

# Passenger Land Transport in Portugal: Improving Competition by Legislative Reform

*José Luís Moreira da Silva*

*Ana Pereira de Miranda*

*Ana Sofia Firmino*

## 1. The Past

### 1.1 Introduction

The Portuguese Transport Sector tends to differ from what prevails in other countries in the European Union ("EU"). Legislation and regulations are very dispersed and fragmented and important differences are shown from mode to mode and even from city to city.

While under previous legislation (the *Regulamento dos Transportes Automóveis*, "RTA") all public transport was considered as "public service" and no new entrants/operators were allowed into the transport system, the Framework Law for Land Transport (Law no. 10/90, of 17 March also known as *Lei de Bases do Transporte Terrestre*, "LBTT") changed the notion of "public service obligation(s)" as well as the idea of "compensation" for the compliance of such obligations.

The general Transport System (by mode of transport) framework can be summarised as follows<sup>1</sup>:

- A State-owned company (METROPOLITANO DE LISBOA) carries out the underground transport in Lisbon;

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<sup>1</sup> Source: MARETOPE - Gerir e Avaliar a Evolução Regulamentar. Operações Locais de Transporte Público na Europa, TIS.PT, CONSULTORES EM TRANSPORTES, INOVAÇÃO E SISTEMAS, S.A., and SIMMONS&SIMMONS REBELO DE SOUSA, Report "Enquadramento Jurídico-Institucional do Sector dos Transportes nas Áreas Metropolitanas de Lisboa e Porto - Primeira Fase.

- State-owned companies on the basis of concession contracts carry out urban transport. Following the implementation of EC Directive no. 91/440/EEC the rail sector was split into an infrastructure manager (REFER), a transport company (CP) and a rail regulator (INTF). REFER was created in 1997 and is now responsible for the operation and maintenance of the Portuguese rail infrastructure; CP exploits the national rail network based upon a delegation from the central government. In some cases this company (CP) may delegate (through concession) the exploitation to another operator via a contract (FERTAGUS).
- Private, state or municipal bus companies in a licensing regime granted by the state or the municipalities exploit the urban, sub-urban and regional transport services;
- Mainly private companies provide inter-urban coach transport. Concessions are needed for normal services that are considered as public service. Express and high quality services are not considered as public services and only require an authorisation. Market concentration is an important point to regard and several large groups control most of the market.

From a legal standpoint, the RTA and the LBTT regimes co-exist and sometimes overlap. In fact, they stand for two different regulatory frameworks, with different underlying objectives and strategies. The LBTT was not yet "transposed" into practice, *i.e.* there are many regulations that are still necessary to create in order to enable the legal regime established by this framework legislation to function.

The intention to regulate LBTT and to proceed with the implementation of the measures is expected by all the Transport Sector agents and operators. As a result, the situation in Portugal is still at a "transitional stage".

In consequence of the existing unclarity of role distribution/allocation in the Transport Sector, the demand for public modes<sup>2</sup> tends to decrease and simultaneously the costs incurred by the operators tend to increase. This in turn conducts to a situation where all the operators and in special the State-owned ones face several difficulties in their process of adaptation towards a competitive environment. The legality of the compensations granted for public service transport is questioned.

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<sup>2</sup> With the correspondent increase in the choice of private transport.

## 1.2 Regulation of Auto Transport (RTA)

Two main legal diplomas - Law no. 2008 of 1945 and Decree no. 37272 of 1948, known as “RTA”<sup>3</sup>, governs the Portuguese legal and regulatory framework for passenger transport. This legislation was introduced in a political and legal context strongly directed by State direction and intervention.

The main guidelines state that all public road transport of passengers shall be considered as “public service” and that no new operators should be allowed into the underlying system. This means leaving competition only to the existing operators.

The main guidelines of the RTA are:

- To subordinate other modes to the rail mode. This main principle associated to market access limitations to new entrants/operators lead to a strong concentration of public sector companies and to the consequent market dominance. This was a dominant feature within the Portuguese transport market until some years ago.
- All public urban transport should be considered as public service, with the operation of the required services depending upon the grant of an authorisation by the Central Administration.
- Competition for lines originated by the Administration (the “Transport Authority”) should remain between the existing Operators. Whenever a new service was needed it should be distributed to the existing companies, giving priority to the oldest in operation.
- As an exception, the RTA allows the initiative of creating new services to be taken by a newcomer operator, but only when it concerned a service not operated by the incumbents.

As a “public service” the Transport Authority (Local and/or Central Administration) could impose a specific operation to the companies such as the establishment, maintenance and extension of certain lines, since it could be granted a “fair

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<sup>3</sup> *Regulamento dos Transportes Automóveis.*

compensation” (*indenização compensatória*) when the new service (or the continuation of the old one) was not economically viable.

