised whereas the entity in charge of the public service also performs commercial activities.[102] This has resulted in the recommendation that 'regulations governing State Aid are devised and implemented in a way which allow the public service and community media to fulfil their function in a dynamic environment, while ensuring that public service media carry out the function entrusted to them by Member States in a transparent and accountable manner, avoiding the abuse of public funding for reasons of political or economic expediency'.[103] It is submitted that EC competition law and the rules on State Aid in particular have an important role to play in this regard. This becomes all the more true when we realise that media markets are highly competitive and subject to considerable regulatory competition.[104]

In relation to the public financing of public service obligations, the last few years have resulted in a considerable degree of innovative case law. The initial stance of the Court of First Instance and Court was that such compensation amounted to State Aid within the meaning of Article 87 EC, irrespective of the possible applicability of Article 86(2) EC.[105] In *Ferring* the Court of Justice reversed this approach, holding that compensation

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[99] Adviesrapport Tijdelijke Commissie Innovatie en Toekomst Pers, p 60, available from http://www.commissiebrinkman.nl/download/TCITP_rapport_23-06-09_LR.pdf. In addition, this committee has also suggested that competition-based objections to setting up one distribution network for newspapers should be set aside, p 43.

[100] *Supra*, n 17, notably the work of JQ Wilson.

[101] See further on this the Amsterdam Protocol on the system of public broadcasting in the Member States, the 1999 resolution concerning public service broadcasting, OJ 1999 C 30/1, the 2001 communication on the application of State Aid rules to public service broadcasting, OJ 2001 C 320/5 and the 2008 draft communication, IP/08/1626 and MEMO/08/671.

[102] The 2001 communication on the application of State Aid rules to public service broadcasting, OJ 2001, C 320/5, explicitly allows for this, para 36.

[103] 2008 European Parliament Resolution on concentration and pluralism in the media in the European Union, 2007/2253(INI), recommendation 37.

[104] In the Netherlands, for example, the Television without Frontiers Directive, Directive 89/552, later amended, OJ 1989 L 298/23, has led to considerable competitive pressure from Luxemburg-based commercial broadcasters. Ultimately this has resulted in the Netherlands regulatory regime being amended so as to make it less stringent and thus bring it in line with the regime applicable in Luxemburg. See Parliamentary Documentation TK 2007/2008 31 356, nr. 3, at p 14.

[105] Case T-106/95 *Fédération française des sociétés d'assurances (FFSA), Union des sociétés étrangères d'assurances (USEA), Groupe des assurances mutuelles agricoles (Groupama), Fédération nationale des syndicats d'agents généraux d'assurances (FNSAGA), Fédération française des courtiers d'assurances et de réassurances (FCA) and Bureau international des producteurs d'assurances et de réassurances (BIPAR) v Commission (FFSA)* [1997] ECR II-229, para 172 and Case T-

for the extra costs incurred in discharging a public service obligation did not constitute State Aid.[106] This has as the effect that the duty to notify and the stand-still obligation no longer apply to such compensation, whilst the Commission will no longer be able to attach any conditions to decisions declaring such aid compatible with the common market. This judgment was met with considerable criticism, particularly from the side of legal and economic scholars.[107] To a large extent this disapproval finds its roots in the perceived lack of guarantees for cost-effectiveness in this approach. For one, the Court did not apply or prescribe a cost-standard (benchmark) in its judgment, which would make it possible for a subsidy for an inefficient public undertaking to completely escape competition scrutiny.[108] This would entail a transfer of consumer welfare to an inefficient firm; such a transfer cannot possibly be in the public interest.[109] Furthermore, the judgment left Member States a considerable amount of discretion in designing and limiting the public service obligation, potentially allowing for subsidisation of other costs made in the name of public interest. Under *Ferring,* such a situation would be immune from judicial review, as the lack of State Aid also renders inapplicable the notification duty and thus scrutiny by the Commission.

The later *Altmark* judgment addresses these criticisms by rephrasing the criteria and adding two new criteria to those found in *Ferring*.[110] First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined. Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings. Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations. Fourth, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure, which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed

46/97 *SIC - Sociedade Independente de Comunicação SA v Commission (SIC)* [2000] ECR II-2125, para 84 and ECJ Case C-332/98 *France v Commission (CELF)* [2000] I-4833, paras 28-33.

106 Case C-53/00 *Ferring SA v Agence centrale des organismes de sécurité sociale (ACOSS) (Ferring)* [2001] ECR I-9067.

107 P Nicolaides, 'The Distortive Effects of Compensatory Aid Measures: A Note on the Economics of the 'Ferring' Judgement' 2002 *ECLR* 313-319. P Nicolaides, 'Compensation for Public Service Obligations: Opening the Floodgates of State Aid?' 2003 *ECLR*, p. 561 – 573 and P. Nicolaides, 'Competition and Services of General Economic Interest in the EU: Reconciling Economics and Law', 2003 *EStAL*, 2, p 183 – 209.

108 As acknowledged by the Court of First Instance in BUPA, CFI Case T-289/03 *British United Provident Association Ltd. (BUPA), BUPA Insurance Ltd., BUPA Ireland Ltd. V Commission (BUPA)* judgment of 12 February 2008, n.y.r., para. 246.

109 P Nicolaides, 'Compensation for Public Service Obligations: Opening the Floodgates of State Aid?' 2003 *ECLR*, at p. 571.

110 Case C-280/00 *Altmark* [2003] ECR I-7747, paras 88-93. See also Joined Cases C-34-38/01 *Enirisorse SpA v Ministero delle Finanze (Enirisorse)* [2003] ECR I-14243.

must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

The effect of *Altmark* is a significant strengthening of the conditions that must be satisfied for the inapplicability of the State Aid rules.[111] Several more recent judgments and decisions clarify, and to a certain degree further strengthen the *Altmark* conditions. Decision 2005/842 contains a block exemption for such compensation and slightly widens the scope of *Altmark*, where overcompensation up to 20% of the costs is allowed for the social housing sector, provided that this is deducted from next years' compensation.[112] Further operationalisation of *Altmark* takes place in the Community framework for State Aid in the form of public service compensation.[113]

Fairly recent in this series of cases and decisions is *SIC II*, an appeal by a commercial broadcaster against a decision declaring certain measures by the Portuguese authorities vis a vis RTP, the public service broadcaster, not to be State Aid.[114] In *SIC II,* the Court of First Instance held that the fourth *Altmark* criterion does not require the undertaking that discharges the public service obligations to be chosen by means of a tender or public procurement procedure.[115] This may seem a severe setback for private parties who want to challenge the way a service of general economic interest is operated in a Member State. Nevertheless, *SIC II* holds a surprise in that the Court of First Instance seriously checks the Commission's appraisal of the compensation in question. In the contested decision the Commission concluded that, on the one hand, there was a verification system that ensures observance of the public service remit and the costs arising there from, whilst on the other hand it identifies that there were doubts regarding the functioning of this system.[116] As a result, even though the decision was annulled on procedural grounds because the Commission had failed to undertake 'a diligent and *impartial* investigation',[117] the Commission is under a strict duty to investigate the documents furnished by the Member State in order to establish that the public funds amount only to a compensation of costs. This shows that even the Commission is under scrutiny in order to avoid capture. Such capture is highly likely, particularly in the public broadcasting sector where the political stakes are high. For

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[111] P Nicolaides, 'Compensation for Public Service Obligations: Opening The Floodgates of State Aid?' 2003 *ECLR*, at p. 572.

[112] Decision 2005/842, OJ [2005] L 312/67, Article 6. Note that overcompensation is only allowed up to 10% for companies providing both public service obligations and commercial activities.

[113] OJ 2005, C297/4.

[114] Case T-442/03 *SIC - Sociedade Independente de Comunicação, SA v Commission (SIC II)* judgment of 26 June 2008, n.y.r.

[115] Case T-442/03 *SIC II* judgment of 26 June 2008, n.y.r., paras 145-156.

[116] Case T-442/03 *SIC II* judgment of 26 June 2008, n.y.r., paras 225-255.

[117] Emphasis added, Case T-442/03 *SIC II* judgment of 26 June 2008, n.y.r., para 254.

one, national measures in this sector are quickly brought under the guise of cultural policy, an area where the EC has very limited competence.[118] To further raise the stakes, the Member States included Article 16 EC as well as a Protocol on the system of public broadcasting attached to the EC Treaty by the Treaty of Amsterdam. Political pressure from the Member States only increased with the preparations for the European Convention and resulted in a plethora of documents concerning these services of general economic interest and non-economic services of general interest.[119] In view of so much political pressure from the Member States as well as the European Parliament, a change in attitude from the side of the Commission may not come as a surprise. However the fact is that, from a strictly legal perspective, nothing has changed. The only legal novelty in this regard is the introduction of Article 16 EC, and this provision explicitly states that it is 'without prejudice to Articles 73, 86 and 87', thus leaving the major legal components of the abovementioned debate untouched. The Protocol on Services of General Interest attached to the Treaty of Lisbon has a similar political character without actually changing the legal framework.[120] Finally, the review of the Guidelines on State Aid for Public Service Broadcasting also takes place in a similar cautious manner, with a third round of consultations currently under way.[121] Notably, the observations of the Association of Commercial Television Broadcasters in Europe make for an interesting read, particularly when compared to the observations submitted by the European Broadcasting Union.[122] Much of the debate centres on the exact definition of the public service remit, as this defines the public service obligation and thus the possibility for compensation. It is with regard to this that the Commission's decisions, as well as the Court of First Instance's case law, show that effective supervision results in a more effective and efficient public broadcasting organisation. In *RTVE*, which concerned the Spanish public broadcasting organisation, State Aid supervision triggered a study which revealed that the workforce employed by RTVE exceeded what was necessary for the public service obligation, resulting in a more efficient public broadcasting organisation.[123] Similarly, the definition of the public service remit for German public broadcasters ARD and ZDF was insufficiently defined.[124] In this case the Commission confirmed the technology neutrality of the

118 Article 151(5) second indent, EC. See further S.A. de Vries, *Tensions within the Internal Market; The Functioning of the Internal Market and the Development of Horizontal and Flanking Policies*, Groningen: Europa Law Publishing 2006.

119 A wealth of documents dealing with this topic can be found on http://ec.europa.eu/services_general_interest/documents_en.htm

120 *Supra* paragraph 1. For an assessment of the impact of this protocol see: F. Amtenbrink & J.W. van de Gronden, 'Economisch recht en het Verdrag van Lissabon I: mededinging en interne markt', [2008] *SEW*, p 323–329.

121 See: http://ec.europa.eu/competition/sectors/media/overview_en.html.

122 All available from: http://ec.europa.eu/competition/consultations/2009_broadcasting_review/index.html

123 See Commission decision of 7 March 2007 in case NN/8/2007, OJ 2007 C 109/2. See also press release IP/07/291.

124 Commission decision of 24 April 2007 in case E/3/2005, OJ 2007 C 185/1. See also press release IP/07/543.

public service obligation, which means that a public service obligation can also exist for non-linear broadcasting on, for example, the internet.[125] At the same time the Commission insisted that this public service character would be examined in advance[126] and that the rules on transparency be applied without mitigation.[127]

At this moment, *TV2 Danmark* is the most recent case where public service obligations are applied.[128] In this case, *inter alia*, a number of commercial broadcasters active on the Danish market argued that the Commission had acted contrary to Article 86 and 87 in authorising an aid scheme for TV 2 Danmark, a public service broadcaster. The Court of First Instance commenced its appraisal of the Commission decision with an overview of the various protocols and resolutions on public service broadcasting.[129] Having thus set the scene, the Court then held that the exact definition of the public service remit is for the Member States. True as this may be, in light of the Court's case law, the fact remains that *Altmark* requires an exactly defined public service obligation. Indeed, the basic argument put forward by the commercial broadcasters – our programming isn't that different from that of the public broadcaster – appears convincing. Nevertheless the Court of First Instance rejects it, holding that this would effectively deprive the Member States of their power to define the public service remit.[130] It is submitted that this fails to take into account exactly what the public service obligation encompasses: an obligation to deliver services that would not be provided in the absence of state intervention. This means that public service broadcasters could certainly provide non-public services in the form of programmes that are barely different from those offered by commercial broadcasters, but that such programmes would have to be provided in fair and undistorted competition with the commercial broadcasters. The State Aid thus saved can then be put to good use compensating actual public service broadcasting. Of course it would be for the Member States themselves to define what constitutes actual public service broadcasting; however, a commercial broadcaster should be able to effectively invoke a legal instrument to ensure that the public service remit is adequately defined and redefined to take account of technical, economic, political and societal changes.

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[125] This is reflected in the amendments to the Television without Frontiers Directive by Directive 2007/65 on audiovisual media services, OJ 2007 L 332/27.

[126] Commission decision of 24 April 2007 in case E/3/2005, OJ 2007 C 185/1, paras 225-236 and 359-374.

[127] Directive 2006/111 on transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings OJ 2006 L 318/17.

[128] Joined Cases T-309/04, T-317/04, T-329/04 and T-336/04 *TV 2/Danmark* judgment of 22 October 2008, n.y.r.

[129] Joined Cases T-309/04, T-317/04, T-329/04 and T-336/04 *TV 2/Danmark* judgment of 22 October 2008, n.y.r., paras 101 – 106.

[130] Joined Cases T-309/04, T-317/04, T-329/04 and T-336/04 *TV 2/Danmark* judgment of 22 October 2008, n.y.r., para 123.

6. CONCLUSIONS

In light of the political fireworks identified above in the form of myriad protocols, resolutions and declarations, the question becomes when and to what extent legal rules and judicial bodies become captured by politics to the extent where they no longer fulfil their regulatory role. The judgment in *BUPA*, similar to that in *TV 2 Danmark*, shows great deference, on the part of the Court of First Instance, in applying the *Altmark* criteria to the Commission decision; declaring that the Irish risk equalisation scheme (RES)-payments did not constitute State Aid because they satisfied the *Ferring* criteria.[131] The RES payments are a means to equalise risks between medical insurance companies that have a relatively 'bad' risk population in comparison to the average insured population, thus ensuring solidarity between insurance schemes and ultimately consumers. In *BUPA* the effect of the RES payments was that BUPA, a private medical insurance company with a market share of 15%, would have to transfer funds to VHI - the incumbent undertaking with an 80% market share.[132] Unsurprisingly, the Court of First Instance accepted that the *Altmark* criteria should be applied to the Commission's decision.[133] The Court then went on to apply a marginal test in view of the complex economic facts. As a result a specific public service obligation is distilled from nothing more than general requirements imposed on all companies offering private medical insurance, such as BUPA and VHI.[134] On a similar note the requirements concerning the prevention of overcompensation and proportionality are glossed over by the Court with remarkable ease.[135] *BUPA* raises a fundamental point concerning the intensity of judicial review, where the Court of First Instance states that its review is limited to manifest errors of appraisal in view of the complex economic facts.[136] If *BUPA* is anything to go by *Altmark* type cases will invariably involve complex economic facts – in fact it makes one wonder whether there will ever be a case involving simple economic facts. This in turn begs the question of what role the Community judiciary actually envisages for itself in judicial review of competition cases. Moreover, is *BUPA* the result of capture of both the Commission and the Court of First Instance? The answer to this question depends on the role attributed to players in the 'market for European norm setting'. Although regulatory competition regarding health care insurance is difficult to envisage, BUPA's reference to the Netherlands RES is telling

131 CFI Case T-289/03 *BUPA* judgment of 12 February 2008, n.y.r. It may be noted that the contested Commission decision predates *Altmark*.

132 Actually BUPA stated that it would consider withdrawing from the Irish market for private medical insurance as a result of the RES payments, T-289/03 *BUPA* judgment of 12 February 2008, n.y.r., para 78.

133 Case T-289/03 *BUPA* judgment of 12 February 2008, n.y.r., para 159.

134 Case T-289/03 *BUPA* judgment of 12 February 2008, n.y.r. paras 182, 183.

135 Case T-289/03 *BUPA* judgment of 12 February 2008, n.y.r. paras. 224 *et seq.* and notably paras 234-238. In this regard, it is particularly poignant that BUPA actually pointed at the Netherlands RES, where such guarantees were in place, para 123. For a critical appraisal of *BUPA,* see: W Sauter, 'Risk Equalisation in Health Insurance and the New Standard for Public Service Compensation in the Context of State Aid and Services of General Economic Interest', *TILEC Discussion Paper* 2008-42, http://ssrn.com/abstract=1310673.

136 Case T-289/03 *BUPA* judgment of 12 February 2008, n.y.r., paras 220-222.

and shows that, short of regulatory competition, there are benchmarks.[137] So, if there are benchmarks in a 'market for health care insurance regulation', what are we to think of the numerous attempts to influence and steer the rules of the game from the side of the major players on this market? It is, of course, the Member States' prerogative to amend the primary law of the Community in order for it to better take account of their national needs. This, however, is something that the Member States have not done for the simple reason that they trust each other even less than they trust the Commission and Community Courts. These observations should not divert attention from the underlying issue in *BUPA*, which is the existence of a rule that – depending on whether BUPA or the Irish government is right – requires risk compensation or the compensation of inefficiency and overconsumption. The latter cannot be good for competition or the level of health care. Similarly, over-allocation of emission allowances, or an excessively lenient application of the provisions on carbon leakage, benefit neither the level playing field nor the fight against climate change. A strict and thorough application of EC competition law is an important instrument to help both competition and these non-economic objectives.

[137] Case T-289/03 *BUPA* judgment of 12 February 2008, n.y.r., paras 123, 124 and 130.

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Can We Protect Competition Without Protecting Consumers?

*Oles Andriychuk**

Competition belongs to one of the most important values of the European Union. However, competition is not an exclusive path to create welfare and generate efficiency. In this respect competition can be seen as a 'luxury product' of market-oriented societies, which is not indispensable for achieving such values as industrial growth, market integration, social coherency, consumer welfare or innovations. Why then should competition be perceived as a separate economic value? What features does it contain which are so important for liberal democracy? How should competition be correlated with consumer welfare? These questions are central to this paper, which argues for conceptual separation of competition and consumer welfare and offers a methodology for the 'unbundled' analysis of these societal values.

COMPETITION-AS-A-MEANS VS COMPETITION-AS-AN-END

It is usually taken for granted that competition-as-a-process in not the most important value of antitrust policy, and that 'the ultimate objective of […] intervention in the area of antitrust and merger control should be the promotion of consumer welfare'.[1] The very term 'consumer welfare' is defined differently by different authors. The representatives of the Chicago School, for instance, consider it as a logical outcome of allocative and productive efficiency. Those, who advocate more interventionist approach to competition policy, measure it rather in terms of low prices and/or variety of choices. The common denominator for both (and some other) theories is the idea that (i) consumer welfare is seen in the utilitarian terms of the *outcomes* which are more important than the *process of competition* and (ii) consumer welfare is the final objective of antitrust policy. This paper proceeds from and concentrates on these two generic features of consumer welfare which are common for different schools of antitrust. In this sense the terms 'consumer welfare', 'consumer interests' and 'efficiency' are used as synonyms. They all are consequentialistic and they all constitute the core of the utilitarian perception of competition as opposed to competition in deontological sense.

Although the mantra of consumer welfare is mainly evident in political rather than judicial outputs in European antitrust,[2] the idea that consumer welfare constitutes the

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* Ph.D. Researcher, European University Institute, Florence, Post-Doctoral Research Fellow, ESRC Centre for Competition Policy, University of East Anglia.

[1] Philip Lowe, 'The design of competition policy institutions for the 21st century – the experience of the European Commission and DG Competition', Competition Policy Newsletter, Number 3, 2008.

