

Prices for gas and electricity are at the center of Europe's political debates. Each week that passes by shows larger numbers of struggling households and businesses. Can Member States prevent further damage by unilateral measures such as price or profit margin caps? Greece adopted a profit margin cap of 30 % on electricity supply prices and other essential products. The measure is effective since July 2022 and inflation dropped in that same month in Greece.

### **A Union Law question : how to set caps on electricity prices as a Member State?**

The Ministers of Energy of the 27 Member states of the European Union requested on September 9<sup>th</sup> 2022 that the European Commission put forward a proposal for setting a price cap on gas. The proposal of the European Commission is expected to be delivered by end September 2022. But what with caps on electricity supply prices? Do Member States also need Commission initiatives in that field?

Greece has decided in March 2022 that in order to protect its households and businesses against the effects of the war in Ukraine, it must organise for some basic needs a margin cap of 30 % profit based on the historic production costs before September 1<sup>st</sup> 2021. It has requested in Spring 2022 the permission of the European Commission to put a profit margin cap on electricity prices for households and businesses and other essential products for consumers such as food or transport services.

The Greek law that fixed these caps became effective in July 2022. Inflation dropped in Greece that same month. Some suggest a link with dropping oil prices. Although during that month crude oil prices per barrel in Europe dropped over 10 USD, no such effect on inflation was noted in most other Member States. According to the statistics of the European Commission, overall inflation went up in the European Union in July 2022. The European Commission noted however for that month a 1,6 % drop in inflation for Greece. Only in two other Member States (Italy and Luxembourg) a drop of around 1 % was recorded. This suggests a link with the coming in effect of measures. What Union law allowed for that profit margin cap of 30 % on electricity supply prices? Should other Member States now follow that example while awaiting the agreement between Member States on price caps on gas and its implantation?

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Who is our blogger ?

Our blogger is a tax expert.

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### **What was decided by Greece?**

In the first weeks of March 2022 the Greek government informed the European Commission of a set of measures it considered to help households, businesses, and farmers with their energy prices. In a television address of May 2022, the Greek Prime Minister announced that a system will be introduced, effective from July 2022, which

disconnects the international price increases in natural gas from electricity bills because :

*"Greece will not wait for Europe's solution, which is taking too long. The hardship of households and businesses cannot wait any longer."*

The scheme sets a 30 % profit margin cap on the production costs of electricity that applied before September 1<sup>st</sup> 2021. Profits that exceed that margin are to be taxed under a 'solidarity dividend' at a rate of 90 %. The collected taxes are to be distributed between consumers with a yearly income that does not exceed 45.000 EUR.

### **What does a profit margin of 30 % on historical production costs means?**

This notion of a profit margin can relate to a gross profit margin (total revenue minus costs of goods sold), an operational profit margin (total revenue minus costs of goods sold & operating expenses often referred to as EBIT) or a net profit margin (revenue minus all expenses often referred to as the EBITDA).

When fixing a margin, it is therefore logic to set a higher margin when aiming at a gross profit margin and a lower margin when looking at a net profit margin. By setting a margin that relates to the production costs of electricity only, Greece opted for a gross profit margin. One could therefor consider that a 30 % gross profit margin is too low and may hamper investment. Especially when considering that even for production costs, prices have gone up since September 1<sup>st</sup> 2021. By the single effect of inflation alone, revenues will be boosted. The share of net profit that can escape a 90 % taxation rate will drop accordingly to that boost.

Such gross profit margin of 30 % based on historical production costs could in turn result in hampering investment decisions in renewable energy. This by the distortion between actual production costs and a sufficient net profit margin that can fall within that 30 % profit margin on historical production costs.

Critical remark no. 1 relates to historical production costs as a criterion for a profit margin cap of 30 % on electricity prices.

A gross profit margin cap of 30 % is too low. Using a historical production cost ignores the effect of inflation on that margin. This method of interfering in price-setting for electricity supply prices may so hamper investment decisions in renewable energy.

### **What Union law forbids interference in energy prices by Member States?**

There is on the one hand the basic principle in the energy-union that Member States cannot disturb the way wholesale prices for energy are formed by the markets.