The Transport Authority could also condition the grant of a new authorization, or the extension of it, to the exploitation by the operator of not requested lines, since it could be granted a fair compensation.

Finally, the above-mentioned Transport Authority could impose conditions in granting or extending authorizations for the introduction of changes in a given line.

According to the RTA, routes are classified as “urban” and “inter-urban”. Urban routes are defined as the ones operated between the limits of the settlements or between the big population centres and the neighbourhood settlements. Inter-urban routes are all the others. Suburban routes have never been defined.

The operation of public transport is done either directly by public service companies owned by the State (either locally or centrally) or by "concessions" (granted without previous tender).

Urban transport concessions are granted by the Administration to the requesting operators and proposes routes, timetables, fares, stopping, boarding and disembarking points. The Central Administration establishes the fares/tariffs with the exception of the networks operated directly by the Local Administration (in this case the Local Administration is free to establish fares).

There are two types of concessions: normal and provisional. Normal concession is granted for 10 years and can be extended. Provisional concessions are granted only for 2 years. Although the operators could require an authorization lower than 10 years when the transport needs were also by a lower period of time.

## 1.3 The Framework Law for Land Transport (LBTT)

Portugal joined the European Community ("EC") in 1986. During the 80s the discussions relating to the reform/restructure of the Transport Sector continued. Too much centralization and "monopolistic" rights to the existing operators were the main critics appointed to the sector (deficiencies within the "old" legal framework). Therefore the Authorities started preparing a "new" legal framework for the transport sector taking into account the European legal standards.

This new framework was defined within the above-mentioned LBTT. The respective major guidelines are:

- **Public service obligations** will only be justifiable as a way to guarantee the efficiency of the system, *i.e.* only when an operation is not economically viable;
- While the previous legislation established a compensation in exchange to the obligation of exploring viable services, the LBTT shifts into another direction – **compensation** will only be due as a result from the incumbency resulting from the imposed **specific obligations of transport** that can be expressed in terms of **quality, quantity and price**. The concept of "quality" is one of the public service components, which was introduced for the first time by the LBTT.
- Urban or local transports are considered **public service** and they are operated either directly by the Local Authorities (Municipalities) or by **concession** granted (without competition) by that body that will also be responsible for setting the fares/tariffs.
- Establishes some **decentralization** by transferring competencies to the Local Administration, leaving to the Central Administration the role of general regulator of the transport systems and the control of the ones that exceed the local scope.
- With the exception of the Metropolitan Areas of Lisbon and Oporto some **deregulation** is introduced within the **market** establishing that: (i) all operators are free to explore the market, depending only upon the compliance with some "technical" conditions; (ii) the responsible authority is obliged to give equal treatment to all operators, irrespective of the public or private composition within the respective equity structure; (iii) Users will have the freedom of choice between

all available transport modes; (iv) infra-structure investments will be subject to planning and coordination in order to obtain maximum profitability of the system; (iv) transport policy should be coordinated with other national policies, *inter alia* land use, regional development, quality of life, protection of the environment, etc.; (v) it defines specific rules for the Metropolitan Areas of Lisbon and Oporto that consider planning and modal co-ordination as the priority principle in the organization of the public transport system within the Metropolitan Areas.

Considering the above framework it is possible to say that **public service obligations** are considered justifiable only as a way to guarantee the efficiency of the transport system. While the previous legislation (*maxime* the RTA) provided for compensation for the obligation to explore non economically viable services, in the LBTT the focus moves to the incumbency resulting from the obligation imposed on the transport service that can be expressed in terms of quality, quantity and price.

The LBTT established also that urban and local public transport should be considered as “public services”.

It should be referred that the present situation within the Portuguese Transport Sector is not very different from the past situation better described above. The LBTT has not yet been regulated (*i.e.* "translated" into practice) and co-exists with the RTA.

As such, as mentioned above, the Portuguese legal framework of public transport is thus characterised by an overlap of two different legislative frameworks (the RTA and the LBTT) that have underlying different strategies and perspectives. This fact gives place to a regulatory confused environment that needs to be clarified and revised.

It is possible to say that the main barriers to change relate to the fact that competencies are not clearly defined/divided at an institutional level, as well as to the fact that there is not an authority (at the central level) responsible for the definition of the policy and guidelines for the Transport Sector.

## 2. The Transition

### 2.1 Reasons for a Change

The main ideas underlying a reform in the Portuguese Transport Sector can be summarised as follows:

- Need to adjustments to European trends (as well as to EU transport and public service related legislation); and
- Financial compensations should result from clear, transparent and non-discriminatory framework.

There are significant challenges for the Portuguese Transport Sector. Such challenges are, *inter alia*: (i) a Political Challenge; (ii) a Legal and Institutional Challenge; and (iii) a Financial Challenge.

