State aid and Services of General Economic Interest

Public support for the operation of regional airports
Útdráttur

Ríkisaðstoð og þjónustur með almenna efnahagslega þýðingu – opinber stuðningur við rekstur sveðísflugvalla.

Umfjöllunarefni þessarar ritgerðar er ríkisaðstoð og þjónustur sem hafa almenna efnahagslega þýðingu. Markmið ritgerðarinnar er að svara spurningunum: mega aðildarríki ESB styðja við rekstur lítila sveðísflugvalla? Á það sama við um EFTA ríkin? Nánar tiltekið er markmiðið að kanna hvort rekstur ósjálfberra sveðísflugvalla geti treyst á opinberan stuðning til þess að tryggja tilveru sínar og, í ljósi eðlismunur á evrópskri samþættingu á grundvelli EES samningsins, hvort það sama eigi við um EFTA ríkin. Í þeim tilgangi fjallar annar kafli ritgerðarinnar um hið almenna bann við ríkisaðstoð og eftirlitskerfi ESB með slíkri aðstoð. Þriðji kafli fjallar um hugtakið þjónusta sem hefur almenna efnahagslega þýðingu og þau skilyrði sem gilda um opinberar greiðslur fyrir veitingu almannaþjónustu. Fjórði kafli fjallar um ríkisaðstoð í formi greiðslu fyrir veitingu almannaþjónustu og fimmti kafli fjallar um ríkisaðstoð við rekstur flugvalla ásamt ákvörðunartöku framkvæmdastjórnar ESB á því sviði. Sjötti kafli fjallar um EES samninginn, tveggja stoða eftirlitskerfi hans með ríkisaðstoð og einnig er gerður samanburður á viðeigandi reglum EES og ESB. Niðurstaða ritgerðarinnar er sú að aðildarríki ESB mega tryggja tilveru lítila sveðísflugvalla ef rekstur þeirra er nauðsynlegur til þess að tryggja tengingu og viðeignandi lifskjór á því sveði sem hans starfar. Með hliðsjón af samræmdum lagaramma EES og ESB á þessu sviði, hinu viðtækia samstarfí Framkvæmdarstjórnar ESB og Eftirlitstofnunar EFTA ríkjanna ásamt meginreglu EES samningsins um einsleitni, er niðurstaða ritgerðarinnar að hið sama eigi við um EFTA ríkin.
Abstract

State aid and Services of General Economic Interest – Public support for the operation of regional airports.

The topic of this study is State aid and Services of General Economic Interest. The objective of the study is to answer the following questions: are EU Member States allowed to publicly support the operation of small regional airports? Does the same apply for the EFTA States? More specifically, the primary purpose is to see whether the operation of small unsustainable regional airports may rely on public support in order to ensure its existence and, in light of the different level of European integration provided by the EEA agreement, whether the same applies for the EFTA States. Chapter two of this study discusses the general prohibition of State aid and the State aid control mechanism in the EU. Chapter three discusses the concept of Services of General Economic Interest and the compatibility conditions for public compensation for the provision of such services. Chapter four discusses State aid in the form of public service compensation and chapter five discusses the State aid policy in the Aviation sector, as well as the Commission decision-making practice in that field. The sixth chapter discusses the EEA agreement, the two-pillar State aid surveillance mechanism and compares the relevant legal framework of the EU and the EEA. The study reveals that EU Member States may ensure the existence of small regional airports if the operation of that airport is vital in order to ensure connectivity and acceptable standards of living in that region. Furthermore, on the basis of the common legal framework of the EU and the EEA in this field, the extensive cooperation between ESA and the Commission and the principle of homogeneity, the conclusion is made that the same applies for the EFTA States.
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services of general economic interest and on the framework for state aid in the form of public
service compensation, OJ L 161.

EFTA Surveillance Authority Decision No 216/14/COL of 28 May 2014 amending for the
96th time the procedural and substantive rules in the field of State aid by adopting new

EFTA Surveillance Authority Decision No 3/17/COL of 18 January 2017 amending for the
one-hundred and second time, the procedural and substantive rules in the field of State aid by
introducing new Guidelines on the notion of State aid as referred to in Article 61(1) of the
Agreement on the European Economic Area, OJ L 342.
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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>EC</td>
<td>European Community Treaty</td>
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<td>ECSC</td>
<td>European Coal and Steel Community Treaty</td>
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<td>ECJ</td>
<td>Court of Justice of the European Union</td>
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<td>EEA</td>
<td>European Economic Area/EEA Agreement</td>
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<td>EEA/EFTA</td>
<td>Iceland, Liechtenstein and Norway States</td>
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<tr>
<td>EEC</td>
<td>European Economic Community Treaty/Treaty of Rome</td>
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<td>EFTA</td>
<td>European Free Trade Association</td>
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<td>ESA</td>
<td>EFTA Surveillance Authority</td>
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<td>EU</td>
<td>European Union</td>
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<td>GBER</td>
<td>General Block Exemption Regulation</td>
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<td>MEO</td>
<td>Market Economy Operator</td>
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<td>OJ</td>
<td>Official Journal of the European Union</td>
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<td>Para.</td>
<td>Paragraph</td>
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<td>PSO</td>
<td>Public Service Obligation</td>
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<td>SAM</td>
<td>State Aid Modernisation</td>
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<td>SCA</td>
<td>Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice</td>
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<td>SGEI</td>
<td>Services of General Economic Interest</td>
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<tr>
<td>TEU</td>
<td>Treaty on European Union</td>
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<td>TFEU</td>
<td>Treaty on the Functioning of the European Union</td>
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Chapter 1 - Introduction

European airports play an important role in Europe, by connecting the states internally and together with the rest of the world. For some regions of Europe, the operation of their airport can be important to facilitate economic growth and for others the airport is vital just to ensure basic connectivity. However, airports require significant investments in infrastructure and their operation is generally subject to strict requirements to ensure safety and security. Indeed, in 2012 it was estimated that around 80% of the costs of an airport are fixed.\(^1\) This means that the profitability prospect of a commercially run airport significantly depends on the level of throughput, i.e., passenger traffic. Consequently, small airports often struggle to cover their operating costs since they have higher costs on a per passenger basis compared to larger airports.\(^2\) These conditions mean that private involvement is mostly limited to large airports while small airports remain publicly owned.\(^3\)

In order to ensure that public intervention, like public financing of regional airports, does not distort competition in the European Union internal market,\(^4\) State aid is generally prohibited and subject to approval by the European Commission.\(^5\) The primary purpose is to ensure that all economic operators can enjoy a level playing field in the internal market. However, public compensation for the provision of Services of General Economic Interest\(^6\) does not constitute State aid.\(^7\) In 2005 the Commission adopted the first SGEI package which clarified the Commissions priorities in the application of EU State aid rules to public service compensation.\(^8\) After a broad debate and public consultations, the Commission adopted a revised package in 2011-2012 where the key State aid principles were clarified and the framework simplified.\(^9\) In 2014, the European Commission\(^10\) published their new Aviation

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4. Hereafter referred to as the internal market.
5. Articles 107 and 108 of the Treaty on the Functioning of the European Union.
6. Hereafter referred to as SGEI.
10. Hereafter referred to as the Commission.
guidelines where the aim of sustainable airport infrastructure and other priorities in the aviation sector were expressed. According to the Commission, European airports should normally bear their own operating costs. The domestic airport infrastructure, and the European as a whole, should be designed to ensure efficient use of the airports and improve connectivity between the Member States. In that respect, the Member States should avoid the duplication of unprofitable airports and promote efficient use of their airport infrastructure in accordance with their domestic needs.

On the basis of the Agreement on the European Economic Area, Norway, Iceland and Liechtenstein participate in the internal market and are obliged to follow common rules on State aid. However, the depth of European integration provided by the EEA agreement is less far-reaching when compared to the European Union. For instance, the EEA agreement has its own legal order that does not entail formal transfer of sovereign powers to supranational institutions. Furthermore, independent EFTA institutions monitor the contract obligations for the EFTA and the basic provisions of the EEA agreement have not been renewed since it was signed on 2 May 1992.

In this context, the purpose of this thesis is to answer the following questions: are EU Member States allowed to publicly support the operation of small regional airports? Does the same apply for the EFTA States? More specifically, the primary purpose is to see whether the operation of small unsustainable regional airports may rely on public support in order to ensure its existence and, in light of the different level of European integration provided by the EEA agreement, whether the same applies for the EFTA States.

To seek answers to these questions, this thesis discusses the scope and application of European rules on State aid and Services of General Economic Interest. The second chapter discusses the general prohibition of State aid under Article 107(1) of the Treaty on the Functioning of the European Union, the State aid control mechanism under Article 108 TFEU

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12 Ibid paras. 13 and 19.
13 Hereafter referred to as the EEA agreement.
14 Hereafter referred to as the EFTA States. Note that Switzerland is an EFTA State but not a member of the EEA agreement and will therefore not be mentioned in this respect.
15 Article 61(1) of the EEA agreement.
16 Hereafter referred to as the EU.
18 Hereafter referred to as SGEI.
19 Hereafter referred to as the TFEU.
and the relevant exceptions provided by the *de minimis* aid Regulation\(^{20}\), the General Block Exemption Regulation\(^{21}\) and Articles 107(2) and 107(3) TFEU. The aim is to explain what kind of public support constitutes State aid, under what conditions such aid can be declared compatible with the internal market and provide an overview of the EU State aid control system. The third chapter discusses the concept of SGEI, the compatibility conditions for public compensation for the provision of SGEI provided by the *Altmark* judgement\(^{22}\) and the SGEI *de minimis* aid Regulation.\(^{23}\) The aim is to explain what kind of service may be regarded as SGEI and under what conditions may the compensation for the provision of such service fall outside the scope of rules on State aid. The fourth chapter discusses the compatibility conditions for State aid in the form of compensation for the provision of SGEI under Article 106(2) TFEU and the SGEI Decision with the aim of explaining the interplay between Articles 107(1) and 106(2) TFEU. The fifth chapter discusses the Aviation guidelines, the State aid policy in the airport sector and the relevant Commission decision-making practice. The aim of this chapter is to explain the compatibility conditions for, on the one hand, Operating aid to regional airports under Article 107(3)(c) TFEU, and the other, State aid in the form of public compensation for the provision of SGEI by airports under Article 106(2) TFEU. The sixth chapter discusses the two-pillar EEA State aid surveillance system and compares relevant EEA- and EU rules, with the aim of assessing whether the same applies for the EFTA States. Finally, the seventh chapter provides a summary of the main conclusions and answers to the questions of this thesis.


\(^{22}\) Case C-280/00 *Altmark Trans GmbH, Regierungspräsidium Magdeburg and Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-07747.

Chapter 2 - State Aid

This chapter discusses the EU State aid policy, the general prohibition of State aid and the EU State aid control system. The aim is to explain what constitutes State aid, what kind of State aid is compatible with the internal market and provide an overview of the EU State aid control system.

2.1. The general prohibition of State aid

In order to protect fair and open competition on level grounds, Article 107(1) TFEU establishes the general principle that State aid is considered incompatible with the internal market. This prohibition covers all aid granted by a Member State to public as well as private undertakings. Article 107(1) TFEU is only applicable to undertakings, i.e. entities engaged in an economic activity regardless of their legal status and the way they are financed.24 The aim is to limit any public intervention to economic activities that can distort competition on the internal market. Purely social activities and the exercise of public powers are characterized as of non-economic nature and, therefore, fall outside the scope of Article 107(1) TFEU and the analysis of this paper.

In essence, this means that article 107(1) TFEU does not apply if the State intervenes in the market by exercising its public power25 or where public entities act in their capacity as public authorities.26 In that regard, if the act in question is a part of the essential functions of the State or is connected to it by its nature, then the activity can be deemed to be an exercise of public power.27 Examples of such activities are: the army or the police,28 air navigation safety and control29 and anti-pollution surveillance.30 However, if it is possible to separate the economic activity from the exercise of the public powers, the entity in question acts as an undertaking in relation to the economic activity and Article 107(1) TFEU is then applicable to that extent.31

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2.1.1. The definition of State aid

Public intervention in economic activities that meet the criteria laid down in article 107(1) TFEU constitutes State aid. Settled case law provides that classification as State Aid requires that all the following conditions set out in article 107(1) TFEU should be fulfilled. Article 107(1) TFEU provides the following:

... any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

2.1.2. The Commissions notice on the notion of State aid

In order to clarify the key concepts in the definition of State aid, the Commission published a Notice on the notion of State aid as referred to in Article 107(1) TFEU. The Notice has no binding legal effect, but it can be considered as a valid instrument to provide clarity on the concept of State aid since most of the Notion is based on settled case law. In addition, the Commissions view, priorities and general practice in this field are presented.

By presenting the Notice, the Commission limits the use of its discretionary powers, but it may deviate from them in particular cases. The following discussion will therefore analyse the definition of State in accordance with the Notice but with references to the underlying case law. Accordingly, the elements that must be considered when defining public support as State aid are the following: the existence of an undertaking, the imputability of the measure to the State, its financing through State resources, the granting of an advantage, the selectivity of the measure and its effect on competition and trade between Member States. Since the concept of undertaking has already been discussed in chapter 2.1., the analysis will begin with the second element.

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32 Case C-345/02 Pearle BV & Others [2004] ECR I-07139. Para. 32
33 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the functioning of the European Union 2016/C 262/01 [2016] OJ C 262. Para. 1 (hereafter referred to as the EU Notice on State aid or the EU Notice).
34 Article 288 TFEU provides that recommendations and opinions shall have no binding force.
2.1.3 The measure must be imputable to the State

An advantage granted by a public authority to a beneficiary is by definition a measure imputable to the State. However, if the advantage is granted through public undertakings the imputability is less evident because a public undertaking may act with more or less independence, according to the degree of autonomy left to it by the State. Therefore, in case of public undertakings, it becomes necessary to examine whether the public authority is involved in the adoption of those measures.

