The Competition Law Limitations of Entrusting Public Services to Public Undertakings

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ABSTRACT

As public authorities are quite slow in departing from the long „tradition" of entrusting provision such services almost exclusively to public undertaking, a serious limitation for such choice is brought by EU law competition rules. When applied in national law for the incorporation by public authorities of undertakings carrying out services of general economic interest, the EU law competition rules require a double obligation to justify (i) an explicit public interest as well as (ii) the failure of the relevant market to provide the elements defining such public interest. Administrative law doctrine has to open up to EU law and especially to its competition rules as well as to public finance law, in order to fully tackle the various elements defining public services.

KEYWORDS: *Public services, public undertakings, services of general economic interest, EU competition law.*

1. Introduction Preliminary considerations

Further to the massive transformations that took and continue to take place in the Romanian economy for the past thirty years, one area that is still looking for efficiency is that of public services. As public authorities are quite slow in departing from the long „tradition" of entrusting provision such services almost exclusively to public undertakings[1)], a rather unexpected limitation for such choice is brought by EU law competition rules. Consequently, the national rules have to consider such limitations and the administrative law doctrine, which traditionally hosted the analysis of public services, has to open up to EU law and especially to its competition rules as well as to public finance law, in order to fully tackle the various elements defining public services.

In the broader context, the economic activities of the state[2)] can be identified by opposition to its administrative activities, on the basis of the old distinction between the exercise by the state of its essential functions, under the regime of public powers –

1) Notable exceptions are only reserved to waste collection services and to water and sanitation in Bucharest, whilst another city has both water and central heating entrusted to private operators.

2) A part of this analysis of the economic activities of the state was developed, with special reference to public undertakings, in Gherghina, S., "*Întreprinderile publice sau despre limitele constituționale ale actiivtății economice a statului*" published in the volume "*Despre Constituție în mileniul III*", Ed. Hamangiu, 2019, pp. 194-213.

imperium[3], and the exercise of activities which do not involve the use of public powers but of state-owned property or of public funds – *dominium*. Although for the most part the economic activities of the state belong to the *dominium* sphere, *i.e.* the policies by which it seeks the administration of the assets it owns, nevertheless certain activities related to economy belong to the sphere of *imperium*, since they involve the use of public authority, such as the regulation and supervision of economic activities carried out by private entities. It was those regulatory and supervisory activities that defined the relationship between the state and the economy before the „purely economic" activities of the state, carried out outside the public power regime, were added. Currently, modern states establish their economic or economy-related activities usually on three coordinates: (i) regulatory and supervisory activities (the „regulatory state"), (ii) economic activities usually carried out by legal persons established and controlled by the state – public undertakings, and (iii) economic activities carried out by entering into contracts with private entities, in order to ensure public services and investment.

As regards the first category, namely the regulation and supervision of the economy, public authorities act within the limits set at constitutional level and by special laws. In the second case, when the state participates in economic activity by offering economic goods and services to the public, acting as an „actor" in the market, together with private entities which normally carry out such activities, direct involvement is often carried out by market-specific entities, *i.e.* public undertakings established and controlled to various degrees by public authorities. Thirdly, the State may participate in economic activity by entering into contractual relations with economic operators, relations under which it acquires goods, works or services. Further, in order to meet the requirements for ensuring compliance with European competition rules, public authorities have to ensure: (i) the dissociation of the functions of the regulator from those of the economic operator, (ii) the dissociation of the economic activity from the management of the related infrastructure and (iii) the accounting separation of monopoly activities from the activities carried out on a competitive basis[4].

Under the principle of free competition, states cannot adopt measures affecting competition between economic operators, which also implies that they cannot adopt measures to create advantages for those economic operators they set up, *i.e.* public undertakings. The limitation thus imposed has the effect of establishing the conditions under which the state or the administrative-territorial unit may exercise both its public powers and its rights as a shareholder in relation to public undertakings. The existence of these conditions outlines a specific legal regime of relations between the state or administrative-territorial units and public undertakings under their control, which is different from that usually applicable in private companies.