In relation to point (i) above ("Political Challenge"), the main changes are determined by the need of coherence, *i.e.* concentration of competencies within the Administrative levels more related to such competencies. It is important to find a point of equilibrium between the competencies of the various levels of organisation of the Transport Sector.

In relation to the so-called "Institutional Challenge" it should be pointed out that it is important to establish a clear framework distributing and allocating responsibilities and competencies. It is important to define politically and strategically, which are the objectives/aims for the Transport System. At the same time the regulatory aspects (including organisation and planning of the Transport System, access to the market and tariff definition) should be carefully considered. Finally, at the operating level it is important to establish a coherent legal framework for the provision of transport services.

Within other EU countries the general trend is to deliver the provision of such transport services to private undertakings/operators. Such provision of services is normally granted by public sector entities (the Transport Authorities). This indicates that the State's role is being shifted from the (direct or indirect) provision of services (the "State-provider-of-services") towards regulation (the "State-regulator"). Normally the relationship between (private) transport services operators and the State/Administration

(*maxime*, the Transport Authorities) is regulated by contracts. The contractual framework to establish between the State and the operators is flexible and depends from the degree of control that the public authorities intend to maintain within the Sector in question (*i.e.* the contracts can vary from simple provision of services, to classical concessions or public-private partnerships).

It should be noticed that any new legal framework for the Portuguese Transport Sector must comply with the Community legal framework (including legislation and recent developments in EU case-law), *inter alia* in respect to the establishment of public service obligations (taking into account that transport services are normally services of general economic interest) and the granting of public (State-granted) compensation for the imposition/maintenance of such obligation(s).

In relation to the "Financial Challenge" it should be noticed that the tariff system for the provision of transport services should be revised. Tariffs and prices should take into account and reflect the costs incurred with the provision of such services. On the other hand, financial compensation for the maintenance/imposition of public service obligation(s) to transport operators should be revised, taking into account the compliance with the Community legal framework better described below in the present Paper.

## 2.2 The European Union Legal Framework

As referred to above, the EU legal framework for transport issues is a key-factor for the need to change the actual Portuguese framework. Reference is made in the present Section to some fundamental EU secondary legislation as well as to recent development in the European courts case-law in respect to some fundamental issues (*inter alia* public service obligation(s) within transport services and State awarded compensation for the maintenance/imposition of such obligations and the co-relation of this sectorial framework with the State aid rules).

**Regulation 1191/69**<sup>4</sup> provides for a regime for action by Member States concerning the obligations inherent in the concept of public service in transport by rail, road and inland waterways. Such common regime is important because Article 77 of the EC Treaty (now Article 73) provides for an automatic exemption for aid representing reimbursement for discharge of **public service** obligation. According to Article 1(1) of Regulation 1191/69 Member States (MS) shall terminate all obligations inherent in the concept of a **public service**. The latter is defined as service, which a transport undertaking would not assume if it were considering its own commercial interests, (or would not assume to the same extent) and under the same conditions. Nevertheless Article 1(2) of the Regulation allows Member States to maintain such obligations in so far as they are essential to ensure the provision of adequate transport services. Article 1(4) provides that financial burdens devolving on transport undertakings, as the result of the maintenance of a public service obligation shall be subject to compensation according to the procedure established in the Regulation.

Section II of **Regulation 1191/69** lays down common principles for the termination or the maintenance of public service obligations. Section III regulates the application of the rules to passenger transport rates and conditions, while Section IV includes common compensation procedures. Section V allows Member States to impose new public service obligations. According to Article 17(2), Member States are exempted from the notification procedure under Article 93(3) (now 88) of the EC Treaty. They must, however, file details of the compensation payments – *i.e.* there is an *a posteriori* obligation to notify instead of an *a priori* obligation to do so.

The above-mentioned Regulation has been amended by **Regulation 1893/91**<sup>5</sup>. The amendments include the introduction of the notion of “**public service contracts**”. The principle of termination of a public service obligation is maintained, but MS have the option to maintain or to impose such obligations for the purpose of supplying certain services or in the interest of certain social categories of passengers.

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<sup>4</sup> Regulation EEC no. 1191/69 (OJ L 156, 28.06.1969) on the action by Member States concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway.

<sup>5</sup> Council Regulation (EEC) 1893/91 of 20 June 1991 amending Regulation 1191/69 on action by MS concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway.

**Public service contract** means a contract entered into by the competent authorities of a MS and a transport undertaking with the view of providing the public the adequate transport services.

A **public service contract** may cover:

- Transport services satisfying fixed standards of continuity, regularity, capacity and quality;
- Additional transport services;
- Transport services at specified rates and subject to specific conditions, in particular for certain categories of passengers or for certain routes;
- Adaptation of services to actual requirements.