Because of the privileged relations that exist between the State and public undertakings and the difficulties for a third party to demonstrate that measures taken were in fact adopted on the instructions of the relevant public authority, the imputability to the State may be inferred from a set of indicators. Through case law review the Commission has provided a non-exhaustive list that can be used as guidance on what indicators are possible to establish whether a measure is imputable to the State or not.

2.1.4. Financing through State resources

The notion of State resources includes all resources of the public sector, intra-State entities, public undertakings and even private bodies if the State has controlling influence over the resources. There is no one way to transfer State resources. This can for example be done in the form direct grants, guarantees, loans or direct investment in the capital of a company. Foregoing State revenue is also sufficient, which means that if the State waives revenue which

38 The concept of public undertakings can be defined with reference to Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings [2006] OJ L 318. Article 2(b) of this Directive states that 'public undertakings' means any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it.
40 Ibid para. 55.
would otherwise have been paid to the State, that measure constitutes a transfer of State resources.46

2.1.5 Economic Advantage
Any economic benefit which an undertaking could not have obtained under normal market conditions is an advantage within the meaning of article 107(1) TFEU.47 This means that an advantage is present if a State intervention improves the financial situation of an undertaking on terms that are different than the normal market conditions. The cause or the objective of the intervention is irrelevant since it is only the effect on the undertaking that matters.48

To assess whether an advantage is present the financial situation of the undertaking, following the measure, should be compared with its financial situation if the measure had not been taken.49 The notion of advantage is therefore based on analysis of the financial situation of an undertaking, in its own legal and factual context, with and without the particular measure.50 However, if the economic activity is carried out in line with normal market conditions it does not confer an advantage on its counterpart and therefore does not constitute State aid.51

The Commission refers to the ’market economy operator’ test52 as the relevant method to assess whether a range of economic transactions, carried out by public bodies, take place under normal market conditions or not.53 The test is used to assess whether the State has acted in a way that a normal MEO would have done in a similar situation. If not, the recipient undertaking has received an advantage which it would not have obtained under normal market conditions.54 The MEO test is commonly done with regard to the following three economic transactions:

1. The market economy investor principle. In case of public investment, it is assessed whether a private investor of a comparable size operating in normal conditions could have been prompted to make the investment in question;

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49 Ibid.
52 Hereafter referred to as the MEO test.
2. The private creditor principle. In cases where the State acts in a creditors capacity, it is assessed whether the debtor would have received the same treatment by a private creditor;
3. The private vendor principle. In cases of sales carried out by a public body, it is assessed whether a private vendor, under normal market conditions, could have obtained the same or a better price.\textsuperscript{55}

\textbf{2.1.6 Selectivity}

Not all State measures that favour undertakings fall under the scope of article 107(1) TFEU. Only those, which grant an advantage in a selective way to certain undertakings or categories of undertakings or to certain economic sectors are prohibited. In order to clarify the notion of selectivity it is useful to distinguish between material and regional selectivity.\textsuperscript{56}

\textbf{2.1.6.1 Material selectivity}

A measure is considered to be materially selective if it applies only to certain undertakings or certain sectors of the economy in a given Member State. For example, if the legal criteria for granting a measure is formally reserved for only certain undertakings, the measure is \textit{De jure} selective. Furthermore, if the structure of a measure is such that it only affects a particular group of undertakings, the measure is \textit{De facto} selective even though the formal criteria for the application of the measure is formulated in general and objective terms.\textsuperscript{57}

\textbf{2.1.6.2 Regional selectivity}

In principle, a measure is considered regionally selective if it applies only to certain parts of the territory of a Member State. However, measures with a regional or local scope of application may not be selective if certain requirements are fulfilled.\textsuperscript{58} In order to determine the selectivity of a measure adopted by a infra-State body it is appropriate to examine whether that measure was adopted in the exercise of powers sufficiently autonomous vis-à-vis the central power and, if appropriate, to examine whether that measure applies to all of the undertakings established in or all production of goods on the territory coming within the competence of that body.\textsuperscript{59} Regional selectivity is a general concept, so the principles set out

\textsuperscript{57} Ibid paras. 121-122.
\textsuperscript{58} Case C-88/03 \textit{Portugal v Commission} [2006] ECR I-07115. Para. 57.
by the Court of Justice of the European Union60 as regards tax measures may apply to other types of measures as well.61 The three following situations have been specifically identified to assess regional selectivity.

1. The first situation is where the central government of a Member State unilaterally decides to apply a lower level of taxation within a defined geographical area. In this situation the measure is regarded as regionally selective.62

2. The second situation is where all the local authorities at the same level have the autonomous power to decide, within the limit of the powers conferred on them, the tax rate applicable in the territory within their competence. A measure taken by a local authority in this situation is not selective because it is impossible to determine a normal tax rate capable of constituting the reference framework.63

3. The third situation is where a regional or local authority adopts, in the exercise of sufficiently autonomous powers in relation to the central power, a tax rate lower than the national rate and which is applicable only to undertakings present in the territory within its competence. The measure is not selective if the authority in question is sufficiently autonomous from the central government of the State because then the region constitutes the geographical reference framework.64 The three cumulative criteria of autonomy are: institutional, procedural, and economic and financial autonomy.65

2.1.7. Effect on trade and distortion of competition

In order for a State measure to be categorized as State aid under article 107(1) TFEU, the measure must distort or threaten to distort competition and, at the same time, affect trade between Member States. These two criteria are often treated jointly and considered to be linked to each other.66 There is no threshold or percentage below which it may be considered that trade between Member States is not affected. This means that even if the amount of the aid is

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60 Hereafter referred to as the CJEU.
64 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the functioning of the European Union 2016/C 262/01 [2016] OJ C 262. Para. 144(3).
low or the recipient undertaking is small, distortion of competition is not ruled out. Generally, a financial aid granted by a Member State that strengthens a firm position over other competing firm in intra-EU trade, is considered to affect that trade.

The recipient undertaking does not necessarily have to be involved in intra-EU trade. Where a Member State grants aid to an undertaking internal activity may be maintained or increased as a result, so that the opportunities for other undertakings, established in other Member States, to enter the market of the granting Member State are reduced. If an aid is considered to effect intra EU-trade, the Commission is not required to prove that the aid has in fact distorted or threatened to distort competition.

This means that for the purpose of categorising a national measure as State aid the Commission examines whether that aid is liable to affect trade between Member States. However, it is not necessary to establish whether that aid has a real effect on such trade and that competition is actually distorted. If the Commission considers that an aid is liable to have an effect on intra-EU trade, it is necessary to establish the reason for that on the basis of foreseeable effects of the measure since the effect cannot be merely hypothetical or presumed.

For instance, one example is if the recipient undertaking offers a service to a limited area within a Member State, the activity is unlikely to attract customers from other Member States. Consequently, if it cannot be foreseen that the measure will have more than a marginal effect on the conditions of cross-border investments or establishment, the measure has a purely local impact and no effect on trade between Member States. If a measure is liable to improve the competitive position of the recipient compared to other undertakings with which it competes, the measure in considered to distort or threaten to distort competition. That means that a public support is liable to distort competition if the aid allows the recipient undertaking to maintain a stronger competitive position than it would have had if the aid had not been provided.

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2.2. EU State aid policy

Fair competition on level playing grounds is considered to stimulate European economic performance and benefit European consumers as it results in greater efficiency, a broader choice of better-quality products and services at more competitive prices. State aid control therefore plays a fundamental role in defending and strengthening the internal market. According to the EU State Aid Modernisation package, the State aid policy should be focused on efficient and effective public spending in order to establish appropriate conditions for Europe’s growth potential.

State aid should be designed and targeted at identified market failures and objectives of common interest so that they complement private spending instead of replacing it. In that respect, a well-designed State aid will not distort competition as it is only used to induce the aid beneficiary to undertake activities it would not have done without the aid. A State aid that does not target market failures has no incentive effect. Such aid is therefore considered to be a waste of public resources since it will hinder economic growth with worse competition conditions in the internal market.

2.3. EU State aid control

The main purpose of State aid control is to maintain a level playing field for all economic entities operating in the internal market. State aid control is used to prevent Member States from using government funds to circumvent competition rules by supporting their domestic industry. State aid control is therefore directed at the Member States and regulates the competition between them.

Article 108 TFEU establishes the EU State aid control system. Detailed rules on the Commissions procedure are provided by Regulation 2015/1589, the so-called Procedural Regulation, which was adopted in 2015. On the basis of the Procedural Regulation, the Commission has adopted Regulation No 794/2004 laying down detailed rules for the

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76 Hereafter referred to as the SAM
77 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: EU State aid Modernisation COM/2012/0209 [2012]. Paras. 2,3,4,5 & 12.
application of Article 108 TFEU. Accordingly, the Commission is required to apply the procedure when a State aid is assessed and when determining whether the aid can be considered compatible with the internal market.

In essence, Article 108(1-3) TFEU provides that the Commission, in cooperation with the Member States, keeps all existing systems of aid under constant review and all new aid should be notified to and approved by the Commission before they are put into effect. This is commonly referred to as the notification and stand-still obligation. When a State aid has been notified, the Commission reviews and assesses whether that aid can be considered compatible with the internal market. The Commission can decide that the aid is compatible with the internal market or it can decide that the aid is being misused. The Commission may then decide it should be altered or abolished within a period of time that is determined by the Commission. If the aid has been granted by the Member State before approval, the Commission has the power to recover the unlawful aid by ordering that the beneficiary should refund the aid.

2.4. The use of State aid

The prohibition of State aid is not absolute because in some areas State aid is considered to be necessary and fair for the proper functioning of the internal market. For instance, the financial crisis in 2008 led to increased demand for State support in order to promote economic recovery. State aid can be used as a tool to pursue a specific policy objective, but they have also been used to benefit local undertakings at the expense of rivals located in other Member States in order to bring a larger share of the industry profits to be earned domestically.

State aid is also sometimes justified on the basis of equity considerations and redistribution of resources in order to reflect the preferences of society in terms of wealth distribution. Member States are therefore often involved in the provision of public services such as health services, transportation, education, national defence and consumer- and environmental protection.

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83 Ibid, Article 13(2).
2.4.1. Correction of market failures

State aid can sometimes be considered helpful to increase economic welfare by improving efficiency in case of market failures.\(^{86}\) In theory, a market failure is present when the market does not provide effective result with the free play of forces. The term efficiency is essential for the identification of market failure.\(^ {87}\)

In economic literature the term efficiency is often divided into productive-, allocative- and dynamic efficiency. In simple terms productive efficiency means that goods or services are created at the lowest possible cost, allocative efficiency means that the price for a good or a service is equal to the marginal cost of their provision and dynamic efficiency means that social welfare is maximized over a period of time as a result of inadequate investment and innovation incentives.\(^ {88}\)

If a market failure is present it is possible that a State intervention could improve the market conditions. Before a State aid can be used as a tool to address a specific market failure it is necessary to evaluate the efficiency of the market and assess whether the theoretical efficiency pursued can ever be achieved. The mere fact that reality does not match the ideal of the theory is not sufficient to deduce a market failure, so the question is rather whether State intervention can in fact produce real improvement that is less inefficient.\(^ {89}\)

2.5. Aid compatible with the internal market

The wording of Article 107(1) TFEU, 'save as otherwise provided in the Treaties' provides that the general prohibition of State aid is far from absolute.\(^ {90}\) For example, Articles 107(2) and (3) TFEU provide numerous derogations from this prohibition, Article 106(2) TFEU provides exceptions for State aid to be granted for the provision of SGEI’s, Articles 107(3)(e) and 108(2) provide the Council with powers to create further derogations if needed, and Article 109 TFEU enables the adoption of block exemptions. For the purpose of this paper, the following discussion will only provide an overview of the available exceptions without analysing all the content in detail. Relevant exceptions will be further analysed in later sections.

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\(^ {86}\) Ibid, p. 8  
\(^ {87}\) Ibid.  
2.5.1. The general de minimis aid Regulation

Under the Commissions Regulation No 1407/2013, small aid amounts, that fulfil the criteria of the Regulation, are not considered to constitute a State aid in the meaning of Article 107(1) TFEU. On the basis of Article 288 TFEU, the general de minimis aid Regulation is legally binding in its entirety and directly applicable in all Member States. Aid that fulfils the conditions of the Regulation falls outside the scope of EU state aid control since it is automatically deemed to have no impact on competition and trade in the internal market.

In general, the Regulation is limited to transparent aid granted to undertakings in all sectors except for: aid for the fishery and aquaculture sectors, aid for the primary production of agricultural products, certain aid to undertakings active in the sector of processing and marketing of agricultural products, aid to export-related activities and aid favouring domestic products. The main criteria is that aid amounts of up to 200,000 euros per undertaking over a three year period, 100,000 euros for road freight transport, does not constitute a State aid in the meaning of Article 107(1) TFEU. Subsidised loans of up to 1 million euros may also benefit from the regulation if certain conditions are fulfilled.

