

## THE FRAMEWORK OF NATIONAL PRICE REGULATION IN THE EUROPEAN UNION, WITH SPECIAL EMPHASIS ON LIBERALIZED MARKETS\*

The paper analyses the requirements erected by EU competition rules, free movement (internal market) law and market liberalization rules against national price regulation. The paper summarizes the main EU law requirements against national price regulation in liberalized markets and assesses, from a critical perspective, the ECJ's jurisprudence.

### EU COMPETITION RULES AND NATIONAL PRICE REGULATION – REGULATED PRICES AS RESTRICTIONS OF FREE COMPETITION

EU competition rules surprisingly do not contain provision on national price regulation. EU competition law does not interdict national rules distorting competition in the market, these are, in general and in themselves, not prohibited; EU law only contains specific bans in this regard. EU law prohibits only particular distorting measures but contains no general prohibition.

EU law contains specific regimes on state action: state aid law, sectoral regulation (market liberalization), as well as a certain immunity for services of general economic interest (*Nagy* [2010] pp. 32–34); from these, sectoral regulation will be addressed in detail. The concept of services of general economic interest (as embedded in Article 106 TFEU) provides an exception (immunity) to an existing legal obligation. The applicability of state aid rules (Articles 107–109 TFEU) may be considered as a theoretical possibility with respect to national price regulation. However, the ECJ established, very early, in *van Tiggele*<sup>1</sup> that state aid rules do not apply to national price regulation, taking into account that the benefit is not conferred by the Member State, and cannot be traced back to public resources.

Article 107(1) TFEU prohibits “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal

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<sup>1</sup> Case 82/77 *van Tiggele* (1978) ECR 25.

market.” Accordingly, a subsidy may qualify as illegal if it is “granted by a Member State or through State resources”.

In *van Tiggele*, the ECJ held that national price regulation cannot qualify as a state aid as the benefit accruing from the regulated prices is not related (directly or indirectly) to the state budget (paras 24–25). The price floor established for distilled spirits in the Netherlands, in essence, protected traders to the cost of consumers. It could be argued that if, in the absence of regulated prices, the distilled spirits had been sold at a lower price, the regulated prices conferred a monetary benefit on traders in value of the difference between the minimum price and the market price (provided, of course, that the former would have been higher than the latter).

The ECJ established that it does not qualify as a benefit “granted by a Member State or through State resources”, if a Member State sets out minimum retail prices to the detriment of the consumers. Although in *van Tiggele* the ECJ dealt with minimum prices protecting traders, the ruling may be, *mutatis mutandis*, applicable also to price caps protecting purchasers as the benefit is (similarly) not “granted by a Member State or through State resources”.

The backbone of EU competition rules comprises of provisions applicable to enterprises. These, in themselves, should not be applicable to Member States, since their addressees are undertakings (save the state or a public entity engages in market conduct). This proposition has to be confined. Notably, if reading competition rules governing market conduct in conjunction with the loyalty clause encapsulated in Article 4(3) TEU<sup>2</sup> and the attached jurisprudence of the ECJ, it can be established that these antitrust rules, through the intermediation of the loyalty clause, do erect requirements against national governments.

On the basis of the loyalty clause, Member States must refrain from adopting or maintaining measures that may make the competition rules (applicable to undertakings) ineffective. It goes counter to this principle, if a Member State prescribes or supports acts that fall foul of EU competition law or reinforces the effects of these, or deprives its own law of its official character through conferring rule-making or legislative power on market operators. A Member State may not force or encourage (assist) an enterprise to violate EU competition rules (*Nagy* [2008] pp. 25–26). Thus, Articles 101–102 TFEU, indirectly though, do establish limits as to state action.

The ECJ condemned numerous Member States for being disloyal, because they encouraged or backed undertakings to conclude agreements restricting competition or reinforced the effects of such agreements or they compelled dominant undertak-

<sup>2</sup> “Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties. The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union’s tasks and refrain from any measure which could jeopardise the attainment of the Union’s objectives.”

ings to abuse their dominant position.<sup>3</sup> It has to be stressed, however, that the ECJ, in *Cullet v Centre Leclerc*, established very early that national price regulation, in itself, does not breach Article 101 TFEU applied in conjunction with the loyalty clause (para 18). Furthermore, Article 106 TFEU establishes an exception to this indirect duty in respect of services of general economic interest. Undertakings providing such services “shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them.”

In *Höfner v Macrotron*,<sup>4</sup> Macrotron hired two employment agents to find a suitable sales manager. However, Macrotron did not engage the person selected by the agents and, as a consequence, refused to pay agents’ fee (paras 2 & 11). At the relevant time, according to German law, employment intermediation came under the exclusive competence of the federal employment office (paras 3–6). Notwithstanding this regulation, numerous enterprises operated in this market, providing consultancy and agency services concerning the recruitment of corporate executives and managers. Though the federal employment office tolerated this ‘grey market’, these agency contracts were invalid as they violated the federal employment office’s legal monopoly and, thus, German law. This should also have been the fate of the above agreements (paras 8–10).