Council **Regulation 1191/69**, as amended by **Regulation 1893/91** has been the subject of a preliminary ruling by the European Court of Justice ("ECJ") of September 17,1998. The Court ruled that although Article 4 of the Regulation 1191/69 allows transport undertakings, which are subject to a public service obligation to apply for the termination of such obligation in whole, or in part, MS have discretion whether or not to grant such a request. This is so even if the applicant demonstrates that a public service obligation entails economic disadvantages. However, MS have to respect the rules of Articles 3, 6(2) and 7 of the Regulation 1191/69. This implies that a refusal can only be based on the necessity of maintaining the provision of adequate transport services. According to Article 3(2) this shall be assessed having regard to:

- the public interest;
- the possibility of having recourse to other forms of transport and the ability of such forms to meet the transport needs under consideration;
- the transport rates and the conditions which can be quoted to users.

Council **Regulation 1192/69**<sup>6</sup> lays down common rules for the normalisation of accounts of railways undertakings. The imposition of financial burdens on railways may cause distortion of competition *vis-a-vis* other modes of transport and also because of different national rules between railways inter se. Elimination may take place:

- by termination of certain classes of financial burdens;

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<sup>6</sup> Regulation (EEC) no. 1192/69 of the Council, of 26 June 1969, on common rules for the normalisation of the accounts of railway undertakings.

- by normalisation of the accounts of the railways including the payment of a compensation for the effects of a financial burden; and
- in conjunction with the progressive harmonization.

In the last of these cases, MS retain the right to decide whether normalisation should take place. According to Article 1(3), normalisation shall not apply to public service obligations covered by Regulation 1191/69. Regulation 1192/69 defines in its Article 4 a number of categories of financial burdens. These are therefore in addition to public service obligations.

Section II of Regulation 1192/69 provides for common rules for compensation and normalisation. According to Article 10, the amount of compensation paid in respect of each category shall be laid down in a table annexed to the annual accounts. The table shall also show compensation for each public service obligation. Article 13 provides that compensation paid pursuant to this Regulation shall be exempted from the requirements of Article 93(3) (now 88) of the EC Treaty.

With the enactment of Regulations 1191/69 and 1192/69, the rules for compensation of public service obligations and other financial burdens were laid down.

**Regulation 1107/70**<sup>7</sup> of the Council of 4 June 1970 on the granting of aids for transport by rail, road and inland waterway applies to aids granted for transport by rail, road and inland waterway, in so far as such aids relate specifically to activities within that sector.

Article 3 of the Regulation just mentioned above prohibits aid pursuant to Article 77 (now 73) of the EC Treaty, except in the cases of circumstances specified in section 1 of that Article. Article 4, as amended by Regulation 1473/75, provides for a temporary exemption from the prohibition of Article 3.

The Regulation is based on Articles 75, 77 and 94 (now 71, 73 and 90) of the EC Treaty.

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<sup>7</sup> Regulation (EEC) 1107/70 of the Council of 4 June 1970 on the granting of aids for transport by rail, road and inland waterway.

Article 94 (now 90) of the Treaty is referred to in the preamble as the appropriate basis for laying down a special notification procedure. The Regulation can be viewed as both applying Article 77 (now 73) and limiting it to the specific cases and circumstances listed in Article 3 (1).

Regulation 1658/82 supplements Regulation 1107/70 with provisions on combined transport and in 1996, the Council adopted Regulation 2255/96, amending Regulation 1107/70. Under this Regulation, the granting of aid for investments in the infrastructure of river terminals was allowed until the end of 1999.

It should be noticed that there are new developments at the EU level in relation to the legal regime of public service obligations. There is a "new" regulatory proposal as issued July 2000 (COM2000 7 final) that intends to replace Regulation 1191/69 as amended by Regulation 1893/91 (the "draft Regulation Proposal"). Main reasons for the revision is that the "old" Regulation - that considers public transport as exclusively national, regional or local business - no longer is supposed to match with the market developments in Europe where a European market for the provision of public transport service is occurring. According to the draft Regulation Proposal the majority of MS have introduced an element of competition in their legislative and institutional framework for public transport. Therefore the European Commission wants to establish clear and fair rules for competition in public transport across the EU.

At the end it is expected that fair award procedures for public transport contracts do not only ensure fair market conditions but also improve the level of services for public transport. Various EC policy papers show the Commission's concerns on the market position of public transport *vis-a-vis* other modes of transport (especially private car use).

The draft Regulation Proposal contains two key-issues:

- public service requirements (former public service obligations);
- the award procedure for contracts.