Regulations n° 2019/941<sup>1</sup> and n° 2019/943<sup>2</sup> see to that principle. Article 3 (b) of Regulation n° 2019/943 sets the general obligation for Member States that market rules must encourage free price formation and not lead to actions which prevent price formation based on demand and supply. Article 10 of that same regulation forbids a maximum or a minimum limit to the wholesale electricity price.

Setting a cap on whole-sale prices for electricity requires modifying the prohibition to do so in that regulation. It cannot be done under the procedure for implementation of regulations. The European Council has no legislative functions (Articles 15 (1) and 31 TEU) ; it must do so with the European Parliament (Article 16 (1) TEU). Legislative acts must be proposed by the European Commission, except when the Treaties state otherwise (Article 17 (2) TUE). In the field of energy, no provisions are found in the Treaties that derogate from the ordinary legislative procedure. Changing these provisions, by setting maximum caps for electricity in wholesale markets will require to engage into the legislative process of adopting new provisions in these regulations. It is therefore likely to take several months before such provisions can become applicable in these wholesale markets.

However, the considered approach is to intervene in this matter through Article 122 TFEU that allows, also in the field of energy, the Council to adapt unilaterally measures on the proposal of the Commission in a short span of time when in the presence of an emergency. It is not the first time the European Union is facing an energy crisis : during the oil crisis of 1974 Member States also wanted to fix maximum prices. The Court of Justice ruled on 23 January 1975 in the case C-31/74<sup>3</sup> that to combat a rise in prices Member States must take, at the Community level, the necessary action for the purpose of prompting the competent Community authority to institute or authorize measures that are consistent with the requirement of earlier regulations that organise the single market in that field. The Court of Justice thereby distinguished between intervening in the formation of wholesale prices – as organised by the regulations for the purpose of the single market in that field *that grant rights with a direct effect in favor of private parties* – and in the price formation on the retail or consumption stages, where action could be allowed on condition not to jeopardize the aims of functioning of the common organization of the market in question. A word of caution must be made regarding regulations adopted under the procedure of Article 122 TFEU when such regulations aim to intervene in price formation on the wholesale markets and modify so the rights with direct effect granted to private parties under the regulations that organise that single market and that were adopted according to the ordinary procedure. In other words ; can a regulation adopted under Article 122 TFEU have the effect to overrule or to a certain extend replace provisions in regulations that were adopted under the ordinary procedure?

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<sup>1</sup> REGULATION (EU) 2019/941 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 5 June 2019 on risk-preparedness in the electricity sector and repealing Directive 2005/89/EC, OJ, 14 June 2019, L 158/1, Article 16 allows 'non-market-based measures' in an electricity crisis only as a last resort that must be necessary, proportionate, non-discriminatory, and temporary. The link with that regulation is that when prices become too high, some users are cut off from energy supply, leading to an energy crisis on the demand side of the market that leads to a programmed overproduction going to the grid and that excessive price or margin caps may hamper electricity production decisions and result over time in electricity crises on the offering side of the market compared to the planned capacity for producing electricity.

<sup>2</sup> REGULATION (EU) 2019/943 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 5 June 2019 on the internal market for electricity, OJ, 14 June 2019, L 158/54, Articles 3 (b) and 10.

<sup>3</sup> CJUE, 23 January 1975, case 31/74, Filippo Galli, §§ 32 - 34

There is on the other hand the basic principle in the energy-union that the price users are demanded to pay for their electricity is to be fixed freely by their suppliers. This principle is laid down in Article 5(1) of Directive n° 2019/944<sup>4</sup>. Interfering in the price setting for the supply of electricity for the purpose of protecting energy poor and vulnerable household customers is prohibited by Article 5(2). Such protection must be organised through social policy or by other means.

### **What Union law allows interference in electricity prices by Member States?**

Article 5(3) of Directive n° 2019/944 organizes a specific derogation to the prohibition of interfering in price setting for the supply of electricity. This derogation seeks protection for energy poor or vulnerable household customers (national measures that are more commonly known as the 'social tariffs'). Article 29 states that these notions are to be defined by the Member States by using a set of criteria, which may include low income, high expenditure of disposable income on energy and poor energy efficiency.

