

## EU competition law – friend or foe to the Labour agenda?

### Introduction

It is suggested by some that EU competition law is a major obstacle to pursuing Labour's manifesto for Government and that BREXIT is an opportunity to facilitate Labour's economic reforms.

If true, this could be a reason to stick with BREXIT despite the broken promises of the Leave campaign.

But is it true? How far does EU competition law constrain Labour's agenda?

### The Labour manifesto

The approach to BREXIT set out in Labour's 2017 manifesto puts jobs and the economy first. It seeks to retain the benefits of the single market and customs union, safeguard European market access for UK agricultural products and retain membership of European agencies such as EUROPOL, Euratom and the European Medicines Agency.

The Labour Party is pro trade and pro investment, seeks unrestricted access to the EU market and would re-join the General Procurement Agreement to ensure access to public markets in all GPA countries. The manifesto does not seek to withdraw from our close economic ties with our European partners.

The 2017 manifesto also states that *"Freedom of movement will end when we leave the European Union"*. This is difficult to square with unrestricted EU market access as free movement of persons is, at least for now, a fundamental principle of the single market. The debate over free movement reform and EU migration is not the subject of this note.

This paper focuses on Labour's aim of widening ownership of the economy and in particular insourcing public services, supporting the creation of publicly owned companies to rival private suppliers and renationalising certain utility industries.

The 2017 manifesto refers to:

- Bringing rail companies into public ownership as franchises expire;
- Regaining control of energy supply networks;
- Nationalising regional water companies; and
- Reversing the privatisation of the Royal Mail.

### EU Principles and Competition Law

Firstly, the EU does not have jurisdiction over the UK's rules on property ownership. The EU is neutral on public ownership. This principle is enshrined in Article 345 of the Treaty on the Functioning of the European Union ("TFEU") (the Treaty setting out the high level legal obligations of membership):

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

The evidence of this is that very large State-owned enterprises run significant parts of the economy of countries such as France and Germany. In fact, German and French State-owned enterprises (eg EDF and Deutsche Bahn) run not insignificant parts of the UK economy as a result of UK privatisations dating back

to the 1980s in energy, rail and water. However, those privatisations were driven by UK policy not EU requirements.

Secondly, EU competition law is designed to curb the market excesses of powerful companies, fight cartels and limit the ability of member states to distort competition through protectionist measures.

A good example of competition law enforcement against companies is the recent £3.9bn fine imposed on Google (Android) for cementing its dominant position by bundling together its apps store and the Google search engine (*ie* consumers can't have one without the other) so as to lock out competitors. Competition law is a means of helping to ensure that markets work fairly and produce beneficial effects for companies and consumers alike.

Similarly, the EU competition rules applicable to governments are designed to ensure fair, open and reciprocal access to markets for national and other EU companies. The rules are based on the notion that if a subsidy, public contract or monopoly is gifted to a 'national champion' without a fair tender process or objective justification based on public service obligations, the effect is to prevent rivals competing and reduce the incentive of the national champion to provide value for money and innovation. The benefits of competition flow through to consumers, investment and job opportunities.

Fairness, transparency, equal opportunity, value for money, reciprocity, regulating market excess - these EU competition law principles are consistent with the aims of the Labour agenda.

EU competition law is also consistent with Labour's specific pledges to widen ownership and ensure that public services work in the public interest, as explained further below.

Relevant competition law for these purposes falls into 3 categories:

- Public procurement (which is based on the free movement of goods, services and establishment rather than competition law but is often classified as competition law);
- State aid law; and
- Article 106, TFEU which has been applied to regulate monopolies.

### **Public Procurement**

The EU public procurement rules require that public bodies (such as Government departments, local authorities and certain utilities) must when seeking offers for public contracts advertise the opportunity, treat all bidders fairly and act in a transparent manner. These rules are implemented in the UK by way of the Public Contracts Regulations 2015 ("PCR 2015") and other regulations (with slightly more relaxed regimes) relating to utilities, concession contracts and defence contracts.