The ECJ, after establishing that the federal employment office was an undertaking as it pursued market activities, examined whether Germany breached the loyalty clause through conferring a legal monopoly on the federal employment office. It established that national law is incompatible with EU law, if it creates a plight where the enterprise cannot avoid violating Article 102 TFEU. The mere fact that a Member State creates a dominant position i.e. it confers a legal monopoly on an enterprise, does not fall foul of Article 102 TFEU, unless the enterprise is under the necessity of abusing its dominance. According to Article 102(b) TFEU, the limitation of production, markets or technical development qualifies as an abuse if it occurs to the prejudice of consumers. The ECJ established that Germany pushed the federal employment office, which qualified as an undertaking from the perspective of competition rules, into violating of Article 102(b) TFEU. Germany conferred a legal monopoly on the office but the latter was not capable of satisfying the demand, while market operators were, due to the legal prohibition, prevented from providing the service concerned (paras 27 and 29–31). The same reasoning was used, in essence, by the Court in *Job Centre II*.<sup>5</sup>

<sup>3</sup> The ECJ pronounced this principle very early, in Case *G.B.-INNO-B.M.* See Case 13/77 *NV GB-INNO-BM* (1977) ECR 2115. As to judicial practice see *Nagy* [2008] 110–131.

<sup>4</sup> Case C-41/90 *Klaus Höfner and Fritz Elser v Macrotron GmbH* (1991) ECR I-1979.

<sup>5</sup> Case C-55/96 *Job Centre coop. arl* (1997) ECR I-7119, paras 29–35.

In *Ambulanz Glöckner*,<sup>6</sup> the ECJ condemned Germany for forcing and encouraging an undertaking to reserve an ancillary market through preventing market entry. According to German law, patient transport services (both emergency and non-emergency) came under the responsibility of the *Länder*, the administrative districts of each region (*Land*) and municipalities, which, however, could provide these public services through licensed non-profit medical aid organizations (*Sanitätsorganisationen*). These organizations were supervised by the *Länder* and the administrative districts, which gave directions and bore the costs (para 4). According to the rules, other organizations could also be authorized in addition to the medical aid organizations. As a matter of practice, this could take place only if the medical aid organizations' capacities were fully utilized and accordingly, this statutory requirement created a *de facto* monopoly position (paras 6–8).

The dispute emerged after the license of *Ambulanz Glöckner* was not prolonged because the local medical aid organizations had surplus capacities and were making losses (para 13).<sup>7</sup>

The ECJ reiterated the holding of *Höfner v Macrotron*. Although a dominant position conferred by national special or exclusive rights is, in itself, not incompatible with EU competition rules, a Member State violates these rules, if the exercise of these special or exclusive rights incites the enterprise to abuse its dominant position or creates a situation like this (para 39). It qualifies as an abuse, if a dominant undertaking, without any objective reason, reserves for itself an ancillary activity. It may infringe competition rules, if the extension of the dominance of an undertaking disposing of special or exclusive rights is the result of a state measure (para 40). This is the case, if there is a sufficiently high probability that taking into account the economic characteristics of the market in question, this prevents enterprises from other Member States from providing ambulance transportation services or from establishing themselves there (operative part of the judgment). Such conduct is regarded as a restriction under Article 102(b) TFEU (para 43).

These cases may provide guidance as to price regulation although they only dealt with the creation of a legal monopoly. Price controls are acts of public authority and, as such, immune from the competition rules enshrined in Articles 101 and 102 TFEU (which apply to undertakings). However, the Member State infringes the principle of loyalty if national price regulation compels firms to breach EU competition law, by way of example through abusing their dominant position. Though regulated prices

<sup>6</sup> Case C-475/99 *Firma Ambulanz Glöckner v Landkreis Südwestpfalz* (2001) ECR I-8089.

<sup>7</sup> The earlier regulation permitted the involvement of for-profit organizations as regards non-emergency patient transportation services, and *Ambulanz Glöckner* was authorized to provide such services. Subsequently, the relevant rules were amended and both emergency and non-emergency services were brought under the scope of the same regulatory regime, which initially applied to emergency patient transportation services.

do not bring about special or exclusive rights, by way of example, excessively low prices, in extreme cases, may result in the restriction of output or the deterioration of quality or may lead to sales at loss.

In summary, EU competition rules (aside from the rules on market liberalization, which will be addressed below) do not contain substantial limits as to national price regulation. Regulated prices are not regarded as state aid as they cannot be traced back to budgetary resources. Theoretically regulated prices may compel an enterprise to violate EU competition rules (e.g. restriction of output, sales below costs) but this scenario may occur only in extreme cases.

#### NATIONAL PRICE REGULATION AND THE LAW OF THE INTERNAL MARKET: REGULATED PRICES AS BARRIERS TO FREE MOVEMENT

EU law interdicts national customs duties and measures having equivalent effect and creates a customs union (Articles 28–31 TFEU). Likewise, EU law prohibits quantitative restrictions and measures having equivalent effects to quantitative restrictions (Articles 34–35 TFEU), though Member States may adopt such measures with reference to local legitimate ends (Article 36 TFEU).

The jurisprudence of the ECJ defines measures having equivalent effects to quantitative restrictions (MEQR) extremely widely. The judicial practice distinguishes between product-bound measures and state acts regulating selling arrangements. The former relate to the physical composition and appearance of the product (such as content, packaging), while the latter refer to the way products are marketed (e.g. Sunday trading rules, licensing requirements).