2.5.2. The general block exemption regulation

According to article 109 TFEU, the Council may determine that certain categories of aid do not need to be notified to the Commission by virtue of article 108(3) TFEU. Furthermore, article 108(4) provides that the Commission may adopt regulations relating to those categories. In 2014 the Commission adopted a revised block exemption regulation (GBER) that applies until 31 December 2020. On the basis of Article 288 TFEU, the GBER is legally binding in its entirety and directly applicable in all Member States. The aim of the GBER is to allow for better prioritization of State aid enforcement activities, provide simplification, enhance

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92 Ibid, article 1.
93 Ibid, article 3(2).
94 Ibid, article 4(3)b.
transparency and ensure effective evaluation in the control of compliance with the State aid rules at national and Union levels.\textsuperscript{96}

Article 1 of the GBER defines the scope and sets out 12 categories of aid which the regulation applies to and also which categories of aid are excluded. General conditions are laid down in Chapter I of the GBER and specific conditions for the relevant category of aid is laid down in chapter III. The common conditions are that aid measures shall not exceed the relevant thresholds\textsuperscript{97}, shall be transparent\textsuperscript{98} and shall have an incentive effect.\textsuperscript{99} Aid that fulfills all the conditions laid down in the GBER, both general and specific, are considered to be compatible with the internal market under articles 107(2) or (3) TFEU and are exempted from the notification obligation in article 108(3) TFEU.\textsuperscript{100}

However, Member States are responsible to ensure transparency in regards of all aid granted under the GBER. Firstly, Member States shall publish key information on the aid on a single website that is available to the general public.\textsuperscript{101} Secondly, Member States shall transmit the summary information about each aid measure exempted under the GBER to the Commission within 20 working days following its entry into force.\textsuperscript{102} Finally, Member States shall maintain for 10 years detailed records with the information and supporting documentation that is necessary to prove that all the relevant conditions in the GBER are fulfilled.\textsuperscript{103}

\textbf{2.5.3. Exceptions under article 107(2) TFEU}

Both Article 107(2) and 107(3) provide derogations from the general prohibition in Article 107(1) TFEU. As derogations, the Articles should be interpreted narrowly.\textsuperscript{104} If a measure constitutes a State aid, Member States can justify their action if the following requirements are met. Article 107(2) TFEU provides that the three following classes of aid shall be considered compatible with the internal market:

\begin{itemize}
\item Ibid, article 4.
\item Ibid, article 5.
\item Ibid, article 6.
\item Ibid, article 3.
\item Ibid, article 9(1).
\item Ibid, article 11.
\item Ibid, article 12.
\end{itemize}
(a) aid having a social character granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
(b) aid to make good the damage caused by natural disasters or other exceptional occurrences;
(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.

Member States must notify the Commission before granting such aid and the Commission will then assess the proposed measure for compliance with the formal and technical requirements provided for by the TFEU.¹⁰⁵

2.5.4. Exceptions under article 107(3) TFEU

In order to achieve objectives of common European interest the Commission has the power to approve certain State Aid as compatible with the internal market. Article 107(3) TFEU provides the following:

3. The following may be considered to be compatible with the internal market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;

(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;

(e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

Unlike the exceptions provided in article 107(2) TFEU, the Commission enjoys a wide discretion in assessing the compatibility of the measures put forward under article 107(3) TFEU. On the basis of sound economic principles, the Commission assesses aid targeted by

Member States at objectives of common interest of economic and social development. The Commission uses a strong economic approach to this compatibility analysis where the core would be a so-called balancing test. The assessment is fundamentally about balancing its negative effects on trade and competition in the internal market with its positive effects in terms of a contribution to the achievement of well-defined objectives of common interest. The Commission’ balancing test consists of the following questions:

1. Is the aid measure aimed at a well-defined objective of common interest?
2. Is the aid well designed to deliver the objective of common interest i.e. does the proposed aid address the market failure or other objectives?
   i. Is the aid an appropriate policy instrument to address the policy objective concerned?
   ii. Is there an incentive effect, i.e. does the aid change the behaviour of the aid recipient?
   iii. Is the aid measure proportionate to the problem tackled, i.e. could the same change in behaviour not be obtained with less aid?

2. Are the distortions of competition and effect on trade limited, so that the overall balance is positive?106

In order to verify that State aid is necessary and proportionate, economic tools are useful to answer these questions. The positive effects of the State aid measure are addressed under questions one and two, while the negative effects on competition and trade is addressed under question three and compares the positive and negative effects of the aid.107

2.6. Summary

In summary, this chapter discussed the concept of State aid as an economic advantage granted selectively by the State to an undertaking operating in the internal market. State aid is generally prohibited under Article 107(1) TFEU in order to avoid distortion of competition and State aid control should ensure that aid is only approved if they contribute to sound use of public finances and promote economic and social cohesion. The prohibition is, however, not absolute since State aid can, in certain circumstances, be necessary for a well-functioning and fairly-run economy, in particular in case of

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107 Ibid, para. 10. p. 3.
market failure. The EU State aid system is thus essentially designed to ensure that aid that facilitates general economic development and pursues a common interest objective without duly distorting competition are deemed compatible with the internal market.
Chapter 3 – Services of General Economic Interest

This chapter discusses the concept of SGEI, the criteria for lawful public compensation for provision of SGEI provided by the Altmark judgment in Case C-280/00 and the SGEI de minimis aid regulation No 360/2012. The aim of this chapter is to explain under what conditions public compensation for the provision of SGEI may fall outside the scope of EU State aid rules.

3.1. The concept of SGEI

The concept of SGEI appears in articles 14 and 106(2) TFEU and in Protocol No 26 to the TFEU. These articles frame the values and the principles that govern the Member States rights to provide SGEI. The concept of SGEI is not defined in the Treaties but the CJEU has recognized that SGEI are services that have special characteristics in relation to those of other economic activities.\(^{(108)}\) Furthermore, the Commission has defined the concept as:

...economic activities which deliver outcomes in the overall public good that would not be supplied (or would be supplied under different conditions in terms of quality, safety, affordability, equal treatment or universal access) by the market without public intervention. The public service obligation is imposed on the provider by way of an entrustment and on the basis of a general interest criterion which ensures that the service is provided under conditions allowing it to fulfil its mission.\(^{(109)}\)

The Commission considers that a service can only be classified as SGEI if it is addressed to citizens or be in the interest of society as a whole.\(^{(110)}\) The concept of SGEI is therefore dynamic as it evolves and depends, among other things, on the economic conditions, the needs of the citizens and social and political preferences in the Member State concerned.\(^{(111)}\)

3.1.1. Member States discretion to define SGEI

According to Protocol No 26 to the TFEU, Member States play essential role and enjoy wide discretion in providing, commissioning and organising SGEI’s as closely as possible to the needs of the users. The diversity between various SGEI’s and the differences in the needs and preferences of users that may result from different geographical, social or cultural situations

\(^{(110)}\) Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest 2012/C 8/02 [2012] OJ C 8. Para. 50.
\(^{(111)}\) Ibid, para. 45.
are recognized. The Member States also agree that high level of quality, safety and affordability, equal treatment and the promotion of universal access as well as of user rights are amongst the shared values of the EU in respect of SGEI.

In line with the principle of subsidiarity, provided in Article 5(3) of the Treaty on European Union, it is for the Member States and not the Commission, to define the quality and scope of SGEI since it depends on their own cultural, societal and economic conditions. The Commission’s view is that in the absence of specific EU rules defining the scope for the existence of an SGEI, Member States enjoy a wide margin of discretion in defining a given service as an SGEI and in granting compensation to the service provider.

The CJEU has confirmed that Member States, whether at national, regional or local level, enjoy a margin of discretion to define what they regard as SGEI’s and the definition of such services can only be questioned by the Commission in the event of manifest error in the definition of the Member State in question. However, the Commission can assess whether there is any State aid in the meaning of Article 107(1) TFEU involved in the compensation. The Member States discretion is limited in sectors that have been harmonised at EU level and where objectives of general interest have been taken into account.

In essence, it is up to the Member States to determine which services they consider to constitute SGEI and also to set the compensation for the provision of such services. However, this margin of discretion is subject to the scrutiny of the Commission and is limited to standards that have been established by relevant EU rules and CJEU case law.

### 3.2. Compensation for the provision of SGEI

As previously discussed in relation to market failure in chapter 2.4.1., Member States may intervene if services of public interest are insufficiently provided by the free market. For instance, instead of providing the service itself, the State can impose a public service

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112 Case T-17/02 Fred Olsen [2005] ECR II-02031 para. 216.
113 Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest 2012/C 8/02 [2012] OJ C 8. Para. 46.
obligation to an undertaking to ensure that the specifically defined demand will be met and then compensate the undertaking for that provision.

However, the CJEU has consistently held that State intervention in characterised and defined in relation to their effect and not purpose or aim. This means that the social character of a State intervention or the fact that it is carried out in the public interest is not sufficient to exclude it from being categorized as aid in the meaning of Article 107(1) TFEU. Consequently, a per se exclusion of specific sectors from the application of the State aid rules is not possible.

3.2.1. The Altmark criteria

In the Altmark case the CJEU held that compensation for the provision of services of general economic interest does not constitute a State Aid and is considered compatible with the internal market when the following four cumulative conditions are met:

1. ...the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined;
2. ...the parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner;
3. ...the compensation does not exceed what is necessary to cover all or part of costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations;
4. ...where the undertaking which is to discharge public service obligations is not chosen in a public procurement procedure, the level of compensation needed has been determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with 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.

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116 Hereafter referred to as PSO.
3.2.2. The SGEI guidelines

In order to further analyse the abovementioned Altmark conditions it is relevant to consider, along with further case law of the CJEU, one of the instruments presented in the SGEI package, the communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest. The purpose of the SGEI guidelines is to clarify the key concepts underlying the application of State aid rules to public service compensation. They address the Altmark conditions in further detail but it is important to note that they have no binding legal effect. Just like the State aid Notice, they can rather be considered as a document that provides clarity on the Commissions view, priorities and general practice in this field. By presenting this kind of instrument the Commission limits the use of its discretionary powers, but it may deviate from them in particular cases.

3.2.3. The first Altmark condition

The first Altmark condition requires the definition of an SGEI task and the need for an entrustment act. This means that the recipient undertaking must in fact be obliged to provide a clearly defined SGEI and the PSO must be based on an act of entrustment. It does not matter whether the obligation is the result of a contract, a legislative or regulatory instrument if the act is emanating from the public authority and binding.

The entrustment act must define the content and duration of the PSO imposed on the recipient undertaking and express that there is a general economic interest in the provision of that service which exhibits special characteristics as compared to the interest of other economic activities. Based on the approach taken by the Commission, the entrustment act must also specify the undertaking, the territory concerned, the parameters for calculating, controlling and reviewing the compensation and the arrangements for avoiding and recovering any overcompensation.

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122 Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest 2012/C 8/02 [2012] OJ C 8. (Hereafter referred to as the SGEI guidelines).
123 Ibid, para. 3.
124 Article 288 TFEU provides that recommendations and opinions shall have no binding force.
125 Case T-301/01 Alitalia v Commission [2008] ECR II-1753. Para 405
In general, the entrustment of a SGEI task implies the supply of services that an undertaking would not assume to the same extent or under the same conditions if it were considering its own commercial interest. The Commission thus considers that it would not be appropriate to attach a specific PSO to an activity, which is already provided or can be provided satisfactorily and under conditions consistent with the public interest by undertakings operating under normal market conditions. Whether the market can provide a service, the Commission assessment is limited to checking whether the Member State in question has made a manifest error.

3.2.4. The second Altmark condition
The second Altmark condition is aimed to ensure ex ante objectivity and transparency in order to prevent Member States from conferring an economic advantage to the recipient over his competitors. The entrustment act should therefore explain how costs flowing directly from the provision of the SGEI is determined and calculated as well as which revenue accruing to the undertaking from the provision of the SGEI must be deducted. The entrustment act must also, where the provider is offered a reasonable profit as part of its compensation, establish a criterion for calculating that profit. The Member States enjoy a wide discretion in determining the compensation as long as the parameters are defined in such a way as to preclude any abusive recourse to the concept of an SGEI on the part of the Member State.

3.2.5. The third Altmark condition
The third Altmark condition is aimed to prevent overcompensation by limiting the compensation to the actual costs incurred. This is important because if the recipient undertaking is overcompensated its competitive position is strengthened and competition could be distorted. The revenue accruing from the provision of the SGEI should be deducted from the total cost.

131 Ibid, paras. 54-59.
so that only the additional costs flowing directly from the provision of the SGEI is compensated.\(^\text{133}\)

According to the Commission, a reasonable profit should be taken to mean the rate of return on capital,\(^\text{134}\) which a typical undertaking, considering the relevant risk, takes as a basis to decide whether it will provide the relevant SGEI for the whole period of entrustment. The Member States may determine the reasonable profit on the basis of an incentive criteria especially relating to the quality of the provided services and to increases in efficiency of productivity levels. Those increases of efficiency must however not come at the expense of the quality of the SGEI.\(^\text{135}\)

\[\text{3.2.6. The fourth Altmark condition}\]

The fourth Altmark condition considers the selection of the provider and is aimed to ensure that the SGEI will be provided at the least cost to the community.\(^\text{136}\) In other words, the condition aims to prevent compensation for costs caused by the recipient’s lack of efficiency.\(^\text{137}\) In order to ensure efficiency and competitiveness the CJEU proposes that the compensation offered must either be the result of a public procurement procedure, which ensures that the undertaking capable of providing the SGEI at the least cost to the community is selected, or the result of a benchmarking exercise, calculating the costs of a typical efficient undertaking, well run and adequately provided with the necessary means to meet the public service requirements.\(^\text{138}\)

A public procurement procedure can only exclude the existence of State aid if it allows for the selection of the tenderer capable of providing the service at the least cost to the community. According to the Commission, the simplest way to meet the fourth Altmark condition is to conduct an open, transparent and non-discriminatory public procurement

\[^{134}\text{The Commission defines the rate of return on capital as the Internal Rate of Return (IRR) that the undertaking makes on its invested capital over the lifetime of the project, that is to say the IRR over the cash flows of the contract. See to that effect: Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest 2012/C 8/02 [2012] OJ C 8. Footnote 85.}\]
\[^{135}\text{Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest 2012/C 8/02 [2012] OJ C 8. para 61.}\]
\[^{136}\text{Ibid, para. 65.}\]
\[^{137}\text{Case T-289/03 BUPA v Commission [2008] ECR II-00081. Para. 249.}\]
procedure in line with the relevant EU Directives. Such a procedure is considered an appropriate method to compare different potential offers and set the compensation so as to exclude the presence of aid. A restricted public procurement procedure with a competitive dialogue or a negotiated procedure with prior publication can also satisfy the fourth Altmark condition unless interested operators are prevented to tender without valid reasons.