If no offers are sought because the public body or utility decides to provide the services itself using its own resources, there is no procurement and the rules do not apply.

There is also specific provision in the rules for the public body to procure the services from a public undertaking that it owns and controls (either a subsidiary or a company owned jointly with other public bodies – a 'shared service provider') without having to go out to tender (Regulation 12, PCR 2015).

There is therefore nothing in procurement law to prevent the 'in sourcing' of contracts by a public body. In other words, when a tendered services contract expires the procuring body may at that point decide

either to provide the services using its own resources or award the contract to a subsidiary public undertaking.

Equally, following the nationalisation of an activity, the government would be able to enter into a services contract (or services concession)<sup>1</sup> with a controlled subsidiary undertaking without infringing the public procurement rules.

There is nothing in procurement law to prevent the renationalisation of sectors.

### **State aid law**

The state aid rules<sup>2</sup> impose constraints on subsidising national undertakings where this has a distortive effect on competition and affects trade between member states in the EU.

The EU rules allow for state funding of industry in a number of areas where the distortion of competition is justified by the industrial policy objective served. In particular, state aid is automatically exempt from the rules where it falls within the “General Block Exemption Regulation” (Regulation No 651/2014). These exemptions cover support for training, research and development, small and medium sized enterprises and undertakings in poorer areas of the EU, including parts of the UK.

The exemptions are generally conditional on there being match funding provided by the recipient undertakings so as to incentivise private investment and limit state funding to areas where it will have the most efficient results.

It is also open to member states to invest in undertakings which compete in markets where this constitutes a ‘market economy’ investment. In other words, member states can fund their own state undertakings provided they reasonably anticipate a financial return on the investment.

Under EU regional policy, there are various sources of EU funds (from the overall EU budget to which the UK contributes) which are channelled to businesses and public projects in the more disadvantaged regions of the EU via institutions such as the European Regional Development Fund (ERDF). Regional policy enshrines the EU principle of solidarity and invests in the development of poorer regions, including parts of the UK.

The EU state aid and regional policy rules thus constitute a developed industrial policy which aims to provide and permit efficient public funding in areas where the market has failed to deliver.

While EU state aid law is regulated at EU level and does therefore provide some constraints on the way in which public funding is allocated, it again broadly aligns with Labour aims and values. It is a solidarity-

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<sup>1</sup> The Concession Contracts Regulations 2016 contain a similar “in house” exemption (Regulation 17). Rail franchise contracts are subject to a specific EU Regulation No 1370/2007 on public passenger transport services by rail and road, which specifically permits the direct award of a franchise contract to a controlled public undertaking without a tender process.

<sup>2</sup> Article 107, TFEU. “Save as otherwise provided in the Treaties, 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 market.”

based support mechanism which recognises and addresses the shortcomings of a free market ‘survival of the fittest’ model.

As regards specific Labour aims, State aid law does not preclude the nationalisation of industries provided that shareholders are paid no more than a market rate<sup>3</sup> and has no effect on the in-sourcing of public services as this does not distort competition.

It may potentially apply to the award of public service contracts to state undertakings without a tender process if the terms of the contract are excessively favourable as that could constitute a subsidy which could distort competition on a market and affect cross border trade. However, there are means of ensuring fair compensation for public services other than holding a competitive tender process.<sup>4</sup>

### **Article 106**

Article 106, TFEU<sup>5</sup> makes provision for the ways in which Member States can support public undertakings and undertakings ‘with special or exclusive rights’, in other words undertakings granted monopoly rights over an area of industry.

These companies are protected from competition law to the extent necessary for them to undertake public service tasks (such as for example a universal postal or telephony service).

