COMISIÓN DE LAS COMUNIDADES EUROPEAS

Bruselas,

2006/2222
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Excmo. Sr. Ministro:

I would like to draw the attention of your Government to the provisions of Real Decreto Ley 4/2006 of 24 February amending the functions of the Comisión Nacional de Energía (CNE), which could be considered incompatible with the free movement of capital and the right of establishment, Articles 56 and 43 of the EC Treaty respectively. In this respect, I should also like to acknowledge the reply of the Spanish authorities of 24 March to the letter of the 3 March 2006 in which the Commission requested information regarding the above-mentioned Royal Decree-Law.

The Commission's understanding of the situation is as follows.

According to point 1, second paragraph, 1st sentence of the sole article of Real Decreto Ley 4/2006 of 24 February, which amends Function 14 of the Additional Provision 11(3)(1) of Law No 34/1998 of 7 October 1998 on the Hydrocarbons Sector, "*an authorisation [of the CNE] shall [also] be required for any acquisition of over 10% of share capital, or any other percentage giving significant influence, in a company that engages, either directly or through other companies belonging to its group, in any of the activities referred to in the preceding subparagraph of paragraph 1*[1]

Moreover, according to the same point 1, second paragraph, 2nd sentence, of the sole Article of the Real Decreto Ley 4/206 of 24 February the "*authorisation shall also be required for direct acquisition of the assets needed to carry out the above activities*".

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1 Companies engaged in "*regulated activities or activities subject to special administrative control, such as thermal nuclear power plants, coal-fired power plants of particular importance in the consumption of Spanish coal, or activities carried out in the non-mainland and offshore electricity systems, as well as storage of natural gas or transmission of natural gas with destination in or transit through Spanish territory by means of international gas pipelines.*"

Finally, according to the sole transitional provision, the "*Royal Decree-Law 4/2006 shall apply to any acquisition provided for in function 14 in Additional Provision 11(3)(1) of Law 34/1998 of 7 October 1998 as amended by this Law [*Real Decreto Ley 4/2006*], which has not yet been carried out at the entry into force of the latter, unless prior to its entry into force, authorisation has been granted from the CNE in the exercise of it function 14 as defined in Additional Provision 11(3)(1) of Law 34/1998 of 7 October 1998 on the hydrocarbons' sector.*"

Compatibility analysis of the relevant provisions

The Commission has conducted an analysis of the situation resulting from the adoption and implementation of this Real Decreto Ley on the basis of the applicable Articles of the Treaty, the interpretation of the relevant provisions set out in the "Communication of the Commission on certain legal aspects concerning intra-EU investment"[2] based on the case-law of the European Court of Justice and recent rulings of the Court[3]. This analysis also takes into account the additional clarifications provided by the Spanish authorities in their letter of 24 March.

Article 56(1) of the EC Treaty stipulates that:

"Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."

According to the nomenclature set out in Annex I to Directive 88/361/EEC (Council Directive of 24 June 1988 for the implementation of Article 67 of the Treaty[4]) direct investment in the form of participation in an undertaking by means of a shareholding is to be considered a capital movement (List item 1A). The explanatory notes appearing in that annex state that direct investment is characterised, in particular, by the possibility of participating effectively in the management of a company or in its control. Thus, the acquisition of controlling stakes in domestic companies by other EU investors is also considered to be a form of capital movement[5]. Likewise portfolio investment operations between Member States are to be considered capital movements (List item III A 1)[6].

"*The acquisition of controlling stakes in domestic companies by an EU investor, in addition to being a form of capital movement, is also covered under the scope of the right of establishment*"[7]. In this sense, Article 43 of the Treaty governing the right of

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2 "*Communication of the Commission on certain legal aspects concerning intra-EU investment*", OJ C220/15 of 19.7.1997.

3 C-58/99 *Commission v Italy* ECR [2000] p. I-3811, C-367/98 *Commission v Portugal* ECR [2002] p. I-4731, C-483/99 *Commission v France* ECR [2002] p. I-4781, C-503/99 *Commission v Belgium* ECR [2002] p. I-4809, C-98/01 *Commission v United Kingdom* ECR [2003] p. I-4641, C-463/00 *Commission v Spain* ECR [2003] p. I-4581 and C-174/04 *Commission v Italy* ECR [2005] p. I-4933.

4 OJ L178 of 8.7.1988 p.5-18

5 *Communication*, op. cit., § 2.3, confirmed in ECJ judgements in cases cited in footnote 2 above.

6 The "*direct acquisition of assets*" could, in certain cases involving the acquisition of land, buildings etc., be considered as a capital movements' operation defined in Nomenclature Item II – "*Investments in real estate (not included under I) A - Investments in real estate on national territory by non-residents.*" However in all cases the operations involved can be considered as capital movements.