According to the Commission, if the provider is not selected in a public procurement procedure the benchmark for the compensation should, if existent, be based on the generally accepted remuneration for that service. If there is no generally accepted remuneration the amount of compensation must be determined on the basis of an analysis of the costs of a typical undertaking. A typical undertaking is well run and adequately provided with the necessary resources to be able to meet the necessary public service requirements and incurs a reasonable profit for discharging those obligations. The Commission considers that the concept of well-run undertaking entails compliance with applicable accounting standard in force and the Member States should apply objective criteria that are economically recognised as being representative of satisfactory management. Member States may for example base their analysis on analytical ratios representative of productivity or relating to the quality of supply as compared with users’ expectations. Consequently, if the undertaking in question does not meet

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140 Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest 2012/C 8/02 [2012] OJ C 8, paras. 63-64.
144 Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest 2012/C 8/02 [2012] OJ C 8, para. 69.
145 See previous discussion on reasonable profit regarding the third Altmark condition in chapter 3.2.5.
the qualitative criteria, laid down by the Member State concerned, the undertaking does not constitute a well-run undertaking in the meaning of the fourth Altmark condition.\textsuperscript{146}

Finally, the Commission’s view is that the reference to a typical undertaking means that if the cost structure of the undertaking entrusted with the provision of the SGEI corresponds to the average cost structure of efficient and comparable undertakings the amount of compensation that will allow the undertaking to cover that cost and a reasonable profit complies with the fourth Altmark condition.\textsuperscript{147}

3.3. The SGEI De minimis aid Regulation

Similar to the general de minimis Regulation\textsuperscript{148} discussed in chapter 2, the Commissions Regulation No 360/2012\textsuperscript{149} provides that aid amounts up to 500,000 euros over three-year period, that fulfil the criteria of the Regulation and are granted to undertakings providing SGEI, are not considered to constitute a State aid in the meaning of Article 107(1) TFEU.

In other words, aid that fulfils the conditions of the Regulation falls outside the scope of EU state aid control since it is deemed to have no impact on competition or trade in the internal market. The SGEI de minimis Regulation was adopted on the grounds of Article 2(1) of the Council Regulation No. 994/98.\textsuperscript{150} On the basis of Article 288 TFEU, the SGEI de minimis aid Regulation is legally binding in its entirety and directly applicable in all Member States.

The SGEI de minimis aid Regulation only applies to undertakings that have been entrusted with the provision of SGEI. However, the SGEI de minimis Regulation provides notable simplifications such as lighter requirements regarding the entrustment and the entrustment act and there are no requirements regarding cost verification or the monitoring of

\textsuperscript{146} Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest 2012/C 8/02 [2012] OJ C 8. paras. 71-72.
\textsuperscript{147} Ibid, para. 75.
overcompensation. The higher threshold provided by the SGEI de minimis Regulation, 500,000 euros instead of 200,000 euros in the general de minimis Regulation, is justified on the basis that at least part of the amount is granted as compensation for additional costs linked to the provision of the SGEI. That means that the potential advantage for an SGEI provider is lower than the compensation amount actually granted, while under the general de minimis Regulation the advantage from the same amount would be higher.

Article 2(7) of the SGEI de minimis aid Regulation generally allows cumulation of aid granted under other Regulations up to the threshold of 500,000 euros. However, Article 2(7) of the SGEI de minimis aid Regulation provides that an undertaking compensated for the provision of SGEI in compliance the Altmark criteria cannot also receive additional SGEI de minimis aid. In essence, this means that the full amount of compensation granted for the provision of SGEI must either meet the Altmark criteria or not exceed the threshold provided in the SGEI de minimis aid Regulation in order to fall outside the scope of EU State aid rules.

3.4. Summary

In summary, this chapter discussed the concept of SGEI, how Member States enjoy a wide discretion in defining SGEI’s, the SGEI de minimis aid Regulation and under what conditions compensation for the provision of SGEI may fall outside the scope of EU State aid rules. The foregoing discussion described that the concept of SGEI is dynamic and can vary between Member States in accordance with their domestic conditions. In essence, if all the Altmark conditions are fulfilled, Member States can provide a public service by imposing a PSO to an undertaking by an act of entrustment and compensate the provider for that provision without being considered to have granted a State aid in the meaning of Article 107(1) TFEU.

It must be noted that this conclusion is not based on Article 106(2) TFEU since such compensation is considered to fall outside the scope of EU rules on State aid. The reasoning is that the Altmark conditions are considered to ensure that the recipient undertaking is only compensated in order to be able to provide the SGEI, so the undertaking does in fact not enjoy a real financial advantage. This means that the compensation does not place the recipient in a more favourable competitive position than its competitors and competition is therefore not

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152 Ibid, para. 74.
153 Ibid, para. 79.
distorted. Consequently, Article 107(1) TFEU is not applicable to such public intervention and there is no need to rely on Article 106(2) TFEU to justify the measure.

This also means that if the Altmark criteria is fulfilled the measure is not subject to prior notification and approval by the Commission under Article 108(3) TFEU. However, if the Altmark criteria is not fulfilled and the general conditions for the applicability of Article 107(1) TFEU are met, compensation for the provision of the SGEI constitutes a State aid that should, in principle, be notified to and approved by the Commission before implementation.
Chapter 4 - State aid in the form of public service compensation

The fourth chapter discusses State aid in the form of compensation for the provision of SGEI, the compatibility conditions for Article 106(2) TFEU and the Commission Decision on the application of Article 106(2) TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEI. The aim of this chapter is to explain under what conditions State aid in the form of compensation for the provision of SGEI can be declared compatible with the internal market.

4.1. Justifying State aid under Article 106(2) TFEU

Article 106(2) TFEU provides that the EU Treaties, in particular the rules on competition, only apply to undertakings entrusted with the provision of SGEI, insofar as the application of such rules does not obstruct the performance of the particular task assigned to them. The development of trade must, however, not be affected to such an extent as would be contrary to the interests of the Union. Many Member States have strong public service traditions which would inevitably be undermined if State aid rules were strictly applied to them.154

Article 106(2) TFEU is therefore an important exemption that is directly applicable in all Member States. That means that State aid in the form of public service compensation may be justified on the basis of Article 106(2) TFEU even though it falls outside the scope of the SGEI decision. However, as an exception, Article 106(2) TFEU must be strictly interpreted. Unlike aid falling within the scope of the SGEI Decision, such aid shall be notified to and approved by the Commission before implementation on the basis of Article 108(3) TFEU.

The compatibility conditions under Article 106(2) TFEU are undeniably very similar to the previously discussed Altmark conditions and the underlying theme in both criteria’s is based on the principles of necessity and proportionality. These similarities mean that the conditions considerably overlap and are often applied together in the decision-making practice.155 However, the CJEU has confirmed that where a public service compensation does not meet the Altmark criteria, and therefore constitutes State aid, Article 106(2) TFEU remains a distinct provision that is applied and not the Altmark criteria.156 For that reason and to avoid repetitions, the following discussion will mainly focus on the differences in the compatibility

conditions of Article 106(2) TFEU in comparison to the Altmark conditions, rather than fully analyse all the equivalent conditions. The following five conditions should be satisfied for the application of Article 106(2) TFEU.\(^{157}\)

1. Existence of a genuine SGEI
2. The provider must be entrusted with the operation of the SGEI
3. The measure must be necessary
4. The measure must be proportionate
5. The derogation must not affect the development of trade to an extent contrary to the interests of the EU

The question to be determined is therefore whether the restriction of competition is necessary and proportionate to enable the holder of an exclusive right to perform its SGEI task in economically acceptable conditions.\(^{158}\)

4.2. The EU framework for State aid in the form of public service compensation

In order to further analyse the abovementioned conditions for the application of Article 106(2) TFEU it is relevant to consider the Commissions communication, which provides a European Union framework for State aid in the form of public service compensation.\(^{159}\) The SGEI framework sets out the compatibility conditions under which State aid in the form of public service compensation, that fall outside the scope of the SGEI Decision, can be found compatible with the internal market on the basis of Article 106(2) TFEU.

In general, and without prejudice to stricter sector-specific rules, the Commission applies the SGEI framework to all State aid in the form of public service compensation that fall outside the scope of the SGEI Decision. However, aid in the land transport sector\(^{160}\), the

159 Communication from the Commission: European Union framework for State aid in the form of public service compensation 2012/C 8/03 [2012] OJ C 8. (Hereafter referred to as the SGEI framework)
As with the SGEI guidelines, the SGEI framework is not legally binding. However, State aid in the form of public service compensation, that fall outside the scope of the SGEI Decision, are subject to State aid control and must therefore be notified to and approved by the Commission before implementation on the basis of Article 108(3) TFEU. Consequently, the Commission SGEI framework is highly relevant since it limits the Commissions use of discretionary powers by providing clarity on the principles and priorities in the Commissions administrative practice in the application of Article 106(2) TFEU.

4.2.1. Compatibility conditions under the EU framework

The first and second conditions for the application of Article 106(2) TFEU require that the provider must be entrusted with a genuine SGEI. These conditions can be considered equivalent to the first Altmark condition. However, even though the entrustment act requirements set forth by the Commission in the SGEI guidelines and the SGEI framework are preferable to ensure transparency, they have never actually been applied so strictly by the CJEU in the interpretation of Article 106(2) TFEU. In the Albany case, the CJEU indicated that the mere fact of creating a sectoral pension fund and requesting the public authorities to make affiliation to that fund compulsory was enough to support the conclusion that the fund was entrusted with the operation of SGEI in the meaning of Article 106(2) TFEU.

The third and fourth conditions for the application of Article 106(2) TFEU are very similar to the second and third Altmark conditions. They provide that it must be shown by the Member State that the contested measure is necessary and proportionate to enable the entrusted undertaking to perform the SGEI under economically acceptable conditions. In other words, the conditions are to ensure that services that could easily be provided satisfactorily by the open market are not publicly supported and to prevent overcompensation by ensuring that only

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161 This sector is covered by the Communication from the Commission on the application of State Aid rules to public service broadcasting (OJ C 257, 27.10.2009) p. 1.
162 Aid to SGEI providers in difficulty are assessed under the Community guidelines on State Aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004) p. 2.
164 Article 288 TFEU provides that recommendations and opinions shall have no binding force.
the actual losses incurred in the operation of the SGEI are compensated, including a reasonable profit. In that respect, it is important to note that the purpose of Article 106(2) TFEU is not to ensure the economic viability of the specific undertaking entrusted with the SGEI, but rather to protect the fulfilment of a task of general economic interest.\textsuperscript{168}

Therefore, these conditions cannot be satisfied only because the receiving undertaking would go bankrupt in the absence of public support if the SGEI could easily be taken over by other operators.\textsuperscript{169} The SGEI framework provides a detailed guidance as to how the Commission considers both costs and reasonable profit should be calculated.\textsuperscript{170} Accordingly, the net cost necessary to discharge the PSO should be calculated using the net avoided cost methodology, or, where the use of that methodology is not feasible or appropriate, the methodology based on cost allocation.\textsuperscript{171} The test for compensation under Article 106(2) TFEU appears to be similar to the requirements under the Altmark criteria but the main difference is that the level of compensation is not limited to the costs of an efficient undertaking.\textsuperscript{172} However, the SGEI framework does provide that Member States should introduce incentives for the efficient provision of SGEI of a high standard, unless they can justify that it would not be feasible or appropriate to do so.\textsuperscript{173}

The fifth condition for the application of Article 106(2) TFEU provides that the aid should not affect the development of trade to an extent contrary to the interests of the EU. The content and scope of this condition has not been confirmed by the CJEU. The SGEI framework provides that non-compliance with applicable EU public procurement rules and Directive 2006/111\textsuperscript{174}, where applicable, would be considered to affect the development of trade to an extent contrary to the interests of the EU.\textsuperscript{175} Compliance with the SGEI framework will usually be sufficient to ensure that aid does not distort competition to an extent contrary to the interests of the EU.\textsuperscript{176} In addition, and in exceptional circumstances where the aid has significant

\textsuperscript{171} Ibid, paras. 24 & 27.
\textsuperscript{176} Ibid, para. 51.
adverse effects on other Member States and the functioning of the internal market, the Commission can require conditions or request commitments from the Member States.\textsuperscript{177}

\section*{4.3. Commissions SGEI decision}

On the basis of Article 106(3) TFEU the Commission adopted a Decision on the application of Article 106(2) TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEI.\textsuperscript{178} Article 288 TFEU provides that the Decision is legally binding in its entirety for all Member States. The purpose of the SGEI Decision is to exempt certain kinds of public compensations for the provision of SGEI from the notification and approval condition in Article 108(3) TFEU in order to increase efficiency in state aid control.

The Decision functions similarly to a block exemption where certain aid measures, provided that they comply with other Treaty provisions and EU secondary legislation, are automatically deemed compatible with Article 106(2) TFEU.\textsuperscript{179} Article 2(1) of the SGEI Decision provides five categories of aid that fall under its scope. Accordingly, aid up to 15 million euro per year may be deemed compatible with the internal market. The focus in the State aid control should be on SGEI’s involving compensation amounts of more than 15 million euros a year and where the potential for distortions of competition is higher.\textsuperscript{180}

The scope of the SGEI Decision is limited to aid granted to undertakings that have been formally entrusted with the provision of SGEI for a period up to 10 years. The period can only be longer if significant investment is required from the recipient undertaking that needs to be amortised over a longer period.\textsuperscript{181} The time limitation prevents the undesirable situation where a single undertaking is entrusted with the provision of SGEI for an unspecified period and closes off the services from competition with greater effect than necessary.\textsuperscript{182} Furthermore, aid


\textsuperscript{178} Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the Treaty on the functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2012] OJ L 7. (Hereafter referred to as the SGEI Decision).

\textsuperscript{179} Ibid, article 3.


\textsuperscript{181} Article 2(2) of the Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the Treaty on the functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2012] OJ L 7.

granted to undertakings in the land transport sector fall outside the scope of the Decision but aid in the fields of air and maritime transport are covered as long as they comply with Regulations 1008/08\textsuperscript{183} and 3577/92,\textsuperscript{184} where applicable.\textsuperscript{185} There are also specific requirements regarding transparency\textsuperscript{186} and reporting/monitoring\textsuperscript{187} that apply to all forms of aid approved under the SGEI Decision.