However, it also gives the European Commission the power to intervene and legislate in areas where the grant of monopoly rights results in or facilitates competition law infringements (such as excessive pricing or poor quality of service, amounting to the abuse of a dominant position). Article 106 has been deployed by the Commission to ‘liberalise’ certain sectors (*ie* open up the sector to competition), which are important to the single market. These include the telecommunications sector, in particular.

The EU has also used general single market powers to open up other significant parts of the economy to competition and reduce barriers to cross border competition, including energy supply, rail services and postal services. As I explain in more detail below, the effect of these measures is that there are limits on the ability of member states to grant monopolies to state undertakings in certain areas of the economy.

This may make the re-nationalisation of companies operating in some sectors less attractive as the case for bringing public service industries under public control (serving the public and socialising profits) and

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<sup>3</sup> Note that Human Rights legislation may constrain the buying out of shareholders at a rate lower than the market rate. Human Rights law is not based on EU Treaty obligations and is not covered by this note.

<sup>4</sup> In the rail sector, Regulation No 1370/2007 lays down specific rules on payment for public service obligations so as to prevent over-compensation.

<sup>5</sup> “1. *In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.*

2. *Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in 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. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.*

3. *The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.”*

the investment it entails is arguably undermined if the industry is subject to competition with market operators. Private operators serve their shareholders and are incentivised, for example, to seek out the most lucrative areas of the sector (“cherry picking”), leaving the more complex or costly public services to the public provider.

The presence of competition also begs the question as to what entities would be nationalised – the re-nationalisation of, for example, Royal Mail would not equate to the nationalisation of the whole UK postal services sector because it has competitors, such as Whistl.<sup>6</sup>

However, public service sectors such as water and energy networks, where there is no economic case for duplicating the network, are considered ‘natural monopolies’ by EU regulators and these areas have been left to national policy choices. Water and energy network providers are generally not subject to competition.

I address the four areas that the 2017 Labour manifesto refers to below.

### ***Rail franchises***

The UK rail network has already been nationalised and is now run by publicly owned Network Rail. However, train operation contracts (franchises) are tendered and operated largely by private providers. Some lines are profitable for which franchisees pay a premium to Government and others require subsidy. There is a history of franchises being let and then failing and much controversy over the fragmented nature of the sector in the UK.

The first point to make on rail franchises is that in-sourcing or nationalisation of passenger franchises need not be costly as it can take place on a rolling basis at the end of existing franchises. There should in principle be no need to buy out shareholders. EU Regulation No 1370/2007 specifically permits the direct award of a franchise contract to a controlled public undertaking without a tender process.

The second point is that a passenger franchises involves point to point routes and are generally not subject to direct rail competition. The 4<sup>th</sup> package of EU rail directives<sup>7</sup> will mandate a degree of competition by extending the right to compete in passenger train operations over the national rail network from 2020. However, member states will be permitted to limit rail access between designated points if access would “*compromise the economic equilibrium*” of a public service contract on the same route.

Under EU rules, an objective economic justification would therefore be required on a case by case basis for protecting publicly run passenger train franchises from competition.

In terms of addressing sector fragmentation, the EU rules impose separation between network infrastructure managers and train operators, so as to ensure that vertically integrated providers do not

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<sup>6</sup> OFCOM recently imposed a record £50m fine on Royal Mail for abusing its dominant position in bulk mail delivery by pricing in a manner which made it difficult for Whistl to compete.

<sup>7</sup> Directive 2016/2370 amending Directive 2012/34/EU as regards the opening of the market for domestic passenger transport services by rail and the governance of the railway infrastructure.

obtain an unfair advantage on international passenger and freight services markets. The separation of track and operation in the UK dates back to privatisation, long before the EU rail regulations caught up.<sup>8</sup>

However, EU law would not prevent franchises being taken back under public control.

### ***Energy supply networks***

The EU has also adopted single market legislation which opens up energy supply services to competition and ensures that energy suppliers have fair access to transmission and distribution networks.<sup>9</sup>

Energy supply is the market in which companies buy electricity from wholesalers or generation companies and sell it on to end customers. Energy supply markets are not divided by region and are not natural monopolies. They may not be highly competitive markets due among other things to customers' reluctance to swap suppliers, but they are to open to competition and regulated by competition law. The EU energy supply directives are designed to ensure secure, competitive and sustainable sources of energy for the EU market.

