II-5.9: The French energy regulator published its first unfavorable opinion regarding the government's proposed natural gas tariffs for residential customers.

Marie-Anne Frison-Roche, Managing Editor and Director

Translated Article PDF

Alternative providerAnticipationCalendarCompetitionCompetition lawCompetitive marketConsultationCostCouncil of stateDominant operatorEconomy of lawEnergyEuropean lawFree marketGasGeneral economic situationGovernmentmanifestation error of appreciationMarket PriceModulated priceNone-binding opinionPoliticsPredictabilityPricePublic serviceRegulated tariffResidential costumerSocial responsibilitySoft lawSovereignTarification

MAIN INFORMATION

The Commission de Régulation de l'Energie (CRE — French energy regulator) published an opinion "regarding the draft executive order regarding the regulated tariffs for natural gas publicly distributed by GDF Suez." This non-binding opinion was published on September 29, 2011, and claims that it is not acceptable for the Government to leave natural gas prices unchanged because these prices do not cover GDF Suez's costs and symmetrically prevent newcomers from competing with it.

CONTEXT AND SUMMARY

In France, natural gas prices are still set by the Government (regulated tariffs) for eligible consumers (residential customers and small businesses). Natural gas at these tariffs is supplied by the operator in charge of this public service mission (GDF-Suez), whereas other operators can only try to compete by attracting these customers with lower prices. Therefore, domestic customers can choose between regulated prices or market prices. Corporate customers can only choose to purchase natural gas at market prices. In the former case, the Government sets various regulated prices for residential clients according to whether they are using the gas in or outside of their homes. But, the energy regulator gives its opinion on the Government's draft tariffs before these tariffs are made official by an executive order. The Government is obliged to ask the regulator for its opinion, but is not obliged to abide by it (also known as a consultative opinion).

The French Government has not modified the tariff for gas supplied to residential customers in years, and each successive executive order maintains the previous tariff (price freezing). Therefore, the previous order published on June 27, 2011 had already frozen the tariffs applicable to residential customers and small businesses, and the regulators had approved this order following their June 23, 2011 deliberation. But, they had also stated at that time that it was "imperious" to increase prices "in order to reflect GDF-Suez's supply costs".

In Autumn 2011, before adopting new prices for residential clients, the Government consulted the CRE on its draft order, which had not modified the prices despite the company in charge of providing natural gas at regulated prices' request that the tariffs be increased by 4.9%.

The regulator's September 29, 2011 consultative opinion first stated that even though the law does not provide for a calendar according to which the Government must consult the energy regulator, it should do so sufficiently well in advance to give the regulator a chance to examine the issue, carry out consultations, etc., in order to be able to form a pertinent opinion and not be faced with a *fait accompli*. Indeed, the Government had requested the agency's opinion on September 27, 2011, and the agency had to give its opinion by October 1, 2011, the day on which the new tariffs were to be published. The opinion was published two days later, on September 29, 2011, and only contains three terse pages.

Furthermore, the opinion is fundamentally unfavorable to the government's proposition. This is the first time such an opinion has ever been unfavorable to the government's proposed tariffs. The stated reasons for this in the decision are economic in nature, and rely upon a French Council of State ruling in the *Poweo* case (December 10, 2007).

The regulator believes that the tariffs imposed on the company within the framework of its public service activities are inferior to its actual costs and is inappropriate for two reasons. Not only are these tariffs an economic burden for the company, but also, they are very unfavorable to competitors, who find themselves unable to compete on the basis of market prices, since on that market, there exists a tariff accessible to consumers at a price lower than the dominant operator's costs. The opinion points out that "a prolonged price freeze on regulated tariffs is not compatible with a competitive natural gas market."

The regulator concludes that the Government must augment the price of natural gas provided to domestic consumers, in function of their various usage profiles, by 8.88% to 10%. It believes that this is an obligation derived from the Council of State's jurisprudence. The fact that one of the agency's commissioners is also a member of the Council of State on leave of duty is probably not without bearing on this declaration.

The agency cites the Council of State's December 10, 2007 *Poweo* ruling, which established that the price of sale to consumers for energy products must be superior to the cost of the good supplied by the provider, and that this rule must be applied both to prices on the competitive market as well as to regulated tariffs. Indeed, this is the only way that new entrants can compete with the incumbent. The CRE points out that regulated tariffs must allow "alternative providers to offer prices that can compete with the regulated tariffs."

The regulator is addressing the prices charged to energy consumers because the coexistence of a system of regulated tariffs (that the provider in charge of providing the public service must charge) and a system of market prices (charged by new competitors whose existence is encouraged) is a major problem for regulation. In this case, imposing tariffs that are less than the operator's costs, even if they are justified by social concerns, both asphyxiates the provider (GDF-Suez), and makes it impossible to compete on price.

This is the occasion for the regulator to provide a lesson on good regulation in a competitive environment: citing the terms of the *Poweo* ruling, it points out that regulated prices must be "predictable" in order to allow agents on the free market to plan ahead and to decide whether or not it is opportune to enter the market on the basis of whether there is a rent to be earned, or at least whether there is profit to be made in comparison to costs, by attracting subscribers away from the former

public provider. Since regulators are often asked to be predictable when exercising their normative powers, the regulator is holding a mirror up to the Government.