## 2.3 Services of General Economic Interest, Public Service Obligations, Compensations and State Aids Rules

Undertakings, which are charged of pursuing services of general economic interest benefit from a most favourable regime taking into account, the dispositions laid down in EC Treaties. In relation to competition issues, Article 86(2) of the Treaty establishes that:

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

With the approval and entering into force of the Amsterdam Treaty, a new Article 16 was added to the EC Treaty, by which services of general economic interest are considered as included amongst the EU's common values:

*"Without prejudice to Articles 73, 86 and 87, and given the place occupied by services of general economic interest in the shared values of the Union, as well as their role in promoting social and territorial cohesion, the Community and the Member States, each within the respective powers and within the scope of application of this Treaty, shall take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions."*

More recently, the access to services of general economic interest was also placed between the fundamental rights of the European Union. Article 36 of the Charter of Fundamental Rights of the EU, solemnly proclaimed the EU Council of Nice, provides:

*"The Union recognises and respects access to services of general economic interest as provided for in national laws and practises in accordance with the Treaty establishing the European Community in order to promote the social and territorial cohesion of the Union".*

The Commission has set out the principles and policies in two communications on "Services of General Interest in Europe" of 1996 and 2000. In its Communication of 1996 the Commission clarified in particular that the provision and development of high-quality services of general interest is fully compatible with the Treaty rules and that the Treaty allows taking full account of the specificities of such services.

As a general rule the Community law leaves it up to the MS as to decide whether they provide public services themselves, directly or indirectly (through other public entities) or whether they entrust their provision to a third party.

It should be noted that many providers of services of general interest receive some form of **public funding** as **compensation** of the public service entrusted to them. Public authorities in the MS, providers of services of general interest, as well as interested third parties therefore need certainty in relation to the application of State Aid rules on such compensations.

In relation to the Community framework, in particular in relation to the qualification of the compensation as aid (or as "State aid" in the sense of the EC Treaty) the financial compensation granted by the State to the provider of a service of general interest constitutes an economic advantage in the sense of Article 87(1) of the Treaty. Referring to the fact that said Article 87(1) does not distinguish between measures of State intervention by reference to their causes or aims but defines them in relation to their effects, the Court of First Instance ("CFI") confirmed that financial advantages granted by public authorities to an undertaking in order to offset the cost of public service obligation classify as aid under Article 87 of the Treaty.<sup>8</sup> Subject to further developments of case-law of the Court, the compensation payments must therefore be subject to the State aid rules if other conditions established in Article 87 of the Treaty are met.

If a compensation is caught by the general prohibition of State aid under Article 87(1) of the Treaty it can still be compatible with EU law. Such compensation can either

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<sup>8</sup> CFI, Judgement of 27 February 1997, *Fédération Française des Sociétés d'Assurances* (FFSA) and Others, Case T-106/95.

qualify for one of the specific exemptions under Article 87 (2) and (3) or 73 in case of inland transport or it may qualify as a derogation under Article 86(2) of the Treaty. The application of Article 73 is specified by secondary legislation, *i.e.* Regulation 1191/69 and Regulation 1107/70 (subject to updating proposals as referred to above).

In relation to Article 86(2), aid granted to a provider of service of general economic interest is in principle compatible with the Treaty if it is necessary for the performance of the respective public service obligation. In its judgement of the FFSA case, the CFI held that:

*“the grant of a State aid may under Article 90(2) of the Treaty escape to the prohibition laid down in Article 92 of the Treaty provided that the sole purpose of the aid in question is to offset the additional costs incurred in performing the particular task assigned to the undertaking entrusted with the operation of a service of general economic interest and that the grant of the aid is necessary in order for that undertaking to be able to perform its public service obligations under the conditions of economic equilibrium”.*

The amount of compensation must in any event be determined on the basis of clear, transparent and non-discriminatory rules. For example the above-mentioned Regulation 1191/69 (in the area of inland transport) provides for an exemption from the obligation to notify compensation base in a formula laid down in advance.

In principle all compensations should be notified. However, there are exceptions to this principle. Taking into account the present legal context there are a few situations that can be pointed out as relevant exceptions. One of those relates precisely with Regulation 1191/69 – as such compensations granted in conformity with the requirements set out in the referred to Regulation concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway are exempted from notification.

Recently the Commission published a “White Paper on Services of General Interest”<sup>9</sup> (the “White Paper”) in which it intends, *inter alia*, to clarify and simplify the legal framework for public service obligations.

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<sup>9</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions, COM(2004) 374 final.

Summarising the development within the EU in relation to services of general interest, the White Paper starts recognising that such services are of crucial importance for the quality of life of European citizens as well as for European undertakings. As such, the White Paper includes the contributions obtained during a public consultation launched after the “Green Paper on Services of General Interest”<sup>10</sup>. The White Paper also reflects the developments laid down by the case law of the ECJ and the CFI (see, *inter alia*, Judgment of 24 July 2003 in the case C-280/00 – ALTMARK TRANS).

The White Paper refers that there are two areas in particular – financing/funding and awarding of contracts – where the MS discretion to define and design the missions of services of general interest normally interacts with Community law.