The treatment of product-bound measures is very strict and was established in *Dassonville*, even non-discriminatory measures are prohibited, if they restrict market access: “[a]ll trading rules enacted by member states which are capable of hindering, directly or indirectly, actually or potentially, intra-community trade are to be considered as measures having an effect equivalent to quantitative restrictions.”<sup>8</sup>

This extremely wide, all-embracing notion was confined in *Keck et Mithouard*<sup>9</sup> (which emerged from the French rules prohibiting sales at loss), where the ECJ introduced the concept of ‘selling arrangements’, holding that, as opposed to product-bound measures, rules on selling arrangements are considered to be measures having equivalent effects to quantitative restrictions only if they are, in law or in effect, discriminatory.

<sup>8</sup> Case 8/74 *Procureur du Roi v Benoît and Gustave Dassonville* (1975) ECR 837, para 5.

<sup>9</sup> Joined Case C-267 and 268/91 *Keck and Mithouard* (1993) ECR I-6097.

- ♦“the application to products from other Member States of national provisions restricting or prohibiting certain selling arrangements is not such as to hinder directly or indirectly, actually or potentially, trade between Member States within the meaning of the *Dassonville* judgment (...), so long as those provisions apply to all relevant traders operating within the national territory and so long as they affect in the same manner, in law and in fact, the marketing of domestic products and of those from other Member States.” (Para 16.)

Member States may maintain restrictions with reference to local legitimate ends under two doctrines. In *Cassis de Dijon*,<sup>10</sup> the ECJ created an exception within the concept of MEQR, holding that non-discriminatory measures justified by the local public interest are not MEQR.

- ♦“Obstacles to movement within the community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognized as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer.” (Para 8.)

Second, Article 36 TFEU contains a statutory exception to the prohibition of MEQR.

- ♦“The provisions of Articles 34 and 35 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.”

One of the major differences between the doctrine of mandatory requirements and Article 36 TFEU is that the former only applies to indistinctly applicable (i.e non-discriminatory) measures, while under Article 36 TFEU even discriminatory measures can be justified. Furthermore, under *Cassis de Dijon*, any local legitimate end may justify a restriction while Article 36 TFEU enumerates the public interest goals that may be used for this purpose.

Accordingly, national price regulation qualifies, in principle, as a measure on selling arrangements and is, hence, prohibited if (directly or indirectly; actually

<sup>10</sup> Case 120/78 *Rewe-Zentral AG and Bundesmonopolverwaltung Für Branntwein (Cassis de Dijon)* (1979) ECR 649.

or potentially) restricts inter-state trade and is (in law or in effect) discriminative. In short, national price regulation entails concerns under the law of the internal market, if it thwarts the market access of foreign products or enterprises and fails to comply with the requirement of equal treatment. As a matter of terminology, it has to be noted that the ECJ's judgment in *Keck et Mithouard*, where the distinction between product-bound measures and rules on selling arrangements was established, was rendered on 24 November 1993 and beforehand, the ECJ used the *Dassonville* formula.

In *Tasca*,<sup>11</sup> Italy set a cap on the consumer prices of certain sugar varieties. The ECJ held that this, in itself, did not qualify as a MEQR. However, it might have had such an effect if the price-cap made the sale of foreign products more difficult or impossible. This is the case if the maximum price is so low that it makes the sale of import products unprofitable (para 13). This proposition was endorsed in *SADAM*<sup>12</sup> and *GB-Inno-BM*.<sup>13</sup>

In *van Tiggele*,<sup>14</sup> the ECJ dealt with price floors. The Netherlands established minimum prices for distilled spirits. The ECJ considered that while price regulation normally does not go counter to free movement, in certain cases it may.

- ♦ “[I]mports may be impeded in particular when a national authority fixes prices or profit margins at such a level that imported products are placed at a disadvantage in relation to identical domestic products either because they cannot profitably be marketed in the conditions laid down or because the competitive advantage conferred by lower cost prices is cancelled out.” (Para 14.)

The prohibition of sale at loss places equal burdens on imported and domestic products and thus may not qualify as a MEQR (para 16.).

If a Member State sets a maximum margin as a particular amount (and not as a price-cost ratio), it may entail no detrimental effects as to the potentially cheaper import products, as in the case at stake where the retail margin made up only a relatively insignificant part of the final retail price (para 17.).

Contrary to the above, the setting of a price floor as a particular amount, which applies indistinctly both to imported and domestic products, may have a negative impact on the former, “in so far as it prevents their lower cost price from being reflected in the retail selling price” (para 18).

If different price-setting methods are used as to imported and domestic products, this may qualify as a MEQR. In *Roussel Laboratoria*<sup>15</sup> the ECJ established that it is

<sup>11</sup> Case 65/76 *Tasca* (1976) ECR 291.

<sup>12</sup> Joined Cases 88–90/75 *SADAM* (1976) ECR 323, para 15.

<sup>13</sup> Case 13/77 *NV GB-INNO-BM* (1977) ECR 2115, para 52.

<sup>14</sup> Case 82/77 *van Tiggele* (1978) ECR 25.