Finally, it is important to point out the main difference between the Altmark conditions and those in the SGEI Decision. As previously discussed in chapter 3.2.6., the fourth Altmark condition requires that the amount of the compensation must be defined either through a public procurement procedure or a benchmarking exercise, calculating the costs of a typical efficient undertaking. The SGEI Decision however does not entail such efficiency requirements. The Member State only needs to prove that the compensation corresponds to the net costs estimated on the basis of the defined parameters contained in the act of entrustment and that there is no overcompensation.\textsuperscript{188}

\textbf{4.4. Summary}

In summary, this chapter discussed the application of Article 106(2) TFEU by reviewing, in particular, the SGEI Decision and the SGEI framework. The SGEI Decision provides a safe harbour for certain kinds of State aid in the form of public service compensation and exempts Member States from the obligation to notify them to the Commission, while other State aid in the form of public service compensation are assessed by the Commission under the SGEI framework. The main difference between the compatibility conditions under Article 106(2) TFEU and the Altmark conditions seems to be the efficiency requirements set forth in the fourth Altmark condition. However, even though no such efficiency requirements have been confirmed by the CJEU for the application of Article 106(2) TFEU, the SGEI framework


\textsuperscript{185} Article 2(3-4) of the Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the Treaty on the functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2012] OJ L 7.

\textsuperscript{186} Ibid, articles 7-8.

\textsuperscript{187} Ibid, article 9.

\textsuperscript{188} European Commission, ‘Guide to the application of the European Union rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest’ (29 April 2013) Commission staff working document SWD 53 final/2 <http://ec.europa.eu/competition/state_aid/overview/new_guide_eu_rules_procurement_en.pdf> accessed 4 February 2018. Para. 110
indicates that the Commission will, in most cases, require Member States to include efficiency incentives in their compensation mechanism for the provision of SGEI.
Chapter 5 – State aid and the operation of regional airports

The fifth chapter discusses the State aid policy in the airport sector with the aim of explaining the compatibility conditions for Operating aid to regional airports under the GBER and, in particular, Article 107(3)(c) TFEU. The concept of SGEI in the airport sector will also be explained.

5.1. The 2014 Aviation guidelines

As a part of the general plan to create a single EU airspace and taking account of market developments, the Commission adopted guidelines in 2014 on State aid to airports and airlines.\(^{189}\) The Aviation guidelines replace and repeal former guidelines from 1994\(^ {190}\) and 2005\(^ {191}\) and take stock of the new legal and economic situation concerning the public financing of airports and airlines. The Commission’s assessment is based on its experience and decision-making practice, as well as on its analysis of current market conditions in the airport and air transport sectors and are, therefore, without prejudice to its approach in other sectors.

The Aviation guidelines specify the conditions under which public financing of airports and airlines may constitute State aid within the meaning of Article 107(1) TFEU and under which conditions it can be declared compatible with the internal market pursuant to Article 107(3)(c) TFEU.\(^ {192}\) The Aviation guidelines apply to State aid to airports and airlines without prejudice to EU legislation as well as other Union guidelines on State aid.\(^ {193}\) However, the Commission will not apply the Aviation guidelines on any national regional aid granted for airport infrastructure.\(^ {194}\) Just like the SGEI guidelines and the SGEI framework, the Aviation guidelines are not legally binding but they limit the Commission’s use of discretionary powers by providing clarity on the principles and priorities in the Commission’s administrative practice.\(^ {195}\)

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\(^{190}\) European Commission Application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aid in the aviation sector (OJ C 350, 10.12.1994, p. 5)

\(^{191}\) Communication from the Commission Community guidelines on financing of airports and start-up aid to airlines departing from regional airports (OJ C 312, 9.12.2005, p. 1)


\(^{193}\) Ibid, para. 21.

\(^{194}\) Ibid, para. 23.

\(^{195}\) Article 288 TFEU provides that recommendations and opinions shall have no binding force.
5.1.1. The State aid policy in European airport sector

The majority of Europe’s airports are still under public ownership and management. However, the gradual completion of the internal market has led to growing involvement of private investment and participation in the airport sector. Full public ownership is mostly common with small airports since they are often unprofitable while larger airports are in a better position to generate profit and, therefore, more suitable for private investment.\(^{196}\) The State aid policy in the airport sector is that State aid control should promote sound use of public resources for growth-oriented policies while limiting competition distortions that would undermine a level playing field in the internal market. The airport infrastructure of some regions of the EU is facing substantial overcapacity in relation to passenger and airline demand. This means that State aid control should focus on avoiding duplication of unprofitable airports and prevent the creation of overcapacities.\(^{197}\)

5.1.2. Economic activities and competition in the airport sector

As previously discussed in chapter 2.1, State aid rules only apply to situations where a public support is granted to an undertaking, i.e. an entity engaged in an economic activity. In the airport sector, the CJEU has confirmed that the operation of an airport, consisting in airport management and the provision of airport services to airlines and other service providers, is considered an economic activity.\(^{198}\) Airports mainly operate to ensure the handling of aircraft, from landing to take-off, and of passengers and cargo, so to enable air carriers to provide air transport services and the cost is generally recovered through airport charges.\(^{199}\) In addition, in certain circumstances, airports may also provide other ancillary services, such as the rental of premises to shop and restaurant managers, parking operators, etc.\(^{200}\)

However, activities such as air traffic control, police, customs, firefighting, activities necessary to safeguard civil aviation are considered to fall under the responsibility of the State

\(^{196}\) According to Airport Council International Europe, 59% of airports were fully publicly owned in 2016, while 15.8% were fully privately owned. The increasing involvement of private undertakings is exemplified by the fact that this proportion has dropped significantly since 2010, when close to 80% of airports were fully under public ownership. see to that effect: Airport Council International Europe, ‘The Ownership of Europe’s Airports 2016’ [2016] p. 3.


in the exercise of its official powers. Such activities are considered to be of non-economic nature and, therefore, fall outside the scope of the rules on State aid. Consequently, and according to the Aviation guidelines, competition in the airport sector can be assessed in the light of airlines criteria of choice by comparing factors such as the type of airport services provided, population and the level of charges. The key factor being the charge level. For instance, public support can distort competition by keeping airport charges at an artificially low level in order to attract airlines.

5.2. Operating aid to regional airports

Operating aid is defined as an aid, either in the form of an advance payment or in the form of periodic instalments, covering the shortfall between airport revenues and operating costs of the airport. Operating costs of an airport in respect of the provision of airport service include cost categories such as cost of personnel, contracted services, communications, waste, energy, maintenance, rent and administration, but exclude the capital costs, marketing support or other incentives granted to airlines by the airport, and costs falling within a public policy remit.

As previously discussed in chapter 2.5.2., the GBER provides that certain categories of aid that fulfil its compatibility conditions are automatically deemed compatible with the internal market and do not need to be notified to the Commission by virtue of article 108(3) TFEU. According to Article 56a of the GBER and subject to the general conditions of the GBER, Operating aid may be granted to an existing regional airport, located in underdeveloped regions and sparsely populated areas, to cover the operating losses and a reasonable profit over the relevant period on the basis of Article 107(3) TFEU. The general conditions are that the airport must be open to all potential users and the average annual traffic during the two financial years preceding the grant may not exceed 200,000 passengers. Furthermore, the granting of the aid cannot be made conditional upon the conclusion of arrangements with specific airlines.

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203 Ibid, paras. 21 & 23.
As regards airports that fall outside the scope of the GBER, the Commission considers that airports should normally bear their own operating costs. Since operating aid constitutes, in principle, a very distortive form of aid, such aid can only be authorised under exceptional circumstances. However, regional airports have commonly received public support for their operation. In order to enable these airports to adapt to new market conditions and to avoid any disruptions in the air traffic and regional connectivity, certain categories of operating aid to airports may still be justified for a transitional period from 2014 to 2024.\textsuperscript{206} At the end of this transitional period, airports should finance their operations from their own resources and operating aid should no longer be granted. However, the Commission acknowledges that small airports could struggle to cover their operation costs so the profitability prospects for airports with less than 700,000 passengers per annum will be reassessed in 2018 in order to evaluate whether special rules should be devised to assess the compatibility of operating aid in favour of those airports.\textsuperscript{207}

To clarify the Commission’s priorities, the Aviation guidelines establish, inter alia, a compatibility criterion for operating aid to airports during the transitional period. The Commission considers that operating aid to airports may be justified on the basis of Article 107(3)(c) TFEU if it contributes to local accessibility and economic development. As previously discussed in chapter 2.5.4., the Commission applies a balancing test to assess the compatibility of aid under Article 107(3) TFEU. The assessment is fundamentally about balancing its negative effects on trade and competition in the internal market with its positive effects in terms of a contribution to the achievement of well-defined objectives of common interest. Accordingly, the following cumulative conditions must be met:\textsuperscript{208}

1. Contribution to a well-defined objective of common interest;
2. Need for State intervention;
3. Appropriateness of the aid measure;
4. Incentive effect;
5. Proportionality of the aid;
6. Avoidance of undue negative effects on competition and trade between Member States

\textsuperscript{207} Ibid, para. 17(d).
\textsuperscript{208} Ibid, paras. 111-112.
5.2.1. Contribution to a well-defined objective of common interest

The first condition is that the aid must contribute to a well-defined objective of common interest. The Commission considers this will be the case if the operating aid increases the mobility of EU citizens and the connectivity of the regions by establishing access points for intra-EU flights, combats air traffic congestion at major EU hub airports, or facilitates regional development. However, duplicating unprofitable airports does not meet the common interest objective. The Commission therefore requires that if another airport with spare capacity is located in the same catchment area, the granting Member State must identify and present the likely effect on the traffic of the other airport located in that catchment area.

In 2016 the Commission assessed an operating aid for the Danish airport of Aarhus. Aarhus was considered a centre of education and research as well as an important business destination. Furthermore, a steady growth in tourist traffic indicated that the airport would play increasingly important role in helping the tourism industry to tap into new target groups. The nearest airports were all over 100 km away and the minimum travel time was approximately 1 hour and 26 minutes by car or 3 hours and 31 minutes by public transport. The operation aid to the airport of Aarhus was therefore considered to meet a clearly defined objective of common interest since it contributed to regional development without duplicating unprofitable airports within the same catchment area.

Similarly, in 2017 the Commission assessed an operating aid to the Frankfurt-Hahn airport in Germany. The airport, which is located in the Rhine-Huns ruck district, an economically underdeveloped and rural area within Germany, was responsible for the creation of around 11,000 jobs and 90% of its employees lived in the region. Furthermore, the airport had generated significant incoming tourism, plans had been made to introduce weekly flights to and from China and no other airports were located within the same catchment area. On this

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210 Ibid, para. 25(12). The Aviation guidelines define catchment area of an airport as a geographic market boundary that is normally set at around 100 kilometres or around 60 minutes travelling time by car, bus, train or high-speed train; however, the catchment area of a given airport may be different and needs to take into account the specificities of each particular airport. The size and shape of the catchment area varies from airport to airport, and depends on various characteristics of the airport, including its business model, location and the destinations it serves.
211 Ibid, para. 114.
212 Denmark – Aarhus Airport (Case SA.44377) [2016] OJ C 121. (Hereafter referred to as the Aarhus airport case).
213 Ibid, paras. 73-75.
214 Ibid, paras. 119-122
215 Germany – Operating aid to Frankfurt-Hahn Airport (Case SA.47969) [2017] OJ C 121. (Hereafter referred to as the Frankfurt-Hahn airport case)
basis, the Commission concluded that the operating aid contributed to the development and connectivity of the region which meets a clearly defined objective of common interest.\footnote{Germany – Operating aid to Frankfurt-Hahn Airport (Case SA.47969) [2017] OJ C 121. Paras. 42-47.}

In 2016 the Commission adopted a Decision on State aid implemented by Romania for Romanian regional airports.\footnote{State aid implemented by Romania for Romanian regional airports (Case SA.30931) [2016] OJ L 166. (Hereafter referred to as the Romanian airports case).} In this case, the close proximity between some of the receiving airports meant that the Commission had to assess whether the financing of the airports would lead to the duplication of airport infrastructure within the same catchment area. The main focus, in this part of the Commissions assessment, seems to be whether one airport in the same catchment area could replace the other. In other words, the Commission assessed the degree of substitutability between the airports operating in the same catchment area. In that respect, the Commission considered that things like differences in the infrastructure and a different business model indicate that the airports are imperfect substitutes for one another. Since the airports in question were not considered substitutable there was no duplication between them.\footnote{Ibid, paras. 129-142.}

\subsection*{5.2.2. Need for State intervention}

The second condition is that there must be a need for State intervention. The Commission, therefore, considers that the Member State must identify the problem to be addressed and the aid must be necessary to bring about a material improvement that the market itself cannot deliver.\footnote{Communication from the Commission: Guidelines on State aid to airports and airlines 2014/C 99/03 [2014] OJ C 99. Para. 116.} In that respect, the Commission acknowledges that the need for public support varies according to the size of an airport and will, therefore, normally be proportionately greater for smaller airports. For that reason, the Commission identifies that airports with up to 700,000 passengers per annum may struggle to cover their operating costs, airports with annual passenger traffic of 700,000 to 3 million should be able to cover most of their operating costs but airports with annual passenger traffic above 3 million should be able to cover all of their operating costs and they will thus not be eligible for operating aid.\footnote{Ibid, paras. 118-119.}

In other words, operating aid is only possible for airports with less than 3 million passengers per year. The identification and the need for State intervention is normally presented

