

# **The Impact of EU accession on Water Services Corporation**

A report prepared by

*EUROPA* Research & Consultancy Services Ltd

for

Water Services Corporation

**PART V**  
**Conclusions**  
**(Competition and Other Issues)**

**May 2000**

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**WATER SERVICES CORPORATION**

Water Services Corporation

Luqa.

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# Introduction

## *Terms of reference*

This volume is part of a wider report on the impact of EU accession on the Water Services Corporation originally commissioned in April 1<sup>st</sup> 1999. The terms of reference are the following:

1. The need to update to the WSC report submitted in July 1996 and prepared by Richard Morris & Associates of Scotland entitled "European Union Water Directives Study".
2. The need for a study of the impact of EU membership on WSC through an assessment of the adoption by Malta of the *acquis communautaire*.
3. Proposals for reform in view of the adjustments rendered necessary by membership.
4. Proposals for a negotiating position to be adopted by WSC in view of accession negotiations.
5. Proposal of an implementation strategy, including a time frame to be followed by the Corporation between now and accession.
6. An implementation programme as a follow-up to the study.

The above constitute the terms of reference of this report.

## *The first phase*

In an initial phase leading to the above, Europa Research & Consultancy Services was given the task to prepare and submit a research report covering the following parts, namely:

1. The need to update to the report submitted in July 1996 by Richard Morris & Associates of Scotland entitled "European Union Water Directives Study".
2. The need for a study of the impact of EU membership on WSC through an assessment of the adoption by Malta of the *acquis communautaire*. This section, which shall form the core of the report, shall include the following sections:
  - (a) Ramifications of the EU **Environment policy** (not covered in point 1);
  - (b) **EU incentives** and how to access them, including

community programmes and funding, both before and after accession:

- (c) EU **Public Procurement** rules;
- (d) EU rules on **Health & Safety at work**;
- (e) **Competition policy** and other issues.

- 3. Proposals for reform in view of the adjustments rendered necessary by membership.
- 4. Proposals for a negotiating position to be adopted by WSC in view of accession negotiations.

*Submission of interim reports: Parts I to V*

Throughout the year 1999, five interim reports were submitted to WSC covering points 1 and 2(a) to 2(e) above.

These reports were duly studied by the WSC in close consultation with Europa Research & Consultancy Services. Subsequently, WSC submitted its views and positions on the points raised in the said five reports.

**Concluding reports**

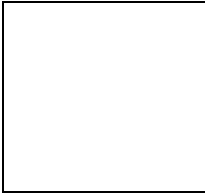
Taking into accounts WSC's submissions on each of the five interim reports, Europa Research & Consultancy is now submitting its final report on each of these reports. For clarity, the concluding report is again divided into five parts on the same lines of division as the interim reports. In this case, however, the concluding report will focus on points 3 and 4 above, namely, proposals for reform in view of the adjustments rendered necessary by membership accompanied with a proposals for a negotiating position and an implementation strategy to be adopted by WSC in view of accession negotiations.

*How this report is divided*

This volume constitutes the PART V of the concluding report and is being submitted in April 2000. It covers the area of the competition policy and other issues. A further four reports, concluding Parts I, II, III and IV are also being submitted.

This volume is divided into the following sections:

- 1. A brief summary of the key legislation and main points arising out of the interim report – Part V (EU Position);
- 2. A brief summary of WSC's position on the EU legislation (WSC position);
- 3. Proposals for reform and implementation (Reform & Implementation) (for the purposes of implementation, the official working



date of 1<sup>st</sup> January 2003 shall be adopted) and

4. Proposals for WSC's negotiating position (WSC Negotiating Position).

*Phase 2:  
Meetings and  
follow-up to  
the report*

The submission of all five concluding reports shall be followed as necessary by information and debriefing meetings with the WSC officials in order to ensure that maximum utility is made out of the report leading to an effective follow-up strategy.

*Note on the  
report*

This report does not attempt to constitute an academic study. Quite the contrary, it tries to tackle the issues in a practical manner diluting their complexities and presenting them in an intelligible and easy-to-read manner. To this end, technical references and footnotes have been kept to a minimum.