Article 9 (2) of that Directive organizes a second derogation under 'public service obligations' that allows imposing on electricity undertakings measures that relate to the price for electricity supplies in general. Such public service obligations must have full regard to the relevant provisions of the TFEU, in particular Article 106, and must be necessary in the general economic interest. Without interfering in the wholesale prices for electricity, Member States may so intervene into the way prices for the supply of electricity are formed.

The Greek measure relates to protecting the general economy (households and businesses) against excessive electricity supply prices. In as far as the protection also relates to businesses, it must be compliant with the requirements under Article 9 (2) of the Directive n° 2019/944. The need to protect businesses and households is also present in other Member States so they could consider similar temporary measures for protection of their economy.

### **What are the requirements for such interventions in prices for supplied electricity?**

When considering such public service obligations a set of requirements must be complied :

- The requirements under Article 106 (2) TFUE : Undertakings entrusted with the operation of services of general economic interest can see their rights under the Treaties reduced when required for the particular tasks assigned to them.
- A full regard to the provisions of the TFUE.

Relevant protective provisions can be found in Article 9 TFUE that sets the promotion of a high level of employment as an objective, or Article 12 TFUE that sets consumer protection requirements as an objective, or Article 119 (1) that relates to the objectives under Article 3 TUE (among which a balanced economy growth and price stability), or Article 119 (2) that states that price stability must govern as the primary objective

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<sup>4</sup> DIRECTIVE (EU) 2019/944 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 5 June 2019 on common rules for the internal market for electricity and amending Directive 2012/27/EU, OJ 14 June 2019, L 158/125.

the general economic policies in the Union, or Article 126 (1) that requests the Member States to avoid excessive government deficits.

- The requirements laid down in Article 5 (4) and (5) of the Directive n° 2019/944 when the general service obligation interferes in the price for supplying electricity :
  - a) Pursuing a general economic interest and not go beyond what is necessary to achieve that general economic interest.
  - b) Be clearly defined, transparent, non-discriminatory and verifiable.
  - c) Guarantee equal access for Union electricity undertakings to customers.
  - d) Be limited in time and proportionate as regards their beneficiaries.
  - e) Not result in additional costs for market participants in a discriminatory way.
  
- The requirements laid down in Article 9 (2) of the Directive 2019/944 :
  - a) Being adopted in the sole purpose of general economic interest.
  - b) Clearly defined, transparent, non-discriminatory, and verifiable criteria.
  - c) Guarantee equality of access for electricity undertakings of the Union to national customers.

### **How do price caps and profit margin caps relate to these requirements?**

- Caps for gas :

A **price cap** for gas leads to a single price for the whole European market. It must be set sufficiently high for maintaining a sufficient level of import and production inside the European Union. It may be less effective in protecting the general economic interest. Attention should be given to apply fast modifications when gas prices change. It may push the suppliers to set prices towards customers at that same level.

A **gross profit margin cap** for gas will hit on principle the groups that produce gas in the European Union. Groups that acquire their gas will only be subject to that measure if they can import at a low price. A similar effect could occur as with price caps ; the maximum gross profit margin will become the standard in setting gas supply prices. However, the groups that produce gas in the European Union may, when 'using up' that gross profit margin in their price, be compelled to supply gas at low prices, forcing the other suppliers that mainly rely on imported gas to lower their gross profit margins in order to keep their share of the market.

The other way around of such a measure could be that gas prices take a dive in other parts of the world and that European produced gas must then lower its gross profit margin in order to keep up with their lowered supply price for imported gas. Could these effects be seen as discriminatory under GATT requirements or is there an objective reason under the need for protection of the general economic interest?

In the field of gas production, it should also be noted that a large share of the production costs are formed by compensations that must be paid by the groups to the countries that gave them concessions on the gas fields in their national territory. Trough taxation of excess profits that take in account these compensations a level

playing field can be restored to some extent. Sufficiently high margins allow in turn a larger tax base for financing aid.