[2] Pinar Akman, "Consumer Welfare' and Article 82EC: Practice and Rhetoric' (2009) 32(1) World Competition 71 at p 71: 'as far as this author is able to detect, the term 'consumer welfare' has been used in merely two competition cases by the Court of First Instance … and has never been referred to by the European Court of Justice'.

ultima ratio for competition policy is increasingly accepted. As Hovenkamp eloquently points out:

> '[j]udges have spoken of antitrust law as a "consumer welfare prescription" for so long that the phrase seldom produces anything but yawns… The rhetoric of "consumer welfare" is very powerful. A statute declaring protection of consumers to be the goal of antitrust would probably pass Congress by a unanimous vote'.[3]

Those who consider that competition should serve only as a means to generate consumer welfare can be seen as advocates of 'utilitarian antitrust', which 'instrumentalises' competition, claiming that competition without efficiency does not deserve protection. According to Kroes, '[f]ree competition is not an end in itself – it is a means to an end'.[4] On the contrary, from the perspective of 'deontological antitrust', competition is perceived as a process. In its report on the mergers in contemplation *Safeway plc and Asda Group Ltd* the UK Competition Commission observed that '[w]hen working effectively, competition involves a process of rivalry between firms'.[5] This process constitutes a societal value in itself, even in the cases when this process does not lead to welfare gains, because '[v]igorous competition between firms is the lifeblood of strong and effective markets'.[6]

These two approaches to competition perceive differently the correlation between competition and consumer welfare. Indeed, the doctrinal relationship between the notions of 'competition' and 'consumer welfare' is ambivalent. On one hand they are analysed in their causal interconnection, where competition is seen as a way to generate welfare (from the utilitarian perspective). On the other hand, competition itself deserves its protection even in circumstances when it does not lead to efficiency gains (from the deontological perspective). As Schaub indicates, '[a]doption of a competition law is a political act. Thus, debate on objectives cannot be limited to economic arguments'.[7] Competition and welfare are considered in the mainstream discourse of antitrust analysis as mutually correlated. Such beneficial interdependence often implies their convergence, which causes several conceptual inconsistencies.

The 'merger' between competition and consumer welfare despite its practical usefulness leads to several analytical problems. One of them is terminological. Anticompetitory[8]

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[3] Herbert Hovenkamp, *The Antitrust Enterprise. Principle and Execution*, Harvard University Press, 2005.

[4] Neelie Kroes, "Free competition' is not an end in itself...', Concurrences, N° 3-2007.

[5] 'Safeway plc and Asda Group Ltd. A report on the mergers in contemplation', September 2003, UK Competition Commission. Cited in Mark Furse, *Competition Law of the EC and UK*, 6th Edition, Oxford, 2008.

[6] White Paper 'Productivity and Enterprise' (Cm. 5233, July 2001), UK Government. Cited in Mark Furse, 'Competition Law of the EC and UK', 6th Edition, Oxford, 2008.

[7] Alexander Schaub, Working Paper, Claus Dieter Ehlermann, Laraine L. Laudati (Eds), *The Objectives of Competition Policy - European Competition Law Annual 1997*, Hart Publishing, Oxford, 1998.

[8] It is more precise to use the category 'competitory' instead of 'competitive'. The meaning of the latter term is much broader and apart from its antitrust sense (i.e. 'involving rivalry') it also encompasses the rather industrial meaning of 'competitiveness' as 'being of good enough value to be successful against other competitors'. See Oles Andriychuk, 'How the Theory of Dialectical Antitrust Perceives the Role of

agreement which benefits consumers often receives its immunity from antitrust sanctions and is usually called procompetitory, even despite the fact that its impact on competition remains negative. And other way around, some agreements which are harmful for consumers are called anticompetitory even despite the fact that they are either procompetitory or competition-neutral. Thus, landmark decision of the U.S. Supreme Court in *Leegin* case recapitulates this formula as well: 'The rule [of reason] distinguishes between restraints with anticompetitive effect that are harmful to the consumer and those with procompetitive effect that are in the consumer's best interest',[9] explicitly equalising anticompetitory effects with the harm to the consumer.

The problem can be explained by the fact that the antitrust theory does not recognise that some market behaviour can be simultaneously pro and anti-competitive and, as Crane observes, that '[s]ome competitive practices that cause harm cannot be controlled without doing damage to similar competitive practices that do good'.[10]

An interpretation of competition solely as a means to increase consumer welfare eliminates substantial characteristics from competition as a process, depriving competition from its original meaning. According to McNutt, 'competition is a process, and as such can be described, rather than defined'.[11] Therefore it is necessary to elaborate methodological instruments for dialectical analysis of these interdependent phenomena without their logical juxtaposition.

It is misleading to define competition by evaluating its external role on the economy. This role is important only from the perspective of performance. From the ontological view however it is irrelevant. Some forms of competition are *good* or *beneficial* others are considered as *harmful* or *undesirable*, but in both cases we talk about different features of the same phenomenon. The idea that 'competition has to bring positive outcomes for economy, otherwise it is not competition' is logically incorrect. It is impossible to qualify the essence of object only by exploring its external effects.

Methodologically, the *effect* of competition on the consumer welfare has to be taken out of the factual context; or the other way around – competition initially has to be explored separately from consumer welfare. If competition indeed is as an independent societal value, then it should not be subordinated to the efficiency gains. The *outcomes* which it brings for the economy (those are usually measured in terms of welfare or efficiency) should be correlated with *competition-as-a-process* only at the external cognitive level. The former cannot just substitute the latter. The mechanism for correlation of different conflicting societal values is encompassed in the idea of balancing. Each

Competition Authorities', The ICC Global Antitrust Review, Issue 2, 2009. http://www.icc.qmul.ac.uk/GAR/GAR2009/GAR%20On-line%20Oles%20Andrychuk%205.pdf

9 *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

10 Daniel A Crane, 'Chicago, Post-Chicago, and Neo-Chicago', Reviewing Robert Pitofski (ed.), *How the Chicago School Overshot the Mark*, Oxford University Press, USA, 2008, in Benjamin N. Cardozo School of Law Jacob Burns Institute for Advanced Legal Studies April 2009, Working Paper No. 259.

11 E.g. Patrick A McNutt, 'Taxonomy of Non-Market Economics for European Competition Policy – The Search for the True Competitive Price' (2003) 26(2) World Competition 303.

regulator faces the necessity to compromise some values for the benefits of the others. By separating competition from consumer welfare, we can envisage the situations where welfare is prioritised over competition – but also other way around: in other cases competition could potentially receive its priority over welfare-related gains. Both situations are conceptually plausible. None would undermine the ontological essence of the value which has become de-prioritised, because the decisions of regulators are based on the unique constellation of the political preconditions which are impossible to predict ex ante with the scientifically relevant probability.

The distinction between utilitarian and deontological competition is implicitly recognised by some regulators, yet has not been sufficiently articulated. Thus, the UK Office of Fair Trading distinguishes competition from consumer welfare:

> 'the OFT views competition as a process of rivalry between firms seeking to win customers' business. This process of rivalry, where it is effective, impels firms to deliver benefits in terms of prices, quality and choice. When levels of rivalry are reduced (e.g. because customers have fewer firms among which to choose or because of coordinated behaviour between firms), the effectiveness of this process may diminish to the likely detriment of customers.'[12]

Thus, OFT recognises the possibility of competition which is not efficient for consumers, but this mere fact does not make this process anticompetitory.

Competition should not be seen as a zero sum game. Even in sports where the parties are fighting for the trophy, which by definition presupposes only one winner and the rest losers, there are other ancillary benefits (positive externalities) aside from the trophy. While most of these effects are neither expected nor directly strived for by the competitors, they bring added value to the market. Within this constellation, the very idea of competition is all about such externalities. The moment of unexpectedness is very important, since it shows the inherent elements of competition, which are of a similar nature to the invisible hand of the market. They are not sufficient for the existence of the contest, but their elimination makes the very concept of competition meaningless.

THE VALUE OF WEALTH

Today consumer welfare is a benchmark for competition. The idea of consumer welfare was imported into the antitrust context by representatives of the Chicago School.[13] They perceived consumer welfare as a standard of appropriateness for antitrust sanctions, though, as Crane notes, 'Chicago's non-interventionism is greatly

[12] Office of Fair Trading, UK, Mergers: Substantive Assessment Guidance, 2003 http://www.oft.gov.uk/shared_oft/business_leaflets/enterprise_act/oft516.pdf .

[13] For an overview of the influence of the Chicago School on modern antitrust see inter alia William E Kovacic, 'The Antitrust Paradox Revisited: Robert Bork and the Transformation of Modern Antitrust Policy', (1990) 36 Wayne Law Journal 1413.

overstated'.[14] The initial presumption was that such presumably anticompetitory practices as distributional restraints or some unilateral conducts are not illegal per se. Consequently, those practices can be cross-checked by the simultaneous benefits for the consumers and, as a result, being declared procompetitory. Thus the Chicago School had advocated 'soft antitrust', by applying a consumer welfare standard: allegedly anticompetitory conduct can be allowed if it brings benefits for consumers. As Fox indicates:

> '[t]he 1980s victory of the Chicago School was more a victory of economic libertarianism and political conservatism than of maximisation of a microeconomic welfare function. 'Consumer welfare' was the label given for the raison d'être of the new regime, but it obscured the fact that the real first principle was non-intervention'.[15]

She follows on by explaining how exactly the term 'consumer welfare' has been operationalised by policy-makers with its subsequent transformation into a benchmark of antitrust enforcement.

Nowadays the yardstick of consumer welfare serves also the opposite purpose. It requires the application of competition remedies in every situation where consumer welfare is likely to be violated. Some authors[16] explicitly equalise harm to competition with harm to consumer. Others go further, claiming that competition law should serve 'as a true means of consumer well-being maximisation'.[17]

Thus the Chicago School paved the intellectual way for its ideological opponents. By deconstructing the legal formalism of per se rules for the benefits of *laissez-faire* policy, the Chicagoans have elaborated conceptual techniques of legal realism. These techniques are widely used by the interventionalists, who apply the same *outcome-oriented* way of reasoning (i.e. consumer welfare standard) for the regulatory purposes which are diametrically opposite to the Chicagoan *laissez-faire* ideals.

The situation was somewhat different in earlier stages of competition policy in Europe, when the Ordoliberal School put on the agenda the necessity to defend the right to compete, considering this a fundamental part of the economic constitution. This being said, while ordoliberals were much closer to perceiving competition as an independent value, even the ordoliberal vision of antitrust did not encompass the notion of

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14 Daniel A. Crane, 'Chicago, Post-Chicago, and Neo-Chicago', reviewing Robert Pitofski (ed.), *How the Chicago School Overshot the Mark,* Oxford University Press, USA, 2008, in Benjamin N. Cardozo School of Law Jacob Burns Institute for Advanced Legal Studies April 2009, Working Paper No. 259.

15 Eleanor M Fox, 'We Protect Competition, You Protect Competitors', (2003) 26(2) World Competition 149.

16 John Temple Lang, Robert O'Donoghue, 'The Concept of an Exclusionary Abuse under Article 82 EC', Global Competition Law Centre Research Papers on Article 82 EC July 2005: 'It could be argued, with some force, that […] there is no harm to the "structure of competition" that, ultimately, does not also lead to direct consumer harm. […] Put differently, there can be no case for intervention under competition law where there is harm to the competitive process, but none to consumers'.

17 Eugene Buttigieg, 'Consumer Interests Under the EC's Competition Rules on Collusive Practice' (2005) 16(3) European Business Law Review 643.

competition as a fundamental ideological choice. It limited antitrust concerns mostly to the rights of competitors, their ability to compete combined with the regulatory idea of 'liberal interventionism'.[18] Thus, although the ordoliberal approach is the closest to solving the antitrust paradox, at the end it treats it as 'the Gordian knot' and offers a more prescriptive than analytical remedy.

Discussion about the relationship between deontological and utilitarian elements of public values is not unique to antitrust. Debate concerning the relationship between deontological rights and utilitarian interests are going on in the domain of legal theory and political philosophy. The spectrum of arguments of both parties is wide and persuasive. Competition law discourse, on the contrary appears to be rather ignorant of this dilemma, which is still implicitly presented in many antitrust considerations. One of the most fruitful polemics in the field occurred between Ronald Dworkin[19] and Richard Posner.[20] Dworkin argued that wealth maximisation should not be seen as a per se legitimate benchmark of the political and judicial interpretation of law. He justified his argument, questioning 'why social wealth is a worthy goal. Who would think that a society that has more wealth, as defined, is either better or better off than a society that has less'?[21]

'Wealth', as utilitarian category, can be seen in the context of antitrust as 'consumer welfare'. Dworkin claimed that if the only standard of appropriateness is wealth maximisation, then every time wealth can be maximized at the expenses of violation of law, it would be done so, because obedience to legal rules is not always the most efficient way to increase welfare. Posner, on the contrary, stated that wealth maximisation will inevitably lead to the development of such deontological values as respect of human rights and individual freedoms and other personal virtues. Furthermore, Posner believed that wealth should not be perceived as utility. He illustrated his claim by showing that '[t]he difference between wealth and utility is that wanting something very much, but not being able to pay more for it than its owner or competing demanders, does not establish a claim to a good in a system of wealth maximization, although it might do so in a system of utility maximization'.[22] Thus, he essentially shifts the debates from a 'rule vs reason' dimension to a 'left vs right' ideological battle. Even under the latter constellation, however, such values as negative economic freedom and wealth maximisation can be in a direct conflict with positive rules and/or moral imperatives.

In the context of antitrust, the utilitarian vision of competition would support only 'the most effective' forms of a competitory process (i.e. those forms of competition, which

[18] Christian Joerges, Florian Rödl, 'Social Market Economy as Europe's Social Model?', European University Institute Working Paper, Law, No. 8, 2004.,

[19] Ronald M Dworkin, 'Is Wealth a Value?', (1980) 9(2) Journal of Legal Studies 191.

[20] Richard A Posner, 'The Value of Wealth: A Comment on Dworkin and Kronman' (1980) 9(2) Journal of Legal Studies 243.

[21] Ronald M Dworkin, 'Is Wealth a Value?', op cit, n 19.

[22] Richard A Posner, 'The Value of Wealth: A Comment on Dworkin and Kronman', op cit, n 20.

bring the benefits for consumers). Those who advocate competition as an independent value claim that the genuine criterion for competition has to be the very intention to access the market. The greater the desire to enter, the greater is competition. The level of competition does not depend on the conditions of accessing the market. Competition can exist in both formats: opened for external competitors and closed for them. In terms of behavioural economics, the main criterion for measuring competition is the willingness of potential competitors to enter this market (not, as it is traditionally suggested, a lack of barriers to entry) and vice versa unwillingness of existing competitors to leave the market (not, as it appears to be with closed markets, the reluctance to block the entrance for the newcomers). It is not to say that a closed model is more desirable for society than an open one, but rather to point out their 'relative irrelevance' for competition. It is not the *structure* of the markets, which is detrimental for measuring competition-as-a-process, but rather their *attractiveness*. Competition in this behavioural context appears similar to the Freudian libido, 'Ordo instinct of economic life', Hayekian 'competition as a discovery process' or to Darwinian notion of 'competition as nature's God'.

PARENTHESES THEORY

$(2 \times 2) + 2 \neq 2 \times (2 + 2)$

Methodologically the conflict between competition-as-a-process and other legitimate societal values (such as welfare-oriented values) can be explored by application of the parentheses theory. The idea behind this method has ancient roots. Essentially, it is borrowed from the language of mathematics. Its formula is: $(2 \times 2) + 2 \neq 2 \times (2 + 2)$, which means that the identical arguments provide different results, depending on their proportion and correlation with one another or depending on the scope of the parentheses. The presence of the parentheses, as well as their place in the equation, changes (sometimes dramatically) the outcome.

Epistemologically, the parentheses relate to the ability to separate a phenomenon for its following independent analysis. In verbal language, the items, taken within the parentheses would mean the consideration of a certain notion as a 'thing-in-itself', outside of the context. A thing-in-itself has to be distinguished from the phonetically similar notion of an 'end-in-itself'. While the former explores the matter without any external context and influence of other things, the latter strives to subordinate everything to it. An end-in-itself has the tendency to internalise and all neighbouring items, whereas a thing-in-itself, on the contrary, tends to exclude alien elements in order preserve the integrity of the cognitive analysis. The former makes a case for domination, the latter – for separation.

Regardless of the practical usefulness, on the abstract level, the things have to be explored with no linkage to other objects, however close and inseparable the connection with other phenomena might appear to be in real life. In the domain of antitrust, competition as a process should be explored without any direct connection to ancillary objects. The rationale behind this claim is valid, if we perceive – as this paper does – competition in its deontological sense. Its 'structural separation' from welfare-oriented values is politically legitimate and logically substantiated, because competition in its economic, cultural and a political senses constitutes the fundament of liberal democracy.

There are direct parallels between the political dimension of competition (encompassed in the idea of the elections, where political parties *compete* for being prioritised by the electorate), its cultural dimension (where intellectual and artistic ideas are freely circulated among the people) and its economic dimension (where firms compete in the markets). All three dimensions of competition are inevitable for liberal democracy. If the hypothesis of this paper is correct, then the economic aspects of competition-as-a-process should be protected regardless of its eventual outcomes. We do not protect only *good* political parties and we do not support only *good* cultural ideas, believing that the competitory framework itself deserves its protection too. The same is the case for the economic competition: it should be protected not (only) because it generates the best outcomes, but as a matter of principle and as a matter public choice. If the former is true, then competition should be methodologically separated from other legitimate societal values for its independent theoretical examination. There is enough room for the following re-focusing and re-investigation of the influence of competition on consumer welfare, but these two analyses should be conducted separately.

On the ontological level, the purposes of different policies are balkanised and controversial: the closer to borders with another policy, the more explicit such controversies become. As Schweitzer indicates, 'competition law norms cannot incorporate an open balancing of all goals set out in Art. 2 and 3 of the EC Treaty without losing their meaning and effectiveness'.[23] Policymakers perform a balancing of different policies and objectives in accordance with their rational political choices and ideological persuasions. Inasmuch as one can prove that competition constitutes a genuine thing-in-itself, which initially has to be internally evaluated and only later undergone the external balancing test, it will be possible then to elaborate a hierarchical constellation of different societal objectives and formulas of their correlation. According to Kirchner, 'competition policy is competing with other policies which may pursue conflicting ends, e.g. agricultural policy, industrial policy, environmental policy'.[24]

This paper tries to prove that competition-as-a-process not only deserves to be explored as a separate phenomenon, but also that due to its internal characteristics it has to be considered among the highest priorities in the taxonomy of values and objectives of the European social-market economy in conformity with Articles 3(1)(g) and 4(1) EC. Competition, therefore, should be seen a *luxury product*, a matter of a deliberate public choice rather than an *indispensable element* of governance. The

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[23] Heike Schweitzer, 'Competition Law and Public Policy: Reconsidering an Uneasy Relationship. The Example of Art. 81', EUI Working Papers, Law 2007/30, Florence, 2007. .

[24] Christian Kirchner, 'Goals of Antitrust and Competition Law Revisited' in Dieter Schmidtchen, Max Albert, Stefan Voigt (eds), *The More Economic Approach to European Competition Law*, Mohr Siebeck, Tubingen, 2007.

protection of competition-as-a-principle safeguards it from the necessity of being permanently correlated with the 'efficiency benchmark'. Thus after being raised up to the level of the constitutional value, competition sometimes can be *inefficient*. Its inefficiency does not necessarily cancel its legitimacy.

The external balancing of different legitimate societal goals has to be performed on a *par in parem* principle, whereas none of these policies has to serve as a final aim for another. This theoretical discussion is indispensable in antitrust theory. One of its dimensions is a correlation between the passive right to compete and the proactive right to benefit from successful competition. Usually the successful competitor is protected by property rights, which reaffirms the existing state of affairs and in static terms protects his 'right to be successful'. Originating in liberal economics and 'modernised' by the Chicago School it intuitively strives to protect such successful competitors, but in a quite unexpected methodological way. Instead of referring to the natural right to economic success or natural right of property, which are in the same hierarchical system with the right to compete, it relies on an argument of consumer welfare; instead of saying 'PR = RC it says PR $\rightarrow$ CW'; instead of saying in deontological terms 'the Right to Compete is as natural as a Property Right' (and therefore the tradeoffs between them are possible on a level of political choices), it says in utilitarian language 'the Right to Compete leads to Consumer Welfare' (and therefore it has to be protected).

The right of successful competitors to benefit from their commercial power is the most appropriate counterbalance to the right of the real and potential competitors to enter into a competition. The main problem with this equation is that it does not leave room for legal and economic certainty: each reasonable economic act has some benefits for some consumers; hence, it immunises the actor from the responsibility of a violation of the right to compete. If one would still mention this logical inconsistency, s/he will be advised to try to look outside the boxes. However, there is no such thing as thinking outside the framework of the premises. The logical reasoning *ipso facto* presupposes a system within which to operate. Logical thinking is possible only inside boxes. Each abstraction requires structural certainty.