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\begin{itemize}
\item \footnote{Germany – Operating aid to Frankfurt-Hahn Airport (Case SA.47969) [2017] OJ C 121. Paras. 42-47.}
\item \footnote{State aid implemented by Romania for Romanian regional airports (Case SA.30931) [2016] OJ L 166. (Hereafter referred to as the Romanian airports case).}
\item \footnote{Ibid, paras. 129-142.}
\item \footnote{Ibid, paras. 118-119.}
\end{itemize}
by the Member State in an *ex ante* business plan which shows the annual traffic of the airport in question and that it will not be able to cover its operating costs in the relevant period.221

5.2.3. Appropriateness of the aid measure

The third condition is that the aid must be appropriate to achieve the intended objective or resolve the problems intended to be addressed by the aid. This means that the granting Member State should demonstrate that no other less distortive aid instrument could allow the intended objective to be achieved.222 If other less distortive aid instruments allow the same objective to be reached, the aid will not be considered compatible with the internal market.223 Furthermore, the Member State should provide incentives for efficient management of the airport by establishing the aid amount, on the basis of an *ex ante* business plan, as a fixed sum covering the expected funding gap during the transitional period.224

A good example of this can be seen in the Frankfurt-Hahn airport case. Germany presented an *ex ante* business plan where the maximum aid amount was determined as a fixed sum covering the expected operating funding gap. The aid would be paid out in instalments between 2018 and 2022 in order to cover the operating losses of 2017-2021. The aid amount was then to be adjusted downward, compared to the maximum amount set *ex ante*, if the actual losses of the airport would turn out to be lower than expected but no adjustment upward would take place if the actual losses turn out to be higher than expected. As such, the Commission considered that the aid was appropriate since the aid amount was in fact limited to the minimum necessary and incentives for efficient management of the airport were maintained.225

5.2.4. Incentive effect

The fourth condition is that the aid must have an incentive effect. According to the Aviation guidelines, the incentive effect is present if the absence of the operating aid leads to a situation, taken into account the possible presence of investment and the level of traffic, where it is likely

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221 Denmark – Aarhus Airport (Case SA.44377) [2016] OJ C 121. Paras. 125-126; Germany – Operating aid to Frankfurt-Hahn Airport (Case SA.47969) [2017] OJ C 121. Para. 49.
222 The Member State can do this by comparing different forms of aid, such as direct grants, loans, guarantees or repayable advances and then choose the least distortive form. Communication from the Commission: Guidelines on State aid to airports and airlines 2014/C 99/03 [2014] OJ C 99. Para. 91.
224 Ibid, para. 121.
that the level of economic activity of the airport would have to be significantly reduced. This assessment therefore depends on the level of economic activity of the airport concerned at the time when the aid is notified or actually granted, but would definitely be the case if, in the absence of the operating aid, the airport would have to close down due to uncovered losses.

5.2.5. Proportionality of the aid

The fifth condition is that the aid amount must be proportionate. According to the Aviation guidelines, the operating aid must be limited to the minimum necessary for the aided activity to take place. This means, to start with, that the aid cannot exceed the expected operating funding gap resulting from the ex-ante business plan for the airport concerned. The maximum permissible aid amount for any airport is limited to 50% of the initial operating funding gap calculated for a period of 10 years.

This means that the initial operating funding gap of the airport is multiplied by 10 and 50% of that amount is the maximum permissible aid amount for the whole transitional period. In order to support small airports, the maximum permissible aid amount for airports with less than 700,000 passengers per annum is limited to 80% of the initial operating funding gap calculated for a period of 5 years.

Furthermore, the airport’s business plan must also demonstrate that the airport will fully cover its operating costs before the end of the transitional period. In other words, operating aid will only be considered proportionate if, on the one hand, the amount of the aid does not exceed the lower of two caps defined ex ante, and the other, the airport’s business plan demonstrates that the airport will be economically sustainable before the end of the transitional period.

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229 Ibid, para. 122. The initial operating funding gap is the average of the operating funding gaps of the airport during the five years preceding the beginning of the transitional period (2009-2013).
231 Ibid, para. 130.
232 Ibid, para. 126.
5.2.6. Avoidance of undue negative effects on competition and trade between Member States

The sixth condition is that the granting Member State must avoid undue distortions on competition and trade. This means, in particular, that the Member State must demonstrate that all airports in the same catchment area will be economically sustainable before the end of the transitional period and the receiving airport must be open to all users and not dedicated to a specific user. 233

5.2.7. Transparency of the aid

The Aviation guidelines require that the operating aid must be transparent. The Commission considers that this condition is fulfilled if the Member State publishes, on a comprehensive State aid website, the full text of all approved operating aid, the identity of the granting authority, the identity of the beneficiaries, the form and amount granted to each beneficiary, the date of granting, the type of undertaking, the region in which the beneficiary is located and the principal economic sector in which the beneficiary has its activities. Furthermore, this information must be kept for at least 10 years, be updated every 6 months and be available for the interested public without restrictions. 234

5.3. State aid in the form of compensation for the provision of SGEI by airports

As previously discussed in chapter 3.2.1., public compensation for the provision of SGEI that fulfils the Altmark criteria is considered compatible with the internal market and falls outside the scope of EU State aid rules. However, if the compensation does not fulfil the Altmark criteria it may constitute State aid in the meaning of Article 107(1) TFEU. 235 If so, the SGEI Decision provides that airports entrusted with the operation of SGEI, which the average annual traffic during the 2 financial years preceding that in which the SGEI was assigned and over the duration of the SGEI entrustment does not exceed 200,000 passengers, may enjoy compensation up to 15 million euro per year. 236 This is subject to the compatibility conditions

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235 Provided that the compensation is not considered a de minimis aid falling outside the scope of Article 107(1) TFEU in accordance with the compatibility conditions under the Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid granted to undertakings providing services of general economic interest [2012] OJ L 114.
236 Article 2(1)(e) of Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the Treaty on the functioning of the European Union to State aid in the form of public service
of the SGEI Decision, discussed in chapter 4.4. Furthermore, State aid to larger airports that fall outside the scope of the SGEI Decision may be declared compatible on the basis of Article 106(2) TFEU, in line with the compatibility conditions of the SGEI framework discussed in chapter 4.2.

In that respect, in any case the airport must be entrusted with a genuine SGEI, correctly defined by the granting Member State. This requires that the Member State can exhibit the special characteristics of the SGEI, as compared to other economic activities provided by the market, and a general interest objective that goes further than simply development of certain economic activities or economic areas as provided in Article 107(3)(c) TFEU.237

5.3.1. Genuine SGEI in the airport sector

As previously discussed in chapter 3.1.1., Member States enjoy a wide margin of discretion when defining SGEI and the Commissions assessment is limited to checking whether the Member State has made a manifest error in that definition. The Aviation guidelines and the Commissions decision-making practice provide that the overall management of an airport may, in well-justified cases, be considered an SGEI. However, an airport can only be entrusted with an SGEI obligation if the two following conditions are fulfilled.

First, the area served by the airport would, without the airport, be isolated from the rest of the EU to an extent that would prejudice its social and economic development. Second, the airport could disappear without the public support.238 In such circumstances, the Commission considers that Member States can entrust the airport with an SGEI obligation in order to ensure that the airport remains open to commercial traffic. However, the SGEI should not cover the development of air transport services.239

5.3.1.1. The isolation condition

The assessment of the first condition should take due account of other modes of transport available in the area and consider whether there are any real alternatives to the airport available.

compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2012] OJ L 7.


Alternative airports are considered by viewing the travelling distance and time to the closest available airport.\textsuperscript{240} If there is, for example, another substitutable airport with spare capacity operating in the same catchment area, that airport would clearly provide a real alternative option. In that respect, if the operation of an airport duplicates another airport in the same region, the operation of that airport cannot be considered to constitute a genuine SGEI.\textsuperscript{241} Furthermore, the Commission considers that high-speed rail services and maritime links served by ferries are transport modes that could, in principle, provide real alternatives to air transport.\textsuperscript{242} As far as other means of transport, like by car, bus or even rail, the Commission considers that such transport cannot be considered to provide a real alternative to air transport.\textsuperscript{243} Notably, things like road, traffic and weather conditions as well as geographical location can matter.\textsuperscript{244}

This assessment essentially considers whether it is possible for the users to reach the same destinations, at least the majority of the most important ones, for similar costs and within a similar timeframe. If that is possible the connectivity of the area should not really be affected by the absence of the airport. A simple example, two passengers with one suitcase each are travelling from Copenhagen to Gothenburg. The travel time is approximately 45 minutes by flight but 3 hours by train. However, in order to make that flight the passenger must arrive at Kastrup at least 1-2 hours before the flight so that he will have time to go through the check-in and the security inspection before boarding the plane around 15-20 minutes before take-off. Additionally, the passenger will have to wait after landing in Gothenburg for the suitcase to arrive before exiting the airport. Meanwhile, another passenger could instantly board a high-speed train at Kastrup and arrive in Gothenburg around the same time. This is a hypothetical situation and a major simplification but an example of how transport modes can be compared.

If the overall assessment concludes that no real alternatives are available, and the absence of the airport means that the connectivity of the region is significantly affected the current activities and business perspectives for companies as well as standards of living for the inhabitants are significantly reduced. Such a result would prejudice the social and economic

\begin{footnotesize}
  \begin{enumerate}
    \item Sweden - Skelleftea Airport (Case SA.38757) [2016] OJ C 406. Paras. 65 & 73.
    \item Ibid, paras. 69 & 73.
  \end{enumerate}
\end{footnotesize}
development of the region.\textsuperscript{245} The first condition can therefore be considered as the element that differs and goes further than the exemption provided in Article 107(3)(c) TFEU.

\textbf{5.3.1.2. The market failure condition}

The second condition requires that the Member State must demonstrate that the economic conditions in the region are of such kind that the operation of the airport will not be able to cover its costs. In that respect, things like low population, limited prospects of increase in air traffic, efficiency measures already implemented at the airport as well as the gradual phasing out of operating aid in the transitional period until 2024 are considered to support the argument that the airport could disappear without the public support.\textsuperscript{246} Such conditions make it difficult for the airport to reach an economically sustainable operation and therefore significantly reduce the prospect of attracting private investment.

In essence, if the economic conditions in the region mean that the operation of the airport would not be provided satisfactorily and on the same conditions, consistent with the necessary public service, by undertakings operating under normal market conditions, the airport could in fact disappear without public support. The entrustment of an SGEI to such an airport would therefore ensure that the region is provided with a necessary service under reasonable conditions that the open market simply cannot provide. The second condition can therefore be considered as the element that differs and exhibits special characteristics as compared to other economic activities provided by the market.

\textbf{5.4. Summary}

In summary, this chapter discussed the State aid policy towards public support for the operation of regional airports. The GBER provides safe harbour for Operating aid to airports with under 200,000 passenger per annum until the year 2020. For airports that fall outside the scope of the GBER, the Aviation guidelines provide that operating aid for such airports are gradually being phased out during the transitional period that ends in April 2024. In essence, such aid is only approved if the existence of the airport is important for economic development in the area it


operates, and the aid is designed and implemented in a way that helps the airport reach economical sustainability before the end of the transitional period.

Furthermore, the chapter also discussed that the overall management of regional airports can be considered a SGEI, subject to the isolation- and market failure conditions. In both parts, the focus of the State aid control is to prevent the duplication of unprofitable airports, promote sustainable operation and limit public intervention to the absolute minimum that is necessary in order to maintain reasonable connectivity inside and between the regions of the EU. However, the micromanaging and the time limits of the GBER and the transitional period of the Aviation guidelines imply that Operating aid to airports cannot be considered as a viable option if the airport in question has to continuously rely on public support. In that respect, the nature and purpose of granting Operating aid must be to help the airport to reach a sustainable operation. In conclusion, if that is not foreseeable and the regional airport in question has to continuously rely on public support in order to be able to operate, the SGEI option offers a preferable, if not the only, long-term solution.
Chapter 6 – State aid and SGEI in the EEA

This chapter discusses the nature of the EEA agreement and the two-pillar system for EEA State aid control with the aim of explaining how the homogeneity objective of the EEA agreement is achieved. Furthermore, the EU rules that were discussed in chapter 5 and have been applied to assess public support for the operation of airports from the EU Member States, are compared to the corresponding EEA rules with the aim of assessing whether they are any different in regards of the EFTA States.

6.1. The EEA agreement

The aim of the EEA agreement is to promote a continuous economic relation between the EFTA States and the EU and its Member States by creating a dynamic and homogenous European Economic Area. For that purpose, some of the rules regarding the internal market have been extended to the EFTA States without any formal ties to the supranational powers of the EU.247 In principle, the common rules of the EEA are based on the rules governing the internal market but, in light of the nature of the EEA agreement, achieved on the basis of sincere cooperation and the principles of equality, homogeneity and reciprocity.248 As previously mentioned in chapter 1, the EEA agreement has not been renewed since it was signed 26 years ago and there are no EEA institutions that have formal legislative powers to update the common rules of the EEA. Instead, to ensure homogeneity, the EEA rules are kept up-to-date, with the corresponding EU rules, by incorporation of EU secondary law, that is EEA relevant, into the EEA agreement on the basis of Decisions made by the Joint EEA committee.249 Thereby, the EEA rules become binding upon the Contracting Parties and subsequently they become, or are made, part of the domestic legal order in the EFTA States.250

6.2. The EEA State aid surveillance mechanism

Currently, Norway, Iceland, Liechtenstein and all of the 28 EU Member states are obliged to follow EEA State aid rules and control on the basis of the EEA agreement. In light of the nature

248 See to that effect, articles 1(1), 3 and 4 of the EEA agreement, as well as the fourth recital in the preamble of the EEA agreement.
249 See to that effect, articles 92 and 98 of the EEA agreement.
250 See to that effect, article 7 of the EEA agreement
of the EEA\textsuperscript{251} and on the basis of Article 108 of the EEA agreement, the EFTA States concluded an Agreement on establishing a Surveillance Authority and a Court of Justice.\textsuperscript{252} Article 4 SCA established the EFTA Surveillance Authority\textsuperscript{253} while Article 27 SCA established the EFTA Court. According to Articles 62(1), 109(1) and 109(4) of the EEA agreement, the EEA State aid surveillance mechanism is based on a two-pillar system where ESA and the EFTA Court monitor the obligations of the EEA agreement on the part of the EFTA States, while the Commission and the CJEU do so on the part of the EU Member states.\textsuperscript{254} ESA shall carry out its State aid review according to Protocol 3 to the SCA but the Commission does so according to the rules laid down in Article 93 EEC (Now 108 TFEU).