*Instructions  
on how to  
read the  
report*

The report relies heavily on the use of margin notes to indicate the contents of each section or paragraph accordingly. This is done to enable easier reference and reading. All margins notes are listed in the content list and on the left-hand side of every paragraph. Reading through the margin notes one can quickly get an idea of the issues that are tackled in the report and cross-refer to different sections.

*Working team*

The team working on the project was led by Dr Joanna Drake and included Dr Mariosa Vella Cardona. Team members hold academic post-graduate training on EU affairs and an active involvement in lecturing and/or research contributions on the subject.

## Competition Law and other issues

*Introduction* As explained in the introduction, this document follows up on Part V of the WSC report which had focused in detail on EU competition policy and is divided into the following sections:

- A brief summary of the key legislation and main points arising out of the interim report – Part V (**EU Position**);
- A brief summary of WSC's position on the EU legislation (**WSC position**);
- Proposals for reform and implementation (**Reform & Implementation**) (for the purposes of implementation, the official working date of 1<sup>st</sup> January 2003 shall be adopted) and
- Proposals for WSC's negotiating position (**WSC Negotiating Position**).

### 1. WSC as a public undertaking for the purposes of Article 86 EC Treaty

#### *EU Position*

*Article 86* As alluded to in our previous report on Competition law, within the context of competition policy, **Article 86** of the EC Treaty is the most important provision, at least in so far as WSC is concerned.

Article 86 is specifically addressed to Member States and lays down the following:

- the general principle that 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 EC Treaty, including the competition rules, that is, Articles 81 and 82 of the EC Treaty.
- provides a narrow **exemption** to the general rule above which exemption applies if three conditions are simultaneously satisfied. These three conditions are namely the following:

(a) the undertakings concerned must have been entrusted with the “**operation of a service of general economic interest**” or “**having the character of a revenue-producing monopoly**”;

(b) the application of the Treaty rules, including the competition rules, would **obstruct the performance in law or in fact of the particular tasks** assigned to it;

(c) in any case the **development of trade must not be affected** (if the exemption were to be made available) to an extent contrary to the interests of the Community.

- provides the Commission with important powers to issue directives and make decisions relevant to the **liberalisation of particular national markets and to prevent breaches of competition law by Member States**.

*Substantive issues*

Thus the Article imposes a fundamental obligation upon Member States not to take any measures contrary to the Treaty rules in favour of certain undertakings, namely **public undertakings and undertakings to which they grant special and exclusive rights**, such as WSC.

The article refers specifically to two types of infringement, namely (a) breach of competition rules including state aid rules and (b) discrimination on grounds of nationality contrary to Article 12 of the EC Treaty. This essentially means that Member States:

- must not discriminate in favour of state-related undertakings and against other EU undertakings and
- they must not allow such undertakings to act in a manner contrary to competition rules.

It may be apt to recall that Article 86 also creates **obligations for undertakings such as WSC directly** even though through the drafting of the Article one could easily be led to believe that it is primarily directed towards Member States. Thus anti-competitive acts performed by WSC such as if WSC were to enter into an agreement with third parties which limits the right of third parties to supply services, could also be caught under Article 86(1).

Article 86(2) provides for certain derogations. In fact, this article of the treaty provides for a derogation from the application of the Treaty rules **in the case of undertakings entrusted with a service of general economic interest** (as interpreted by the ECJ: reference to previous report may be made) **or**

**undertakings having the character of a revenue-producing monopoly.**

**It is important to remember that the derogation applies to ALL treaty rules, but especially to competition, freedom to provide services, and free movement of goods. Thus a public undertaking *may* behave in a way that restricts competition, free movement of goods, free provision of services but only if it could not otherwise carry out the special task (i.e. the task of general economic interest or the task to produce revenue) with which it has been entrusted.**

However, it may be apt to recall that in our previous report a distinction was made between the **original** scope of application of the derogation as opposed to the **recent** scope of application, and this in line with developments in the interpretation of Article 86 by the ECJ.