<sup>15</sup> Case 181/82 *Roussel Laboratoria* (1983) ECR 3849.

contrary to Article 34 TFEU if a Member State fixes prices of import products on the basis of the price charged by the producer of the pharmaceutical products in the country of origin, while the price is frozen for domestic products on the level at a given reference date (para 25).

In *Cullet v Centre Leclerc*,<sup>16</sup> French law established minimum retail prices for fuels exclusively with reference to the prices of French refineries. The latter were covered by a price limit although this was, in principle, set in accord with European prices, if the latter were more than 8% higher or lower than these prices, the price limit was determined by the cost prices of the French refineries. As a matter of practice, French refineries sold at the highest prices permitted by the law (para 5). The ECJ found that this price-setting methodology is adverse to foreign products as it deprives them of the competitive advantage they may enjoy due to their potentially lower prices (para 29).

In *Roelstraete*,<sup>17</sup> Belgian law regulated the retail margin of meat. It was determined, as a fixed sum, the margin a butcher could include in the price per kilogram. Retail prices consisted of the average weighted purchase price calculated on the basis of the receipts of the preceding four weeks, the maximum gross profit margin (determined as a fixed sum) and the value-added tax (para 2).

The ECJ considered that the Belgian legislation, through fixing the sum of the margin applicable to both domestic and imported products, discouraged traders from importing meat from other Member States. Traders had to cover the import expenses from this margin, that is, the extra costs attached to importation decreased the profitability of import products in comparison to domestic products (paras 21–22). The same line of interpretation was followed by the Court in *Lefèvre*,<sup>18</sup> as to a similar French regime (para 13).

In *Vocarex*,<sup>19</sup> Belgian law prohibited sales at a low margin (sales at loss were prohibited and excessively low margins were considered to be sales at loss) (para 3). The ECJ found that this price regulation was not a MEQR.

In summary, national price regulation violates the rules of the internal market (free movement), if it distinctively restricts the entry of foreign products into the market of another Member State. Accordingly, a price cap is incompatible with the internal market, if it prevents or thwarts the importation of more expensive foreign products (which may be more expensive due to the importation costs). A price floor is counter to the law of the internal market if it restricts the importation of foreign products through depriving them of their competitive advantage consisting in lower prices. The prohibition of sale at loss (or at a negligible margin), in principle, does not infringe the law of the internal market.

<sup>16</sup> Case 231/83 *Cullet v Centre Leclerc* (1985) ECR 305.

<sup>17</sup> Case 116/84 *Henri Roelstraete* (1985) ECR 1705.

<sup>18</sup> Case 188/86 *Lefèvre* (1987) ECR 2963.

<sup>19</sup> Case C-63/94 *Vocarex* (1995) ECR I-2467.

The ECJ's jurisprudence on retail minimum prices can be criticized on the ground that price floors do not make traders disinterested in purchasing cheaper foreign products. From an economic perspective, retail price floors do not make the trader interested in purchasing and reselling the more expensive local products. Instead, the trader's interest is to keep on purchasing the cheaper foreign merchandise and to resell it at a higher margin. Though the minimum price is secured by the law, the trader will try to cut input costs to a minimum to maximize his profit. The trader is obviously not interested in sharing the guaranteed margin with domestic producers through purchasing the more expensive local brand. However, the ECJ's concerns are valid from a consumer perspective. The Court very probably had in mind the situation where both the foreign and the domestic product is on the shelves of the local convenience store and the final consumer has to choose one. If they are of the same or similar price, the consumer would very likely opt for the local (well-known) brand as opposed to the plight where the price of the imported product is significantly lower than that of the domestic merchandise. In this case, the lower price may be a reason to overcome the loyalty to the local brand.

#### MARKET LIBERALIZATION RULES AND PRICE REGULATION: REGULATED PRICE AS THE HINDRANCES TO MARKET OPENING

The ECJ's jurisprudence (in particular *Federutility* and *Enel*)<sup>20</sup> suggests that in industries covered by market liberalization regimes (electronic communications, electricity, natural gas, railway, postal services), Member States may not introduce or maintain price regulation, unless they are specifically authorized or obliged. Although these regimes permit states to adopt and maintain such regulatory measures with reference to public services, this price-control is confined both in terms of scope and time.

#### Natural gas

Directive 2009/73/EC governing the internal natural gas market treats network services (access to the network) as natural monopoly and, accordingly, subjects them to regulated prices which are to be set by the national regulatory authority. On the contrary, the energy product itself is not subject to price control, the production and trade of natural gas are regarded as activities prone to competition. The only provision that, in respect of the latter, makes mention, in the context of public services, of regulated prices is Article 3(2) of the Directive. The Directive on internal natural gas market (in line with its predecessor, Directive 2003/55/EC) does not pronounce

<sup>20</sup> Case C-242/10 *Enel*.

natural gas to be universal service which is very probably due to the circumstance that the majority of European consumers do not use it (see *Cremer et al.* [1998] p. 7.). Nonetheless, the Directive establishes public service obligations in Article 3(2) and consumer protection requirements in Article 3(3). These provisions enable Member States to introduce universal service also in respect of natural gas, albeit the national playing field was confined by the ECJ in *Federutility*.<sup>21</sup>

In this case, Italy set regulated prices on the basis of reference prices, justified by the absence of workable competition and the interests of final consumers. The ECJ established that this can be maintained only under certain conditions although Member States may regulate retail prices after the opening of the market (that is, 1 July 2007) (paras 17–24).