Setting sufficiently high levels under both types of caps may be required for maintaining production within Europe and yield effects that are more proportionate for all undertakings in that market.

- Caps for electricity :

Electricity undertakings have various ways for acquiring the electricity they supply in turn to their customers. They can produce it entirely within the group they form a part of or buy it entirely or use a mix of both. Member States with more sun or wind, with or without nuclear sites will have a different production mix ; their national groups will typically have an inherently different mix of production costs. A **single price cap** for the electricity that is supplied for the whole of the European Union may then result in large profit margins for some and little to no profit for other electricity undertakings. A price cap also heavily distorts competition since it could be seen as a permission to ask that price and may keep energy prices artificially high over a long period of time.

You have to determine in your formula for the electricity supply a fixed share of the gas price in that mix. A preferred mix per climate type or other relevant production elements leads to dividing the Union in sections. By doing so, you can be in turn found discriminating against electricity undertakings that use in that section a higher mix of gas and electricity undertaking that use that mix of gas and between electricity undertakings that have no use of gas or less than the fixed share and the electricity undertakings that use that fixed share.

Such effects can be considered as both discriminatory and in violation of the specific requirement of not going beyond what is required for the protection of the general economic interest and the freedom for electricity undertakings to set their supply price for electricity.

A **gross profit margin cap** based on the mix of production costs for supplying that electricity to the customer allows to achieve better the objective of protection of the general economic interest and complies with proportionality when set sufficiently high :

- For yielding non-discrimination between electricity undertakings that have different mixes of acquired electricity. An electricity undertaking that acquires such electricity from another electricity undertaking at lower prices under the profit margin cap will in turn be able to sell at lower prices to its customers while maintaining a profit margin for itself. It is unclear how a price cap leaves a place in the electricity-market for a profit for such 'intermediary' electricity undertakings that play an essential role in providing information and price comparison to consumers.
- Investments in renewable energy are boosted by sufficiently high profit margins caps, what can be less achieved by price caps.
- Investments in production of electricity through burning gas will yield the lowest profit margin for that type of production under a profit margin cap since it will

be the most expensive. A price cap may still be enough profitable to maintain or enlarge the part of gas production in the mix of the electricity undertaking.

- A high profit margin cap leaves a better tax base for fiscal measures that can lessen the burden of public spending for maintaining economic activity through aid or fiscal measures under high energy prices for oil and gas.
- A profit margin cap is less invasive than a price cap in the free price setting by electricity undertakings. That freedom remains the basic principle in the TFUE and the Directive n° 2019/944.

By prohibiting an excess of profit in the supply price, you will obtain a generally lower supply price by breaking up the link between the production factor of gas and the price for supply of electricity to customers. The more electricity that is not produced by gas, the greater the effect of profit margin caps on lowering prices for the whole of the economy will be.

Example:

- (1) Introducing a high gross profit margin cap of 50 % on production costs for supplied electricity does not considerably affect the effectiveness of the measure:

Production cost / energy	Nuclear	Renewable	Oil	Gas	Total
kWh produced in fall 2022	0,03 euro	0,06 euro	0,1 euro	0,3 euro	
Mix	50 %	30 %	10 %	10 %	
Cost 1 MWh	15 euro	18 euro	10 euro	30 euro	73 euro
<b>Profit margin 30 %</b>					<b>21,9 euro</b>
Supply price					94,90 euro
1 MWh gas price					300 euro
Factor = /3					(205,10 euro)
<b>Profit margin 50 %</b>					<b>36,50 euro</b>
Supply price					109,50 euro
Factor = / 2,7					(190,50 euro)

- (2) When setting a price cap for gas in comparison to other parts of the world, you get a poorer effect without a profit margin cap on supplied electricity prices.

When considering gas markets prices in other parts of the world and fixing for example the price cap in relation to these other markets at 200 EUR for Europe (1/3 less than 300 EUR in the example above), you still come out at electricity prices that are a 100 % more expensive when determined without a gross profit margin. Compare 200 euro per MWh for supplying electricity with a profit margin cap set at 30 % (81,90 euro) or 50 % (95,25 euro).