2. The principle of free competition and the freedom to provide public services

Generally, the principle of free competition is the basis for the organisation of the economic activity of private entities, ensuring a framework for the conduct of those activities free from artificial interventions that would favour any of its competitors. In

3) Daintith, T. C., *Legal Analysis of Economic Policy*, in Journal of Law & Society, 1982, 9, p. 215.

4) Braconnier, S., 2015, *Droit public de l'économie*, Paris: PUF Thémis droit, pp. 104-106.

accordance with Article 135 (1) of the Constitution, Romania's economy is a market economy, therefore is to function according to market rules based on the free interaction between supply and demand, which implies that such interaction is based on free initiative and competition. Consequently, by virtue of the principled provisions of Article 135(1), the economy must have as essential elements the free initiative of economic operators and the free competition between them, any regulation, action or omission of public authorities being subject to this constitutional imperative.

These constitutional provisions impose a negative obligation on public authorities not to adopt or apply measures of any kind that would affect the structure of the market economy. In view of the fact that Article 135(1) expressly refers to the basic conditions defining the market economy, namely free initiative and competition, it is clear that the negative obligation, the limitation imposed by the constitutional text, concerns any measures of the public authorities which would affect either of the two conditions.

Moreover, the economic freedom implied by the free initiative is in turn enshrined constitutionally in Article 45, according to which „*the free access of the person to an economic activity, free initiative and their exercise under the law are guaranteed*.". The relationship between these two constitutional provisions – Articles 45 and 135 (1)– is one of the most interesting, as it involves a direct relationship between the conditions for the free access to an economic activity, for free initiative and for the exercise of those freedoms and the general obligation imposed on the state not to affect the elements of the market economy, including free initiative. As a result of establishing that necessary relationship between the two constitutional provisions, any legislation establishing conditions relating to the exercise of economic freedom shall in turn be subject to the general limitation imposed by Article 135 (1), which cannot affect any of the elements — free initiative and free competition — on which the market economy is based.

Also, the obligation of the state to not affect free competition, established by Article 135(1) of the Romanian Constitution, is completed by the obligation provided by par. (2) of the same article, which provides that „*the state must ensure: a) freedom of trade, protection of fair competition ...*", which presupposes that, in addition to the obligation not to affect free competition, the state is obliged to act by adopting appropriate regulations to protect those elements of the general economic interest listed in art. 135(2), including freedom of trade and protection of fair competition.

Much more precise provisions on the pre-eminence and application of the principle of free competition are included in the Treaty on the Functioning of the European Union, complementing the national constitutional reference. According to art. 106(1) of the Treaty on the Functioning of the European Union (TFEU), a state may not take measures of any kind for the benefit of public undertakings or of undertakings to which it grants special or exclusive rights, if such measures infringe the rules of the same Treaty governing competition, as established by art. 18 and art. 101-109. The second paragraph of Article 106 TFEU, however, establishes an exception to this general limitation of the state's intention to support public undertakings, stating that public undertakings providing public services may benefit from state measures derogating from the competition rules provided for by the TFEU insofar as these derogations are necessary to ensure the continuous provision of those public services.

The exception thus established gives priority, under certain conditions, to the significant public interest represented by ensuring the functioning and continuity of public

services, over the principle of free competition[5]. In order to allow the optimal functioning of public services, if it were hindered by the rigorous application of the rules embodying the principle of free competition, the state may adopt measures derogating from the latter rules only to the extent necessary to achieve the objective pursued.

3. Services of general economic interest and public interest

In the absence of legal provisions enshrining the right of the state to perform direct economic activities, the legal grounds for such right cannot be found in the general provisions of art. 45 of the Constitution, which enshrines solely the economic freedom of the citizens, although this article generally sets the grounds for the legislation concerning incorporation of companies. Somehow similar to Romanian administrative law, there is no legal provision in French law on the freedom of the state to pursue economic activities, but more than 100 years of Council of State jurisprudence and doctrinal analysis have developed a solid theory of the limits and conditions under which public authorities can set up companies[6].