*Developments  
in the  
interpretation  
of Article 86*

- The **traditional approach** to Article 86 was to the effect that the fact that an undertaking to which a State grants exclusive rights has a monopoly is not as such incompatible with the Treaty rules on competition. This meant that the existence of a monopoly as such was not contrary to Article 82 which prohibits the abuse of a dominant position. However, in its relations with third parties, the monopolistic undertaking was to behave in a fair manner consistent with the competition rules. This meant, in particular, that there was to be no imposition of unfair charges or conditions and no discrimination in favour of national suppliers against foreign suppliers by the dominant enterprise unless such competitive behaviour would prevent them from carrying out their task.
- Under the new approach, the European Court of Justice maintains that the competition rules apply not only to the way in which the monopoly is exercised **but also** to the existence of the monopoly itself. Such an approach essentially means that the existence of the monopoly itself as granted by the state may be contrary to the Treaty **unless the monopoly is necessary to perform a task of general economic interest**. This necessity test is of the utmost importance. (reference may be made to our previous report for examples of how this test has been applied by the ECJ in practice) .

This development in the interpretation of Article 86 meant that whereas the **original scope** of application meant that the

derogation was rarely used because the infringement of treaty rules would only be allowed if it would otherwise be **IMPOSSIBLE**, not just difficult, for the relevant undertakings to carry out their special tasks, under the **recent scope** of Article 86 (due to a new interpretation of Article 86 as explained above) **there are greater opportunities for undertakings of general economic interest to rely on the derogation. This is so because the derogation is in fact now used to determine whether the very existence of a monopoly is necessary to perform a task of general economic interest.**

The characteristics of a service of a general economic interest have been identified as being the following:

- (i) the obligation to provide a service fulfilling certain essential needs to the population;
- (ii) the provision of an essential service throughout a defined territory;
- (iii) the provision of an essential service to all consumers within the territory;
- (iv) the provision of an essential service under affordable conditions.

**The distribution of water has been held to be a service in the general economic interest.**

The **necessity test**, referred to above, is based on economic considerations, namely:

- the undertaking must have sufficient revenue to carry out its task;
- there must be a necessary economic equilibrium for the undertaking carrying out the task in the general economic interest;
- the legislation applying to it is also to be considered in compliance with certain standards;
- whether the grant of the exclusive right is necessary to enable the undertaking to meet all the obligations imposed upon it by the State.

*Summary of  
EU position*

To summarise, the position is as follows:

- The grant of exclusive rights to an enterprise constitutes a “measure” within the meaning of art.86(1), the validity of which must be checked against Article 86(2).
- The way that this is done is through an application of the

“necessity test” alluded to above.

- This test defines the permitted scope of monopolies or rather limit their maximum limit.
- Beyond this limit, they are likely to be considered incompatible with the Treaty.
- Furthermore, the fact that an undertaking is carrying out a task in the general economic interest does not give it an open licence to act anti-competitively. It remains subject to EU competition rules, namely, arts. 81 and 82, unless these rules prevent it from the performance of its tasks.

How WSC is likely to be affected

Thus the **position of WSC** is the following:

**Subject to the necessity test, WSC’s monopoly as provider and distributor of water services is not as such considered to be incompatible with the treaty rules on competition, although WSC retains its duties to act fairly and in accordance with EU competition rules in relation with third parties.**

**The distribution of water has been held to be a service in the general economic interest.**

The relationship between state-related undertakings and competition rules

Does Article 82 apply?

It may be apt, at this point, to take a brief look and recall what the position is in so far as the relationship between state-related undertakings and the competition rules is concerned – Articles 81 and 82 and Article 86. Are the competition rules (81 and 82) rules applicable anyway to public undertakings having special or exclusive rights and carrying out a task in the general economic interest?