Links with other documents in the same sector

BRIEF COMMENTARY

First of all, this is the first time that the French energy regulator has so bluntly resisted the Government in what is considered to be the heart of energy's political economy: its price. Indeed, the "freeze" on what the population has to pay for its energy consumption is a political question, and politicians can lose elections when energy prices increase. Therefore, decisions on this topic most often follow election calendars, rather than logic. In this opinion, the regulator reminds the Government that, although sometimes politicians reason in ways foreign to the economy, there are nevertheless limits.

This limit is perfectly expressed: it is not possible to continually economically force a provider to sell beneath its costs on the justification that the power to set prices is politically sovereign.

Furthermore, whether or not the Government should be held accountable to the competition authorities for such price fixing is legally debatable. Indeed, the regulatory agency's opinion cites the Council of State's jurisprudence: it also could have cited the Constitutional Council's jurisprudence, which, in a November 30, 2006 ruling on the Loi relative au secteur de l'énergie [Act relating to the energy industry], established that European Community directives regarding the energy industry are intended to open that industry to competition and therefore the conformity of national interpretations with such directives must be interpreted according to that goal.

Secondly, the opinion is not binding and therefore it could be concluded that it is of little importance that a regulator bridles at the Government's power of setting prices. But, consultative opinions are part of soft law, and we know how important soft law is in regulation. Furthermore, when the regulator complains that it did not have enough time to study the issue, it is because these opinions are supposed to be a sort of co-regulation and express the regulator's opinion as much as they are supposed to express the industry's. Besides, the Autorité de Régulation des Télécommunications, the predecessor of France's current telecommunications regulator, the ARCEP, was, at its creation, only endowed with the power to emit consultative opinions, especially concerning the attribution of radio wave frequencies, but it was enough that these opinions were made public, that they were seriously justified by the regulator, and that industry was consulted before they were drawn up, to make them mandatory de facto, and this reality was eventually made law.

Thirdly, the regulator cites the Council of State's December 10, 2007 ruling in the Poweo affair, which states that "the price of sale of natural gas to non-eligible clients [not eligible to opt for market prices] are to be defined in function of the intrinsic characteristics of the supply and cost of this commodity. These prices are to cover the entirety of these costs…" After having enumerated the various applicable costs, the judges state that "even though the ministers in charge of the economy and of energy able to make decisions relating to these prices in virtue of Paragraph 7 of the Act of January 3, 2002, can, within the limits of said Act, legally take into account the general economic situation, and particularly that of households, in order to modulate the public price of sale of natural gas, without the prices they set being obliged to integrally recoup all of the variations in the cost of supply of natural gas distributed in this fashion, the combination of Paragraph 7 of the aforementioned law and Paragraph 2 of the Decree of November 20, 1990, makes it clear that these tariffs cannot be below providers' average costs."

It might have been instructive to refer to a ruling published the same day by the Council of State, in the Syndicat professionnel des entreprises locales gazières [Professional union of local natural gas corporations]. Indeed, following an opinion published by the Conseil de la Concurrence [former French competition authority], the Council of State provided the same legal justifications as in the foregoing ruling, but in this particular affair added that, "it has not been averred that the rise in price was, at the time, based on manifestly erroneous predictions; and therefore, the authorized rise in price was free of both legal errors and manifest errors of appreciation."

This means that in the present case, since the Council of State's judicial review can be exercised over an executive order fixing natural gas prices, and since circumstances have changed, the Council of State could censure the Government's decision rather than reject the appeal against it, like in 2007. Indeed, the jurisdiction could conclude that there was a legal error with regards to competition law, since national judges are also direct judges of the correct application of European Union legislation.

The Council of State could also have performed a factual review, which is within its powers of judicial review. Indeed, making reference to the "manifest error of appreciation" allows French administrative courts to substantially review the administration's actions, for example, to see whether or not in the present case the reasoning behind its decisions was erroneous.

Is an economic error, such as obliging a corporation to sell at less than its costs, a "manifest error of appreciation" in our legal system? That depends on the degree to which the economic analysis of law has penetrated it. A general overview of the Council of State's jurisprudence regarding merger review—an area over which the high court exercises "substantial" judicial review—might lead us to answer affirmatively.

It is therefore important to classify the affirmations contained in the opinion by their importance. Firstly, the fact that maintaining a tariff that seems illegal in light of administrative, and even constitutional, jurisprudence, because it does not cover the provider's costs, makes the act vulnerable to judicial abrogation, and has great importance in that the reader will observe therein the premises for a law suit. Secondly, the art of rulemaking (there is indeed an art to rulemaking, just as there is an art of lawmaking) says that the Government should neither surprise the regulator by only allowing it twenty-four hours to render its opinion, nor should it hinder economic agents' ability to anticipate for the future. This is the behavior of a bad regulator; but that is not a question for the law. Thirdly, and lastly, the freeze on natural gas prices for domestic customers and small businesses is a social policy that demonstrates the shock between competition, which the regulator is in charge of safeguarding, and regulation, which balances competition with another principle.

But, is this equilibrium thrown off balance when the State is reminded that social concerns do not allow it to make a company go bankrupt—and forcing it to sell beneath its costs for a prolonged period of time will eventually have that outcome—unless it institutes measures such as subsidies, equalization funds, or allowing the company to otherwise viably meet demand.