It is interestig to point out that, starting from a similar constitutional provision, the French Council of State developed the interpretation that, in principle, the pursuit of economic activities is reserved exclusively for private entities. Consequently, any state intervention in this area, by incorporation of public companies or by supporting private economic agents is a violation of the constitutional freedom insofar as it is not justified by a significant public interest. Although over 100 years of jurisprudence the breadth of the public interest considered by a public authority to justify the initiation or support of an economic activity has varied from the total absence of private initiative to its quantitative or even qualitative insufficiency, the principle that public authorities have to find a solid justification for any economic activity they may either undertake or support has been strengthened by jurisprudence starting from the imperative of protecting the economic freedom of private persons[7].

The principle of economic neutrality enshrined in art. 345 TFEU[8], which establishes that the rules established by the Treaty, including those on competition comprised in art. 101-109, cannot be interpreted in the sense of privileging a certain form of property – public or private –, further allows the state to carry out economic activities by setting up public undertakings. Most of them will be incorporated for providing public services.

However, under Article 106(1) TFEU such public undertakings or private undertakings to which the State has entrusted special or exclusive rights will be subject to competition rules just like private economic operators. A regime derogating from the rules of competition shall be permitted by Article 106(2) of the Treaty in respect of those economic activities carried out by public authorities, which are qualified as services of general interest of an economic nature, in so far as they fulfil a number of conditions: (i) to be

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5) Braconnier, S., *op. cit.*, p. 98-99; F. Colin, 2017, *Droit public économique*, Sixth Ed., Paris: Ed. Gualino, pp. 213-215; Delaunay, B., 2018, *Droit public de la concurrence*, Second Ed., Paris: LGDJ lextenso, pp. 178-182.

6) Cherot, J.-Y., 2007, *Droit public économique*, Second Ed., Paris: Economica, pp. 52-80, Braconnier, S., *op. cit.*, pp. 16-44, Colin, F., *op. cit.*, pp. 26-45, pp. 146-160, Delaunay, B., *op. cit.*, 97-114.

7) *Ibidem*.

8) *"The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership*."

carried out by entities pursuing an economic activity, and (ii) to have been organised in areas where the free market is not in a position to ensure the public interest pursued (such as the continuity and universality of the service at reasonable uniform costs). The entity entrusted with the public service in question will be subject to public service obligations as obligations to ensure that the public interest pursued by that activity is satisfied (uniform access, tariffs, etc.). Derogations from the application of rules designed to ensure free competition are permitted insofar as the full application of those rules would impede the performance of that public service. They must also be proportionate to ensuring the fulfilment of public service obligations[9)].

In the context thus determined by the application of the competition rules laid down in European Union law, it is necessary to clarify the scope of the economic activities which the state and the administrative-territorial units may carry out, since those rules apply only to entities pursuing economic activities. Thus, insofar as the activities carried out by a public undertaking are not economic in nature, they will not be subject to competition rules. In order to identify economic activities, in the context of establishing the scope of European Union competition law, the case-law of the Court of Justice of the European Union (CJEU) has developed a functional approach, involving a case-by-case analysis, centred on two key concepts: economic activity and, respectively, undertaking, as an entity carrying on economic activity. Thus, the Court defined economic activity as any activity consisting in the supply of goods or services to a given market[10)] and the undertaking was defined as any entity, irrespective of its form of organisation, which carries out economic activity under conditions subject at least potentially to competition[11)].

In the light of this case-law, the state may carry out economic activities by setting up undertakings, which may be autonomous regies or companies but may also take other forms permitted by national law, the form of organisation of the undertaking and its financing being irrelevant[12)]. Regardless of their name (companies, national companies, municipal companies, autonomous regies or other entities included or not in the public administration), public undertakings may be legal persons whose object of activity is the offering of goods and services to the public (*i.e.* an economic activity, in terms of the case-law of the Court) and whose decisions are controlled by the state (in the broad sense of the term, which includes both central and local public authorities and institutions). Admittedly, this does not preclude the possibility that a number of public undertakings may not carry on an economic activity, where their main activity is not to offer goods or services to the public but pursue a social objective based on the principle of solidarity[13)] or carry out an activity which is a matter of the exercise of public powers[14)].