The main practicality of the parentheses theory is that it provides an effective tool for the separation of means from ends; it offers a method of re-establishing the causal linkage whenever it has been lost incidentally or changed intentionally. For instance, depending on the context, one would prefer listening to music to reading a poetry, or even would consider this as a zero-sum game (i.e. the more s/he listens to music the less time remains for reading a poetry), yet this ad hoc rational choice of the individual by no means reflects the essence of both – *reading* and *listening*. It is so even regardless of the fact that from a subjective utilitarian perspective these practices will be in direct conflict with each other.

The separate and independent existence of competition law is not a necessity, if it does not pursue *sui generis* tasks. If its task is limited to total welfare maximisation, it is a total welfare maximisation law, if it is limited to the maximisation of consumer welfare – it is a consumer welfare law etc. Competition policy may be pro-consumer, consumer-neutral or anti-consumer, because the primary purpose of competition policy sensu stricto is *protection* of competition-as-a-process (Art 81-82 EC and major part of merger regulation) and the secondary purpose of competition policy sensu stricto is *promotion* of competition-as-a-process (sector-specific regulation, liberalisation policy and some elements of merger regulation). The internal incentives of competition policy should never be neither competition-neutral nor anticompetitory. Antitrust policy has to be concerned only with competition-as-a-process. If competition happens to be anti-consumer, government has to decide to what extent it has to apply it. Such a trade-off is inherent to every regulatory action.

As Lowe shows:

> 'competition authority should ideally intervene at the right time […] In the real world, however, external constraints – resulting from limited resources and the institutional context – often disrupt this ideal. No competition authority has the resources to do all possible cases. Some form of prioritisation is necessary'.[25]

Each political decision is the consequence of many compromises between different policies. Such compromises, however, do not reflect the nature of these policies. The utilitarian reduction of competition to its positive influence on consumers is only practical from the political point of view, since it allows conducting a more effective governing. However, scientifically this approach is reductive and purpose-oriented and therefore doubtful.

CONCLUSIONS

Why is it necessary to distinguish competition as a deontological value and welfare-oriented utilitarian values as two epistemologically different policies? Beside theoretical clarity, taking them in separate parentheses helps to find proper causal links between them. It is not the same to say the 'European economy is efficient because it ensures the freedom to compete' and 'the freedom to compete exists because it ensures the efficiency of the European economy'. In these days of fast economic growth of planned-oriented economics with the command-based approach to the regulation of the markets and against the current background of recession in many liberal economies, one could rhetorically dispute the efficiency of the latter, and give priority to allegedly more efficient models of economic regulation.

Presuming that this is the case, then should we sacrifice the freedom to compete to alleged economic efficiencies that arise from the restriction of this freedom? The freedom to compete is a thing-is-itself, which is inevitable for the liberal spirit of European democracy. The limits of this freedom are possible only in its external application, inasmuch as it has to be counterbalanced with other interests in the society. Economic efficiency and consumer welfare are valuable and legitimate goals of

25 Philip Lowe, 'The design of competition policy institutions for the 21st century – the experience of the European Commission and DG Competition', Competition Policy Newsletter, Number 3, 2008.

European economic policy as well, but they are not goals of antitrust itself, they are the goals of economic-efficiency policy and consumer-welfare policy respectively.

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Competition First? Application of State Aid Rules in the Banking Sector

*Szymon Gebski**

The paper discusses application of the State aid rules in the banking sector. It compares the rules relevant to that sector before October 2008 with the legislative framework adopted as a response to the financial crisis. The research question is focused on how the balance between limiting distortions of competition and rebuilding financial stability is struck, and on a more general level it examines the role of State aid control in managing the financial crisis. The paper finds that the Commission has firmly applied the legal test on the notion of aid, mainly due to its expertise originating from previous cases in the banking sector. On the compatibility level, in the rescue phase the crux of the method is a relaxed approach towards solvent banks, with due safeguards concerning remuneration, exit and lending to the real economy. This allowed the stabilization of the financial system, with the cost of treating competition issues as subordinate. In the restructuring of distressed banks, the overriding aim of financial stability serve to justify various measures that are otherwise not a standard under the R&R Guidelines. For that reason the risk of moral hazard may be hardly evitable in the future. With regard to the management of the crisis, it is submitted that under Article 87(3)(b) State aid should be compatible as a part of a broader structural and regulatory programme.

1. INTRODUCTION

The ongoing financial turmoil has left a considerable footprint on the EC State aid legal framework. From October 2008 the European Commission (the Commission) has adopted under Article 87(3)(b) a new legislative package, which aims to remedy a serious disturbance in the Member States' economies. The newly adopted secondary legislation is based on principles of the Community guidelines on State aid for rescuing and restructuring firms in difficulty (the R&R Guidelines), but sets more detailed provisions reflecting the systemic risks addressed. The paper analyses the new legislation[1] and compares it with the former approach to State aid control in the banking sector in order to observe how the Commission has reconciled the goal of limiting the distortion of competition with the overriding aim of financial stability, and to examine the role of State aid control in managing the current financial crisis.

It is submitted that the recently adopted State aid rules set a new balance between competition and financial stability. Under the rescue aid this is achieved through a distinction between sound and distressed banks, whereas in the restructuring phase the overriding principle of financial stability largely influences the scope of compatibility rules. As regards crisis management by the Commission through State aid rules, a two-step approach is defined. In the first place, the Commission preserved basic principles of the State aid legal framework and ensured coordination of public interventions,

* Ph.D. candidate at the Law Department, European University Institute.

1 The paper concerns developments up to 09.09.2009.

whereas, in the second place, it has taken a more pro-active approach through the regulation of restructuring in the banking sector.

As a starting point, the paper looks at the notion of State aid, as developed in the recent decisions taken by the Commission, pursuant to a massive notification by Member States of rescue measures. Secondly, it examines the legal base and conditions for State intervention in the banking sector, both under the R&R Guidelines and the new legislative framework. The question that this part of the paper tackles, is how Article 87(3)(b) allows the operationalision of the reduction of systemic risks while preserving competition.

2. APPLICATION OF ARTICLE 87(1) CRITERIA IN THE BANKING SECTOR. THE RULE OF LAW AS LEVERAGE TO COORDINATED CRISIS MANAGEMENT

2.1. Political Engagement to Preserve the Rule of Law

The logic of the EC Treaty provisions on State aid implies that the discretionary power of the Commission (exercised under Article 87(3) EC) is triggered insofar as a given State measure fulfils criteria set in Article 87(1) EC. This first step of scrutiny is, therefore, of great importance not only as to its impact on principles guiding national measures and their material scope, but it also implies increased role of the Commission in drafting and implementation of national public policies.

Although the current financial turmoil has provoked a sudden and massive involvement of national measures, the Commission has managed to find consistently the existence of State aid, and to preserve unconditionally the logic embedded in the Treaty. However, what is a recurrent practice of the Commission in normal times, might not be as obvious in the exceptional circumstances of a financial crisis where banks may fail overnight. Hence, it has to be pointed out that preservation of the logic of State aid control in the current crisis seems to be first a result of a political commitment, expressed by Member States during the ECOFIN Council on 7th October 2008, to take measures that enhance the soundness and stability of the banking sector. What is crucial is that the Council underlined the need to establish a coordinated framework and a set of common principles that would guide national measures, among which it enumerated a protection of the legitimate interest of competitors through state aid rules.[2] Recommendations of the ECOFIN Council confirmed the political mandate of the Commission to act pursuant to State aid practice, and more importantly gave a sign that Member States were not willing at that time to avail of Article 88(2) EC, which would have allowed them, subject to unanimity in the Council, to approve exceptional measures addressing the crisis and to bypass the Commission's discretion. This risk of decreasing the rule of law in State aid control, for the sake of addressing financial stability, has not materialised.

[2] See the press release of the 2894th Ecofin Council meeting on 7 October 2008 (13784/08), available on the Council's website at: www.consilium.europa.eu.

2.2. Application of Article 87(1) to Emergency Rescue Measures in the Banking Sector

Article 87(1) states that:

> 'save as otherwise provided in this Treaty, 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 common market'.[3]

The European Court of Justice (ECJ) has confirmed in *Altmark* that:

> 'Article 92(1) of the Treaty lays down four conditions. First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition'.[4]

The focus of examination by the Commission, and therefore analysis of this paper, is primarily on the notion of state resources and on the issue of selectivity and economic advantage. The effect on trade and distortion of competition usually play little role in Commission's assessment of State measures under Article 87(1), this has been even further exacerbated in the examination of measures adopted in the current crisis.

2.2.1. Intervention by the State or through State resources

As clarified by the Court in *Stardust Marine*[5] and *Pearl*,[6] in order to qualify as State aid a measure has to be granted directly or indirectly through State resources and be imputable to the State. In the current crisis, this condition has been fulfilled by the mere fact that any transfer of financial resources, in the form of direct recapitalisation or when triggered by the State guarantee, in fact involved public resources originating directly from the State's budget or a special fund created for that purpose by the State.[7] The Commission found that a guarantee scheme was imputable to the State when the support was to be provided by means of a fund governed by private law, in which the State held 34% of capital, whereas major private banking groups owned 66% of the capital.[8] Despite the majoritarian participation of private capital, the resources were

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[3] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12006E087:EN:HTML.

[4] C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-07747, para 75.

[5] C-482/99 *French Republic v Commission* [2002] ECR I-04397, paras 23-24.

[6] C-345/02 *Pearle BV, Hans Prijs Optiek Franchise BV and Rinck Opticiëns BV v Hoofdbedrijfschap Ambachten* [2004] ECR I-07139, paras 36-37.

[7] Commission Decision NN 48/2008 of 13.10.2008 *Guarantee scheme for banks in Ireland*, OJ C(2008)6059, para 45.

[8] This was the case of "La société de refinancement des activités des établissements de crédit" (SRAEC), created to issue bonds guaranteed by the French State, and consequently to use the funds collected to finance French banks registered and operating in France, Commission Decision N 548/08 of 30.10.2008 *Mesures de refinancement en faveur des institutions financieres*, OJ C(2008)6617, para 5.

imputable to the State due to its right of veto and the fact that *in fine* the State bore economic risks of the fund's operations.[9]

The Commission also found that a measure was imputable to the State when it was first publicly announced by representative of a government and when such declaration was enshrined in a national legislative act.[10] Quite importantly, Member States have proceeded from announcement of a measure to its enactment, which allowed for a clear-cut application of Article 87(1). However, the Commission has recognised in the past that the focus on effects should be extended to also take into account the intent to award aid. This somewhat innovative approach allowed for a mere announcement on the part of public authorities, which aimed to pre-empt downgrading of a bank by rating agencies, to be capable of constituting State aid.[11] Given the fragility of the balance of power between the Commission and the Member States in the area of State aid, it has to be welcomed that the latter abstained from massively announcing the intent to provide State support, with a view to merely induce reaction of financial markets. The work of the Commission might have been obstructed, if the Member States had in the end desisted from providing such support.

2.2.2. Selectivity and addressing 'systemic' risks

One striking element of those few decisions adopted in October 2008 is that initially some Member States claimed that the criterion of selective economic advantage was not fulfilled. First, as concerns selectivity, the measures adopted clearly escaped qualification as general economic policy measures, since they primarily concerned the banking sector and sectoral aid has always been considered by the Court selective.[12] The sole exception seems to concern measures provided by a national central bank, when it acts within the remit of a monetary authority of the Eurosystem.[13] The Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (the Banking Communication) provided that individual support to a financial institution by a central bank was not State aid when the beneficiary was solvent, the liquidity was fully secured by a collateral and provided at a market rate.[14] This is in line with the argument

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[9] Ibid, para 55.

[10] Ibid, para 44.

[11] Commission Decision NN 25/2008 of 30.04.2008 *WestLB riskshield*, para 37. Along the same line the Commission decided in the France Telecom, where it pointed out that 'an announcement which induced the rating agencies from further downgrading France Telecom was capable of constituting state aid, because such public declarations are equivalent from a legal standpoint to a guarantee and were placing the State's reputation on the line, with economic costs in the event of non-compliance' - see Commission Decision C 13a/2003 of 2.08.2004 *France Telecom*, OJ 2006, L 257/55, para 194.

[12] C-173/73 *Italy v Commission* [1974] ECR 00709, para 17.

[13] Communication from the Commission of 25.10.2008 on The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ 2008, C270/8, para 51; Commission Decision N 533/2008 of 29.10.2008 *Support measures for the banking industry in Sweden*, OJ C(2008)6538, para 32.

[14] OJ 2008, C270, para 51.

prevailing in the academic literature, that intervention by a central bank, acting as 'a lender of last resort', is conceived along the deposit insurance, as a way to prevent or minimise negative effects of a crisis.[15] From a State aid law perspective, measures adopted by central banks seem to correspond to the first best solution, which under the modernised balancing test enshrined in the State Aid Action Plan has to be privileged over State aid.[16]

It can be argued that the Commission views the support provided by central banks restrictively. It recognised that some beneficiaries fulfilled conditions required for a central bank's intervention (i.e. had a particular quality of collateral) only as a result of a previous State aid. Although from the point of view of the central bank such State measure was irrelevant, the liquidity provided by it to a beneficiary (especially when it formed a package of measures taken in parallel by the government and the central bank) constituted aid, as the collateral was only eligible due to a previously granted State measure.[17] Accumulation of such support resulted in a rather unusual examination by the Commission of measures taken by a central bank under the compatibility rules of the R&R Guidelines.[18]

With regard to selectivity the Commission has consistently resisted pressure to allow for measures addressed only at the major national financial institutions. Application of the principle of non-discrimination was tested in the exemplary case of the Irish guarantee scheme, where the Ministry of Finance had initially intended to apply the scheme to six major Irish banks, which were indicated by the central bank as those facing the greatest risk from the systemic perspective. It was only within the dialogue with the Commission that Ireland extended the scope of the guarantee to other banks' subsidiaries in Ireland, 'with a significant and broad based footprint in the domestic economy', as well as to foreign branches of 'a systemic significance'.[19] In search of an objective and non-discriminatory method for eligibility of financial institutions some States opted for a specific quota of the market share. This was the case of the Spanish guarantee scheme, which indicated that all solvent credit institutions registered in Spain and having a share of at least 1/1000 of the credit market were eligible for a guarantee.[20] Along the same line, introduction of the objective criterion relating to a percentage of Tier 1 or Tier 2 capital, to allow only sufficiently capitalised banks to avail of the guarantee, was not found discriminatory.[21]

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15 E Carletti, 'Competition and financial markets' OECD Discussion Paper DAF/COMP(2009)2, pp 5-6.

16 State Aid action plan: Less and better targeted state aid: a roadmap for state aid reform 2005-2009, European Commission Consultation Document COM (2005)107, p 7.

17 Commission Decision N 520a/2008 of 13.11.2008 *Urgent measures to guarantee the stability of the Italian banking system*, OJ C(2008)6989, para 60; N 533/2008, op cit, n 13, para 33.

18 Communication from the Commission of 01.10.2004, OJ 2004, C244/2.

19 Commission Decision NN 48/2008, op cit, n 7, para 47.

20 Commission Decision NN 54/B/2008 of 23.12.2008 *Guarantee scheme for credit institutions in Spain*, C(2009)3069, para 41.

21 Commission Decision N 533/2008, op cit, n 13, para 5.

The problem of eligibility of potential beneficiaries reflects well the balance required between a clearly discriminatory aid addressed only to 'national' banks and support to financial institutions of significant importance to national economy, which are considered as 'systemic'. Application of objective criteria to banks incorporated and operating in a given State appears to provide for a non-discriminatory character of a measure. However, this legal requirement of non-discrimination, driven by internal market concerns, has the effect that not only large and 'systemic' banks, but in practice also smaller banks are eligible for aid. In consequence, all banks seem to qualify as 'systemic', which mirrors the specific rationale of public intervention in the banking sector, as explained in economic theory. This is exemplified by a recent decision on restructuring aid to Kaupthing Bank,[22] where the Commission found a bank with €2.3bn balance sheet and 23,000 depositors to be systemic.

2.2.3. Economic advantage

The issue that raised most concerns in the application of Article 87(1) to the first rescue measures notified in October 2008 was the exercise of the Market Economy Investor Principle (MEIP).[23] Again, we can observe that Ireland, being among the first States to provide support to its banking sector, asserted that the guarantee involved no aid as it was to be provided on commercial terms, in accordance with the MEIP. The State would charge a fee for the provision of the guarantee and it would attach additional conditions to limit possible misuse of the scheme.[24] Nevertheless, the Commission noted that given the very large scope of the guarantee in current financial circumstances no private investor would have granted such support, in terms of its material scope and the overall value. Hence, it pointed out that such guarantees do not exist on the market and, given that the measure allowed to achieve the intended result of intervention, it could be granted only by the State.[25] Moreover, the Commission refused to calculate the remuneration only on the grounds of additional cost for the State induced by the guarantee.[26] In its decision concerning the Danish guarantee scheme, the Commission stated that private participation did not alter the State aid element, and recalled that concomitance of public and private interventions has to be proportionate to each party's interest and provided under the same conditions and industrial rationale.[27] This was a clear-cut application of the previous line of case-law, as established in *Alitalia*.[28] Therefore, the deposit guarantee scheme with a capped banking industry contribution

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[22] Commission Decision N 344/09 of 09.07.2009, paras 54-55.

[23] Its usefulness with regard to the banking sector was proven in the German Landesbanken cases, T-228/99 and T-233/99 *Westdeutsche Landesbank Girozentrale and Land Nordrhein-Westfalen v Commission* [2003] ECR II-00435.

[24] Commission Decision NN 48/2008, op cit, n 7, para 36.

[25] Ibid, para 48.

[26] Ibid, para 50.

[27] Commission Decision NN 51/2008 of 10.10.2008 *Guarantee scheme for banks in Danemark*, C(2008)6034, para 32.

[28] T-296/97 *Alitalia - Linee aeree italiane SpA v Commission* [2000] ECR II-03871, para 81.

did not escape the State aid prohibition, when the State bore unlimited liability above the sum provided by the private sector. It was only the unlimited liability of the State that conferred a sufficient credibility for the guarantee to achieve its effect.[29]

Thus, the Commission explicitly rejected any possibility for the State intervention in the current financial turmoil to escape Article 87(1).[30] This is a corollary of the fact that the public intervention is mainly driven by the purpose of addressing financial crisis. Subsequently, (i) the Commission managed to qualify as State aid all measures taken by the Member States in the current financial turmoil, except for a limited scope of measures taken by central banks, and (ii) consequently gained power to exercise discretion over measures notified by Member States. It can be claimed that this firm and convincing application of Article 87(1) has been only possible due to the Commission's past practice concerning aid granted to the banking sector and, in particular, a more elaborate application of the MEIP. Secondly, due to the potential risk for the State of being forced to repay the illegal aid, the Commission's position vis à vis Member States has been reinforced.[31] Thus, the logic of Article 87(1) prevailed over a temptation to avail of the seriousness of the crisis, to create a parallel system of exceptions[32] driven by the aim of aid, i.e. financial stability, directly under Article 87(1). Hence, the Commission has defended its position as a guardian of the State aid principles embedded in Article 87(1).

3. Competition, Financial Stability, Return to Viability or Preventing Moral Hazard. How Does a Compatibility Assessment Under Article 87(3)(b) and (c) Allow Managing the Multiplicity of Goals?

3.1. Application of State Aid Rules to the Banking Sector under the R&R Guidelines.

3.1.1. Particularity of the rescue and restructuring in the banking sector.

The logic of the R&R Guidelines is that a rescue aid is a one-time assistance aiming to keep the ailing firm afloat for the time needed to work out a restructuring or liquidation plan.[33] It should be restricted to a minimum necessary to keep the firm in business for the rescue period. The second step foresees a possibility to grant restructuring aid,

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[29] Commission Decision NN 51/2008, op cit, n 27, point 32.

[30] Commission Decision N 548/08, op cit, n 8, point 58.

[31] C-199/06 *Centre d'exportation du livre français (CELF) and Ministre de la Culture et de la Communication v Société internationale de diffusion et d'édition (SIDE)* [2008] ECR I-00469, paras 51-52.

[32] For a discussion of such possibility see Ch Koenig, 'Instant State Aid Law in Financial Crisis, State of Emergency or Turmoil', EStAL 4/2008, pp 627-629. In that context it has to be recalled that case-law decisively rejects the possibility to reduce the material scope of Article 87(1) by giving legal value to aims of a measure; see C-487/06 P, *British Aggregates Association v Commission* [2008] ECR I-10505, para 92.