Production cost / energy	Nuclear	Renewable	Oil	Gas	Total
kWh produced price cap	0,03 euro	0,06 euro	0,1 euro	<b>0,2 euro</b>	
Mix	50 %	30 %	10 %	10 %	
Cost 1 MWh	15 euro	18 euro	10 euro	20 euro	63 euro
<b>Profit margin 30 %</b>					<b>18,9 euro</b>
Supply price					81,90 euro
1 MWh gas price					200 euro
Factor = /2,44					(118,10 euro)
<b>Profit margin 50 %</b>					<b>31,50 euro</b>
Supply price					95,25 euro
Factor = / 1,9					(104,75 euro)

You also avoid by the choice for profit margin caps that more compensation weights on the budgets of the Member States when aiding customers (households and businesses) that can acquire electricity at a lower price. A price cap may yield the same or even a better immediate result but is more inclined to reduce price competition between electricity undertakings and may so lead over a longer period to a generally higher overall cost for the state budgets to aid households and businesses.

Critical remark no. II relates on principle to price caps for supplied electricity.

A price cap on electricity supply may organise an artificially high price over a longer period and distort competition by discriminating between electricity undertakings that have different mixes in the costs for acquiring the electricity they supply to their customers. It interferes more in the free price determination than a gross profit margin cap that can yield similar results without less interference and can therefore be found in violation with the TFEU and Directive n° 2019/944.

A gross profit margin cap of 50 % interferes less directly in the rights of the electricity undertakings for free price setting and allows to achieve the protection of the general economic interest better. It is compliant with the requirements of the TFEU and the Directive n° 2019/944.

### **The CJUE ruling of 14 October 2021 in the case C-683/19 on general service obligations that levy a contribution on the revenue of some Spanish electricity undertakings.**

On 14 October 2021 the CJUE rendered its ruling in the case C-683/19<sup>5</sup> concerning the financial contribution that was levied as a general service obligation through a formula that takes in account the number of supplies and the number of customers to divide under the qualifying electricity undertakings in Spain the costs for all electricity undertakings in Spain to provide a social tariff that was implemented by Spain under

<sup>5</sup> CJEU, 14 October 2021, Viesgo Infraestructuras Energéticas SL e.a., C-683/19, EU:C:2021:847



a prior Directive that organized this derogation<sup>6</sup>. The way how that social tariff was implemented was no part of the preliminary questions. The used formula resulted in 5 undertakings that had to bear 99 % of these costs.

The CJUE had to decide on the questions if such a financial contribution levied only on certain electricity undertakings could be considered compliant with the requirement of non-discrimination and if such contribution could be organised without observing the requirement of a limitation in time that applies for Social Tariffs and without an obligation to compensate.

On the first question, the CJUE ruled that *"Article 3(2) of Directive 2009/72 must be interpreted as precluding the cost of a public service obligation consisting in supplying electricity at a reduced rate to certain vulnerable consumers from being borne solely by the parent companies of groups of companies or, where applicable, companies that simultaneously carry on electricity production, distribution and retail activities, since that criterion, chosen by the national legislature in order to distinguish among companies which must bear that cost and those which are exempted entirely from that burden, results in a difference in treatment which is not objectively justified between the various companies operating on that market"*.

The CJUE considered that electricity undertakings can be subjected under Article 106 TFUE to general service obligations. General service obligations are measures that result in modifying the fact of supplying, the quantity supplied or the conditions of the supply and can only be organised when serving an *exclusive* general economic interest. Such a measure must as a general service obligation be on principle levied without discrimination *from all electricity undertakings that are active in that sector*.

The financial contribution was found to form an inherent part of the Social Tariff measure that also strikes these same electricity undertakings and formed a separate general service obligation for them. Any difference in treatment must be objectively justified. There was no objective justification found between the chosen criteria and the objective to spread the cost for the Social Tariff according to the ability-to-pay principle over the electricity undertakings.