9) For the application of the proportionality principle in qualifying public service obligations as an essential element of services of general economic interest, see joint cases C-205/99 *Analir* (2001), T-202/10 *RENV II* (2015), T-454/13 *SNCM v. Commission* (2017).

10) Joint cases C-180/98 to C-184/98 *Pavel Pavlov et al. v. Stichting Pensioenfonds Medische Specialisten* (2000), par. 75.

11) C-475/99 *Ambulanz Glöckner v. Landkreis Sudwestpfalz* (2001), par. 20.

12) C-41/90 *Höfner & Elser v. Macrotron* (1991), par. 21.

13) C-159/91 şi C-160/91 *Poucet et Pistre* (1993), C-218/00 *Cisal* (2002), par. 38-42, C-205/03 *FENIN* (2005), par. 25, 26, C-350/07 *Kattner Stahlbau* (2009), par. 44-59.

14) C-364/92 *Eurocontrol* (1994), C-343/95 *Porto di Genova* (1997), C-266/96 *Corsica Ferries* (1998), C-113/07 *Selex* (2009), C-50/08 *Commission v. France* (2011), C-138/11 *Compass-Datenbank* (2012).

It should be pointed out that this functional, non-formal way of identifying the undertaking – as an entity subject to competition rules – by reference exclusively to the activity it carries out can lead to practical situations in which a legal person carries out both activities which can be classified as an economic activity under the terms set out in the CJEU case-law and activities which cannot receive such a qualification (*e.g.* activities which are carried out in the exercise of powers of public power). Consequently, the competition rules will apply only to economic activities, not to non-economic activities. Such a functional structure, based on a case-by-case analysis, leads to a fluidity in the scope of the application of competition rules but at the same time ensures that this area is strictly limited to economic activities likely to generate a market governed by those rules. In relation to the provisions of Article 106(2) TFEU and the regime derogating from the rules of competition which it establishes with regard to services of general economic interest, economic activities of a public undertaking may or may not be classified as services of general economic interest.

The aim of this derogatory regime is to allow public services of an economic nature, referred as services of general economic interest, to receive state support, even if that support is able to give them an advantage over competitors. The establishment of detailed coordinates of financial relations between the State (public budgets) and public undertakings, with a view to determining the applicability of competition law rules, shall take place in accordance with Directive 2006/111/EU on the transparency of financial relations between Member States and public undertakings. The record of these financial relations makes it possible to identify derogations from the general competition regime established by EU law and to comply with the limits permitted in accordance with Article 106(2) TFEU.

The public authorities may therefore decide to create a service of general economic interest, which may be further supported under the regime derogating from the competition rules established by Article 106(2) TFEU. The condition necessary to justify the application of this derogatory regime and therefore the functioning of a public service under the regime of services of general economic interest is the existence of a precisely identified public interest, which cannot be ensured under the given market conditions, and which can only be achieved by setting up a public service to be carried out by one or more entities to which precise obligations are imposed on the performance of those elements of the service which are not provided by the free market[15)].

The state enjoys a wide margin of discretion in classifying a service that it offers to the public as a service of general economic interest, and such decision can only be challenged in case of a manifest error[16)]. The European Commission may verify to what extent there is a public interest justifying state intervention in the market by organising a service of an economic nature characterised by the imposition of specific obligations to ensure those elements of the service which the free market does not offer.

The most important effect of the recognition of an economic service of general interest is that the entity performing that service will be able to receive support from public authorities in the most diverse forms involving the use of public funds, proportionate

15) Sauter, W., 2015, *Public Services in EU Law*, Cambridge University Press, pp. 128-129.