[33] OJ C 244, op cit, 18, para 15.

which has to be based on 'a feasible, coherent and far-reaching plan to restore a firm's long-term viability'.[34] Financial and physical restructuring may involve:

> 'reorganisation and rationalisation of the firm's activities on to a more efficient basis, typically involving the withdrawal from loss-making activities, the restructuring of those existing activities that can be made competitive again and, possibly, diversification in the direction of new and viable activities'.[35]

A particularity of the rescue and restructuring aid is that it directly neutralises the effect of a competitive process that leads to loss-making and exit of a firm. Pursuant to Schumpeter's theory of creative destruction, innovation and entrepreneurship allow new entrants to gain market power that erodes the position of old firms and ultimately may cause the exit of such firms.[36] As the economic theory suggests, loss-making is a market signal that resources are better used elsewhere; hence a subsidy to the undertaking in difficulty allows it to maintain or increase its market share at the expense of its rivals.[37] From this perspective the R&R aid has a clear anticompetitive effect.

One of the few exceptions, for which assumptions mentioned supra do not hold, concerns the banking sector, where a failure of one institution can lead to a loss of confidence in the market as a whole, resulting in negative externalities (risk of contagion) for other financial institutions.[38] Origins of this specificity of the banking sector lie in its vulnerability to bank runs, resulting both from a loss of confidence by depositors, from banks' poor performance and their propensity to take excessive risks on the asset side.[39] Thus, a collapse of a bank may have negative effects on financial stability. Although 'financial stability' appears to be the major justification for the current massive intervention in the financial sector and is explicitly referred to as a rationale underlying the recently adopted set of legislation, the term lacks a clear definition.

Financial stability can be defined as:

> 'the joint stability of the key financial institutions operating within financial markets and the stability of those markets. For the financial institutions, this generally means that they are sound, meaning that they have sufficient capital to absorb normal, and at times abnormal, losses and sufficient liquidity to manage operations and volatility in normal periods of time. Market stability … generally [means] the

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[34] Ibid, para 17.

[35] Ibid.

[36] B Lyons, J Van Reenen, F Verboven, X Vives, 'EAGCP Commentary on European Community Rescue and Restructuring Aid Guidelines' of 6 February 2008, p 4.

[37] Ibid, p 2.

[38] Ibid.

[39] E Carletti, op cit, n 15, pp 3-6.

> absence of the kind of volatility that could have severe real economic consequences'.[40]

Financial stability can be also defined as a situation in which the financial system is capable of performing its three key functions simultaneously:

> 'First, the financial system is efficiently and smoothly facilitating the intertemporal allocation of resources from savers to investors and the allocation of economic resources generally. Second, forward-looking financial risks are being assessed and priced reasonably accurately and are being relatively well managed. Third, the financial system is in such condition that it can comfortably if not smoothly absorb financial and real economic surprises and shocks [systemic risks]'.[41]

This definition implies that the objective embedded in financial stability is to maintain the functioning of financial system and its ability to support the efficient functioning of the economy, which can be achieved by putting in place, 'mechanisms to prevent financial problems from becoming systemic or from threatening the stability of the financial and economic system'.[42] Therefore, it signifies that financial stability can be both a short and a long-term exercise, which encompasses both addressing systemic risks and regulatory crisis prevention.

The systemic risk is defined as, 'the risk that an event will trigger a loss of economic value or confidence in (…) a substantial portion of the financial system that is serious enough to quite probably have significant adverse effects on the real economy'.[43] The effect of systemic risks on the economy can occur through payment system disruptions, causing a failure of illiquid but solvent firms; disruptions in credit flows, creating reductions in the supply of funds to finance investments; and collapses in asset prices, inducing failures of financial as well as non-financial firms and households and decreasing economic activity.[44]

Clarifying the rationale of State support is a vital exercise, which allows the State to set the goals of the intervention better, to identify specific actions that need to be taken and to assess the effectiveness of intervention, which *in fine* provides arguments to phasing-out public support. Thus, different policy tools may be appropriate at various levels of tackling the issue of financial stability. Preventing systemic risks and supporting a proper functioning of the market, should be a primary concern of

[40] G Schinasi, 'Responsibility of central banks for stability in financial markets', IMF Working paper WP/03/121, p 4.

[41] G Schinasi, 'Safeguarding financial stability: theory and practice' (2006), as in DW Arner, *Financial stability, economic growth and the role of law*, Cambridge, CUP, 2007, p 72.

[42] DW Arner, *Financial stability, economic growth and the role of law*, ibid, p 100.

[43] Group of Ten, Consolidation in the Financial Sector, pp 126-127, available at http://www.bis.org/publ/gten05ch3.pdf, as in DW Arner, 'The global credit crisis of 2008: causes and consequences', (2009) 43(1) The International Lawyer 96.

[44] B. Lyons, 'Competition policy, bailouts and the economic crisis', CCP Working Paper 09-4, p 5; DW Arner, 'The global credit crisis of 2008: causes and consequences', (2009) 43(1) The International Lawyer 96.

financial regulation. However, limitations in regulatory arrangements, like those contained in the Basel II accord, appear to have even contributed to the growth of unregulated exposures, excessive risk-taking and weak liquidity risk management.[45]

At this background, it can be argued that the role of public financial support and, consequently, the reach of the State aid legal framework is important, but still limited when compared with financial regulation. Therefore, it is submitted that the aim of State aid in crisis management is, first, to address systemic risks and prevent their further aggravation by means of a rescue aid, and second, to address a long-term problem of financial stability through the examination of restructuring plans. It is put forward that this gives little scope for regulation by means of State aid rules, which can address only individual actors of the financial markets, and still subject to some restraints. However, a coherent and coordinated approach to restructuring has the potential to result in a sound financial sector, which would provide ground for any structural regulatory reform.

3.1.2. Application of the R&R Guidelines in the banking sector until October 2008 - The search for appropriate legal base

Until October 2008 application of the R&R aid to financial institutions had to follow all principles of the R&R Guidelines and there was no provision acknowledging specificity of the banking sector.[46] Starting from the mid 90s to October 2008, the main reason for the application of these rules to the banking sector was the need to maintain the minimum solvency level required by the EC Banking Directives.[47] This already provides for a major discrepancy between the aim of public intervention and its legal justification, which under the R&R Guidelines pointed at the prevention of any actual or potential 'serious social difficulties'[48] provoked by a bankruptcy of a financial institution.

The main feature of decisions adopted before October 2008 is that the Commission has persistently refused to refer to Article 87(3)(b), which allows granting aid 'to remedy a serious disturbance in the economy of a Member State', that is currently the legal base for a newly adopted legislation in the banking sector. There has been very little said on that provision, before the current crisis. The Court clarified that Article 87(3)(b) necessitates a narrow interpretation of what is a serious disturbance, since it must affect

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[45] Financial Stability Forum, 'Report of the financial stability forum on enhancing market and institutional resilience', p 9.

[46] Within the R&R Guidelines, the only provision that directly relates to the banking sector concerns the form of rescue aid, which can be granted not only by means of a loan guarantee or a loan, but can equally take other forms, OJ 2004, C244/2, para 25(a).

[47] Directive 2006/48/EC of 14.06.2006 relating to the taking up and pursuit of the business of credit institutions (OJ 2006, L177) and Directive 2006/49/EC of 14.06.2006 on the capital adequacy of investment firms and credit institutions (OJ 2006, L177).

[48] OJ 2004, C244/2, para 25(b).

the entire economy of the Member State concerned and not merely one of its regions or parts of its territory.[49]

A major application of Article 87(3)(b) concerned a Greek aid scheme, approved in 1987, aiming to provide aid for restructuring of forty-five undertakings, among which twenty-two were liquidated for the reasons of viability.[50] The Commission accepted the aid scheme because it formed an integral part of a programme of economic recovery, embracing *inter alia* monetary and fiscal reforms.[51] The decisive argument for the Commission's decision was that, 'si l'on permettait à un pan aussi important de l'industrie grecque d'être mis en liquidation, les chances de réaliser avec succès les objectifs du programme d'austérité s'en trouveraient gravement compromises'.[52] However, this did not translate into a lax approach, as the Commission recognised that only fundamentally viable undertakings, which due to economic crisis fell into difficulty, were eligible and subject to restructuring. Hence, this first use of Article 87(3)(b) ensures that it is not a provision that can legitimize pouring money into economy, with no conditions attached. On the contrary, focus on viable companies and emphasis on restructuring, are proportionate measures tackling a serious economic disturbance.

However, apart from this example, the criteria of application of Article 87(3)(b) can only be defined *a contrario*, when Commission indicated in which situations it should not apply. In the *Credit Lyonnais I* decision[53], the Commission stated that although it was aware of the special sensitivity of financial markets and of the possible undesirable negative consequences of the Credit Lyonnais bankruptcy, Article 87(3)(b) was not applicable when aid intended to remedy only the difficulties of a single recipient, the problems of which were connected with the bank's aggressive lending and investment policy[54]. In *WestLB* the Commission confirmed that a serious economic disruption is not remedied by aid that, 'resolve[s] the problems of a single recipient [...], as opposed to the acute problems facing all operators in the industry'.[55] This approach has been reiterated in subsequent Commission's decisions, despite calls from Member States to avail of Article 87(3)(b).[56]

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[49] T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG v Commission* [1999] ECR II-3663, para 167; C-57/00 P and C-61/00 P, *Freistaat Sachsen and Volkswagen AG and Volkswagen Sachsen GmbH v Commission* [2003] ECR I-09975, paras 97-98.

[50] Décision de la Commission 88/167/CEE concernant la loi 1386/1983 par laquelle le gouvernement grec accorde une aide à l'industrie grecque, JO 1988, L76, p 5.

[51] JO 1988, L76, p 5.

[52] Ibid.

[53] Commission Decision 95/547/EC of 26.07.1995 giving conditional approval to the aid granted by France to the bank Credit Lyonnais, OJ 1995, L308 (*Credit Lyonnais I*).

[54] Ibid, para 7.

[55] Commission Decision NN 25/2008 of 20.04.2008 *WestLB riskshield*, OJ 2008, C1628, para 41.

[56] See i.e. Commission Decision 98/490/EC of 20.05.1998 concerning aid granted by France to the Credit Lyonnais group, OJ 1998, L221 (*Credit Lyonnais II*); Commission Decision 98/204/EC of 30.07.1997

This lack of legal certainty concerning conditions triggering application of Article 87(3)(b) in the banking sector has been nevertheless welcomed in the economic theory. Accordingly, provision of liquidity to banks in difficulty by the State, acting as a lender of last resort, should remain discretionary as a high degree of certainty concerning this type of support would create moral hazard encouraging potential beneficiaries to bear higher risks.[57] As the Commission recognised in *GAN* decision, a confidence of the bank that the State would intervene encouraged the unsound management and delayed the corrective action of the market.[58] It is submitted that by refusing to apply Article 87(3)(b) the Commission created at that time a sort of intermediary situation between a bank in difficulty due to its wrong business strategy and a systemic failure concerning all financial institutions.[59] The outer limits of the 'too big to fail' were tested in two decisions concerning Credit Lyonnais, which at the time of granting aid was the biggest institution of the banking sector in France. As regards specificity of the banking sector and the bank's importance for the national economy, the Commission did not find it a reason to deviate from Article 87(3)(c). In *Credit Lyonnais I* it was declared that:

> 'while difficulties encountered by one or a number of banks do not necessarily lead to a crisis of confidence throughout the system, the failure of a single bank of some size, though due to internal management errors, may place a number of other credit institutions which are financially linked to it in difficulty, thereby causing a more general crisis. State support may be necessary but that should not mean unconditional support for the failing institution, and the support should not be provided without serious action being taken on the definitive restructuring and on the individual limitation of the competitive distortion caused by the aid'.[60]

This gave instruction, on the Commission's discretion, to bend the rules in the extreme case of a bank that would be too big to fail.

3.1.3. Compatibility assessment of R&R aid to banks before October 2008. The nature of a link between competition and financial stability

Hence, the Commission based its decisions on the R&R Guidelines, under which banks were treated as any other undertaking, with the sole exception of the 'one time, last time' principle.[61] The restructuring of a bank necessitated submission and monitoring of a plan on return to viability, as well as the adoption of compensatory measures: contribution by the bank to the restructuring costs to limit the amount of aid (of at

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conditionally approving aid granted by France to the GAN group, OJ 1997, L78; Commission Decision NN25/2008 *WestLB,* ibid; Commission Decision NN 70/2007 of 5.12.2007 *Northern Rock*, OJ 2007, C6127.

57 M Aglietta, 'A lender of last resort for Europe', Working Paper CEPII as in P.-B. Barets, 'Le droit des aides d'Etat applique aux secteurs dela banque et de l'assurance', Concurrences 1/2007, p 16.

58 Commission Decision 98/204/EC of 30.07.1997 conditionally approving aid to granted by France to the GAN group, OJ 1997, L78, p 10.

59 P-B Barets, op cit, n 57, p 16.

60 Commission Decision 95/547/EC, op cit, n 53, para 3.2.

61 Pursuant to that rule, rescue and restructuring aid should be granted only once, OJ 2004, C244/2, para 72.

least 50% in case of a large bank), limitation on the growth of the balance sheet, assets divestment to reduce market power and compensate competitors.[62] For Credit Lyonnais, the *qui pro quo* principle required the bank to indirectly compensate rivals by reducing its commercial presence both in France and in Europe through the sale of subsidiaries, which limited the bank's balance sheet by 1/3.[63] Along the same line, it has to be acknowledged that other decisions taken in the banking sector under the R&R Guidelines confirmed the strict approach towards substantial compensatory measures, both at home and in foreign markets.[64]

The role of compensatory measures in the banking sector is a good example on the interaction between competition and long-term financial stability. On the one hand, they limit the negative effect of a subsidy on competitors, which is a corollary of the 'effects on rival's profits' standard. This notion of the *qui pro quo* principle is a clear transposition of the logic of the R&R Guidelines. On the other hand, a particularity of the banking sector is that the extent of compensation cannot deprive beneficiary of resources necessary to fulfil and maintain the required solvency ratio during its return to viability. The Commission noted that:

> 'the objectives of competition policy and those of prudential banking policy cannot be mutually incompatible, since both are designed to achieve a common end, namely the development of a competitive, healthy banking sector'.[65]

Furthermore, the Commission submitted that the solvency ratio limited credit institutions ability to grow irresponsibly and held back the growth of inefficient institutions, as they could only increase their own capital by either attracting new capital or by increasing their profits.[66] Thus, this restraint on growth of less efficient banks, coupled with compensatory measures imposed on the beneficiary of aid, 'illustrates very clearly the way in which prudential policy and competition policy complement each other'.[67]

Therefore, in the light of those decisions, the crucial exercise consisted in finding the right balance in drafting compensatory measures between a dirigiste policy and the requirements of prudential regulation. Further, the aim of State aid control exercised by the Commission was to ensure that a subsidy did not drastically alter the level playing field in a sector that was subject to deregulation. It was exactly in that place, that

62 Ibid, paras 34-45.

63 Commission Decision 98/490/EC, op cit, n 56, p 75.

64 See i.e. Commission Decision 98/204/EC, ibid; Commission Decision 2000/600/EC of 10.11.1999 conditionally approving the aid granted by Italy to the public banks Banco di Sicilia and Sicilcasa, OJ 2000, L256; Commission Decision 99/288/EC of 29.07.1999 conditionally approving the aid granted by Italy to the Banco di Napoli, OJ 1999, L116.

65 Commission Decision 98/490/EC, op cit, n 56, p 75.

66 Seventh Survey on State aid in the European Union in the Manufacturing and Certain Other Sectors, COM(1999) 148.

67 Commission Decision 2001/89/EC of 23.06.1999 conditionally approving aid granted by France to Credit Foncier de France, OJ 1999, L34, para 94.

competition met financial stability, ensured by prudential regulation. It can be implied that the State aid control, when applied to individual cases pursuant to the R&R Guidelines, certainly did not serve to regulate the entire sector through the back door, its aims were rather modest and tailored to the situation of the beneficiary.

3.1.4. Article 87(3)(c) and the R&R Guidelines brought to their limits

Given this experience, it appears quite natural that the Commission in the period directly preceding October 2008 applied the R&R Guidelines to banks that fell in difficulty as a consequence of the sub-prime mortgage lending in the US. In the few cases decided by the Commission, that is aid to IKB,[68] Sachsen LB,[69] Northern Rock[70] and Roskilde Bank,[71] it has consistently refused to apply Article 87(3)(b) and followed the R&R Guidelines. This implied a grant of rescue aid *inter alia* in the form of guarantee on deposits,[72] working capital facility or acquisition of toxic assets.[73] The ultimate decisions taken under the traditional legal base concerned Bradford & Bingley[74] and Hypo Real Estate Holding AG,[75] and it is in particular in the former case that we find boundaries of the R&R Guidelines. In the fall of 2008, Bradford & Bingley was downgraded by major rating agencies, its solvency ratio dropped and its permission to accept deposits was about to be withdrawn, effectively closing the bank down. In response, the bank was nationalised. The decision contained a package of measures designed to ensure financial stability by protection of retail depositors (prevention of bank runs) and support to bank's orderly winding down.[76] Although the decision was based on point 25(b) of the R&R Guidelines, justifying aid by prevention of serious social difficulties, it is clear that the structural measures indicated therein went beyond the protection of jobs and primarily aimed at protecting deposits and preventing aggravation of systemic risk.

3.2. A New and Temporary Legal Framework for State Aid in the Banking Sector.

As argued *supra*, the Council and the Commission have made a political decision to depart from the R&R Guidelines and construct a new compatibility assessment framework. Although, one may agree with the claim that this departure lacked sound

[68] Commission Decision C 10/2008 of 11.03.2008 *Restructuring aid to IKB*, OJ 2008, C76.

[69] Commission Decision C 9/2008 of 4.06.2008 *Restructuring aid to Sachsen LB*, OJ 2008, C71.

[70] Commission Decision NN 70/2007 of 5.12.2007 *Northern Rock*, OJ 2007, C135.

[71] Commission Decision NN 36/2008 of 31.7.2008 *Roskilde Bank*, OJ 2008, C238. In the end the bank was liquidated and a guarantee was granted by the State to cover losses incurred by the central bank and Danish banking association (IP/08/1633).

[72] NN 70/2007, op cit, n 70, para 44.

[73] C 9/2008, op cit, n 69, para 99.

[74] Commission Decision NN 41/2008 of 01.10.2008 *Rescue aid to Bradford & Bingley*, OJ 2008, C290.

[75] Commission Decision NN 44/2008 of 02.10.2008, OJ C 293; Commission press release IP/08/1453.

[76] NN 41/2008 op cit, n 74, paras 2-4.

legal reasoning on why the R&R Guidelines might not apply,[77] this does not devalue the new regulation in legal terms. State aid law is a process driven framework, which the Commission's discretion reflects clearly. Given that Article 87(3)(b) does not contain any balancing mechanism and that the compatibility criteria it sets are purely descriptive (reflecting the serious economic disturbance), this new legal base allows for a greater flexibility than the R&R Guidelines.

Deviation from the usual R&R rules demonstrates the fact that restructuring measures addressing systemic risks need to go beyond the social justification of aid to a bank. Furthermore, the R&R Guidelines are applicable to firms that are in difficulty due to their endogenous problems, whereas international market failure in the financial sector[78] justifies an approach that takes into account a specificity of the sector and exogenous (systemic) character of the problems faced by some banks. It can also be claimed that a coordination function of State aid rules can best be ensured when Member States draft and notify to the Commission general aid schemes instead of individual aid measures, as has been the case under the R&R Guidelines.