The requirement to allow competition in energy supply markets therefore impedes the ability to nationalise this part of the sector. EU law would not however prevent a Labour Government sponsoring entry by a state undertaking into the energy supply market and seeking to take market share from the incumbents or indeed acquiring an existing energy supply business, provided it is a 'market investment'.

By contrast, operators of energy networks (such as National Grid in the UK) are considered utilities and continue to operate under monopoly rights, subject to certain limited exceptions under UK law. National Grid was privatised in 1990 and is investor owned. National Grid operates the high voltage transmission network. In the UK there are also 14 licensed electricity distribution network operators ("DNOs") and 8 licensed gas distribution networks ("GDNs") which run low voltage distribution networks taking electricity from the national grid to business and domestic users. These are geographically separate and also regulated as monopolists.

EU law recognises that these energy networks are natural monopolies which may be efficiently operated by sole providers and does not constrain national policy choices on whether the provider is a public undertaking or a private utility. EU law does regulate this activity in order to safeguard competition in the downstream markets. For example, by requiring separation or "unbundling" of energy transmission businesses from energy supply or generation businesses so as to reduce the risk that vertically integrated undertakings, whether public or private, would discriminate against competitors in the supply and generation markets.

However, the nationalisation of energy networks would not be prohibited by EU law.

### ***Water***

The water sector is in the same position as energy transmission and distribution. It is recognised by the EU as a natural monopoly and the privatisation of the UK water sector and attempts to introduce competition have come from national rather than EU policy.

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<sup>8</sup> The UK industry structure dates back to the Railways Act 1993. The first EU Rail Directive 91/440/EEC was dated 29 July 1991, but only required separate accounts between infrastructure management and transport operations.

<sup>9</sup> See Directives 2009/72/EU and 2009/73/EU on common rules for the internal market in electricity and gas.

EU law has introduced certain regulatory requirements on the water sector relating to the environment. However, there is nothing in EU law to prevent the re-nationalisation of the UK water sector.

### **Post**

Postal services is an area where the EU has intervened and required market liberalisation.<sup>10</sup> National authorities are required to safeguard a universal postal service by designating one or more companies as universal services providers.<sup>11</sup> But they must also ensure that a fair system is in place for licensing competing providers who may in turn be required to contribute towards the universal service.

A re-nationalised Royal Mail would no doubt continue to be designated as the universal service provider and the funding of that role would be protected by the EU rules. However, it would operate in a competitive environment, as demonstrated by the recent £50m fine imposed by Ofcom on Royal Mail for abuse of its dominant position, with the risk that its core revenues may be eroded over time.

The EU rules would not however prohibit re-nationalisation of Royal Mail.

### **Conclusion**

EU competition law is a friend to Labour. The EU is based on principles which are familiar to any Labour policy agenda.

Specifically, EU competition law is consistent with the overall aims of the 2017 Manifesto, the insourcing of services, the creation of public undertakings and nationalisation plans in relation to rail franchises, water undertakings and energy network operators. The postal sector is in a slightly different situation and the introduction of competition in post would need to be considered in weighing up the benefits of re-nationalisation.

BREXIT cannot therefore be sensibly depicted as an opportunity to pursue Labour economic reforms free of the shackles of EU law. They can be pursued within the EU and provide no reason to leave.

**Simon Taylor**

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<sup>10</sup> Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008 amending Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services. Article 7 states that: “Member States shall not grant or maintain in force exclusive or special rights for the establishment and provision of postal services.”

<sup>11</sup> Article 4 states: “Member States shall take measures to ensure that the conditions under which universal services are entrusted are based on the principles of transparency, non-discrimination and proportionality.”