16) Joint cases C-66/16 P to C 69/16 P *Comunidad Autónoma del País Vasco e.a./Commission* (2017), par. 69, C-91/17 P *Cellnex Telecom v. Commission* (2018).

to the public service obligations imposed and under certain conditions laid down by the relevant legislation at European level, mainly that included in the Almunia Package[17], and by the relevant case-law of the Court of Justice of the European Union. In those circumstances, public undertakings entrusted with the performance of a service of general economic interest may be supported by the public shareholder within the limits thus established by the regime derogating from competition rules, since such support may not be qualified as state aid, or, as the case may be, shall be qualified as state aid that is compatible with the internal market.

On the other hand, insofar as the condition of recognition of the service of general economic interest and therefore the application of the derogatory regime from the competition rules is not fulfilled, the entity which will perform that service, insofar as it is an undertaking (i.e. carries out an economic activity, offering goods and services to a given market), will be fully subject to competition rules, which means that its shareholder, a legal person governed by public law, will not be able to support it because such support will often be incompatible state aid. In relation to the criterion thus established by competition law, a criterion constructed in the place occupied by the public undertaking in the market[18], those undertakings will have a different legal regime depending on how they perform a service of general economic interest or not.

The application of the competitive criterion indicates three main categories of public undertakings: (i) undertakings engaged in non-economic activities, (ii) undertakings which carry out economic activities but which cannot be classified as services of general economic interest, and (iii) undertakings carrying out services of general economic interest.

However, if we look at this structure in the light of the need to justify a public interest at the time of the establishment of such a public undertaking, the conclusions may be able to replace the absence of the relevant case-law and the doctrinal analyses devoted to this subject. It is important to point out that the functional and not organic approach on which the CJEU case-law is based in defining economic activity leads to the analysis of each of the above three categories not in relation to the entity itself, but to its actual activities[19]. Therefore, an entity – a public undertaking – may carry out several categories of activities of the above, in which case the analysis is to be made in relation to each activity.

Public undertakings carrying out services of general economic interest may include only entities in respect of which an explicit public interest has been identified, the

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17) Consisting of: (1) The Commission Communication on the application of European Union State aid rules to compensation for the provision of services of general economic interest, 2012/C 8/02, (2) Commission Decision 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 compensation for the public service obligation granted to certain undertakings entrusted with the provision of a service of general economic interest, (3) Communication from the Commission To the European Union Framework for State aid in the form of compensation for the public service obligation 2012/C 8/03 and (4) Regulation (EU) No 1493/1999 Commission Regulation (EC) No 360/2012 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.

18) Admittedly, the criterion is set for all undertakings (i.e. entities engaged in economic activity in a competitive environment), not applicable only to public undertakings.

19) Jones, A., Sufrin, B., 2004, *EC Competition Law*, Second Ed., Oxford University Press, p. 741.

satisfaction of which cannot be ensured by the free market, through private economic operators operating on the relevant market, which justifies public intervention[20)].

4. Conclusions

When applied in national law for the incorporation by public authorities of undertakings carrying out services of general economic interest, the EU law competition rules require a double obligation to justify (i) an explicit public interest as well as (ii) the failure of the relevant market to provide the elements defining such public interest. Also as a result of those rules, where they set up public undertakings engaged in economic activities which are not services of general economic interest, the financial relations between public authorities (shareholders) and the undertaking must fall within the limits laid down by European competition rules[21)].

The limitations imposed on those financial relationships, which in principle assume that they are carried out in such a way that the conditions for their classification as incompatible State aid are not met, seriously limit the exercise by public authorities of some of their shareholder rights compared to the exercise of similar rights by a private entity.

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20) Sauter, W., *op. cit.*, pp. 112-116.

21) Directiva 2006/111/CE a Comisiei privind transparența relațiilor financiare dintre statele membre și întreprinderile publice, precum și transparența relațiilor financiare din cadrul anumitor întreprinderi. Commission Directive 2006/111/EC on the transparency of financial relations between Member States and public undertakings and the transparency of financial relations within certain undertakings.