On the second question, the CJUE answered that the financing of Social Tariffs measures must be distinguished from the Social Tariffs themselves. Their financing can be organised as a general service obligation that in itself does not intervene into the way the price for supplying electricity is determined. Such a financing measure does then not fall under the requirement for a limitation in time and does not trigger the obligation for compensating the electricity undertakings that are subjected to it.

### **What about taxing excess profits as 'solidarity dividends' at a 90 % tax rate ?**

A 90 % tax rate is clearly disproportionate. It has similar effects as seizing property or as a fine that entails the obligation for motivation if that sanction should be applied or not in full in that specific case. It is also unclear how you can revert from a gross profit

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<sup>6</sup> Article 3(2) of Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, JO, 14 August 2009, L 211/55 (derogation now organised under Directive 2019/944, Articles 5 and 9).

margin to a notion of dividends for taxation purposes? It will be difficult to uphold under the requirements of proportionality under the ECHR and the Charter.

When concerned about effectiveness of the measure and collecting income for aiding suffering companies (state aid) and households, it would then be preferable to :

- qualify sales of electricity above the gross profit margin as a criminal offence,
- set that gross profit margin high enough at a 50 % rate for proportionality purposes,
- ensure effective taxation in all sectors through an operational profit margin of 20 % on the revenue that is collected in excess of the revenue from sales of electricity /EBIT ratio for that electricity of 2018 or 2019 (prior to Corona that resulted in an abnormal drop on the demand side),
- by comparing these ratios, you take the effects of inflation in account,
- the corporate tax rate on that income could be set at progressive rates between 25 % and 50 %.

#### Conclusions for the Greek measure?

By opting for a gross profit margin on production costs to interfere in the prices for electricity supplied to customers (businesses and households) for a general economic interest, that measure can be found compliant with the TFUE and Directive n° 2019/944. The measure seems to yield effective results in addressing inflation in the first month of its implementation.

By opting for historical production costs on September 1<sup>st</sup> 2021, the measure can be found discriminatory. By qualifying excess profits as dividends that are taxed at a rate of 90 %, the measure is in violation with the ECHR and the Charter.

#### **So, what can be done at the level of a Member State such as Belgium in fall 2022?**

Member States that wish to adopt a similar measure and implement a profit margin cap on the price of electricity supplied to their households and business, effective in October, will do well to consider the ruling of 14 October 2021 of the CJUE :

- The financing of Social Tariffs measures can be limited to financial contributions from that same energy sector and organized as a general service obligation.
- When not intervening in the price for supplied electricity that financial contribution must not be limited in time nor does it give cause for compensation.
- Such measure must strike *on principle* all companies active in that sector on the basis of non-discriminatory criterions.

A general service obligation that also interferes in prices for supplying electricity to households and businesses must comply with all the requirements of Article 9 (2) of the Directive n° 2019/944.

A financial contribution that is levied only on the profits from nuclear production of electricity or on the basis of how the electricity is produced is not compliant with these

requirements. All electricity undertakings that are allowed to provide electricity to the national grid and sale should be on principle considered when determining the criteria of a financial contribution and the exemptions that can be objectively justified.

The measure is considered to be effective and compliant with the requirements of the TFEU and the freedom for suppliers to set their prices when taking the form of a high (50 %) gross profit margin on current costs for producing the supplied electricity.

In that form it also yields the best results in reducing the factor gas in determining the price for supplied electricity and allows so for far lower prices that businesses and household must pay. It results in significant less public spending since less financial aid will be required.

When prohibiting sales prices that go above the gross profit margin, the excess revenue can be seized, and offenders can be held publicly accountable for their lack of consideration for the national general economic interest to protect households and business during this crisis.

When considering specific measures that make the energy sector contribute proportionality more than other sectors to these budgetary needs, Article 106 TFUE that protects the general economic interest, and an increased ability-to-pay can be invoked. Taxation on that basis must be on principle levied on all companies selling electricity over the national grid and exemptions must have an objective justification.

One could suggest exemptions under safe harbors such as a minimum level of electricity sold through the grid and a minimum increase of gross revenue compared to the 2018 or 2019 ratio gross revenues from selling electricity / EBIT production factors + 20 % on that ratio (inflation in part) before applying progressive corporate income tax rates.

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