The answer is an **affirmative one** (subject to the fulfilment of the criteria alluded to in our previous report) so that a state-related enterprise, such as WSC, is still subject to **Article 82** which prohibits the abuse of a dominant position by a dominant undertaking, particularly if:

- it abuses in its dealings with third parties e.g. through unfair or discriminatory practices; or
- it prevents all competition by third parties in its principal field or ancillary activity, as a result of the exercise of the exclusive right held by the undertaking in question. This would be particularly the case if the monopoly was **manifestly unable to meet the demand on the market** (we shall come back to this point in dealing with the Hofner case below – see also previous report – to comment on the extent

to which this “manifest inability” is applied).

The effect of Article 82 application is that either the monopoly becomes illegal *per se* and should be abolished or else it might limit the scope of the monopoly although not abolish it entirely.

Note however, that for Article 82 to apply, one of the conditions is that:

- the **undertaking in question must act in a way that affects trade between Member States.**

However, Blum argues<sup>1</sup> that in certain cases a monopoly does not affect trade between member states even where it covers an entire territory of a member state. He writes: “This can be the case with monopolies over territories situated on the fringe of the EC for example Ireland, Greece, Denmark, where, in certain sectors of activities and because of geographic reasons, trade between Member States is unlikely. It is a question of fact in each case.”

**Clearly, using the same logic, Malta should also be considered in the same category and therefore it may be argued that the retention of monopoly rights in the hands of WSC does not affect inter-state trade and therefore that the monopoly rights need not be forfeited by WSC.**

*Does Article 81 apply?*

Article 81 of the EC Treaty has also been held to apply to public undertakings. However, the derogation found in article 86(2) has been held to apply to exempt **agreements between state-related undertakings which have been entrusted with a task of general economic interest.** These agreements are subject to the competition rules – whether or not they have been encouraged by public authorities – unless, as has already been explained, these rules would obstruct the performance of a task of general economic interest.

#### **WSC Position**

*WSC's present position*

It might be immediately apt to point out that the position of WSC under Maltese law is different from what its position is under EU law. This is so since, as already highlighted in our previous report, Maltese competition law, (by virtue of Article 30) exempts WSC from the application of competition rules.

However, insofar as EU competition rules apply to WSC, WSC must be aware of its obligations especially vis-à-vis foreign

<sup>1</sup> Blum, Logue, State Monopolies under EC Law, Wiley, 1998 at pg. 65.

suppliers. EC competition rules will be applicable to WSC if its behaviour is such **as to effect inter-state trade** and is not merely of a national import in that it has only a local impact. This entails an examination of **various issues** relating to the present position of WSC. However, in the main, it has just been said above, that since Malta is geographically isolated from the EU internal market, it may be argued – as Blum does on other isolated jurisdictions – that WSC’s monopoly does not affect inter-state trade and is therefore not illegal under EU law.

**Costs and conditions charged by WSC:**

In view of what has been discussed above, it is interesting to identify the costs and conditions which are charged by the WSC, in relation with third parties. This is so in order to establish whether WSC as an undertaking, to which Article 86 applies, is acting anti-competitively in its relations with third parties in that it is either imposing unfair charges or conditions or discriminating in favour of national suppliers against foreign suppliers as well as whether it is justified in doing so since it is necessary for the performance of its task.

In accordance with information forwarded by WSC officials, it is safe to state that the tariffs which are charged by WSC are charged according to rates established by the Corporation **and approved by the Minister**. These include basically the following:

- Cost of water as established by LN 58 / 1999.
- Service charges as established by LN 58 / 1999.
- Licensing of swimming pools (LN 108 / 1999) and an annual fee is charged to swimming pool owners.
- Licensing of importation of pumps (LN / 1997). No fees are charged in connection with this importation but importers are requested to inform buyers of submersible pumps to seek relevant permit from WSC.
- Registration fees are charged to operators of private wells, owners of drilling rigs and water tanker operators and as established by LN 120/1997; LN 165/1997 and LN 167/1997.

**Since tariffs are established by government by legal notice and since tariffs are also established on the basis of public**

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<sup>2</sup> Corbeau, C-320-91 (1991)ECR 1-2533.