6.2.1. ESAs tasks and competences in the field of State aid – Comparison with the Commission

Article 62(1) of the EEA agreement provides that ESA shall constantly review any plans to grant or alter State aid, as well as all existing systems of State aid. However, certain aid to the fisheries sector and those that are inseparably linked to trade in products falling outside the scope of the EEA agreement fall outside ESA’s competence.\textsuperscript{255} Article 5 SCA stipulates that ESA’s main task is to ensure that the EFTA States fulfil their obligations under the EEA agreement with correct application of EEA law and by ensuring transposition of EEA law into the domestic legal order.\textsuperscript{256} For that purpose, ESA can inter alia take decisions, issue opinions

\textsuperscript{251} See for example, the transfer of State aid decision-making powers to the Commission would, for constitutional reasons, not be accepted by Norway and Iceland and the Opinion of the Court of Justice 1/91 considered that a common EEA Court would be incompatible with the EEC Treaty. See Dora Sif Tynes, ‘The EEA Surveillance Mechanism’ in: Arnesen, Finn Arnesen, Halvard Haukeland Fredriksen, Hans Petter Graver, Ola Mestad & Christoph Vedder (eds.) Agreement on the European Economic Area: A Commentary, (Beck, C. H., Hart, Nomos & Universitetsforlaget, 2018) p. 840-841.

\textsuperscript{252} Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice [1994] OJ L 344/1. (Hereafter referred to as the SCA). This agreement was concluded in line with the principles of homogeneity and reciprocity where the EFTA States had to establish an independent surveillance mechanism which made it possible to deal with infringements of EEA law in regards of the EFTA States. See Dora Sif Tynes, ‘The EEA Surveillance Mechanism’ in: Arnesen, Finn Arnesen, Halvard Haukeland Fredriksen, Hans Petter Graver, Ola Mestad & Christoph Vedder (eds.) Agreement on the European Economic Area: A Commentary, (Beck, C. H., Hart, Nomos & Universitetsforlaget, 2018) p. 840.

\textsuperscript{253} Hereafter referred to as ESA.

\textsuperscript{254} The function of the two-pillar mechanism was confirmed in Case T-115/94 Opel Austria [1997] ECR II-00039. Para. 108.


and notices, formulate recommendations and bring relevant matters before the EFTA Court.\(^\text{257}\)

Article 23(1) of Part II of Protocol 3 to the SCA provides a special infringement procedure in the field of State aid. This article corresponds to the second paragraph of Article 108(2) TFEU\(^\text{258}\) and provides that ESA may refer the matter to the EFTA Court directly under Article 1(2) of Part I of Protocol 3 to the SCA.

Article 24 SCA provides that ESA shall give effect to the State aid provisions of the EEA agreement and ensure that those provisions are applied by the EFTA States.\(^\text{259}\) Article 1 of Protocol 26 to the EEA agreement provides that the SCA should provide ESA with equivalent powers and similar functions to those of the Commission in the field of State aid. Article 2 of Protocol 26 to the EEA agreement lists both the Procedural- and the Implementing Regulations with relevant amendments.\(^\text{260}\) Protocol 3 to the SCA then reproduces common rules on the power and function of ESA in the field of State aid.\(^\text{261}\)

However, Protocol 26 to the EEA agreement is partly outdated since certain amendments to the Procedural Regulation and the Implementing Regulation have not been incorporated into the EEA agreement. Consequently, the EEA procedural rules are less up to date than the rules applicable in the EU.\(^\text{262}\) In particular, there are no rules on requests for information made to sources other than the competent national authorities,\(^\text{263}\) sector investigations\(^\text{264}\) cooperation with national courts\(^\text{265}\) and the new rules on the admissibility of complaints remain\(^\text{266}\) inapplicable in the EFTA pillar. The actual impact of this lack of homogeneity on the functioning of the EEA State aid surveillance mechanism remains to be

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\(^{257}\) For example, following an infringement procedure under Article 31 SCA.

\(^{258}\) The Commission would refer the case to the CJEU while ESA refers the case to the EFTA Court.

\(^{259}\) Article 49 of the EEA agreement concerns transport aid, Articles 61-64 cover the general rules on State aid and secondary State aid rules are in Protocols 14, 26, and 27 and Annex XIII and XV to the EEA agreement.


\(^{261}\) Article 1 of Part I of Protocol 3 to the SCA mirrors Article 108(1-3) TFEU, Part II of Protocol 3 to the SCA implements the Procedural Regulation and ESA has implemented the Implementing Regulation with technical amendments through Decision No 195/04/COL.


\(^{263}\) Provided by Articles 7 and 8 of the Procedural Regulation.

\(^{264}\) Provided by Article 25 of the Procedural Regulation.

\(^{265}\) Provided by Article 29 of the Procedural Regulation.

\(^{266}\) Introduced in Article 11(a) of the Procedural Regulation.
seen but it has been pointed out that the reason is rooted in Norway’s hesitation to grant ESA with the competence to impose fines or periodic penalty payments on undertakings in case of failure to comply with requests for information.267

Regardless of these minor differences, ESA’s tasks and competences in the field of State aid seem to be very similar to those of the Commission. ESA’s competence is however limited to surveillance while the Commission has the competence to participate in rule-making and legislative initiatives. For example, Article 106(3) TFEU provides that the Commission can adopt decisions and directives in order to ensure the application of Article 106 TFEU. Similarly, Article 108(4) TFEU provides that the Commission can adopt regulations relating to relevant block exemptions. ESA does not have such competences. Instead, in order to ensure reciprocity, the relevant measures adopted by the Commission are incorporated into Annex XV and Protocol 26 to the EEA agreement on the basis of a Decision of the EEA Joint Committee.268

6.2.1.1. Cooperation between ESA and the Commission in the field of State aid

In line with the homogeneity and reciprocity principles, Articles 62(2) and 109(2) of the EEA agreement provide that ESA and the Commission shall cooperate to ensure uniform surveillance throughout the EEA. Protocol 27 to the EEA agreement sets out the rules on the cooperation in the field of State aid. Accordingly, ESA and the Commission exchange information and consult each other on surveillance policy issues and individual cases, formally and informally. Furthermore, Article 5(2)(c) of the SCA provides that ESA shall carry out cooperation, exchange of information and consultations with the Commission.

According to Protocol 27 to the EEA agreement, ESA and the Commission have a number of meetings both periodically or at the request of either surveillance authority. At these meetings they review all relevant policy issues and discuss State aid development in order to adopt new guidelines. Periodic surveys on State aid in the EU and EFTA States are prepared and implemented through the publication of State aid scoreboards269 and they notify one

another and exchange views of all State aid decisions as well as when either authority decides to refer a case to the CJEU or the EFTA Court. Furthermore, according to point II under the heading ‘GENERAL’ on page 11 of Annex XV to the EEA Agreement, ESA has the obligation to consult with the Commission and adopt relevant guidelines that correspond to those adopted by the Commission in order to ensure that the field of State aid is interpreted identically by both surveillance authorities.270

Articles 64 and 109(5) of the EEA agreement further ensure the objective of a homogenous surveillance in the field of State aid and provide a mechanism, involving the EEA Joint Committee, to deal with any inconsistencies in this respect. In essence, in case of disagreement or if the Commission or ESA considers that the other surveillance authority’s practice may result in a distortion of competition within the EEA, the mechanisms can be invoked in order to initiate exchange of views to find a commonly agreed solution before the measures may be adopted to remedy the resulting distortion of competition. Currently, neither surveillance body has never invoked these mechanisms.271 However, these mechanisms remain an important tool to prevent lack of homogeneity in State aid control and demonstrate the importance of the sincere cooperation carried out between ESA and the Commission in order to ensure homogenous application of State aid rules.

6.2.2. The tasks and competences of the EFTA Court

Before the EEA agreement was signed in 1992, The Court of Justice found that a common EEA court for the EU and the EFTA States would be incompatible with the EEC Treaty (now TEU and TFEU) since it would be contrary to its exclusive competence to interpret EU law.272

Subsequently, Article 27 SCA established the EFTA Court pursuant to Article 108(2) of the EEA agreement. Accordingly, the EFTA Court’s competence covers ESA’s procedures and decisions in the field of State aid, as well as dispute settlements between two or more EFTA States. Articles 27-41 SCA provide that the EFTA Court has the competence to give judgements and advisory opinions on the application and obligations of the EEA agreement, the Agreement on a Standing Committee for the EFTA States and of the SCA. Similarly, the


270 Paragraph 26 of Annex XV to the EEA agreement.


CJEU does so on behalf of the Commission. However, contrary to the competences of the CJEU, the EFTA Court does not have the competence to impose fines on the EFTA States for failure to comply with its judgements.

6.2.2.1. Homogenous interpretation of EEA law and EU law by the EFTA Court

Article 6 of the EEA agreement provides that provisions of EEA law, which are identical in substance to the corresponding legislation in EU law, shall be interpreted in conformity with the relevant rulings of the ECJ (now CJEU) given prior to the date of signature of the EEA agreement. Article 3(1) SCA provides that the homogenous interpretation is extended to Protocols 1-4 to and the acts listed in Annexes I and II to the SCA. This means that the substantive and procedural rules in the fields of public procurement, state aid and competition law are subject to homogenous interpretation. In this respect, it must be noted that even though the articles only deal with rulings of the ECJ given prior to the date of signature of the EEA agreement, the reference does not mean that it is optional whether the future judgements of the CJEU would be followed. Article 3(2) SCA extends the homogenous interpretation to CJEU judgements given after the signature of the EEA agreement. The EFTA Court has interpreted Article 3(2) SCA as requiring it to interpret EEA rules in conformity with CJEU judgements concerning substantively identical EU rules.

Furthermore, article 105 EEA provides that the development of relevant case law from the CJEU is under constant review and due account should be taken to the principles laid down in such judgements. This means that the principles in the relevant judgements of the CJEU should be respected even though it is rendered after the EEA agreement was signed. The reality seems to be that it doesn’t matter whether the relevant judgement is delivered before or after the date of signature of the EEA agreement. In that respect, the EFTA court has confirmed

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273 Articles 17(1) and 19 TEU.
274 See to that effect, Article 260 TFEU.
275 Article 2(a) of the EEA agreement provides that this covers the main Agreement, its Protocols and Annexes as well as the acts referred to therein, and EU secondary law incorporated into the EEA agreement.
276 Article 6 EEA refers to the EC- and the ECSC Treaty but, for contextual reasons, this paper will refer to the EU or the TFEU where relevant.
279 The original EEC rules have been reshuffled following amendments to the EU Treaties, and the current TFEU does not consider the date of ECJ judgements. The EFTA Court has for example not given the wording of article 6 EEA much attention and has substituted the reference to the EEC Treaty for the EC Treaty. See to that effect: Case E-1/94 Restamark [1994] paras. 46 and 64; Case E-3/98 Rainford Towing [1998] paras. 19-20; See also Skouris, ‘The Role of the Court of Justice of the European Union in the Development of the EEA Single Market’ in: EFTA Court (ed.), The EEA and the EFTA Court [2014] p. 5. And, Pal Wenneras ‘Temporal
that national courts of the EFTA states are bound to interpret national law as far as possible in conformity with EEA law. This entails that the national courts must apply their own interpreting methods as far as possible in order to achieve the result sought by the relevant EEA rule.\(^{280}\)

However, the principle is in fact limited to a certain extent. For example, if the CJEU interprets EEA relevant secondary law, on a legal basis that is not existing in the EEA, the interpretation of the secondary law might not formally bind the national courts in the EFTA States. The rationale is that the national courts have to exercise their jurisdiction on the basis of the relevant and applicable legal sources. Without such independence, the national courts of the EFTA could not claim legitimacy.\(^{281}\) However, such circumstances are only a narrow exception to the general principle that EEA law should be interpreted in conformity with relevant case law from the CJEU.\(^{282}\)

### 6.3. Prohibition of State aid in the EEA - Comparison with the EU

The general prohibition of State aid in the EEA is provided with Article 61(1) of the EEA agreement. According to the EFTA Court, an intervention by the State or through State resources that confers a selective advantage on the beneficiary, is liable to affect trade between EEA States and distorts or threatens to distort competition constitutes State aid in the meaning of Article 61(1) of the EEA agreement.\(^{283}\) In comparison, without prejudice to some technical adaptions, Article 61(1) of the EEA agreement corresponds to Article 107(1) TFEU as they are identical in wording and substance. In support, the EFTA Court has even referred to the case law of the CJEU on Article 107(1) TFEU when interpreting the elements of Article 61(1) of the EEA agreement.\(^{284}\)


\(^{284}\) See to that effect, Case E-1/16, Synnove Finden AS v The Norwegian Government [2016] OJ C 9/08. paras. 39-42; Joined Cases E-4/10, E-6/10 and E-7/10 Liechtenstein and others [2011] EFTA Ct. Rep. 16. Paras. 69-79. In these cases, the EFTA Court refers to Article 107(1) TFEU and relevant CJEU case law in support of its analysis. It should also be noted that the EFTA Court does not seem to distinguish between the notion of an undertaking for the purposes of competition law and state aid law and defines undertaking in the same way for the purpose of Article 61(1) of the EEA agreement. See to that effect, Case E-8/00 Landsorganisasjonen I Norge [2002] EFTA Ct. Rep. 114. Para. 62. Where the Court refers to case law of the CJEU for the definition of an undertaking under Article 53 of the EEA agreement which deals with unlawful agreements between...
Furthermore, ESA introduced guidelines on the notion of State aid as referred to in Article 61(1) of the EEA agreement by Decision No 3/17/COL of 18 January 2017. ESA’s notion of State corresponds to Commission’s notion of State aid for Article 107(1) TFEU. Just like the Commission’s notion of State aid, ESA’s notion of State aid is not legally binding, but they set out how ESA interprets the definition of state aid on the basis of relevant case law and practice. ESA’s notion of State aid even stresses that ESA is bound by it and only has a limited margin of discretion in applying it.