The relationship between the new set of legislation and the R&R Guidelines is that the former constitute a *lex specialis* foreseeing specific criteria for the financial sector, while the R&R Guidelines, and in particular, their logic and basic principles are of general application.[79] It can be claimed that the secondary legislation adopted to tackle the crisis reveals a two-step approach, which in its content, as it has been already pointed out elsewhere, is consistent on principles and flexible on the means.[80] In the first place, when confronted with massive notifications of national rescue measures, the Commission focused primarily on the preservation of basic principles of the Treaty, like non-discrimination (see *supra* at para 1), proportionality and necessity, which are common both to State aid rules and free movement provisions. It is also within this first step that we see a rough coordination of national measures through the secondary legislation, but with a certain discretion being left to the Member State as to the choice of appropriate measures. This also sets limit to the Commission's scope for intervention, as ultimately it is the Member State that makes the decision on whether to intervene. Hence, the first step primarily reveals the aim to preserve the level playing field and to coordinate national rescue measures. It could be claimed that the second step of the legislative reaction of the Commission is more pro-active, as it intends to reassure its position as not only a guardian of the Treaty and of the principles contained therein, but also as a distinct party in the process of addressing systemic crisis and rebuilding financial stability. Along the same line, it is interesting to verify to what extent may the State aid rules serve to regulate the substantive provisions concerning

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77 RM D'Sa, 'Instant state aid law in a financial crisis – a U-turn?', EStAL 2/2009, p 142.

78 See i.e. Commission Decision NN 51/2008, op cit, n 27, para 40.

79 OJ C270, op cit, n 13, para 6.

80 D Gerard, 'EC competition law enforcement at grips with the financial crisis: flexibility on the means, consistency in the principles', Concurrences 1/2009, pp 46-62.

return to financial stability and how they set a balance between competition and financial stability.

Since the adoption of the new legislative framework, from October 2008, the Commission has taken 39 individual aid decisions and has approved 26 aid schemes: 11 guarantee schemes, 7 recapitalisation schemes, 6 schemes combining guarantees with recapitalisation and 2 asset relief schemes.[81] Until August 2009, the total volume of approved guarantee measures amounted to €2.9 trillion (with a take-up rate of 32.8%) and of the recapitalisation measures to €313 billion (take-up rate of 54.8%).[82]

3.2.1. Banking Communication

The Banking Communication,[83] based on Article 87(3)(b), recognised systemic risks inherent to the financial crisis due to the fact that it affected fundamentally the sound financial institutions whose difficulties stemmed from the general market conditions, which have severely restricted access to liquidity.[84] Consequently, not only healthy banks had problems in access to liquidity, but due to their central role in the economy, also other sectors were concerned with the drying up of the loan market (disruption in credit flows).

The Banking Communication clarified that both general schemes (open to undetermined number of financial institutions) and individual aid can be approved on its basis. However, the practice provides that individual aid is granted either in the absence of a general scheme at the moment the bank enters into difficulties, or due to the fact that the bank is not eligible for aid under the scheme.[85] The Banking Communication allowed the provision of guarantees covering liabilities of financial institutions, to establish recapitalisation schemes and ultimately set criteria for a controlled winding-up.

The principles guiding application of these measures are those of non-discrimination and proportionality. Proportionality implies that a measure has to be well-targeted and necessary to be able to achieve the objective of remedying a serious disturbance in the economy and has to minimise the negative spill-over effects on competitors and other Member States.[86] In practical terms, proportionality limits the material scope of guarantees to retail deposits, certain types of wholesale deposits, as well as short and medium-term debt instruments.[87] The guarantee should not include subordinate debt and an indiscriminate coverage of all liabilities, as it would rather preserve interests of

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81 As of 09.09.2009, Memo/09/380.

82 'DG Competition's review of guarantee and recapitalisation schemes in the financial sector in the current crisis', 7 August 2009, pp 2-4.

83 OJ C270, op cit, n 13.

84 Ibid, para 2.

85 State Aid Scoreboard Spring 2009 Update, COM(2009) 164, p 21.

86 OJ C270, op cit, n 13, para 15.

87 Ibid, para 21.

risk capital investors[88] and consequently may not directly help address the market failure. Furthermore, to better address systemic risk, some States allowed for provision of a guarantee only to solvent banks (that is with a core capital ratio (Tier 1 ratio) of at least 7%).[89] State commitments have to be also limited in time, the schemes can last from 6 months up to maximum 2 years (but with a period of issuance limited to 6 months)[90] and may be further extended upon Commission's approval,[91] provided that every 6 months the State carries out review of measures applied. So far, the Commission has accepted a prolongation of all renotified schemes.[92] This two-year limit, ending in the fall of 2010, should be regarded as a rough indication of a gradual phasing-out of the guarantee schemes and a tool in the hands of the Commission allowing to get back to usual R&R rules. It should be also regarded as an attempt to ring-fence the new legislation to the systemic risks. It is certainly a legal commitment and it might be inquired what will be its political value if the situation targeted by the aid does not ameliorate.

The principle of necessity signifies that aid has to be limited to minimum, which implies a significant contribution by beneficiary. Thus, a guarantee must be provided against adequate remuneration. Given the difficulty to determine such market conform rate of remuneration in times of systemic crisis, the Commission acknowledged that a fee charged for the provision of a guarantee shall be as close as possible to the market rates, and that it has to reflect the degree of risk, as well as the beneficiaries different credit profiles.[93] In practice a number of Member States followed the recommendations of the European Central Bank.[94] To limit the distortions of competition, in particular towards banks not benefiting from a guarantee, a beneficiary should be subject to behavioural constraints ensuring that it does not engage in aggressive expansion. This can be done by restrictions on commercial conduct, such as advertising invoking a guarantee, pricing, business expansion (through introduction of market share ceilings) or prohibition of conduct that runs against the objective of the guarantee, like new stock options for management.[95] Since guarantees are conceived as temporary rescue measures, they have to be followed by appropriate adjustments; that is either restructuring or liquidation.[96]

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[88] Ibid, para 23.

[89] See i.e. Commission Decision N 625/2008 of 12.12.2008 Rescue package for financial institutions in Germany, OJ 2009, C43/1, para 10; Commission Decision NN 51/2008, op cit, n 27, para 43.

[90] Some States opted for a duration of three years - see Commission Decision N 533/2008 of 29.10.2008 Support measures for the banking industry in Sweden, para 43.

[91] OJ C270, op cit, n 13, para 24.

[92] "DG Competition's review of guarantee and recapitalisation schemes in the financial sector in the current crisis", 7 August 2009, p 2.

[93] OJ C270, op cit, n 13, para 26.

[94] See i.e. Commission Decision N 520a/2008 of 13.11.2008 *Urgent measures to guarantee the stability of the Italian banking system*, OJ 2009, C29, para 75.

[95] OJ C270, op cit, n 13, para 27.

[96] Ibid, para 29.

3.2.2. Recapitalisation Communication

Recapitalisation is the second structural measure aiming to tackle systemic risks and restore financial stability. Its conditions are specified in the Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition[97] (Recapitalisation Communication). Recapitalisation is governed by principles that apply *mutatis mutandis* to guarantees; hence the Recapitalisation Communication is focused on some specificities of this measure. A more detailed guidance has been necessary, as some Member States envisaged recapitalisation of banks, not to rescue them but to ensure lending to the real economy. This provides for a multiplicity of goals and the need to ensure a requisite equilibrium, so that provision of liquidity is treated differently depending on its objective. The Commission underlined that:

> 'a balance must be struck between competition concerns and the objectives of restoring financial stability, ensuring lending to the real economy and dealing with the risk of insolvency. On the one hand, banks must have sufficiently favourable terms of access to capital in order to make the recapitalisation as effective as necessary. On the other hand, the conditions tied to any recapitalisation measure should ensure a level playing field and, in the longer-term, a return to normal market conditions'.[98]

This appears to be a reasonable approach to tackle direct symptoms of systemic risks. An adequate remuneration, close to a market price and providing for exit incentives, is a crucial element to reconcile competition and financial stability, but also to prevent moral hazard. However, it has to be underlined that the remuneration, given the sudden increase of market price due to systemic risks, has still remained below the market price.

In return for liquidity the State may i.e. receive shares or silent participations.[99] For solvent banks, when State capital injections are made on equal terms with significant participation of private investors (30% or more), the Commission will accept the remuneration set in the deal.[100] In general, the Commission followed recommendations of the European Central Bank, which set a price corridor for solvent banks between 7 to 9.3%.[101] The usual behavioural safeguards attached to recapitalisation prohibit aggressive commercial conduct and impose acquisition ban. As to exit incentives, the

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97 OJ 2009, C10/2.

98 OJ 2009, C10/2, para 11.

99 Commission Decision N 512/08 of 27 October 2008 *Support measures for financial institutions in Germany*, para 12.

100 Ibid, para 54.

101 OJ 2009, C10/2, para 27.

Communication provided either for increase over time of the pricing structure or for a restrictive dividend policy.[102]

When Member States use recapitalisation to finance the real economy, 'they should attach effective and enforceable national safeguards to recapitalisation which ensure that the injected capital is used to sustain lending'.[103] Although this clause is a tool to address one of the main symptoms of systemic risks, its inherent danger is the one of market fragmentation, since the State primarily aims to ensure lending to its national economy. Thus, it is submitted that the clause should not limit lending to undertakings, in a way that would contravene the internal market objective and impede cross-border provision of funding to profitable projects. Recapitalisation of banks that are not fundamentally sound is subject to stricter requirements; either they submit a restructuring plan[104] or wind-up.[105]

Within the ongoing prolongation of recapitalisation schemes, the Commission has introduced an additional condition on coupon payments on hybrid capital and prohibited such payments, when they are funded from State aid.[106] Although this constitutes an additional safeguard against misuse of aid, it is interesting to examine how in practice, the ban would be executed, i.e. towards a contractual obligation of a bank to pay.

3.2.3. Impaired Assets Communication

The third legislative measure is the Communication on the Treatment of Impaired Assets in the Community Banking sector (the Impaired Assets Communication).[107] In light of the economic literature on previous banking crisises, adoption of the said measure is a necessary element of the return to long-term financial stability. An adequate policy to tackle the crisis should in fact provide in the first place for a guarantee on deposits to prevent bank runs, require separation of the good and bad assets and clear bank's balance sheets from the bad assets, and finally should allow recapitalizing of the asset-cleansed banks by finding new equity holders (either State or private investors).[108] The lesson of the Japanese banking crisis confirms that the failure

[102] Ibid, paras 31-33. See i.e. Commission Decision N 625/2008 of 12.12.2008 *Rescue package for financial institutions in Germany*, OJ C(2008) 8629 fin, para 17, which introduces a dividend ban or provides for an increase of remuneration by 0.5% annually.

[103] OJ C(2008) 8629 fin, para 39.

[104] Ibid, point 44.

[105] In the case of a controlled winding-up the Banking Communication provides for a set of rules to minimise moral hasard, avoid distortions of competition and ensure that no aid is granted to the buyers of the financial institution - see OJ C270, op cit, n 13, paras 43-50. In practice it has been applied to Roskilde Bank, see NN 36/2008, op cit, n 71.

[106] Commission Decision N244/2009 of 27.06.2009 *Commerzbank*, OJ C 147, p. 4; Commission Decision N352/2009 of 24.07.2009 *Prolongation of the Austrian Scheme*, OJ C 172, p. 3.

[107] Communication from the Commission on the Treatment of Impaired Assets in the Community banking sector, OJ 2009, C72.

[108] A Blundell-Wignall, P Atkinson, S Hoon Lee, 'The Current Financial Crisis: Causes and Policy Issues', OECD 2008, pp 13-14.

to take the second step might prolong the financial turmoil, since unless banks are cleared from bad assets, further recapitalisation might be required to avoid credit crunch.[109] In this context, the Impaired Assets Communication is genuine policy-making by the Commission.

The policy aim is to overcome uncertainty concerning the valuation and location of the impaired assets, by encouraging banks to a full disclosure of toxic assets, prior to a government intervention. The Communication highlights the need for a coordinated approach. This is to be achieved through development of categories of eligible assets (baskets) and their ex-ante valuation, based on common methods, such as a valuation of asset's real economic value[110] (rather than current market value), certified by independent experts and validated by banking supervisory authorities.[111] Interestingly, the Communication recognised that when putting a bank into administration, or when its winding up is unadvisable for reasons of financial stability, it could be granted aid in the form of guarantee or asset purchase to allow it to devise a plan for restructuring or orderly winding-up. Accordingly, nationalisation options may also be considered.[112] The latter provides for a recognition of a 'too big to fail' excuse for a bank whose winding-up might have dangerous systemic implications. The downside of such approach is that it may only improve the moral hazard.

The reason why State aid control may be triggered with regard to asset relief programmes is that under R&R aid, asset relief is a structural operation which requires assessment of an adequate contribution of the beneficiary to the costs of the impaired assets programme; necessitates in-depth restructuring through focussing on its core business, reorientation of business models, closure or divestment of business subsidiaries, changes in the asset-liability management; and necessary measures to remedy competition distortions.[113] Asset relief measures can be granted for six months and are conditional on the submission of details of the impaired assets' valuation, as well as a restructuring plan.

3.2.4. Restructuring Communication

The systemic crisis has forced the Commission to apply a coordinated approach in the restructuring phase. The Restructuring Communication,[114] issued in August 2009, complemented the EC legislative framework adopted under Article 87(3)(b). The core elements of the Restructuring Communication are: restoration of the long-term

[109] Ibid, p 15.

[110] Under the Spanish Fund for the Acquisition of Financial Assets remuneration is set through the mechanism of the reverse auction, which enables the Fund to purchase highly rated assets at the highest possible remuneration (interest rate) - see Commission Decision NN 54/A/2008 of 04.11.2008, para 15.

[111] OJ C72, op cit, n 107, paras 20 and 33.

[112] Ibid, para 23.

[113] Ibid, para 49.

[114] Commission Communication on the return to viability and the assessment of restructuring measures in the fianancial sector in the current crisis under the State aid rules, OJ 2009, C195.

viability, burden sharing and limiting distortions of competition. Building on these three basic principles of the R&R Guidelines, the Restructuring Communication set detailed provisions adjusted to the specificity of the systemic crisis in the financial sector. So far, the only decision on restructuring adopted under Article 87(3)(b) is the decision on aid to West LB[115] approved in May 2009. However, its particularity is that the restructuring plan was approved directly under Article 87(3)(b), while taking due account of the three principles of the R&R Guidelines, since at that time there was no specific secondary legislation on restructuring of banks in the systemic crisis.

Since restructuring is a corollary of the rescue aid, the scope of legislation is limited to situations when the State has provided funds. More specifically, banks that are fundamentally sound (see supra) and banks benefiting from asset relief which have also received aid that does not exceed 2% of the their risk weighted assets, are only requested to provide a viability plan.[116]

The core element of the viability review and specificity of restructuring, which aims to ensure financial stability, is the stress test. The test should take into account 'the current state and future prospects of the financial markets, reflecting a base-case and worst-case assumptions'.[117] The stress test should therefore assess future viability of a bank in a different range of scenarios, from a profound recession to economic recovery, and be compared with sector-wide benchmarks. However, given the 5-year period in which a restructuring plan has to be assessed, it might be a difficult exercise, both for a Member State and the Commission, to reach agreement on such forecasts and the viability review. This uncertainty and diverging views might create obstacle to a smooth adoption of restructuring plans. Assessment of future viability will be exercised by the Commission on the grounds of information on the bank's business model, funding structure, corporate governance, risk managements, asset-liability management, cash-flow generation, adequacy of capital in line with supervisory regulation and the remuneration incentive structure.[118] The plan should compare various scenarios of withdrawal from activities which would remain structurally loss making in the medium term, including a break-up and absorption by another bank or winding-up, to allow the Commission assess, at least in theory, which of the options is the least distortive and serves best financial stability. So far, the only example of West LB indicates that the systemic crisis does not alter application of substantial viability remedies under Article 87(3)(b). The bank's restructuring plan contained significant measures, i.e. 50%

[115] Commission Decision C 43/2008 of 12.05.2009 *Aid for the restructuring of West LB*, OJ C 3900.

[116] OJ C72, op cit, n 107, para 55. The viability plan should comprise information on the use of public funds, on the path towards exit from the reliance on State support and should demonstrate the risk profile to allow evaluate bank's business plan. This would constitute a lighter form of review of bank's viability, then the one required in the restructuring plan.

[117] The viability of a bank is defined in the Restructuring Communication as bank's ability to cover all its costs including depreciation and financial charges and provide an adequate return on equity, taking into account its risk profile. The restructured bank should be able to compete in the marketplace for capital on its own merits in compliance with regulatory requirements, OJ 2009, C195, op cit, n 114, para 13.

[118] Ibid, para 11.

reduction of balance sheet, change of ownership structure through a sale of the bank and of nearly all its subsidiaries. The sale of the bank is to be preceded by unbundling of its activities into three core business areas.[119]

Burden sharing aims to limit the amount of aid through bank's own contribution. This translates into a sale of bank's assets or provision of capital by shareholders, in proportion to their stake. A novelty is that own contribution can be lower than 50% and postponed in the rescue phase for reasons of financial stability; it should not be further delayed in the restructuring.[120] Thus, when the costs of restructuring so necessitate, farther-reaching compensatory measures may be applied. The problem of burden sharing includes also the necessity to balance between accumulation of bank's own funds to finance restructuring and attracting new private capital. The ban on dividend or coupon payments might in the short-term increase bank's solvency, but limit in the long run its access to private funding. Hence, the Restructuring Communication prohibited payment of dividends and coupons on outstanding subordinated debt, with a view to limit the misuse of aid. However, it treated more favourably payment of coupons on newly issued hybrid capital.[121] This exemplifies the level of Commission's interference in a bank's daily business, justified by the aim of reassuring financial stability and preventing short-sighted free riding on the public funding. However, this approach also largely relies on the regulatory classification of capital (subordinated debt). Given the regulatory failure of risk assessment under the Basel II accord, this might provide for incentive to banks to circumvent the rules and purposefully wrongly classify the capital.

Limiting distortions of competition is probably one of the toughest tasks to accomplish under the currently overriding objective of financial stability. As the paper has argued supra, until October 2008 the Commission has found no clash between the two. On the contrary, as *Credit Lyonnais II* provided, prudential regulation and competition can go hand in hand. However, given the recent massive public intervention, addressing a systemic crisis should not result in a long-term damage to competition. The scope of compensatory measures shall result from: (i) the amount of aid and conditions and circumstances under which it was granted; and (ii) characteristics of the market on which the beneficiary bank will operate (size, scale and scope of bank's activities) after implementation of the viability remedies.[122] Therefore, this allows for the observation that both the level of burden sharing and pricing (influencing amount of aid) and the extent of viability oriented divestitures (limiting market presence) set a starting point for the scope of competition-oriented remedies. It is however clear that since remuneration of aid has been initially set at a level that helps to address the symptoms of systemic crisis, the pricing in restructuring phase may not rise drastically for the same reasons. That is why the Restructuring Communication allowed including claw-back clauses or

[119] *WestLB*, op cit, n 115, paras 68, 71, 73-74.

[120] OJ C195, op cit, n 114, paras 22-24.

[121] Ibid, para 26.

[122] Ibid, para 30.

setting additional compensatory measures.[123] The scope of compensatory measures may include divestment of subsidiaries, portfolios of customers or business units or other structural measures, which should be applied both on domestic and foreign markets.[124] Although in theory, the viability and competition remedies are separate and pursue different goals, provisions of the Restructuring Communication allow the observation that competition remedies should primarily support a return to a long term-viability and may not always constitute stand-alone remedies. This sets a new standard, in which the overriding aim of financial stability influences the scope of acceptable competition distortion. In practice, as the decision in *West LB* provided,[125] viability remedies might be sufficient to avoid imposition of further structural measures.

Restructuring plans should contain acquisition bans for at least three years, save for exceptional circumstances where acquisition is a part of consolidation process necessary to restore the financial stability and upon notification to the Commission.[126] This gives a wide discretion to the Commission in the restructuring phase, but may be a necessary safeguard in cases when most of the players on a given market are subject to both structural remedies and acquisition bans. When finding a buyer is objectively difficult, then ultimately one of those players might be allowed to acquire divested parts of another bank, for the sake of ensuring financial stability. The upshot of that discretion is a genuine power of the Commission to independently run sectoral policy, which might be close to an industrial policy-making.

The systemic effects of cumulated application of a number of restructuring plans at the same time have been foreseen in the Restructuring Communication. It provided that implementation of structural measures might be extended to five years (three years usually), when finding a buyer is objectively difficult and to avoid depressing markets through 'fire sales'.[127] Furthermore, to ensure equal treatment between various plans adopted at the same time, the Commission committed to compare measures applied in cases relating to the same markets or market segments.[128]

Although the balance between discretion of the Commission and voluntary commitments by Member States is delicate, the Commission can examine the degree of market opening and expect the State to also propose measures that favour entry.[129] So far the Commission has not been explicitly vested with such a power and this requirement of market opening has not been codified in the State aid legal framework. The only application of such possibility in the past concerned restructuring aid to

[123] OJ C195, op cit, n 114, para 25.