The ECJ examined the legality of price regulation by investigating whether the liberalization of the market implies the exclusion of regulated prices. Namely, the Directive on the internal natural gas market contains no specific prohibition on price regulation. The ECJ also considered whether the purpose of assuring public services may justify the exceptional regulation of prices (in case the first question is answered in the affirmative). It is to be noted (again) that the Directive on the internal natural gas market does not contain the concept of universal service (contrary to the Directive on the internal electricity market), hence, natural gas universal service has no independent legal basis and can be deduced only from the Directive's provision on public services and the doctrine of services of general economic interest (as included in the TFEU).

Directive 2009/73/EC provides for the regulation for certain tariffs (e.g. network fees) and apart from these, it contains no express provision as regards national price controls. It neither allows nor prohibits regulated prices. The ECJ, however, deduced this prohibition from the Directive's purpose (market liberalization and the competitive natural gas market – para 19) and the consumers' right to freely choose the service provider.<sup>22</sup>

- ♦“Although it is not explicitly stated in that provision [Article 23(1)(c) of Directive 2003/55], or indeed in any other provisions of that directive, that the price for the supply of natural gas must, as from 1 July 2007, be determined solely by the operation of supply and demand, that requirement follows from the very purpose and the general scheme of that directive, which, as its 3rd, 4th and 18th recitals state, is designed progressively to achieve a total liberalisation of the market for national gas in the context of which, in particular, all suppliers may freely deliver their products to all consumers.” (Para 18.)

<sup>21</sup> Although in this case the ECJ interpreted the previous natural gas directive, there is no difference between the two directives as to the provisions concerned. For the sake of simplicity, if possible, the references in this paper are made to Directive 2009/73/EC, although the ECJ's judgment refers to Directive 2003/55/EC.

<sup>22</sup> Articles 2 and 23 of Directive 2003/55/EC and para 17 of the judgment.

Afterwards, the ECJ addressed the Directive's provision on public service<sup>23</sup> to ascertain the conditions of derogating from the above general prohibition. It held that "it follows from the wording of Article 3(2) that measures adopted on the basis thereof must be adopted in the general economic interest, be clearly defined, transparent, non discriminatory and verifiable, and guarantee equality of access for EU gas companies to national consumers" (para 22). Member States have no automatic right to regulate prices with reference to public services and this can be done only in case of necessity and the regulatory intervention has to be restricted both in terms of scope and time. Article 3(2) of the Directive permits state intervention only by reason of general economic interest and makes an express reference to TFEU 106.

Member States have a very wide margin of appreciation as to the definition of the general economic interest, and local peculiarities and policy considerations may legitimately gain ground in the frame of this. "In that context, Member States are entitled, while complying with the law of the Union, to define the scope and the organisation of their services in the general economic interest"; "[i]n particular, they may take account of objectives pertaining to their national policy". (Para 29.) EU law follows a minimalist approach as to the definition of services of general economic interest, "requirements concerning the public service must be capable of being interpreted, subject to the observance of the law of the Union, 'on a national basis,' and 'taking into account national circumstances.'" (Para 30.)

- ♦ "It follows from the above that Directive 2003/55 allows Member States to assess whether, in the general economic interest, after 1 July 2007, it is necessary to impose on undertakings operating in the gas sector public service obligations in order, in particular, to ensure that the price of the supply of natural gas to final consumers is maintained at a reasonable level having regard to the reconciliation which Member States must make, taking account of the situation in the natural gas sector, between the objective of liberalisation and that of the necessary protection of final consumers pursued, as mentioned in paragraphs 18 and 20 of this judgment, by the Union legislature." (Para 32.)

It is to be noted that though Member States have, indeed, a wide give as to the definition of services of general economic interest, the ECJ's judgment implies that the power to regulate prices is not automatic, can be exercised only in case regulatory intervention is justified and, if they do, they have to set out their reasons, in particular because under Article 3(11) of the Directive on the internal natural gas market Member States are obliged to inform the Commission about all measures adopted for the provision of public services and about their potential impact on domestic and international competition.

<sup>23</sup> Article 3(2) of Directive 2003/55/EC.

In the case at stake, the ECJ considered the protection of final users against the market power of service providers to be a legitimate general economic interest and sanctioned the endeavor to pursue “a general economic interest consisting in maintaining the price of the supply of natural gas to final consumers at a reasonable level having regard to the reconciliation which Member States must make, taking account of the situation in the natural gas sector, between the objective of liberalisation and that of the necessary protection of final consumers pursued by [the] Directive.”<sup>24</sup>

Regulatory intervention, taking the form of price regulation, shall be proportionate. It follows from the requirement of proportionality that its ambit has to be limited to the domain where it is necessary (material scope); may be maintained only for a limited period of time (temporal scope) and may cover only users who truly need protection (personal scope). Public service obligations set out by the Member State “may compromise the freedom to determine the price for the supply of natural gas only in so far as is necessary to achieve the objective in the general economic interest which they pursue and, consequently, for a period that is necessarily limited in time.” (Para 33.)