6.3.1. Operating aid to airports in the EEA – Comparison with the EU

As previously discussed in chapter 5.2., the Commission decision-making practice, that is based on the Commission Aviation guidelines, implies that Operating aid to airports may be approved for a transitional period on the basis of Article 107(3)(c) TFEU. In comparison, the Article 61(3)(c) of the EEA agreement corresponds to Article 107(3)(c) TFEU and their wording is identical. ESA enjoys a wide margin of discretion its assessment and applies a balancing-test to assess the compatibility of aid under Article 61(3)(c) of the EEA agreement corresponding to the balancing-test that the Commission applies in its assessment of Article 107(3)(c).

Furthermore, the general de minimis aid Regulation and the GBER, previously discussed in chapters 2.5.1. and 2.5.2., have both been incorporated into the EEA agreement and are therefore binding upon ESA and the Contracting Parties. In addition, ESA has


285 EFTA Surveillance Authority Decision No 3/17/COL of 18 January 2017 amending for the one-hundred and second time, the procedural and substantive rules in the field of State aid by introducing new Guidelines on the notion of State aid as referred to in Article 61(1) of the Agreement on the European Economic Area, OJ L 342. (Hereafter referred to as ESA notion of State aid).

286 The first footnote of ESA notion of State aid states the following: ‘These Guidelines correspond to the European Commission (‘the Commission’) Notice on the notion of State aid as referred to in Article 107(1) TFEU.’

287 See to that effect, paras. 3-4 of ESA notion of State aid. See also, Norway - Templarheimen II – Aid for the construction and operation of the sports facility Templarheimen (Case No. 81396) EFTA Surveillance Authority Decision No: 013/18/COL [2018] OJ C 146. Paras. 23 and 25 where ESA refers to the notice in its Decision-making practice.


290 The general de minimis aid Regulation was incorporated into point 1ea. of Annex XV to the EEA agreement on the basis of the Decision of the EEA Joint Committee No 98/2014 of 16 May 2014 amending Annex XV (State aid) to the EEA Agreement. The GBER was incorporated into point 1j. of Annex XV to the EEA
introduced guidelines on State aid to airports and airlines by Decision No 216/14/COL of 28 May 2014\(^{291}\), which correspond to the Commission Aviation guidelines,\(^{292}\) and provide that Operating aid may be approved for a transitional period pursuant to Article 61(3)(c) of the EEA agreement.\(^{293}\)

### 6.3.2. State aid in the form of compensation for the provision of SGEI by airports in the EEA – Comparison with the EU

The EFTA Court has confirmed that public compensation which does not comply with one or more of the Altmark conditions, see the Altmark criteria discussed in chapter 3.2.1., must be regarded as State aid.\(^{294}\) As previously discussed in chapter 5.3., airports can be entrusted with the operation of SGEI and State aid in the form of public compensation for such provision can be justified on the basis of Article 106(2) TFEU. Without prejudice to some technical adaptions, the wording of Article 59(2) of the EEA agreement is identical to the wording of Article 106(2) TFEU. Furthermore, the PSO-Regulation\(^{295}\), which has been incorporated into Annex XIII of the EEA agreement\(^{296}\), provides a definition of PSO, rules on the entrustment act, the parameters for calculating the compensation in order to prevent overcompensation, general requirement of tendering procedures and mandatory rules on the publication of invitations to tender for public service contracts.\(^{297}\)

The approach of the EFTA Court to Article 59(2) of the EEA agreement corresponds to the approach of the CJEU to Article 106(2) TFEU. In that respect, the EFTA Court has confirmed that the applicability of Article 59(2) of the EEA agreement is subject to, first, that the undertaking in question must be entrusted with the operation of a SGEI by an act of public

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\(^{291}\) EFTA Surveillance Authority Decision No 216/14/COL of 28 May 2014 amending for the 96th time the procedural and substantive rules in the field of State aid by adopting new Guidelines on State aid to airports and airlines, OJ L 318. (Hereafter referred to as ESA Aviation guidelines).

\(^{292}\) See to that effect, in recitals 3-4 under ‘Whereas’ in ESA Aviation guidelines a reference is made to the Commissions Aviation guidelines and noted that they are of relevance to the EEA.

\(^{293}\) ESA Aviation guidelines, para. 112.


\(^{296}\) Decision of the EEA Joint Committee No 85/2008 of 4 July 2008 amending Annex XIII to the EEA agreement.

authority and, secondly, that strict application of EEA rules would obstruct the performance of its necessary tasks. The concept of SGEI is in line with the case law of the CJEU where it is the special characteristics of the interest in the SGEI that distinguishes it from the general economic interest of other economic activities. Furthermore, it is up to ESA to assess whether services are genuine SGEI in the application of Article 59(2) of the EEA agreement. Moreover, Article 59(2) of the EEA agreement does not cover advantage enjoyed by undertakings entrusted with the operation of SGEI in so far as that advantage exceeds the additional costs of performing the SGEI.

However, as previously mentioned in chapter 6.2.1., Article 59(3) of the EEA agreement does not establish a competence for ESA to adopt binding secondary rules for the application of the article, while Article 106(3) TFEU does so for the Commission. Instead, the relevant EU secondary law, such as the SGEI de minimis aid Regulation and the SGEI Decision, has been incorporated into the EEA agreement and are therefore binding upon ESA and the Contracting Parties. Furthermore, ESA has published guidelines that provide a framework for State aid in the form of public service compensation, which corresponds to the Commission SGEI framework.

6.4. Summary

In summary, this chapter discussed the nature of the EEA agreement and the two-pillar surveillance mechanism in the field of State aid. In essence, the system is designed to ensure homogenous interpretation and application of the State aid rules for both the EU Member States as well as the EFTA States but at the same time preserve the nature of cooperation established

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301 The SGEI de minimis aid Regulation was incorporated into point 1ha. of Annex XV to the EEA agreement on the basis of the Decision of the EEA Joint Committee No 225/2012 of 7 December 2012 amending Annex XV (State aid) to the EEA Agreement. The SGEI Decision was incorporated into point 1h. of Annex XV to the EEA agreement on the basis of the Decision of the EEA Joint Committee No 66/2012 of 30 March 2012 amending Annex XV (State Aid) to the EEA Agreement.
302 EFTA Surveillance Authority Decision No 12/12/COL of 25 January 2012 amending, for the eighty-fourth time, the procedural and substantive rules in the field of state aid by introducing new chapters on the application of state aid rules to compensation granted for the provision of services of general economic interest and on the framework for state aid in the form of public service compensation, OJ L 161. (Hereafter referred to as ESA SGEI framework).
303 The first footnote of ESA SGEI framework states the following: “This Chapter corresponds to the European Union framework for State aid in the form of public service compensation (2011) (OJ C 8, 11.1.2012, p. 15)”.
by the EEA agreement. The origin of the EEA legal framework governing State aid and compensation for the provision of SGEI is the corresponding EU law. The governing primary law in this field is much the same as it was when the EEA agreement was adopted. Relevant secondary law has been incorporated into the EEA agreement and the tactical amendments do not change their substance. Furthermore, corresponding guidelines have been adopted to ensure homogenous application of those rules by the Commission and ESA.

However, it is important to reiterate that guidelines have no binding legal effect so their ability to influence the field they are presented in is always linked to, first, the following decision-making practice by the competent surveillance authority, secondly, the following case law regarding such decisions. In that respect, ESA has not yet applied their Aviation guidelines to assess public support for the operation of airports by the EFTA States. This means that, regardless of their binding nature upon ESA, it remains to be seen whether they really apply in the same way towards the EFTA States, particularly in context of the detailed conditions for Operating aid during the transitional period and, crucially, the isolation condition for a genuine SGEI in airports.
Chapter 7 – Conclusion and final remarks

The primary purpose of the foregoing research was to answer the following questions: are EU Member States allowed to publicly support the operation of small regional airports? Does the same apply for the EFTA States? More specifically, the primary purpose was to see whether the operation of small unsustainable regional airports may rely on public support in order to ensure its existence and, in light of the different level of European integration provided by the EEA agreement, whether the same applies for the EFTA States.

As the foregoing analysis has explained, in order to avoid that public intervention distorts competition in the internal market, State aid is generally prohibited under Article 107(1) TFEU. Such intervention goes against the general interest of the EU and is therefore considered incompatible with the internal market. The prohibition is far from absolute since State aid may be necessary, in particular, in case of a market failure. In that respect, various exemptions are provided, both by the TFEU and other secondary law. The aim of State aid control is to ensure sound use of public finances and promote economic and social cohesion. The EU State aid system is thus essentially designed to ensure that aid that facilitates general economic development and pursues a common interest objective without duly distorting competition are deemed compatible with the internal market.

SGEI are services delivered in the interest of the society as a whole. SGEI are provided through public intervention in circumstances where they cannot be delivered sufficiently by the open market. Therefore, the concept of SGEI is dynamic and can vary between Member States in accordance with their domestic conditions. Compensation for the provision of SGEI, that fulfils the Altmark criteria, falls outside the scope of State aid rules. Furthermore, because of the importance and the special nature of SGEI, Article 106(2) TFEU provides that State aid rules only apply to undertakings entrusted with the provision of SGEI, insofar as the application of State aid rules does not obstruct the performance of the particular task assigned to them.

The basic purpose of a regional airport is to help people to travel between that region and other parts of the world. The most important object is to connect the region with the biggest cities of that State and other European States. In other words, the aim is to facilitate connectivity between regions and states. The importance of the regional airport in question is therefore dependent on its location, the economic conditions in that region and the quality of other public transportation options. Consequently, the importance of regional airports varies significantly. For some regions of Europe, the operation of its airport is vital in order to support the economic development of that area and promote higher standards of living for its people.
In other regions, the airport merely offers an option that could easily be substituted by other transport means, such as high-speed trains or maritime ferries.

In regard to the first question, whether the EU Member States are allowed to provide public support for the operation of a small regional airports. Without prejudice to de minimis aid, the foregoing analysis has explained that if the region in question is highly developed, with many inhabitants, strong economic conditions and various means of public transportation, the answer would generally be no. The operation of airports in such regions should, in principle, be able to bear its own cost and should not receive public support. However, for less developed regions and rural areas some options are available.

First, on the basis of Article 107(3) TFEU, the GBER provides a safe harbour for Operating aid which is granted to cover the funding gap and a reasonable profit for airports with less than 200,000 passengers per annum located in remote regions and very rural areas. Furthermore, on the basis of Article 106(2) TFEU, the SGEI Decision provides a safe harbour for compensation up to 15 million euro per year for the provision of SGEI by airports with less than 200,000 passengers per annum. For airports that fall outside the scope of these block exemptions, the Commission decision-making practice, which follows the Aviation guidelines, indicates that Operating aid may be approved on the basis of Article 107(3)(c) TFEU if it helps the airport to reach a sustainable operation before the end of the transitional period in 2024. However, that option does not provide a long-term solution that allows the Member States to ensure the existence of an unsustainable regional airport.

Secondly, the Commission decision-making practice, that follows the Aviation guidelines and the SGEI framework, has also indicated that State aid in the form of public compensation for the provision of SGEI by a regional airport may be deemed compatible with the internal market on the basis of Article 106(2) TFEU. Whether the operation of a regional airport may constitute a genuine SGEI depends on the economic conditions in that region and the quality of other public transportation options. If the market is unable to provide that service and the region would be isolated if the airport is closed down, the operation of that airport may constitute a SGEI.

The Commission decision-making practice, regarding both the granting of Operating aid and provision of SGEI, is mostly supported by non-binding guidelines which are adopted by the Commission. These guidelines provide principles in the Commission assessment regarding, inter alia, the maximum amount of the aid, the way the aid is granted, control of overcompensation, efficiency and transparency. These guidelines are all aimed at preventing unnecessary distortion of competition in the internal market and the Commission duly follows
these guidelines in its decision-making practice. This means that the decision-making practice will, in that way and with further practice, shape this field of law. These guidelines are however still rather new, so their binding influence is subject to future practice and case law.

On the basis of the Commission decision-making practice in the field of State aid, and without prejudice to future case law, the conclusion to the first question is that EU Member States may ensure the existence of a small unsustainable regional airport with public support if the operation of that airport is vital in order to ensure connectivity and acceptable standards of living in that region.

In regard to the second question, whether the same applies for the EFTA States. To begin with, even though the basic provisions of the EEA agreement have not been renewed since it was signed in 1992, vast amount of EU secondary law has been incorporated into the EEA agreement. The Treaty provisions, the secondary law and the underlying guidelines provided by the surveillance authorities seem to be the same in substance for the EU Member States under EU law and for the EFTA States under EEA law. Without prejudice to some minor differences in the competences of ESA and the Commission, the State aid surveillance mechanism also seems to be the same for the EU Member States under EU law and the EFTA States under EEA law. However, it must be noted that the conclusion to the first question is, to a large extent, based on the decision-making practice of the Commission in the field of State aid to airports in the EU. That decision-making practice seeks grounds in non-binding guidelines and the approach has neither been confirmed nor rejected by the European courts. Furthermore, no such decision-making practice by ESA currently exists. It would therefore be brave, even reckless, to state unconditionally that the same applies for the EFTA States. However, the extensive cooperation between ESA and the Commission in the field of State aid, the governing principles of homogeneity and reciprocity together with the strong overall cooperative nature of the EEA agreement, strongly indicates that ESA will apply the same rules in the same way for the EFTA States. Subject to the foregoing considerations, the conclusion to the second question is that the same applies for the EFTA States.
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