[124] Ibid, paras 35-36.

[125] *WestLB*, op cit, n 115, paras 83-85.

[126] OJ C195, op cit, n 114, paras 40-41.

[127] Ibid, point 15.

[128] Ibid, point 38.

[129] OJ C195, op cit, n 114, paras 44-45.

Alstom,[130] where the oligopolistic structure of the relevant market would have been reinforced by the application of traditional R&R aid divestments.[131] This gives the Commission a potential leeway to influence the outlook of the market after adoption of a number of restructuring plans and creates a thin line between regulation of the market and decisions on individual aid. Although, such approach generally allows putting a foot in the door of closed markets, it can be claimed that only objective data on the degree of market penetration, and not ideological concerns, should serve as a benchmark triggering such commitments.

Quite significantly, the Commission agreed to depart from the 'one time last time' principle and declared that when provision of additional aid during the restructuring period is justified by financial stability, it should be possible, but subject to ex ante notification.[132] Although this is a major deviation from the R&R Guidelines, where additional aid was prohibited save for exceptional circumstances, this however codifies past practice. In *Credit Lyonnais II* the Commission justified additional aid by unforeseeable circumstances in the financial sector for which the bank was not responsible.[133] This however bears the risk of postponing a gradual phasing-out of support measures to the financial sector.

3.2.5. On the role of State aid control in crisis management

To operationalise reaction to the systemic risk and to ensure financial stability, within the framework of the rescue aid, a distinction has been made in the treatment of illiquid but otherwise fundamentally sound banks and banks that are characterized by endogenous problems. The main differences are that solvent banks do not need to present restructuring plans, are not subject to compensatory restraints and are not bound by growth limitations. A relaxed approach towards solvent banks, but with due safeguards concerning remuneration, exit and lending to the real economy, intends primarily to remedy a market failure and is a novelty in the approach to rescue aid. Distressed financial institutions are required to wind-up or to present a far-reaching restructuring plan with significant compensatory measures.

Furthermore, the approach adopted by the Commission in the rescue phase, large-scale public intervention on generous terms, has certainly led to diminishing the scope of systemic risks. The numerous State interventions seem to have improved financial stability, without taking into account competition concerns. It is in the restructuring phase that the Commission has more discretion and can impose measures that would explicitly limit the distortion of competition and enhance financial stability. However, in the Restructuring Communication we observe a departure from the past practice.

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130 Commission Decision 2005/418/EC on the aid measures implemented by France for Alstom, OJ 2005, L150, para 204.

131 C Galand, E Marteil, A Bacchiega, F Malbo, E Valle, 'Commission authorises restructuring aid to Alstom under condtitions', Competition Policy Newsletter 3/2004, p 15.

132 OJ C195, op cit, n 114, point 16.

133 Commission Decision 95/547/EC, op cit, n 53, p 37.

The overriding principle of financial stability seems to justify various measures that are otherwise not a standard under the R&R Guidelines (see *supra*). Therefore, it might be argued that it is necessary to ring-fence application of Article 87(3)(b) only to systemic crisis. For that reason, the choice of a new legal base has the advantage of facilitating return to normal R&R rules.

A possible critique of the approach developed under the new legislative framework is that in fact the Commission allowed the grant of all notified measures which, while addressing systemic risks, has enhanced moral hazard. The only element that effectively limits moral hazard is the fact that liquidation of a bank is an option under the Banking Communication. This has been exercised so far towards a limited number of banks.[134] Still, the Banking Communication allowed banks to continue their operations during the liquidation procedure, under condition that they do not start new activities until withdrawal of the banking licence. However, the fact that no time-limit is indicated for a complete winding up, except for reference to the 'period strictly necessary',[135] may further exacerbate moral hazard and make the Commission subject to interest lobbying.

Thus, restructuring of aid beneficiaries and credible bankruptcy regime coupled with a modernised prudential regulation, adopted as a package of measures, can help to establish financial stability.[136] From the legal point of view, a broad approach to remedying the disturbance in the economy, both at the individual (beneficiary) and regulatory levels, appears to be the major condition to justify aid under Article 87(3)(b). In fact, when we examine application of Article 87(3)(b) in the past, we find that the restructuring aid scheme for Greek undertakings was approved because it constituted a part of a structural programme aimed to remedy the crisis of national economy. Although, it is apparent that the reaction to the current financial crisis has been first marked by a rescue aid, and it is only now that we see EU proposals for regulatory measures,[137] the fact that State aid is a part of a broader picture constitutes the standard for compatibility assessment of aid under Article 87(3)(b).

The response provided by the Commission to tackle the systemic crisis, raises concerns on the application under Article 87(3)(b) of the 'more economic approach', embedded in the modernised balancing framework, introduced in the State Aid Action Plan (SAAP). This more economic approach to State aid relies on a three-step test that looks at the market failure, examines whether the aid is well targeted, establishes a magnitude of effects on trade and competition, and weighs positive and negative effects.[138] Under the SAAP, the test serves as the main decision criterion and a legislative tool. However, this approach is completely absent under the 87(3)(b) legislative package, although it can be asserted that the idiosyncrasy of that legislation is a combination of the R&R aid

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[134] See i.e. Commission Decision NN 39/2008 of 05.11.2008 *Aid for liquidation of Roskilde Bank*, OJ 2009, C12.

[135] OJ C270, op cit, n 13, para 47.

[136] B Lyons, op cit, n 44, p 11.

[137] See Memo IP/09/1347 ,'Commission adopts legislative proposals to strengthen financial supervision in Europe'.

[138] COM (2005)107, op cit, n 16, p 6.

with responses to a market failure. Furthermore, the inherent aim of the 'more economic approach' to State aids is to check whether the aid is in fact an adequate solution to remedy a market failure, as aid should be a second best option.[139] However, in the 'instant law making'[140] applied to tackle systemic risks, there is no deliberate search for an adequate policy option. The best option, namely a modernised regulatory framework, seems to be only an issue in the aftermath of the crisis.

A final point, concerns future problems originating from nationalisation or increased public ownership of banks, i.e. in case of Northern Rock and Commerzbank.[141] Decisions concerning German Landesbanken, as well as examples of GAN Group or Credit Lyonnais, reveal that public ownership of financial institutions may be detrimental to competition and endanger financial stability, since it creates a moral hazard that the State would always provide funds to ailing financial institution of major importance to national economy. As the Commission pointed out in *Credit Lyonnais II*:

> 'management failings were accentuated by confusion between the roles of the state as shareholder, the state as entrepreneur, the welfare state and the state as legislator, a confusion which resulted in the state as shareholder allowing a situation of unprecedented gravity to degenerate further, contrary to its asset-related interests'.[142]

This further accentuates the long-term risks emanating from current public interventions and highlights the need to include in the restructuring plans a time limit for gradual withdrawal of the State or a change in corporate governance. However, given the ownership neutrality imposed by Article 295 EC, the latter depends on the voluntary commitments by the State, which might be an obstacle in bringing the sector back to sound market conditions.

4. CONCLUSION

The Commission has consistently applied the notion of State aid, which allowed it to exercise discretion towards measures adopted by Member States. This firm application of Article 87(1) would not have been possible without a political decision to fully apply State aid control and, second, the Commission's expertise originating from past cases on aid in the banking sector. Consequently, this gave the Commission a leeway to assess the balance between competition and financial stability.

As regards compatibility assessment in the period preceding the financial turmoil, application of the R&R Guidelines, including strict compensatory measures, allowed to align competition with prudential regulatory policy aiming at financial stability. The new legislative framework adopted under Article 87(3)(b) recognised the need to apply a

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139 Ibid, p 7.

140 A term coined with respect to State aid law applied in the current financial crisis by Ch Koenig, op cit, n 32 p 627.

141 Commission Press Release IP/09/711.

142 Commission Decision 98/490/EC, op cit, n 56, p 63.

coordinated approach, aimed at a number of sound and distressed banks. Clear identification of systemic risks and recognition of specificity of the banking sector allowed the introduction of structural measures that may help to address those risks and establish the long-term financial stability. To operationalise the balance between competition and financial stability, under rescue aid, the crux of the method applied is the relaxed approach towards solvent banks, but with due safeguards concerning remuneration, exit and lending to the real economy. This allowed the stabilisation of the financial system, with the cost of treating competition issues as subordinate to the overriding aim of the public intervention. In the restructuring of distressed banks, despite application of basic restructuring aid principles, the overriding objective of financial stability seems to justify various measures that are otherwise not a standard under the R&R Guidelines (i.e. departure from the 'one time last time principle'). For that reason the risk of moral hazard may be hardly evitable in the future. Further, it appears that although in theory the viability and competition remedies are separate and pursue different goals, the Restructuring Communication and (still limited in number) cases decided so far indicate that competition remedies would primarily support a return to a long term-viability and may not always constitute stand-alone remedies. This would set a new standard, in which the overriding aim of financial stability influences the scope of acceptable competition distortions.

Although the Restructuring Communication provides only guidance on how to restructure, the corollary of a systemic approach is that the Commission has the leverage to influence the post-crisis design of the market by expecting commitments for market opening, going beyond its standard practice, or by applying its discretion to lift the acquisition ban.

It is submitted that the aim of State aid control in crisis management is primarily to address systemic risks and prevent their further aggravation by means of a rescue aid, and second, to address a long-term problem of financial stability through the examination of restructuring plans. A coherent and coordinated approach to restructuring has the potential to result in a sound financial sector, which would provide ground for future regulatory reforms.

It appears that the fact that State aid is a part of a broader structural programme constitutes the standard for compatibility assessment of aid under Article 87(3)(b). However, the legislation adopted under that provision is far from a 'more economic approach' that is the driving decision-making and legislative criterion in the State aid legal framework. That is why the choice of a new legal base has the advantage of facilitating return to normal rules and allows to ring-fence the application of Article 87(3)(b) to systemic crisis.

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The Compulsory Licence of Intellectual Property Rights under the EC Competition Rules: an analysis of the exception to the general rule of ownership immunity from competition rules

*Floris OW Vogelaar**

This contribution analyses the special position of intellectual property right owners in the context of competition law enforcement. Whereas normally an intellectual property right provides an almost absolute and exclusive right to exploit the intellectual innovation achieved, such exploitation may have to be shared with third parties wishing to obtain access to the protected right in order to pursue exploitation activities of their own, whether or not in competition with the original owner of the right. In particular this may be the case if such access is indispensable for the achievement of the third party's objectives. This contribution focuses on the issue of 'compulsory licensing', which may be seen as impinging upon the absolute ownership of an intellectual property right with the direct effect of making that right open to competition. The owner of the intellectual property right may be seen as a gatekeeper, who under certain specific circumstances may be forced to grant third parties access to the right to exploit his protected property, even against his will. From an economic point of view, his position is comparable to that of other 'owners' of exclusive user rights, such as the owners of an essential facility or the undertakings holding an exclusive concession to provide services of general economic interest. Also these may be seen as gatekeepers who may under specific circumstances be forced to grant third party access to the whole or parts of their exclusive ownership or concession. This contribution analyses, inter alia in the light of the 2007 *Microsoft* judgment of the CFI, whether all gatekeepers are subject to the same rules in relation to granting third parties access to their individual exclusive rights. The analysis will focus on the doctrines developed by the Commission and the European Courts in the context of Art 82 EC only.

INTRODUCTION

In this contribution, we will deal with some competition law issues of compulsory or obligatory licensing of intellectual property rights (IPRs) as these have developed over the years in the case law of the European Courts and the decisional practice of the European Commission ('the Commission'). These issues will be analysed within the general doctrines relating to the abuse of dominance as laid down in Article 82 EC rather than in the context of the traditional thinking on IPR licensing which would fall within Article 81 and the group exemption Regulation 772/2004 on the transfer of technology ('the TTBER'). Compulsory licensing does not occur regularly but should be seen as an exception to the rule. In general, from a strategic point of view

* Prof Vogelaar has been reading Competition and Regulation at the Law faculty of the University of Amsterdam from May 1999 until his retirement in June 2009. This article is an updated and expanded version of an article which was published in the Dutch language in the *Liber Amicorum* 2008 for his then retiring colleague Prof Egbert Dommering.

compulsory licensing will hurt the IPR-owner forcing him to licence whether or not that fits within his normal business strategy.

It will be shown below that from a competition law perspective, forced third party access to certain exclusive rights and compulsory licensing seems to be comparable in their economic effect. A comparable doctrinal approach seems to have taken place. For a proper analysis, it is sometimes necessary to think 'out of the box' taking into account developments in law relating to subjects which intrinsically may be said to be comparable by their very nature. In this case reference should be made to the developments in the field of 'essential infra-structures' (EIFs) and the granting of concessions to provide services of general economic interest (SGEIs).

In this context, we should also include in this analysis the recent Notice of the Commission on exclusionary practices under Article 82, and in particular the role of IPRs as seen in that document by the Commission.[1]

ABUSE OF DOMINANCE IN GENERAL

One of the main objectives of the European competition rules is to guarantee unrestricted competitive conditions in an open market economy.[2] In such an open market economy there is neither room for cartels nor for abusive use of dominance. When monitoring these competitive conditions, the Commission aims to guarantee a level playing field. Not only private undertakings but also Member States will be called to order when taking measures to the detriment thereof. The task of competition authorities – primarily the Commission but also National Competition Authorities (NCAs) – is not the protection of individual competitors but the protection of effective competitive market conditions. Protection of (the unrestricted development of) consumer welfare comes first and competition authorities cast a critical eye on any market developments that would be contrary thereto.

In the context of Article 82 EC a distinction has traditionally been made between 'exclusionary' and the 'exploitative' abuse. The first category involves undertakings holding a dominant position excluding their competitors by other means than competing on the merits of the products or services they provide, i.e. 'foreclosure of the market'.[3]

Competing fairly is not the problem. The problem emerges when dominant undertakings create artificial barriers to market entry for (potential) competitors.

In its Guidance Notice on Exclusionary Conduct, the Commission only once refers to IPR-related cases, to wit in the context of the chapter on 'refusal to supply and margin

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[1] Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ 2009, C45/7. In addition, the Commission reportedly is still working on a further guidance paper concerning exploitative conduct which would complement the present Guidance Notice of February 2009.

[2] As laid down in the Articles 3(1)(g) and 4 ECT.

[3] Guidance Exclusionary Conduct, op cit, n 1, para 5

squeeze'.[4] In doing so, the Commission mentions two forms of abusive conduct in particular. In the first place mention is made of situations where the dominant undertaking competes on the 'downstream market' with the buyer it refuses to supply. The term *downstream market* is used to refer to the market for which the refused input is needed and includes both products and services. The other example concerns a rather more exploitative refusal to supply, e.g. for retaliatory purposes or tying arrangements.

It is in the first category that the Commission mentions the examples of:

(i) refusal to supply products to existing or new customers
(ii) refusal to licence IPRs including the situation in which the licence is necessary to provide interface information, or
(iii) refusal to grant access to an EIF or a network.[5]

In these cases, the Commission announces that application of Article 82 should merit special consideration and might lead to the imposition of an obligation to supply on the dominant undertaking. In its footnotes in this new Notice, the Commission refers to IPR cases like *Microsoft*, *Magill* and *IMS Health* which will be analysed in this contribution below. The fact that the Commission refers to these IPR-cases makes it clear that the subliminal message is that normal use of the specific substance of IPRs will not normally create competition problems but the artificial use of such right will, in particular when these rights are used to obtain extra advantages in the market which would not be obtained without such improper artificial use. Such use of IPRs is undoubtedly capable of running against the prohibition of Article 82 ECT. In its new Notice, the Commission emphasises the efficiency gains of 'normal' competitive conduct and the fact that residual competition should not be impeded in markets on which a dominant undertaking is active.[6] Normally, IPRs will lead to an acceptable (statutory) dominant position which remains immune to the application of the competition rules.[7] However, it is the further restriction of free competition and the creating of further barriers to the emerging of residual competition by the 'over-extensive' use of IPRs which is normally held to be objectionable.

In exclusionary abuse cases the main issue normally is whether third party access to the market is impeded. One sees this development not only in the case law on EIFs but also where any hypothetical niche market is being developed within a service, the performance of which has been proclaimed a SGEI. The general issue in those cases invariably is whether third parties will have to be admitted to the (co-)use of the existing infra-structure or public concession. Which undertakings will be allowed to transport gas or electricity through an infra-structure of pipeline grids or electricity cable networks already in existence, and owned by some other undertaking, whether or not that undertaking is active downstream using its own EIF to provide competing

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[4] Ibid, 75 *et seq* in Chapter D.

[5] See Guidance, op cit, n 3, at para 78, and the cases mentioned in the footnotes to that paragraph.

[6] Known from the case law of the Court of Justice, *inter alia* in Case 322/81 *Michelin* [1983] ECR 3461.

[7] Case 24/67 *Parke Davis v Probel*, [1968] ECR 81.

services itself? Which undertakings may take part in the market for postal services, and for which type of services? Which undertakings will have access to telecoms (glass fibre) cable conduit streets? Which undertakings will be granted the right to publish TV-guides, thereby making use of programming details which might be protected by copyrights and owned by the programme makers or broadcasting companies? Under which circumstances would it be possible for third parties to force a patent owner to grant a licence deemed indispensable for these third parties to commence competing with that owner or to start new activities so far not pursued by the owner of that patent? To what extent will 'cherry-picking' by (emerging) competitors be possible within the wide range of tasks usually granted to undertakings providing SGEIs?

Third Party Access seems to be the name of the game in all of these far from imaginary examples. Therefore, we will first explore the legal developments in the areas of EIFs and SGEIs.

Essential Infra-Structural Facilities (EIFs)

EIFs are infra-structural installations incapable of duplication but indispensable to suppliers of certain services.[8] In this context, one should think of a gas pipeline and electricity wire grids and networks, the rail paths for the running of a train service, large maritime ports, an international airfield, etc.

The EIF doctrine is seen as part of the assessment of market behaviour under Article 82 ECT. In accordance with standing case law of the European Courts and the decisional practice of the Commission, ownership of an EIF creates dominance. Third party access issues come up depending on the manner in which the owners of the EIF defines the thresholds for making use of their infra-structural property to accommodate potential users/service providers. When these access thresholds are objective and non-discriminatory, Article 82 is not likely to come in play. However, most problems arise in those cases where the EIF owner, through its downstream operations, is also the user of the EIF and thus a provider of services on the secondary market where making use of the EIF is indispensable. Practice shows that the downstream operations of the EIF-owner are given priority or a (at least) a more advantageous treatment quite rapidly, thereby placing other users of the same EIF at a distinct competitive disadvantage.[9]

The first example in the Commission's decision practice has been the case of the two competing ferry services using the same maritime harbour of departure (clearly an EIF), one of the undertakings also being the owner of that harbour.[10] The owner of the EIF gave preferential treatment to his own ferry operations. In its decision, the Commission defined this preferential treatment as an abuse of a dominant position within the meaning of Article 82 EC. It is not necessary for the owner of an EIF to be active on

[8] Commission Decision *re Port of Rødby*, OJ 1994, L55/52; Commission Decision *re British Midland (Zaventem)*, OJ 1995, L216/8.