*a. Financing Issues*

The principle that MS have autonomy in relation to making policy choices regarding the services of general interest equally applies to the financing issues. The financing mechanisms applied by MS include direct financial support through the State budget, special or exclusive rights, tariff averaging, amongst other tools. As a general rule a MS can choose which financing mechanism is used. In the absence of harmonisation in relation to this issue, the main limit to this requirement is that such financing mechanism should not distort competition within the common market.

However, the practical application of this rule is sometimes complex. It has not always been clear under what conditions compensation for services of general economic interest would actually constitute a State aid.

The ECJ has set out a number of conditions under which compensation for services of general economic interest does not constitute a State aid. This happened in the above-mentioned ALTMARK TRANS ECJ’s decision<sup>11</sup>.

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<sup>10</sup> COM(2003) 270, 21.05.2003.

<sup>11</sup> On the interpretation of Article 92 of the EC Treaty (now, after amendment, Article 87 EC), Article 77 of the EC Treaty (now Article 73 EC), and Regulation (EEC) No 1191/69 of the Council of 26 June 1969

By order of 6 April 2000, received at the Court on 14 July 2000, the *Bundesverwaltungsgericht* (Federal Administrative Court) referred to the Court for a preliminary ruling under Article 234 EC a question on the interpretation of Article 92 of the EC Treaty (now, after amendment, Article 87 EC), Article 77 of the EC Treaty (now Article 73 EC), and Regulation (EEC) No 1191/69 of the Council of 26 June 1969 on action by Member States concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway, as amended by Council Regulation (EEC) no. 1893/91 of 20 June 1991.

The question arose in proceedings between ALTMARK TRANS GMBH (ALTMARK TRANS) and *Nahverkehrsgesellschaft Altmark GmbH* (*Nahverkehrsgesellschaft*) concerning the grant to the former by the Magdeburg Regional Government, (the *Regierungspräsidium*) of licences for scheduled bus transport services in the *Landkreis of Stendal* (Germany) and public subsidies for operating those services.

It follows from those judgments that, where a State measure must be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations, so that those undertakings do not enjoy a real financial advantage and the measure thus does not have the effect of putting them in a more favourable competitive position than the undertakings competing with them, such a measure is not caught by Article 92(1) of the Treaty.

However, for such compensation to escape classification as State aid in a particular case, a number of **conditions** must be satisfied.

- **First**, the recipient undertaking must actually have **public service obligations** to discharge, and the obligations must be clearly defined. In the main proceedings, the national court will therefore have to examine whether the public service obligations which were imposed on ALTMARK TRANS are clear from the national legislation and/or the licences at issue in the main proceedings.

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on action by Member States concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway (OJ, English Special Edition 1969 (I), p. 276), as amended by Council Regulation (EEC) No 1893/91 of 20 June 1991 (OJ 1991 L 169, p. 1).

- **Second**, the **parameters** on the basis of which the **compensation** is calculated must be **established in advance in an objective and transparent manner**, to avoid it conferring an economic advantage that may favour the recipient undertaking over competing undertakings.  
Payment by a Member State of compensation for the loss incurred by an undertaking without the parameters of such compensation having been established beforehand, where it turns out after the event that the operation of certain services in connection with the discharge of public service obligations was **not economically viable**, therefore constitutes a financial measure which falls within the concept of State aid within the meaning of Article 92(1) of the Treaty.
- **Third**, the compensation cannot exceed what is necessary to cover all or part of the **costs** incurred in the discharge of **public service obligations**, taking into account the relevant receipts and a reasonable profit for discharging those obligations. Compliance with such a condition is essential to ensure that the recipient undertaking is not given any advantage that distorts or threatens to distort competition by strengthening that undertaking's competitive position.
- **Fourth**, where the undertaking which is to discharge public service obligations, in a specific case, is **not** chosen pursuant to a **public procurement procedure** which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

It follows from the above considerations that, where public subsidies granted to undertakings expressly required to discharge public service obligations in order to compensate for the costs incurred in discharging those obligations comply with the conditions set out above, such subsidies do not fall within Article 92(1) of the Treaty. Conversely, a State measure which does not comply with one or more of those conditions must be regarded as State aid within the meaning of that provision.

It should be noticed that there are other important references in relation to European courts' case law in relation to the matter public service obligation *vs* compensation/State aid. One of such fundamental references is the CFI's decision in the case "DANSK BUSVOGNMAEND" (referring to the regime established by Regulation 1191/69 in relation to the granting to certain public transport services operators of financial compensation)<sup>12</sup>.