7 *Communication*, op. cit., § 2.4.

establishment provides that "... *restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited.*"

1. In view of the above, the provision of point 1, second paragraph, 1st sentence of the sole Article of Real Decreto Ley 4/2006 of 24 February, that subjects to the authorisation of the CNE the acquisition by any persons of over 10% of the capital, or any other percentage giving significant influence in regulated companies or the direct acquisition of assets needed to carry out regulated activities in the energy market, constitutes a restriction to direct investment in the company in question. Additionally, since the constraints would "*restrain investors from buying non-controlling stakes for portfolio investment purposes, they can also be considered as restrictions on portfolio investments operations*"[8]. Therefore, this provision constitutes a restriction to the free movement of capital.

2. Point 1, second paragraph, 2nd sentence of the sole Article of the Real Decreto Ley 4/2006 of 24 February provides that an "*authorisation shall also be required for direct acquisition of the assets needed to carry out the above activities*". Such acquisition of assets involves a direct investment operation subject to a prior authorisation regime which could affect cross-border direct investment and hence, be an obstacle to capital movements.

As regards these two measures, it must be recalled that the Court in its rulings[9] has determined that prior authorisation requirements represent restrictions. Whether such restrictions can be justified or not is a separate question, and is treated subsequently.

The Commission therefore takes the view that the two measures identified above are restrictions to direct investment in the energy sector and therefore to the free movement of capital and the right of establishment, Articles 56 and 43 of the EC Treaty respectively, and must be justified in order to be considered as compatible with Community Law.

Analysis of possible grounds for the justification of restrictions identified above

The Court of Justice has confirmed that the free movement of capital "*may be restricted only by national rules which are justified by reasons referred to in Article 58 EC or by*

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[8] *Communication*, op. cit. § 3.7.

[9] Joined cases C-358/93 and C-416/93 *Bordessa* [1995] ECR p. I-361 §§ 24-25:
"*24 As the Advocate General pointed out at point 17 of his Opinion, authorization has the effect of suspending currency exports and makes them conditional in each case upon the consent of the administrative authorities, which must be sought by means of a special application.*
25 A requirement of that nature would cause the exercise of the free movement of capital to be subject to the discretion of the administrative authorities and thus be such as to render that freedom illusory (see Joined Cases 286/82 and 26/83 Luisi and Carbone v Ministero del Tesoro [1984] ECR 377, paragraph 34). It might have the effect of impeding capital movements carried out in accordance with Community law, contrary to the second paragraph of Article 4 of the Directive." See also joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera and Others* [1995] ECR p. I-4821 §§ 24-25.

overriding requirements of the general interest and which are applicable to all persons and undertakings pursuing an activity in the territory of the host Member State.. [10]

For the analysis of the possible grounds for justification of the restrictions identified above, the Commission has considered the arguments presented in the preamble of the Real Decreto Ley explaining the reasons for the adoption of this measure, as well as the criteria (described below) for the authorization procedure.

The preamble to Real Decreto Ley 4/2006 provides little guidance as to the precise justification advanced by the authorities for the restrictions introduced on capital movements and establishment in the energy and gas sector. The decree, however, notes that "*trends as regards company mergers in the international and European energy markets have highlighted certain deficiencies in the current legislation*" and that "*under current legislation it is not possible to scrutinise all takeovers affecting Spanish energy policy interests in general and public security in particular*".

The Commission would recall that a restriction on the basic freedoms in respect of takeovers affecting Spanish energy policy interests in general would not appear to be covered by the exceptions provided for in the Treaty. Neither could it be considered as an imperative requirement in the general interest, since Spanish energy policy interests could cover a broad range of economic interests. In this context it should be recalled that it is settled case law that **restrictions on the freedoms can not be justified on economic grounds**[11].

The criteria to be applied by the Comisión Nacional de la Energía (CNE) when considering applications for authorisation suggest other possible grounds for justification of the restrictions identified above, as confirmed by the Spanish authorities in their letter of 24 March 2006. According to paragraph 2 of the sole Article of Real Decreto Ley 4/2006 of 24 February, the CNE may refuse the authorisation in question or grant it, subject to certain conditions, for any of the following grounds:

a) *"The existence of significant risks or adverse effects, whether direct or indirect, in relation to the activities referred to above".*

b) *"Protection of the general interest in the energy sector, in particular in order to guarantee that industry policy objectives are adequately met, with particular reference to assets that are strategic for energy supply, i.e. that can affect guarantee and security of supplies of gas and electricity, and are defined in the Decree-law".*

c) *"The possibility that the company carrying out the activities referred to above may not be able to perform them with sufficient guarantees as a result of any other activity carried out by the acquiring or acquired company".*

d) *"Any other reason relating to public security.*

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[10] Judgement of 13 May 2003 in case C-463/00 *Commission v Spain* op. cit. § 68.