[9] Discrimination pursuant to Article 82(c) EC may also be an issue, but this will not be dealt with in this contribution

[10] Commission decision re *Port of Rødby*, OJ 1994, L55/52.

an upstream or downstream market in order for discriminatory conduct in relation to upstream or downstream participants to constitute abuse. In *British Midland/Zaventem* the owner of the Brussels-Zaventem airport granted one undertaking, Sabena, quantity rebates on the fees payable for baggage handling that were in practice not available to competing air transport carriers. One of those competing air carriers, British Midland, filed a complaint and, also here, the Commission found an abuse of dominance.[11]

Both cases involve physical infra-structures. In *Magill* following these earlier two cases a similar doctrinal approach was given to EIFs based on copyright and, therefore, it is argued, to a virtual EIF.[12] Although the European Court in its judgment did not use the terminology of 'essential infra-structure', it did apply and endorse the EIF-doctrine developed by the Commission in the cases mentioned earlier by analogy. Unsurprisingly, *Magill* makes reference to earlier case law on the refusal to supply. Both cases were similar in that they dealt with a refusal to grant access (or rendered access difficult) to a market by the owner of some property which was deemed indispensable to a potential entrant of the market concerned. *Zoja* can be relied on since a distributor with a long-standing commercial relationship saw his distribution contract terminated by an undertaking in a dominant position and, consequently, experienced the immediate risk of going out of business.[13] Regardless of whether the refusal of access is concerned with a physical infra-structure or with the denial of access to an essential IPR, the systematic approach should not be different. IPRs have thus become 'virtual' EIFs which may be indispensable for the development of a certain hitherto non existing market. It is merely a variation on the theme of the many occurring market access puzzles, albeit it that for both the refusal to supply and the refusal to grant a licence the European Court has formulated that a number of additional special circumstances should apply for the required copyrights to constitute an abuse of a dominant position. Abuse of dominance will only be found when:

(i) the use of the IPRs (in this case the copyrights) are indispensable for achieving the envisaged objective
(ii) without which it would be impossible to bring on the market the envisaged product (comprehensive weekly TV-guides for all programmes of all British broadcasters)
(iii) such that the refusal to licence would effectively prevent the appearance of the new product
(iv) for which there was a clear consumer demand, and
(v) whereas no objective grounds for the refusal to licence could be identified; all the more so now that it had become clear that the IPR-owner did not have any intention himself to introduce and offer a similar product to the market (probably out of well-understood self interest).

11 Commission Decision re *British Midland/Zaventem*, OJ 1995, L216/8.

12 ECJ in the Joined Cases C-241 & 242/91P, *RTE (Magill TV-guides),* [1995] ECR I-743.

13 ECJ in the Joined Cases 6/73 & 7/73 *Commercial Solvents and Istituto Chemiothrapico Italiano v. Zoja* [1974] ECR 223.

The structure and the build-up of the reasoning of the European Court fits the pattern already established in *Zoja*, even though in that case the facts were about the arbitrary stopping of supplies in a long-standing commercial relationship, whereas in *Magill* the facts centred around a new market entrant requesting access to certain copyrighted programme data. However, third party access should be identified as the common denominator in both cases. The physical and virtual cases are similar in that they deal with a refusal to grant access (or rendered access more difficult) to a market by the owner of some property which was deemed indispensable to a potential entrant of the market concerned.

Shortly after *Magill*, the European Court handed down the *Bronner* judgment,[14] in which the Court repeated almost verbatim the *Magill* criteria. However, it was held to be equally important that in cases where IPR-protection did not play a role and where a case simply relied on a (non-protected) commercial market position achieved by a hard working, efficient and successful undertaking, a way into access to its distribution network could not be forced by a smaller competitor save in very exceptional circumstances. This case dealt with the claim of small newspaper owner Oscar Bronner to 'piggy-back' on the efficient newspaper distribution network of his much larger competitor Mediaprint for the distribution of his own two small newspapers. Arguing that setting up a distribution network of his own would not be economically viable because of the very small numbers of his newspapers sold or subscribed to. 'Tough luck', was the Court's finding. There are no special circumstances that would justify the granting of access to a competing distribution network as long as the setting up of a network of his own - which might maybe come slightly more expensive - remained a possibility. Hence, Mediaprint's distribution network was not held to be indispensable for Bronner's aspirations to enter the market and neither was it held impossible to duplicate.

Special or Exclusive Rights in SGEIs and the Notion of Market Power

The case law dealing with the SGEIs has developed along similar lines. In the first place, the Court has held that undertakings vested with the task to provide *services of general economic interest* within the meaning of Article 86 EC and which for that purpose had been granted special or exclusive rights, frequently would be held to enjoy a dominant position within the meaning of Article 82 EC (in the case of *exclusive* rights) or, at least a position of collective dominance (in case of *special* rights).[15] This second category will be relatively less important in this contribution as in most cases the undertakings which are to be granted special rights will derive such rights from concessions granted by the public authorities as a result of public procurement tenders.

[14] ECJ in Case C-7/97 *Oscar Bronner v Mediaprint*, [1998] ECR I-7791. It is worth noting that the Bronner case was mentioned also in the Commission's Guidance Notice on abusive exclusionary conduct, op cit, n 1, at para 83.

[15] Although in Case C-475/99 *Ambulanz Glöckner* [2001] ECR I-8089 the Court made clear that dominance had to be established in each instance and could not be inferred automatically from the fact that the undertaking was public or enjoyed special or exclusive privileges (Cf. in particular recitals 31-38).

Normally, the concession granting authorities will supervise whether the holders of such concessions effectively compete with each other.[16] The situation is more difficult in those cases where the special rights have been granted to a limited number of undertakings as the direct result of the liberalisation of a formerly regulated market and where this limited number of holders of special right concessions is presumed to compete with each other.

An example hereof has been the legal maximum of five telecoms undertakings that could hold (tendered) concessions for the provision of mobile voice telephony in the Netherlands in the early years of this Century. The concession concerned a special right enabling the holders of such a concession to enter the mobile voice telephony market. An undertaking not having such concession, by law, did not have access to the market concerned and could not be active in that field. The Dutch telephony incumbent KPN acquired one of these newly issued concessions. KPN also continued to be the owner of the connection infra-structure needed to make it possible for mobile phones to communicate. In order to solve possible problems of market power and potential abusive thereof in the mobile voice telephony market in the country (e.g. by price squeeze type of behaviour), a special telecoms regulator was created, called OPTA.[17] This regulator is capable of issuing a sort of 'yellow card' to one or more of the concession holders by finding those who hold what is called 'considerable market power' (aanmerkelijke marktmacht). Once a finding of that kind has been made, OPTA can start regulating to some extent the business of the undertaking concerned, with the sole objective of guaranteeing effective competition on a level playing field. As such, a system of *ex ante* control over the market has been created, that *inter alia* is meant to avoid or mitigate the emergence of (collective) market power.

A similar form of *ex ante* control in the Netherlands is now exercised in the liberalised markets for gas and electricity by the *Dte*[18], one of the departments (called Chambers) of the NMa.[19] Therefore, in all three markets SGEIs provide the services required to the market, i.e. the users and the consumers.

Things did not go smoothly in all cases where exclusive or special rights were granted. In *Höfner & Elser v Macrotron*[20] the European Court held that an undertaking providing SGEIs and enjoying a statutory monopoly was dominant within the meaning of Article 82 EC. This dominance might be abused in those cases where the undertaking providing the SGEI effectively hinders third parties in their efforts to supply certain services competing with those (potentially) offered by the entrusted undertaking in a situation in which that undertaking decided not to provide such an aspect of service, or

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16 Cases where apparently this supervision was missing were shown in the judgments of the ECJ in Case 30/87 *Bodson Pompes Funèbres* [1988] ECR 2479 and Case 209/98 *Sydhavnen Sten & Grus* [2000] ECR I-3743.

17 The so-called *Onafhankelijke Post en Telecommunicatie Autoriteit* (the Independent Post and Telecoms Authority), the creation and the powers whereof are based on the Dutch Telecommunications Act.

18 *Dienst Toezicht Energie* with tasks and powers laid down in the Gas Act and the Electricity Act.

19 The national Dutch Competition Authority.

20 ECJ in Case C-41/90 *Höfner & Elser v Macrotron* [1991] ECR I-1979.

is shown to be incapable of doing so. This will especially be the case when there is market demand for such a type of service. Although the undertaking providing the SGEI operates on the basis of statutory provisions (which in principle have to be complied with), the European Court construes Article 86 EC in such a way that a public authority entrusting a SGEI has to make sure that the entrusted undertakings are fully equipped for their task. Failing this (i.e. not supplying the market with certain services) and in the case where there is an obvious demand from the market (which can be satisfied by other private entrepreneurs) the Member State fails to comply with its Treaty obligations as laid down in Articles 10 and 86 EC when it is to be expected that the entrusted undertaking will abuse its statutory monopoly within the meaning of Article 82 EC by trying to keep these new providers of services off the market. Obviously, the entrusted undertakings are likely to do everything within their means to deny newcomers, capable of providing the services needed, access to their reserved market. Also in *Höfner*, as in *Magill*, additional special conditions have been formulated for the finding of abuse:

(i) the exclusive right granted to the entrusted undertaking includes the services concerned (in *Höfner* these were: head-hunting for leading positions in the commercial market)
(ii) the SGEI is not sufficiently equipped to perform that part of the rights granted to it on an exclusive basis, or is not capable to satisfy all market demand
(iii) whilst the emergence of a private market is rendered impossible as a result of the strict enforcement of the statutory rules, and
(iv) private undertakings have shown their interest to become active in that *niche* of the market and, what is more, would be capable of satisfying the obvious demand for the neglected service.

Again, as in *Magill*, but then only with a different legal background, *Höfner* is concerned with 'third party access'. The case is about impeding the emergence of a market of services for which there is an obvious demand, but which cannot develop as a result of legal obstacles.[21]

The second judgment to be discussed in this context is *Corbeau*.[22] The Belgian entrepreneur Corbeau faced criminal law prosecution for infringing the Belgian Postal Act by setting up a private courier service for 'same day' mail delivery for all law firms in his home-town of Liège. It was established that the incumbent Belgian mail service provider RTT did not offer a comparable service. In line with previous judgments, the European Court held that Corbeau could not be denied the right to enter this market and provide his *niche* service, because the incumbent undertaking did not offer a comparable service and apparently was not capable of starting to do so. *Corbeau* is

[21] This general line of thought was developed by the European Court in a series of judgments in the early 90s of last Century, in each instance with a similar result. Cases to be mentioned include: Case C-260/89 *ERT* [1991] ECR I-2925; Case C-179/90 *Porto di Genova* [1991] ECR I-5889; Joined Cases C-115-117/97 *Brentjens* [1999] ECR I-6025 and Case C-475/99 *Ambulanz Glöckner* [2001] ECR I-8089.

[22] ECJ in Case C-320/91 *Procureur du Roi v. Corbeau* [1993] ECR I-2533.

particularly important in that the Court held that in the exercise of their entrusted tasks, undertakings providing SGEIs are allowed to apply cross-subsidisation. They were permitted to use revenues derived from economically more viable services to subsidise activities within the package of entrusted tasks which were economically less viable. This ruling implied, however, that 'cherry picking' would not be allowed for potential entrants of a niche market within the context of a larger SGEI package and thus leaving the economically less viable activities to the SGEI. This would lead to a situation of unfair competition *vis-à-vis* the incumbent SGEI which normally has the legal obligation to offer to the market the entire package of services (as defined in their concession). However, for those services not offered by the incumbent itself which would be dissociable from the legal package of services, a competitor would be free to develop a niche market. Any action to impede the emerging of such activity would be held an abuse of the legal monopoly, and therefore an infringement of Article 82 EC.

Moreover, in *Porto di Genova*, it has been pointed out that insufficient or poor use of market opportunities by the legal monopolist may be held to be abusive when a private undertaking is prepared to make use of those opportunities more efficiently, e.g. by investing in modern production equipment to perform the services required more quickly or more cost efficient.[23]

From this and from both *Höfner* and *Corbeau* it can now be concluded that undeveloped market opportunities are open to private market entrants, in potential competition with the incumbents, as long as these opportunities have not been used by the legal monopolist, *i.e.* the entrusted undertaking holding exclusive rights. Any attempt from the side of the incumbent to frustrate the emergence of such new activities would constitute an infringement of Article 86 (by the Member State) in conjunction with Article 82 EC (by the incumbent). Consequently, the legal monopolist has the duty towards the market to avail himself with modern and efficient equipment so as to render the exercise of his tasks (in the general economic interest) as cost efficient as possible.

From the above, it can readily be understood, why in its Guidance Notice on exclusionary conduct the Commission criticises behaviour that does not bring about any efficiencies in the interest of the consumer.[24] Such behaviour is likely to put the objectives of the competition policy, *i.e.* the bringing about of efficient market structures to the benefit of the consumer and, hence, of consumer welfare, in jeopardy.

Competition Law and IPRs

The purpose of this contribution is mainly to see whether the competition law approach towards IPRs has developed along similar lines. The specific substance of IPRs is generally accepted to guarantee some scope for the reward for innovation achieved and to grant the successful innovator a reasonable period of competitive

[23] *Porto di Genova*, op cit, n 21, at 19.

[24] Commission's Guidance, op cit, n 1, para 5.

tranquillity so as to enable him to recoup his investments for the innovative effort. Potential competitors of his would be precluded from using the protected innovation without such licence. In this context, one of the options for the IPR-owner would be to licence his (legally) protected innovation to third parties against payment of a reasonable royalty fee. The opportunity of being awarded patent protection, plant propagating rights, model rights, copyrights and other comparable IPRs often requires large investments to secure innovative progress. Along similar lines, the same might be said of trademarks, copyrights, model rights and the like. Also there, potential large investments (in terms of publicity costs, of actual writing time, of creative efforts) have preceded the innovative and (legally) protected results. Nevertheless, this protection offered is not absolute. In particular, it does not provide immunity to the application of the competition rules

As early as in *Parke Davis* v *Probel*, the Court held that the protection of the IPRs only goes as far as the specific substance of the IPR concerned. Therefore, whilst normal activity to protect this specific substance would not constitute an abuse, behaviour going disproportionately further than the specific substance of the IPR concerned would be considered abuse of the dominant position derived from the legally protected status of the IPR.

A number of abuses were included within this type of infringement of Article 82, that were of less relevance to this contribution. Mention could be made of the obligation to make royalty payments over and beyond the period of legal protection of a patent, or the prohibition to challenge the validity of the patent once a licence agreement had been entered into. More recently, the Commission accused the Anglo-Swedish undertaking AstraZeneca of using a whole plethora of tricks and ruses to extend the legal protection period of its patents for certain medical drugs disproportionately in order to postpone the emergence of (cheaper) generic medical drugs with an equivalent medical treatment effect and purpose once the patent protection would have expired. The Commission has held this to constitute an abuse to the detriment of the consumer and consumer welfare.[25]

For this contribution the issue considered is: are there circumstances in which the holder of an IPR can be obliged to licence others (third parties) to exploit the IPR and would there be additional special circumstances which would render it more likely that such obligation would emerge? Within Article 82, this question may be classified somewhere in between the themes of 'refusal to sell' and 'foreclosure of the market'. In both instances one might argue that potential new entrants of a (niche-)market would be denied access. It is herewith argued that there are three categories of undertakings

[25] Commission Decision *re AstraZeneca* 37.507/F3 of June 15, 2005. A non-confidential version has been published on DG Comp's website on July 19, 2006. Probably because of the great length of the decision (over 200 pages) a short summary was published in the OJ 2006, L332/24 only. At the time of writing of this article, an appeal was pending before the Court of First Instance which hopefully will be decided upon later this year.

that may desire competition to be restored or imposed in the area of the IPR and so for a compulsory licence to be granted:

(i) The applicant of a licence in fact wishes to engage in the same activities as the IPR-owner, and for that reason wants to start competing with the latter;

(ii) The applicant of the licence needs the licence because he wishes to use the technology then becoming available to him to engage in activities not pursued by the IPR-owner. The applicant of the licence wants to enter a niche market or to expand his activities on that market, and for that purpose the licence is indispensable to him;

(iii) The technology protected has *de facto* turned into the market standard. This standard may have been patented. It may also consist of secret know-how. Any third party aspiring to enter the market of that standard faces the difficulty of obtaining the legal (and thus licensed) use of the technology involved. A broad and generous licencing policy on the side of the IPR-owner may stimulate further innovation and in doing so, it may also contribute to the increase of consumer welfare.

Each of these categories will now be considered in turn.

(i) The undertaking wishing to start activities in competition with the IPR-owner using the (protected) technology

In *Volvo* v *Veng*[26], the Court has dealt with this type of aspiration in a very concise and firm manner. Volvo accused Veng of infringing its protected design rights for the body-work of its Volvo cars. Veng defended this claim arguing that by denying the necessary and indispensable licence to use the protected designs for the manufacture of bodywork needed for the repair of damaged Volvo cars, Volvo abused its dominant position. The Court held that the refusal to grant a licence to exploit an IPR is not itself an abuse of a dominant position. This may only be different if additional special circumstances could be identified. These might include, according to the Court, the refusal without an objective reason to grant licences when similar licences are granted to other third parties already, or making the granting of the licence conditional upon the payment of an unreasonably high royalty fee with the direct result that it would be impossible for the licencee to enter the market in an economically viable manner. In this case, Volvo manufactured all bodywork needed for repair purposes themselves and had not licensed any other third party to do the same. On the same day, the Court took the opportunity to specify the notion of additional specific circumstances in another case involving motor cars in a situation where the original manufacturer had stopped manufacturing spare parts for one of its models although many cars of that model were still on the road. In such a case, the Court held it reasonable that a licence should be granted to a third party willing to continue the manufacture of those spare parts.[27]

[26] ECJ in case 238/87 *Volvo v Veng* [1988] ECR 6211

[27] ECJ in case 53/87 *Maxicar v Renault*, [1988] ECR 6039

In a similar vein though some years later, the Commission in remarkably careful wording held in the case of *Lederle-Praxis Biologicals* that:

> 'at the current stage of EC competition law, it is doubtful whether one could impose an obligation upon a dominant firm [...] as a remedy to ensure the maintenance of effective competition in the [...] market, to share its intellectual property rights with third parties to allow them to develop, produce and market the same products [...] which the alleged dominant firm was also seeking to develop, produce and market.'[28]

For that reason, it must be safe to assume that when the IPR-owner on a regular basis is using the specific substance of his innovative creation and refuses to share this substance with would-be potential market entrants, Article 82 is not infringed. Consequently, there is no tension between competition law and policy and the legitimate protection of IPRs. However, if he no longer uses his IPR, legitimate requests for the grant of a licence may arise.

(ii) An undertaking wishing to enter a (niche) market in which the IPR-owner is not active.

This category shows the most similarity with the developments described above relating to the EIFs and the undertakings granted the special or exclusive right to provide SGEIs. There is no judicial authority in relation to IPR although *Maxicar* comes close and may possibly be situated in both the first example as in this second one. For further guidance, we will have to look at other sources to assess what might be permissible in the field of licencing. In the first place reference could be made to the 'field of use' restrictions[29] established in *Maize Seed*[30] and the TTBER.[31] A field of use restriction in a licencing agreement is normally thought to fall within the category of the so-called 'inherent restrictions' which fall outside the scope of the prohibition of Article 81(1) ECT. By analogy, we may have to accept that some form of indication that licences based on a field of use restriction may generally be permissible under Article 81 EC. The positive news would then be that no major problems are to be expected from that point of view.

More problematic might be the assessment under Article 82 EC. Here, one should primarily look for guidance from *Magill* and *Porto di Genova*. For Article 82 to apply, there should be at least the identification of some form of abuse of dominance. It is herewith argued that we might expect the Courts to apply the *Magill* criteria by analogy to any other case in which IPRs would play a role. This would mean that an abuse of dominance is only found if there are specific circumstances beyond a mere refusal to

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[28] Cf. the XXIVth Report on the Competition Policy of the Commission (1994), at p 353.

[29] We should think of a patent with a broad underlying range of technical application possibilities, which then will be licenced for one field of application only.

[30] ECJ in Case 258/78 *Nungesser & Eisele v Commission (Maize Seed)* [1982] ECR 2015.

[31] Cf. in particular Article 4(1)(i) & (ii) in Reg 772/2004, OJ 2004, L123/11.

licence. For a potential applicant of a licence to be entitled to the grant thereof it is suggested that the following criteria are to be met:

(i) without the licence the applicant will not be able to develop, produce or market the product or service involved (i.e. the criterion of indispensability)
(ii) the results achieved by the IPR cannot be duplicated without disproportional efforts
(iii) whilst the IPR-owner is not (or no longer) active in developing, producing or marketing the application in which the applicant is interested
(iv) there appears to be consumer demand for such application.

The judgment in *Porto di Genova* may play a role in this discussion, as in that judgment it was held that a dominant undertaking's refusal to invest in modern production equipment for the benefit of his buyers constituted one of the elements contributing to an abuse of its dominant position. There was no alternative for the buyers as they could not go to another supplier, and for that reason they paid too much for the services that were offered to them by a supplier using technologically outdated equipment. If we are to draw a comparison with that line of thought and the position of the IPR-owner who is by choice leaving one of the possible applications of his IPR unused, the conclusion may be drawn that the buyers, and thus the consumer, are being denied a (new) market opportunity. This may be even more be so in cases where the owner deliberately leaves the new opportunity unused so as to recoup his investments in the earlier technology first, whereas others would be willing to invest in the new market opportunity and there would be demand for such a 'new' offer in the market.