One fundamental distinction operated by the referred to case law is the separation between the public service obligations that public authorities must eliminate and the transport services that such public authorities may assure by way of contracts of supply of public service (establishing, however, that public authorities may maintain or impose public service obligations). According to the case law in reference it is only in the latter cases (*i.e.* cases where public service obligations are imposed or maintained) that the compensation mechanisms provided for by Regulation 1191/69 (and maintained by the draft Regulation Proposal referred to above) can be used. The DANSK case establishes a clear distinction between the **contractual regimes** (public service supply contracts normally preceded by a public tender / public awarding procedure/mechanism) and or the **public service obligations**, that can be object of special **compensation** mechanisms pursuant to autonomous and restricted terms.

The DANSK jurisprudence also clarifies that Regulation 1191/69 (as well as the Draft Regulation Proposal) provides for a sector derogation in relation to the general regime relating to the prohibition of State aids. Such derogation results from special mechanisms provided for in certain legal instruments (*maxime* Regulations) and cannot be appreciated by other EU institutions (like the Commission) as they are no State aids in the classical sense. The "aids" (compensation) in question must be limited to the amounts that are exclusively and directly necessary to the compliance of public service obligations as such (and not as subventions aiming at the coverage of the financial losses of the undertakings in question).

Another important distinction resulting from the DANSK jurisprudence relates to possible compensation for additional costs resulting from the compliance with a **special mission** that is assigned to an undertaking charged with the management of a **service of**

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<sup>12</sup> Judgment of the CFI, 17 June 2003, Case C-383/01.

**economical general interest**, when the granting of such aid is necessary for the compliance of such undertaking with the underlying public service obligation(s).

The DANSK BUSVOGNMAEND jurisprudence completes and clarifies previous decisions like the above-mentioned ALTMARK TRANS. In the DANSK case, the CFI considered that the undertaking, which was granted compensation (COMBUS), was not charged with public service obligations. According to the ALTMARK jurisprudence that are certain conditions for a given compensation (granted to an undertaking charged with the provision of a service of general economic interest) not to be considered as a State aid. Such conditions are: (i) first, the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined; (ii) second, the parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner; (iii) third, the compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations; (iv) fourth, 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.

*b. Public Procurement Issues*

The White Paper also refers to public procurement issues, emphasizing the fact that it is necessary to provide a clear and transparent framework for the selection of undertakings entrusted with services of general interest. In order to clarify the applicable rules, the Community has undertaken an effort in order to clarify and to simplify the public procurement directives<sup>13</sup>. Such new directives are due to be transposed by all MS by

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<sup>13</sup> Directive 2004/18 of 31 March 2004 on the coordination of procedures for the award of public works, contracts, public supply contracts and public service contracts and Directive 2004/17 of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal service sectors, OJ L 134, 30.04.2004.

January 2006 and should make it easier for all awarding authorities concerned to comply with their obligations of transparency under the EC Treaty.

The White Paper contains some important definitions in relation to these matters in the borderline between public service obligations and services of general interest as well as services of general economic interest.

As such “services of general interest” cannot, according to the White Paper, be found in the EC Treaty itself. It is the term service of general economic interest that is used in the Treaty. This is a boarder term than services of general economic interest and covers both market and non-market services which the public authorities consider of general interest and subject to specific public service obligations. The term “services of general economic interest” is used in Articles 16 and 86(2) of the Treaty. The term is not defined in the Treaty itself or in secondary legislation. However, it is commonly agreed that the term refers to services of an economic nature that the Community or the MS subject to specific public service obligations by virtue of a general interest criterion. Such services are generally provided by big network industries such as transport, energy and communications. In relation to the notion of “public service”, this is a less precise term. It can have different meanings, referring sometimes to the fact that services are offered to the public in general, and sometimes highlighting that such services have been assigned a specific role in the public interest. In relation to “public service obligations” such term is used in the White Paper and it refers to some specific requirements that are imposed by public authorities on the provider of a deemed service. These obligations intend to ensure that certain public interest objectives are met. These obligations can be applied at Community, national or regional level.

### **3. Recent Development and Future Trends in the Portuguese Transport Sector Legal Framework**

#### **3.1 The Metropolitan Transport Authorities**

Recently a legislative reform has begun. The Portuguese Government created two Transport Authorities in Lisbon and in Oporto (the Metropolitan Transport Authorities -

*Autoridades Metropolitanas de Transportes*, "AMTs") and is preparing the development of the LBTT that will regulate the land transport of passengers in the Great Metropolitan Areas of Lisbon and Oporto.

The AMTs were created by Decree-law no. 268/2003, of 28 October (modified by Decree-Law no. 232/2004, of 13 December).

This Decree-Law established that the Metropolitan Transport Authorities of Lisbon and Oporto are public business entities (*entidades públicas empresariais*), which are autonomous as regards its administration, finances and property.

The AMTs are subject to the management of the Ministry of Public Works, Transports and Communications and the Local Authorities of the respective metropolitan areas and to the powers of guardianship both of this Ministry and of the Ministry of Finance and Public Administration, pursuant to Decree-Law no. 558/99, of 17 December.