- ◆ “First, such an intervention must be limited in duration to what is strictly necessary in order to achieve its objective, in order, in particular, not to render permanent a measure which, by its very nature, constitutes an obstacle to the realisation of an operational internal market in gas. (...)” (Para 35.)

“Secondly, the method of intervention used must not go beyond what is necessary to achieve the objective which is being pursued in the general economic interest.” (Para 36.)

“If, following those verifications, it were to be shown that such an intervention is capable of being justified in that way, the requirement of proportionality would imply in particular that it be limited in principle to the price component directly influenced upwards by those specific circumstances” (Para 38.)

“Thirdly, the requirement of proportionality must also be assessed with regard to the scope *ratione personae* of the measure, and, more particularly, its beneficiaries.” (Para 39.)

In the context of limits in terms of time, the ECJ highlighted that a mere reference to the national legislation’s provisory nature is not sufficient.

- ◆ “[T]he referring court should examine whether and to what extent the relevant national law requires the administration to make a periodic re-examination, at close intervals, of the need for it to intervene in the gas sector and the manner of its doing so, having regard to the development of that sector.” (Para 35.)

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<sup>24</sup> Operative part of the judgment.

The ECJ made a very important remark regarding the possible beneficiaries of price regulation. While the Court recognized enterprises as well as consumers may benefit from the regulatory intervention, it also stated that the public service obligations, in principle, do not fulfil the requirement of proportionality. On the other hand, not only vulnerable but all consumers may be sheltered through price regulation.

- ♦“In that regard, it should be emphasised that that requirement does not prevent ‘reference prices’ for the supply of natural gas, such as those at issue in the main proceedings, from being applied to all customers whose consumption of natural gas is above a certain threshold rather than being limited to the circle of those, expressly referred to in Article 3(3) of Directive 2003/55, who must necessarily be protected on account of their vulnerability.’ (Para 40.)

“If, as some of the applicants in the main proceedings maintain before the Court, the definition of ‘reference prices’ for the supply of natural gas, such as those at issue in the main proceedings, applies also to undertakings irrespective of their size, which it is for the referring court to verify, it should be noted that Directive 2003/55 does not in principle exclude the possibility that the latter may also benefit, as final consumers of gas, from the public service obligations which Member States may adopt in the context of Article 3(2) of that directive. The 26th recital of that directive states in particular that measures taken by the Member States to protect final consumers may differ according to whether they are addressed to households or to small- and medium-sized undertakings.” (Para 41.)

“ In that case, however, it would be necessary to take account, in assessing the proportionality of the national measure in question, of the fact that the situation of undertakings is different from that of domestic consumers, the objectives pursued and the interests present being not necessarily the same and also of objective differences between the undertakings themselves, according to their size.” (Para 42.)

- ♦“In those circumstances, apart from the specific case, referred to at the hearing, of management companies of apartment blocks, the requirement of proportionality referred to above would not, in principle, be complied with if the definition of ‘reference prices’ for the supply of natural gas, such as those at issue in the main proceedings, were to benefit individuals and undertakings in an identical manner, in their capacity as final consumers of gas.” (Para 43.)

The public service obligations have to be clearly defined, transparent, non-discriminatory and verifiable, and shall guarantee equal access for European gas companies to consumers (para 44). In respect of equal treatment, it has to be inquired

- ♦ “...whether, having regard to the whole of the measures which may have been taken in that area by the Member State concerned, the definition of ‘reference prices’ for the supply of natural gas, such as those at issue in the main proceedings, which applies in an identical manner to all undertakings supplying natural gas, must nevertheless be regarded as discriminatory.” (Para 45.)

It would be so if such intervention were to lead in reality to imposing the financial burden arising “from the intervention mainly on some of those undertakings, in this case those not also carrying on the business of producing/importing natural gas.” (Para 46.)

It has to be noted that in *Federutility*, the ECJ faced a general, industry-wide price regulation, which covered one subgroup of market operators. However, this does not qualify as *strictu sensu* universal service price regulation where the Member State appoints a universal service provider (supplier of last resort, default supplier, public service operator etc.) whose prices are fixed.

Para 33 of the ECJ’s judgment refers to “the freedom to determine the price for the supply of natural gas” and makes no mention of cases where a Member State ensures the availability of natural gas at a given price through appointing a universal service provider. It is dubious whether the holding of *Federutility* encompasses only general industry-wide price regulation or it extends also to prices secured through a universal service provider. This is a pivotal question: although natural gas is not considered to be an EU universal service, quite a few Member States characterize it as such. In Hungary, Act XL of 2008 on the supply of natural gas, in Section 34(1), repeats the corresponding provisions of electricity universal service, with the difference that in the natural gas sector universal services extends only to those users who are already connected to the infrastructure. In Spain, natural gas equally qualifies as universal service and reasonable prices are secured. Spain terminated the regulation of retail prices and provides cost-based prices to small consumers in the form of supplier of last resort prices (*IEA* [2009] p. 64 and p. 70, *CNE* [2010] pp. 12–13, *CNE* [2011] pp. 124–126).