Logically, one should possibly add the *Corbeau* criterion to the four (cumulative) criteria mentioned above. The application involved should be capable of being dissociated with the (field of) applications currently in use by the IPR-owner himself. When that is not the case, we would fall back to the *Volvo* v *Veng* or the *Maxicar* situation and that would leave us with little room to accept abuse of dominance, and consequently, to accept the necessity that there should be a cause for a (compulsory) licence.

Also, an undertaking seeking a (compulsory) IPR-licence should be able to do away with the potential analogy with the *Bronner* case. He should be able to identify additional specific circumstances of such a compelling nature that in all reasonableness it could not be expected for him to try and develop his market ambitions and the possible associated niche market by developing a technology of his own alongside the IPR-protected technology of the IPR-owner. If we look at the puzzle from this end, it may not be very surprising that in *Lederle-Praxis Biologicals* the Commission issued the carefully worded warning that one should not assume the right to obtain a (compulsory) licence too soon. In that situation the applicant for the licence wished to enter in direct competition with the original IPR-owner rather than it being a case of the type presently discussed, where such direct competition is not in issue. A compulsory licence should be an *ultimum remedium* in all circumstances.[32] If ever such an

[32] This *ultimum remedium* should be identified as a 'structural measure' which the Commission could impose to bring an infringement of Article 82 to an end in cases where no other remedy would available to do so. Such

analysis should be needed, it is herewith contended that in any case one should look at the legal developments in the other two legal doctrines discussed above, to wit the legal doctrines in the fields of EIFs and SGEIs.

Therefore, we may conclude that it should be possible in principle to obtain a compulsory licence in specific circumstances, if only to grant the Commission the opportunity of realising one of the most important objectives in competition law, *i.e.* the stimulation of innovation by investment and the ensuing increase of consumer welfare.

(iii) The IPR-protected or secret technology has developed into the de facto market standard

The Commission's general policy towards technological standardisation may be found in its Notice on the applicability of Article 81 to horizontal cooperation agreements.[33] Standardisation agreements include agreements on, 'technical specifications in markets where compatibility and interoperability with other products or systems is essential'.[34] In this Notice it is clearly indicated that the Commission favours agreements dealing with technological standardisation provided that undertakings not party to the agreement are not excluded from using the agreed standard. In that context, it seems to be of less importance that the parties to the agreement together enjoy a large market share. On the contrary, according to the Commission, this might even enhance the effectiveness of the standard chosen.

However, in the context of the assessment of the last criterion of Article 81(3), the Commission points out that when these standards would not be accessible to third parties, this might result in undesirable discriminating or foreclosure effects. There may come a time when the standard shows such a firm hold on the market that it has become *the* factual standard used. Private undertakings having developed such a standard might then be held to enjoy a position of collective dominance. Even then there might not be a problem as long as these standardised norms are applied in as open a manner as possible. Third parties should be granted access to the technology required for the application of the standard on clearly objective and non-discriminating conditions. The Commission's policy in this respect tallies seamlessly with the objective that innovation should be undertaken on as broad a level as possible in order to enhance consumer welfare. Also, it seems to tally with the more economic effects based approach of competition policy in which the strict demarcation between dominance and market power is no longer defined in terms of black and white. Ever since the introduction of Regulation 1/2003 and the group exemption regulations of the 'safe harbour'-type, these notions more or less seem to transform gradually from one into

a structural measure should at all times be applied in a proportional manner. Cf. Article 7(1) of Council Regulation 1/2003, OJ 2003, L1/1.

[33] Cf. Commission Notice, Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, OJ 2001, C3/2, paras 159-168.

[34] Ibid, para 159.

the other.[35] Also, within the framework of Article 81(3) and using modern economic reasoning, the Commission monitors whether or not too great a level of market power develops with the direct result that access to such a relevant market might be impeded. In any event, such emerging market power would render the application of a group exemption regulation impossible.[36] Hence, market power exceeding the regulation's market share threshold may also result in the non-applicability of Article 81(3) at the individual level.[37] And then, a still larger market power may be held to constitute a position of dominance and, consequently, may lead to the application of Article 82 ECT.

In the cases *IMS-Health*[38] and *Microsoft,*[39] the factual norm was not the result of cooperation between market players but rather the result of individual innovative efforts and investments. In such a context, the question should be answered whether the Commission's policy, as formulated to deal with collective market power under Article 81(3), may be transposed to the application of Article 82 without difficulty. In particular, aspects of compatibility and interoperability will draw attention. Should undertakings desiring to make use of this factual standard to start some market effort of their own be granted access to this standard; would these be entitled to obtain some form of licence (always under reasonable contractual conditions) if and when they would so wish?[40]

In both cases, it was one undertaking that had developed a norm that then became the *de facto* standard in the market. In *IMS-Health* this was the so-called '1860 brick structure' for the building-up of a catalogue and the systematic reporting of medical drugs. In the *Microsoft* case Windows has been identified as *the* standard for most computer operating systems. Both undertakings were held to be dominant within the meaning of Article 82 EC. Hence, it could be argued that by becoming the market standard their norms constituted an 'essential technological facility' ('ETF') paraphrasing slightly the notion of 'EIF'. It could be said that it would no longer make sense for other market participants to try and develop a technological standard of their own – if only because of the costs involved and the established user preference – as the market would simply not be prepared to accept a new standard. Whatever the case might have been, this was the experience of NDC, which wanted to take on IMS

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35 As is also made clear in the recent Commission Notice on Guidance on the enforcement priorities in applying Article 82 of the Treaty to exclusionary conduct, op cit, n 1.

36 Cf. the existing maximum market share percentages (the so-called market caps) allowed at 30%, 25% and 20% respectively.

37 Cf. also the Commission Guidelines on the application of Article 81(3) ECT, OJ 2004, C101/97, paras 105-116.

38 ECJ in Case C-418/01, [2004] ECR I-5039.

39 CFI in Case T-201/04, [2007] ECR II-3601.

40 My Ghent colleague I Govaere came up with a critical analysis of this case (dating from before the Microsoft judgment) titled: 'Het actuele spanningsveld tussen EG-mededingingsregels en intellectuele eigendomsrechten', in Actualiteiten in het Europese mededingingsrecht, 35th Asser Colloquium on European Law, TMC Asser Press 2006.

Health with a competing catalogue but did not get a foothold on the market. As a result NDC applied for a licence from IMS Health. In *IMS Health*, the European Court held that NDC was entitled to a compulsory licence under reasonable conditions. The mere refusal to grant this licence would constitute an abuse of dominance. The Court ruled that for the granting of a compulsory licence additional specific circumstances had to be put forward which for the applicant would render indispensable the obtaining of such a licence. It is interesting to note that the CFI held that it would suffice that the licence would have some potential or even hypothetical use to the applicant.[41] Also in this case, the Court mentioned that the object of the licence should be to develop new products or services which were not on offer by the IPR-owner in spite of the fact there was evidence of potential consumer demand for that product or service.[42] It was accepted, though, that refusal to grant a licence would be acceptable on objective grounds.[43] Regrettably, the Court did not state any examples of what such grounds might have been. It is herewith contended that such grounds might be the usual ones that give rise to an acceptable refusal to supply, i.e. an unreliable 'business record', reasonable doubt as to whether the contractual counterpart would be capable of fulfilling his financial obligations or the fact that the buyer is known for repeatedly committing breach of contract. From *Microsoft*, it has become clear that the mere protection of an intellectual property right as such will not qualify as an objective justification for the refusal to grant a licence.[44]

In *IMS Health,* the Court deals with the issue of a compulsory licence of a protected IPR, without which the applicant would not have been able to offer its (new) service to the market. In its ruling, the Court not only applied the *Magill* criteria by analogy but also the *Corbeau* criteria, and in doing so the Court appeared to indicate the view that these different doctrines are strongly interrelated, as has been defended in this article. In these circumstances one has, indeed, to think out of the box. Moreover, the Court reasoned entirely in line with what previously had been formulated by the Commission in the standardisation chapter in its Guidelines on Horizontal Cooperation Agreements. Whether we deal with collective market power or with individual dominance, this is only one more step to take. *Il n'y a qu'un pas!* As it now appears, there is uniformity of policy in this respect.

In *Microsoft*, the Court of First Instance rules in similar vein. In that case, the facts were about two different alleged types of abuse of a dominant position; the first being Microsoft's refusal to grant a licence (Article 82(b)) and the second Microsoft's alleged bundling and tying practices of the operating system Windows with the Microsoft media player (Article 82(d)). In this article, only the refusal to licence will be vetted. Windows appears generally to be recognised and accepted as the market standard – and for that reason, and in my wording, as an ETF – and, consequently, Microsoft gets the

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41 Case T-201/04, 335.

42 In *IMS Health* the IPR concerned was a copyright.

43 See n 38 above, operative part of the judgment, in part 2.

44 See n 41 above, 690.

honour of being held dominant. Many parties in the market and many consumers will presumably have applauded that qualification. However, the case goes much further than the *IMS Health* case. On the one hand, the case is not concerned with the legally protective umbrella of an IPR (as *Microsoft* was about secret non-patented know-how) and on the other hand, the case was about several applications for a licence which in itself would render more transparent, certain data about the interoperability of Windows with all sorts of other applications for which that operating system was deemed indispensable, regardless of whether or not such applications competed with applications that were on offer by Microsoft itself.[45] Also in this case, the CFI holds that refusal to grant a licence would be capable of constituting abuse of dominance if additional specific circumstances would apply. This means that there can no longer be any misunderstanding about the underlying legal theory in this respect. It is interesting to note that in the *Microsoft* case a variation emerged of the known list of additional specific circumstances, as we knew them from previous case law already:[46]

(i) The refusal to licence should be related to a product or service indispensable for the pursuit of a (different) activity on the same, on a neighbouring or on an adjacent market;
(ii) The refusal to licence has the effect that all effective competition on those markets will be precluded;
(iii) The refusal to licence prevents the emergence of new products for which there is consumer demand on the relevant market.

These specific conditions should merely be seen as variations on the themes already known and defined in *Höfner*, *Magill*, *Corbeau* and *IMS Health*. Both the Commission and the Court of First Instance made explicit reference to these cases. Moreover, it is herewith suggested that *RTL-Telemarketing* should be added to this shortlist,[47] in which the Court took the view that an undertaking providing a SGEI and granted an exclusive right for that purpose cannot reserve for its own commercial purposes a secondary market for which no special or exclusive rights have been granted. This would be all the more so, if the abuse would result in denying access to that secondary market of market players that might be eminently suited to provide that market at a lower cost or with technically better products or services.

Also in the cases in which an EIF played a role, best known to us all, the dispute was about access to a secondary or a neighbouring market. Invariably, these cases were about an owner of an EIF using that structural infrastructure for commercial 'downstream' activities of its own in direct competition with (or even excluding access to) other market players using the same EIF. Therefore, it is concluded that, in European competition law, ETFs are being treated in the same manner as EIFs.

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[45] Ibid, 36-42, explaining the nature of 'interoperability'.

[46] Ibid, 331-332.

[47] ECJ in Case 311/84 *RTL-Telemarketing*, [1985] ECR 3261.

In *Microsoft*, the CFI indicated that, 'the appearance of a new product, as envisaged in *Magill* and *IMS Health*, cannot be seen as the only parameter which determines whether a refusal to licence is capable of causing prejudice to consumers'. It should be borne in mind that in Article 82(b) mention is made not only of 'a limitation of production or markets but also of a limitation of technical development', in other words of innovation to the direct benefit of the consumer.[48] From this wording, it should be concluded that apparently the consumer interest could be prejudiced in an indirect manner as well because either certain products may not be put on the market or as a result of the refusal to licence, these products may not have to cope with the rigour of innovative competition from third parties. According to the CFI, Microsoft had influenced the effective competitive structure of the market to the detriment of potential competitors, because Microsoft had build-up too significant (one should presumably read: dominant) a market share.[49] Keeping the interoperability at an artificially low level amounted to a barrier to entry for potential market entrants and competitors. This reasoning very much sounds like established case law, in which it was held that an undertaking in a dominant position bears special responsibility for the maintaining of effective competitive conditions on the market on which it is dominant and where competition has suffered by the mere presence of the dominant undertaking already.[50]

The CFI then ticks off one by one, and in an accurate manner, these specific circumstances to conclude that, in its analysis of the underlying decision under appeal, the Commission did not commit a 'manifest error of appraisal'[51] in its factual and economic assessment. As a result, all three conditions had been satisfied. In this article, it would not be interesting to deal with the question as to whether the CFI is right or wrong in its factual and economic findings. It is above all the construction of the CFI's reasoning that is of interest to this contribution. This system seems to be logical and consistent not only *in se* but also compared with previous case law. Here, it should be noted that in each case emphasis is laid on the fact that the case should be concerned with 'new' products for which there is potential consumer demand. In *Microsoft*, this criterion seems to be extended to new products that are capable of competing with products of the IPR-owner existing already and which, in doing so, may contribute to the innovation of the market to the consumer's benefit. Therefore, this approach seems to go further than the approach as in *Volvo* v *Veng, Maxicar* and *Lederle-Praxis Biologicals* as previously known and acclaimed. For an ETF, the approach is now by analogy similar to the one for EIFs, and also that finding arguably is a consistent way of looking at things. In a standardised and competitive market structure, this seems to be what it is all about. It is not just about one competitor wishing to compete with another

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48 See n 41 above, 647.

49 Ibid, para 664.

50 See n 6 above, ECJ in Case 322/81 *Michelin* [1983] ECR 3461, in particular in para 57. In *Microsoft*, para 229, reference is being made to this judgment, so that we may safely assume that the CFI's reasoning has been founded *inter alia* on this case.

51 Since the ECJ in case C-204/00P *Aalborg Portland v Commission*, [2004] ECR I-123, this is the established criterion for the appraisal on appeal of Commission decisions.

competitor, who also happens to be an IPR-owner. It is about bringing innovation to the market in a situation in which the dominant IPR-owner either fails to do so spontaneously or decides not to do so in his well-understood self-interest.

Moreover, special mention should be made of the finding of the CFI not wishing to grant (extra) protection to owners of secret know-how not legally protected by an IPR. The fact that a dominant undertaking chooses to protect its technology by (secret) know-how rather than by a patent (bringing about protection by law) constitutes a unilateral business choice. Such business choice should not entitle the owner of the know-how to any higher degree of protection.[52] It should be accepted that this constitutes an indication of a consistent competition law approach of IPRs in general as well.

The Instrument of Commitment Decisions pursuant to Article 9 of Council Regulation 1/2003

As from May 1st 2004, undertakings may offer commitments to the Commission when they are having a discussion with that authority whether or not they are acting in abuse of their alleged dominance. The Commission may but is not obliged to accept such specific commitments for future market behaviour in exchange for bringing the investigations (or even: the procedure once it is initiated) to an early end. These commitments are then transposed into remedies which will be imposed upon the undertaking under investigation in a formal Commission decision. Such a decision can only be taken subject to the specific rules of due process as recently formulated by the CFI in its judgment re *Alrosa*[53] and as such will then form the legal framework within which the future market behaviour of that undertaking is to be monitored. Behavioural infringement of these remedies may attract fines without the Commission having to bring further evidence of breach of Article 82. Hence, the question as to whether the behaviour of the dominant undertaking constituted an abuse, or even whether the undertaking under investigation was dominant in the first place, is of no further relevance once a remedies decision is taken by virtue of Article 9 of Regulation 1/2003.

In the future, and in view of the very 'costly' experience gained by Microsoft as an undertaking held to be dominant and abusing that position,[54] it seems advisable to undertakings that come under an Article 82 investigation to try and solve a case of refusal to licence along the lines and within the procedure of 'commitments' pursuant to Article 9 of Regulation 1/2003 first. This seems to be more efficient from a procedural point of view than what we have seen so far in *Microsoft*. It would be all the more advisable, as this would be nothing new in the Commission's enforcement history. We have seen this type of approach already in the past. Already in the 1970s, and therefore in an era well before the Commitments instrument was formally created,

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52 See n 41 above, 692-693.

53 CFI in Case T-170/06 *Alrosa v Commission*, [2007] ECR II-2601.

54 To which we now may add *Intel* as well, having fetched an all-time record fine of €1.06 bn in May 2009 for monopolising the market of computer processor chips, IP/09/245.

the Commission and IBM reached a written agreement according to which IBM committed itself to handle requests related to interoperability from competitors in a specific and informatively lenient manner in exchange for the Commission stopping its investigation into whether IBM was dominant and, if so, whether IBM's consistent behaviour (refusal to communicate these data to third parties) constituted an abuse under Article 82 (then 86) ECT. In this manner, a formal procedure which had been dragging on for years was ended in an efficient manner. Originally, the case started after the Commission had received a complaint from IBM competitor Memorex, which related to the request by Memorex for IBM's obligatory release of data concerning the operating system of its large computers (main frames) in order to make interoperability possible between those computers and 'peripheral equipment' that could be plugged into these computers and which was to be developed by IBM's competitors such as Memorex. Many of the cases mentioned in this contribution at that time had not been brought before the Courts in Luxemburg as yet. The Commission-IBM settlement should therefore be regarded as an example of legally innovative 'pioneering' on both sides. In 1978, the parties signed an agreement specifying IBM's market behaviour in this respect for a period of four years. In 1982, the life of this agreement was extended for yet another period of four years and its text remained almost unchanged. Then in 1986, IBM refused to agree and sign another extension of the agreement arguing that it could no longer be said to have a dominant position, whatever the arguments, leaving open whether they had enjoyed such a position in the past. IBM had good arguments for this change in willingness to cooperate with the Commission as they had *de facto* lost the hectic battle for the PC market that had raged in the earlier half of the eighties. Networks of PC's were deemed to be a viable and less costly alternative for IBM's large computers and IBM had lost market share rapidly. Consequently, it wanted to devote all efforts and energy getting its market share up instead of being bound by restrictive covenants with the Commission for which presumably there was no longer a legal basis nor a need in the market. The Commission was wise enough not to revive its original investigation against IBM, so IBM's refusal to extend the commitments agreement for a third time brought an end to this long-lasting case of investigation and prosecution of over a decade.[55]

CONCLUDING REMARKS

On the basis of the above analysis some (careful) conclusions might be drawn. In the first place it seems obvious that IPR-owners enjoying a dominant position within the meaning of Article 82 EC bear a special responsibility for the up-keeping of an effective competitive structure on their relevant market as well as on the market(s) that are deemed to be derived from this initial market. This duty exists in the interest of innovative efforts and consumer welfare.

[55] The Commission reports extensively about this case and the factual circumstances described above in its VIIIth, XIIth and XVIth Annual Competition Reports.

Second, it should be remembered that the use of IPRs in accordance with their specific substance is not affected by the European Courts' case law on the relation between IPRs and competition law. Normal use of an IPR is – so to say – immune from competition rules interference. However, 'refusal to licence' should be seen as a *species* of the *genus* 'refusal to supply' and the Commission deals with these two types of refusal in a similar vein.

Third, this leads to the conclusion that refusal to licence by an IPR-owner may only then constitute an abuse of a dominant position within the scope of Article 82 EC when that undertaking (a) can be said to enjoy a dominant position and (b) special circumstances may be shown. For the construction of those circumstances, reference should be made to and guidance should be derived from the parallel doctrines developed by the European Courts in the field of EIFs and SGEIs.

Fourth, it should be concluded that in the case of public enforcement of the competition rules, it is for the Commission and the NCAs to establish on a case-by-case basis whether such specific circumstances prevail. In the case of private enforcement, it is for the national courts to establish whether this would be the case but it would be for the litigating parties to provide the national courts with sufficient evidence.

Fifth, as was made clear in *Microsoft* once again, the mere ownership of an IPR does not constitute sufficient objective justification to refuse a licence, provided other specific circumstances would point in the direction of a compulsory licence. Additional specific circumstances set aside the immunity of an IPR from the competition rules. However, licences may continue to be refused on objective grounds by analogy to the objectively justifiable grounds identified in the case law on refusal to supply.

Sixth and last, the conclusion seems justified that the instrument of 'commitment decisions' pursuant to Article 9 of Council Regulation 1/2003 would be eminently suitable for early resolution of a dispute concerning a refusal to licence between the Commission and an IPR-owner. A 'trench war' between these two parties should be avoided at all costs to encourage early innovation and increased consumer welfare.