The AMTs are established for an undetermined period of time and pursue objectives of public interest regarding the management, planning, exploration and development of the transport system in Lisbon and Oporto Metropolitan Areas, jointly with the urban development and physical planning.

We must point out that the AMTs as regards planning must propose and execute the guidelines of the transports policy for the Metropolitan Areas in order to favour the mobility of public transport.

As regards, the organization of the market, the AMTs must evaluate the efficiency and quality of the public transport services and supervise the respect for the laws and regulations applicable to their attributions, as well as the execution of contracts, concessions or authorizations, and programmes of exploration.

The AMTs must also execute contracts, and allow the exploration of the transport services.

In what concerns the financing of each system of Metropolitan transports it is made through funds of tariff revenues or others established in the system, by the budgets of local government units, by the State Budget, and by specific rates that may be introduced.

A last note to mention that all entities operating in providing services of transport and manage infrastructures must cooperate in all that may be required by the AMTs so that these entities can fulfil their functions.

## 3.2 The new Legal Framework for Public Service Obligations within the Transport Sector in Portugal

Considering the above-mentioned necessity of changes within the Portuguese Transport Sector (*inter alia* in relation to the respective compliance with the European Community legal framework) the Portuguese Government is preparing the development of the LBTT that will regulate the land transport of passengers in the Great Metropolitan Areas of Lisbon and Oporto. This new law (still a draft proposal at the moment) takes into account the guidelines on such matters under the terms of the above-mentioned EC Regulations.

The Government wants to define a new policy of public service to improve competition and to establish a new regulatory framework that requires formal contracts/agreements between the newly created transport authorities (the AMTs) and transport operators. Such contracts must, according to such new legal framework be preceded by public tenders.

The creation of the AMTs was a significant step for the restructuring of the Transport and Mobility Systems in Portugal. Following this process of restructuring and reorganization of the Transport System, the above-mentioned draft legislative proposal intends to establish the Regime for the Public Service of Transport of Passengers in the Great Metropolitan Areas of Lisbon and Oporto.

This draft Proposal of law intends to take into account and comply with the Community guidelines and legislation, namely in issues relating to the granting of **fair compensation payments** (*indemnizações compensatórias*) to the transport operators pursuant to Regulations 1191/69/EEC (modified by Regulation 1893/91/EEC), 1192/69/EEC and 1107/70/EEC.

This draft Proposal of law also intends to establish a regime for the organization of the system of public transport of passengers in the Metropolitan Areas of Lisbon and Oporto, through the definition of **public service obligations**. The AMTs must set out the routings, the frequency and the tariffs of transport.

The system of public transport of passengers in the Great Metropolitan Areas is a **service of general interest**, organized by the AMTs, in compliance with the principles of integration, universality and continuation of the services rendered, as well as to the social and economic cohesion and to the consumers' protection. Considering its competences, the AMTs may establish **obligations of public service** by an agreement (contract) or unilaterally.

According to the draft Proposal of law, the service of public transport of passengers is dependent of a previous licensing by the competent bodies within the AMTs. However, the services of transport that are explored by the Municipalities do not need to be licensed by the AMTs. These licenses can be issued only for a maximum period of 5 years.

The **obligations of public service** must be created preferably by a **contract**, where it is determined the duties and the rights of the transport operators. The contracts in question may be **concessions of public services** or **contracts for the provision of services**.

The rendering of the public service of transports is done by the operator's through adequate contractual mechanisms, but the Transport Authorities have the possibility to impose public service obligations whenever it may be necessary. Such public service obligations may be subject to compensation mechanisms, pursuant to the regime established by Regulation 1191/69/EEC, as referred to above.

Other compensation payments to be made to the operators are determined by Regulations 1192/69/EEC and 1107/70/EEC. Different compensation payments or aids of public entities to transport companies that may be different from the ones established in the draft Proposal of law or in the Community Regulations are null and forbidden.

A last note to mention that this new proposed legal diploma aims to create harmonization between national and Community provisions regarding the Transport Sector, in particular in relation to establishing a clear framework in relation to State-granted compensations to transport operators, as well as a clear definition of public service obligations within the provision of transport services.

## 4. Conclusion

The Portuguese Transport System (Land Transport of Passengers) legal framework tends to be confused, unclear, sometimes not complying with relevant EU secondary legislation and recent developments in the European Courts decisions. The need for a reform is clear.

Recently two important steps were taken towards such legislative and institutional reform: the Metropolitan Transport Authorities (announced in the 1990 LBTT) were created (the AMTs) and a development/regulation of the LBTT is being prepared as the "Public Service Regime of Passengers Land Transport in the Great Metropolitan Areas of Lisbon and Oporto".

Competitiveness, regulation, transparency and non-discrimination are being improved. A revolution is under way by legislative reform.