Finally, it is to be noted that this Italian regime survived, with strings attached, the ECJ’s preliminary ruling procedure and remained in force (*Cavasola–Ciminelli* [2012] 114.).

### Electricity market

The regulatory and statutory pattern of Directive 2009/72/EC on the internal electricity market is, in essence, in line with the Directive on the internal natural gas market, with the significant difference that electricity is considered to be an EU universal service. Accordingly, the Directive on the internal electricity market treats network services (access to the network) as a natural monopoly and subjects them

to regulated prices, which are to be set by the national regulatory authority, while the energy product itself is not subject to price control. The production and trade of electricity are regarded as activities prone to competition. The possibility of price regulation is mentioned both in the provision on public services, in Article 3(2), and in the provision on universal service, in Article 3(3); the latter embraces “the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable, transparent and nondiscriminatory prices.” The institution of universal service enshrined in Article 3(3) implies the automatic right and duty of Member States to intervene (contrary to public service obligations embedded in Article 3(2) which tie regulatory intervention to conditions). The legal basis of the regulatory intervention is given, though the method and extent – notwithstanding the wide margin of appreciation of Member States – is subject to EU law restraints.

Due to this conceptual difference, the ECJ’s jurisprudence on natural gas can be extrapolated to the electricity market only outside the ambit of universal service and raises the question “does the ECJ’s ruling in *Federutility* provide guidance as to the electricity market?” The system and structure of the natural gas and electricity directives are very similar and the goal of market liberalization may be deduced in both schemes and the provisions on public services are, in essence, identical. This general parallelism was approved also by the ECJ in *Enel*,<sup>25</sup> where it referred to *Federutility* as guidance; AG Cruz Villalón, in his opinion in *Enel*, mentions *Federutility* as the “the first case-law concerning those rules on public service obligations in the energy sector – provides a direct precedent for the interpretation of Article 3(2) of Directive 2003/54” (para 2). Accordingly, the analysis of *Enel*, in essence, follows the structure and pattern established in *Federutility* (paras 32, 39 & 50).

It must be stressed that the ruling in *Federutility* provides no guidance as to the construction of the electricity universal service, though it is good law outside this domain. It is important to emphasize this again, since the above regulatory differences between the two directives are quite often disregarded and not infrequently the position emerges in the scholarship that *Federutility* is directly applicable to the electricity sector (*Energy Community* [2012] pp. 5–6.).

As regards the electricity market, it was the *Enel* judgment that pronounced that, in the absence of a specific authorization to regulate prices, regulatory price controls are, in principle, prohibited but may be justified with reference to general economic interests. In this case, Italy obliged, as regards dispatching and balancing services, electricity companies disposing of installations essential to the operation and security of the electricity system to make supplies to the distribution system operators at fixed prices.

<sup>25</sup> Case C-242/10 *Enel Produzione SpA v Autorità per l’energia elettrica e il gas* (2011) ECR I-13665.

When analyzing the case, the ECJ simply skipped the detailed examination of whether, in the absence of express authorization, national price regulation is contrary to the Directive on the internal electricity market. The Court took this prohibition as given, and moved to analyze the exception to this prohibition, that is the pre-conditions of regulatory intervention. Accordingly, the Court examined the existence of three requirements:

- ♦“Legislation providing for such intervention must pursue an objective in the general economic interest and be consistent with the principle of proportionality”, as well as “[s]uch obligations must also be clearly defined, transparent, non-discriminatory and verifiable, and must guarantee those undertakings equality of access to national consumers.” (Para 48.)

According to the ECJ, “the electricity dispatching service is a public service designed to ensure that, within the national transmission system, the supply of electricity matches demand, thereby guaranteeing security and continuity in the energy supply)” (para 51). Accordingly, the ECJ considered that “rules governing essential installations pursue a general economic interest objective” (para 54). The requirement of proportionality is met, if regulation is “appropriate for securing the objective which it pursues” and does not “go beyond what is necessary in order to attain it” (para 55). As to suitability, the Court noted that the national regulation “applies solely in cases where there is only one generating unit which, owing to its technical features and the speed with which it can vary its power output, is capable of supplying the resources needed to meet the dispatching requirements” (para 57), “these are generating installations which are strictly necessary and vital in order to meet dispatching service requirements” (para 62). As to whether the intervention went beyond what was necessary (para 63), it established that the regime appeared to secure fair remuneration for operators owning such installations (para 68). Finally, the ECJ established that the intervention was limited in terms of time, because “the list of essential installations is annually reviewed and updated, it would appear that installations are not kept on it for more than a limited period” (para 75).

In electricity reasonable prices are part of the universal service package. The Directive on the internal electricity market gives no guidance as to when can prices be regarded as reasonable, conferring a wide margin of appreciation on Member States.<sup>26</sup> In 2010, 16 out of 27 Member States had in force some form of price regulation in the house-hold segment.<sup>27</sup> The usual mechanism was to appoint a universal service provider (supplier of last resort, public service provider) and to cap prices.

<sup>26</sup> Cameron [2005] p. 25.

<sup>27</sup> ERCEG [2010]. As to the determination of end-user regulated price see ERCEG [2010] p. 11.

## SUMMARY

This paper analysed Member States' give as to price regulation from the perspective of the EU internal market and competition rules.