[11] See C-367/98 *Commission v Portugal* op. cit. § 52 "*It is settled case-law that economic grounds can never serve as justification for obstacles prohibited by the Treaty (see, as regards the free movement of goods, Case C-265/95 Commission v France [1997] ECR I-6959, paragraph 62, and, in relation to freedom to provide services, Case C-398/95 SETTG [1997] ECR I-3091, paragraph 23).*"

1. *The security and quality of supply, defined as the uninterrupted physical availability of the products or services in the market art reasonable prices in the short or long term for all users, irrespective of their geographical location; and, in addition:*

2. *Security with respect to the risk of insufficient investment in or maintenance of infrastructures failing to guarantee, on a continuous basis, the minimum services necessary to guarantee supply."*

With respect to a) the Court has established that *"... in order to be so justified, the national legislation must be suitable for securing the objective which it pursues and must not go beyond what is necessary in order to attain it, so as to accord with the principle of proportionality"*[12]. In addition, regarding legislative measures in authorisation procedures, the ECJ has established that investors need to be given clear indication of the specific, objective circumstances in which prior approval will be granted or withheld.[13]

The Commission notes that the risks or adverse to consider by the CNE are not explicitly defined. In addition, these risks and adverse effects do not need to be either serious or immediate to refuse authorisation. In these circumstances, investors cannot have clear indication of the specific and objectives circumstances that could lead to a refusal of imposition or conditions as a result of the authorisation process. Moreover, without explicit definition of risks and adverse effects, the proportionality of the measure is questionable. Therefore, **the need to assess risks and effects cannot justify these restrictions** on the acquisition of more than 10% in the participation in companies and the acquisition of certain assets.

Similar considerations apply to paragraph c) above. Apparently, the simple "possibility" of difficulties in the supply could be sufficient reason to deny authorisation. The "nature" and "sufficiency" of guarantees are not defined and are left to the discretion of the CNE. Thus, **for the above reasons,** the Commission considers that the restrictions on the acquisition of assets and participations above 10% of the capital **cannot be considered proportional and would not allow any potential investor to ascertain a priori their chances of getting the requested authorisation.**

With respect to paragraph b) the Court has accepted that the protection of the "general interest" may justify an obstacle to the free movement of capital. *"However, the Court has also established that the requirements of public security, as a derogation from the free movement of capital must be interpreted strictly, so that their scope cannot be determined unilaterally by each Member State without any control by the Community institutions. Thus public security may be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest to society."*[14]

Far from being specific and explicit, industrial policy objectives are not defined. In addition, the criterion does not require any "genuine and sufficiently serious threat to a fundamental interest to society". Therefore, the measure gives discretion to the Spanish

[12] See judgement of 13 May 2003 in case C-463/00 *Commission v Spain* op. cit. § 68.

[13] See judgement in *Commission v Spain*, case C-463/00 op. cit., § 74; *Église de Scientologie*, case C-54/99 ECR[2000] p. I-1335 , §§ 21 and 22 as well as *Canal Satélite Digital*, case C-390/99 ECR[2003] p. I-3373, §35 and *Analir and others*, case C-205/99 ECR[2001] p.1271, §38.

[14] Judgement of the Court of 4 June 2002 in case C-503/99 *Distrigaz*, § 47.

authorities to refuse authorisation even when the conditions required by the Court are not met. Therefore, **this argument cannot justify the restrictions imposed on the acquisition of assets and participations beyond 10% of the company's capital.**

Finally, with respect to paragraph d) security of supply of oil products and electricity is recognised, in certain circumstances, as a public security reason accepted by the Court.[15] The Commission considers, however, **that the measure is not proportionate** and therefore cannot justify restrictions on the acquisitions of participations beyond 10% of the company's capital nor the acquisition of certain assets for the following reasons:

- As stated above in paragraph (b) above, the Court's requirement of a "genuine and sufficiently serious threat to a fundamental interest to society" is not included and authorisations could be denied even if this requirement is not met.

- The Commission notes that although the ECJ clearly acknowledged that, in certain circumstances, the safeguarding of energy supply is a legitimate requirement in the public interest, it only upheld the relatively more limited scheme of Belgium[16] where the regime is restricted to certain decisions concerning the strategic assets of the company, whereas it considered the regime of France[17], which is based on controlling the capital ownership structure of the enterprise, to be incompatible with Community law.

- In addition, in the ruling on the Belgian case[18], the Court put the emphasis on the suitability and proportionality of the ex-post "opposition" mechanism as a non-restrictive way to achieve the objectives of security of supply. An ex-ante authorisation procedure for the acquisition of certain assets or participations in excess of 10% would appear disproportionate to the intended objective. Furthermore, prior authorisation from the CNE must be obtained before an acquisition can be authorised in accordance with the legislation on the securities market[19]. In a properly regulated sector, national and Community measures could encompass mechanisms to achieve those objectives without any detriment to the Treaty freedoms. For instance, regulatory measures can be more suitable and less restrictive than ex-ante authorisations to ensure the proper maintenance of infrastructures in the long term or the interrupted supply of energy[20].

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15 See judgement of 13 May 2003 in case C-463/00 *Commission v Spain* op. cit § 73 and judgements of 4 June 2002 in case C-503/99 *Distrigaz* op. cit. § 46 and C-483/99 *France* op. cit., § 47.

16 Judgement of 4 June 2002 in case C-503/99 *Commission v Belgium op. cit §§ 49-5.*

17 C-483/99 *Commission v France op. cit.§§ 50-53.*

18 C-503/99 *Commission v Belgium* op. cit. § 49.

19 Paragraph 2(d)3 of Real Decreto Ley 4/2006

20 Actually, national laws No. 34/1998 *Ley del Sector de Hidrocarburos* and No. 54/1997 *Ley del sector eléctrico* already include provisions to ensure continuity of supply and infrastructure maintenance. Furthermore, in the Commission's view, Community directives No 2003/54/EC (OJ L176, 15/07/2003 p. 37–56) and No 2003/55/EC (OJ L176, 15/07/2003 p.57-78) concerning Community rules for the internal market in electricity and in natural gas respectively, provide a framework for the exercise by Member States of powers in respect of the public service obligations imposed on the privatised undertakings without the need for governments to interfere with the ownership of the companies. Specifically, the provisions of the directives lay down strictly defined parameters that in the Commission's view ensure the maintenance of a balance between the respect of competition concerns and the protection of essential public services. An additional ex-ante authorisation seems thus redundant and less suitable as it will be more difficult to ascertain the risks of insufficient maintenance or interruption of supply.

Furthermore, the Commission notes that these criteria are very similar -and actually, practically identical- to those indicated in Disposición adicional vigésima quinta and Artículo 94 of Law No 62/2003 of 30 December de medidas fiscales, administrativas y del orden social amending, respectively, Law No 5/1995 of 23 March on the legal arrangements for disposal of public holdings in certain enterprises and the disposición adicional vigésima séptima of Law No 55/1999 of 29 December de medidas fiscales administrativa y del orden social regarding public holdings in the energy sector, which are the subject to current infringement procedures. In both cases, the Commission has rejected in the context of those infringement procedures that the justifications included in the aforementioned provisions can justify restrictions to the free movement of capital and right of establishment.

Thus, the Commission does not consider that the restrictions to capital movements and establishment set out in 1 and 2 above, related to the authorisation required to acquire stakes above 10% and certain assets, are justified.

Moreover, the Commission notes that the sole transitional provision of Royal Decree Law 4/2006, applies to any acquisition which has not as yet been carried out at the date of entry into force, unless prior to this date authorisation has already been granted. As confirmed by the authorities in their reply to the Commission's letter of 3.3.2006, the CNE had already granted GAS NATURAL, S.D.G. on 8.11.2005 the authorisation to proceed with the acquisition of ENDESA. Given that the acquisition of ENDESA has still not taken place, this implies that different rules would be applied to other potential purchasers of ENDESA. The fact that Spanish authorities deemed such new rules not necessary at the point in time when GAS NATURAL was granted the authorisation constitutes a further strong and significant indication, in the Commission's view, that the measures in question cannot be considered to be proportional.

Conclusion

The Commission of the European Communities consequently takes the view that both provisions of point 1, second paragraph of the sole article of Real Decreto Ley 4/2006 of 24 February 2006 are incompatible with the free movement of capital and the right of establishment guaranteed by Article 56 and 43 of the EC Treaty respectively.

In these circumstances, and under the terms of Article 226 of the Treaty establishing the European Community, the Commission requests that the Spanish government submits its observations on the contents of this letter within two months of receipt thereof.

After taking note of these observations, the Commission may, if necessary, deliver a reasoned opinion foreseen in Article 226 of the Treaty. It also reserves the right to issue a reasoned opinion if the observations fail to reach it within the time specified.

Yours faithfully,

Por la Comisión

Charlie McCreevy

Miembro de la Comisión