National price control is incompatible with the internal market, if it thwarts free movement (that is, the market access of foreign products, services or the freedom of establishment). National price regulation, as a set of rules relating to selling arrangements, goes counter to the law of the internal market, if it entails differential treatment as to foreign and domestic products. Accordingly, a price-cap falls foul of the law of free movement, if it prevents the importation of more expensive foreign products (which may be more expensive because of the importation costs). Likewise, a price floor infringes the law of the internal market, if it deprives foreign products of their competitive advantage consisting in lower prices. On the other hand, the prohibition of sale at loss, at cost-price or at minuscule margin, in principle, does not violate the law of the internal market.

Only the rules of market liberalization, in essence, can be regarded as substantial restrictions as to national price regulation from EU competition rules. This implies that the industries not covered by sectoral (market opening) regimes are free from these restraints. Price regulation may not be considered to be state aid as it does not concern the public budget. Although there is a theoretical possibility that through determining regulated prices a Member State incites or compels an enterprise to infringe competition rules (e.g. restricting output, selling at loss), as a matter of practice, this can be established only in extreme cases.

The ECJ established, in the context of energy market liberalization, that, as a general principle, if the applicable sectoral regime does not specifically authorize a Member State to regulate prices, national price control is, in principle, illegal, and can be maintained only with reference to the general economic interest. As a corollary, national price regulation may be introduced and maintained only if it is justified, and has to be proportionate in terms of scope and time. This doctrine may be extrapolated to other liberalized markets.

The ECJ established in *Federutility* that market opening excludes price regulation in itself, that is, in liberalized markets it is irreconcilable with EU law's command of market opening to regulate prices. This implies the proposition that in case of public services (services of general economic interest) price controls may be, though exceptionally, maintained, however, certain requirements apply. Member States have no subjective right to regulate prices as this would go counter to the concept of liberalized market. Furthermore, no matter how long the road to workable competition, price regulation – at least a general application – must be provisory.

The prohibition established in *Federutility* is very interesting if put in the light of the industries that have remained intact from the liberalization waves of the preceding decades (that is, most part of the EU's economy). In liberalized markets,

price regulation, in the absence of specific authorization, is considered to be prohibited, if it restricts competition. Outside this domain, national price regulation is prohibited, if it restricts importation in addition to the restriction of competition. Here, national price control is regarded as unlawful, if it restricts imports (or export) thus restricting free movement. This is the case, if it makes the market entry of foreign products impossible or less attractive. This bifurcation may lead to self-contradiction. In liberalized markets price controls may not be maintained once competition becomes workable. In sectors where no liberalization rules were introduced, presumably because these were not needed, as they were liberalized and competitive markets, the regulation of prices cannot be challenged on the basis of EU law, unless it is an obstacle to free movement.

It is also important to note that the limits set in *Federutility* do not apply to services qualifying as universal service. This concept was not analysed by the ECJ in *Federutility*, as this case was based on the Directive on the internal natural gas market which does not contain this concept (contrary to the Directive on the internal electricity market). In case of universal service, if it is codified in the market liberalization regime at stake, there is an express EU law requirement to secure the fairness (affordability, reasonableness) of prices. Regulatory intervention motivated by the purpose of universal service is ‘self-justifying’.

In *Federutility*, the ECJ established that, since there is no universal service as to natural gas, price regulation has to be justified with reference to public services. The status of electricity is, however, different, due to the presence of the regulatory concept of universal service. The electricity universal service encompasses the right to be supplied with electricity of a particular quality at “reasonable, easily and clearly comparable, transparent and nondiscriminatory prices”<sup>28</sup> and the right to reasonable prices creates an automatic possibility and duty to regulate prices, without a demand for justification. Accordingly, the regulatory intervention carried out for the purpose of universal service demands no such justification, it is automatically legitimate, provided it does not transgress the EU regulatory framework. EU law demands the provision of universal service, including the requirement of reasonable prices.

Another very important point is that while in *Federutility* Italy introduced industry-wide price regulation, the customary mechanism of providing universal service is the appointment of a universal service provider, which is subject to universal service requirements, including the requirement of reasonable prices. In this scheme, formally, there may be no regulated price. It is another question that the economic effects of the general industry-wide price-cap and those of the universal service price (which is applied solely to the appointed universal service provider(s) but not enforced on all market operators) are similar (in fact, the same). In the latter case, though alternative service providers may, from a legal perspective, charge higher

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<sup>28</sup> Article 3(3).

prices, due to the presence of the universal service price (capped by the regulator), they very probably would not be able to sell these products.

It is to be noted though that the foregoing is only half-true and a little bit over-simplified. Service providers compete along various parameters, not only with price, but with quality. This includes the quality of the physical product but also the quality of the customer service, billing and customer-relations. Regulated-prices have straight-jacketing effects on alternative market operators. Still, it has to be noted that notwithstanding the above economic equivalence between industry-wide price regulation and the universal service provider's prices, the ECJ may easily come to the conclusion that the prices enforced on the universal service provider (which are some sort of a social transfer) may not share the fate of the regulated prices condemned in *Federutility*. The pricing freedom of alternative (non-universal) service providers is, at least from a legal perspective, not subject to restriction.

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