**social considerations, it is safe to argue that WSC is not in any way abusing its monopoly rights through its tariffs.**

**The amount and type of exclusivity conferred on WSC:**

It is also important to ascertain the **amount** and **type** of exclusivity conferred on WSC by Maltese law. Such an exercise would help in the application of the necessity test as identified above. In fact one must establish whether Maltese law is too far-ranging and broad in the conferment of exclusive rights so as to render the exclusivity of certain tasks unnecessary. For instance, Article 3 of the Water Services Corporation Act confers on WSC a number of exclusive rights. These are namely the following:

- Acquisition, production, sale, distribution, exportation and disposal of domestic, commercial, industrial and other purposes.
- Conservation, augmentation and operation of water resources and sources of supply,
- Functions related to water conservation, supply and distribution as may be deemed appropriate,
- Treatment disposal and reuse as appropriate of sewage and waste water,
- Provision for the use of stormwater run-off and rural areas.

It is important to note, however, that such exclusivity should be maintained by WSC **strictly where necessary and for WSC to farm out other tasks whenever possible.**

However, on the basis of information forwarded by WSC officials, it might be safe to state that this far-ranging exclusivity is not a realistic one since whilst the Act grants such exclusive powers to the WSC, in practice it should be noted that **exclusivity is not strictly applied.** Third parties, for example, are known to carry out certain tasks which in accordance with the WSC Act should form part of WSC's exclusivity. These include the following:

1. Between 1947 and 1955, farmers having registered wells were granted a licence to abstract groundwater according to the registration conditions and specifying pump equipment and abstraction rates.
2. Over the past years a number of boreholes have been opened and in 1997, LN 120/97 was issued to enable owners to register these boreholes. However theoretically the operations of these boreholes is still not covered by a permit. Moreover 1947-55 registered borehole owners have never had their licence renewed.

3. Private water tanker services are available with operators required to register with the WSC. LN 167/97 was published to allow registration of water tanker service but again these operators are in the majority operating without a licence.
4. Operation of drilling rigs. Drilling rigs are required to be licensed by the WSC. LN 165/1997 was issued to enable owners of drilling rigs to register their equipment.

In the above cases, it seems that although registration was carried out, the WSC has not invoked its powers to issue licences for regulating these activities.

Furthermore a number of hotels operate their own small water production (R.O.) facilities. Similarly no licences or permits have ever been issued in this respect.

These examples, in practice, impinge, on the exclusivity which has been conferred on WSC by the WSC Act so that reality is different from what is established legally. Furthermore, the very fact that a monopoly provider tolerates infringement on its monopoly i.e. where it accepts competition by others by failing to challenge them vigorously, might be classified as behaviour that is similar to the one condemned as being anti-competitive in the *Hofner* case (as discussed in our previous report) - in that the monopoly is manifestly unable to meet the demand on the market and hence is deemed to be abusing of its dominant position.

Other cases in point which might invoke the applicability of the *Hofner* case, in so far as WSC are the following situations:

- the fact that there are circumstances (albeit small) where consumers are not connected to the water distribution network and therefore are without a permanent supply. According to information forwarded by WSC officials, currently WSC has approximately 3-4 km outstanding extension works where no water main is provided and approximately 300 km of temporary water mains. In the case of households without a main, a temporary bowser service is provided free by the WSC.
- there are consumers with different levels of service, e.g. services situated in remote areas or those of a specific nature (e.g. high rise buildings) who do not necessarily enjoy the levels of service or quality as those provided in the remainder of the country.

### **Applicability or otherwise of the Hofner case**

We recall that in the Hofner case, the ECJ condemned monopoly rights where the monopoly in question was manifestly unable to meet demand. (Hofner is discussed in more detail in the previous report). In the Hofner case, the monopoly in question provided employment services in Germany and tolerated hundreds of private companies to effectively infringe its exclusivity. This, in itself, was seen as evidence of the fact that the monopoly was manifestly unable to meet demand for services.

How does this apply to WSC? Firstly, it must be said that WSC is not manifestly unable to meet demand since the cases where infringement of exclusivity are “tolerated” are not alarmingly high as was evident in Hofner (where similar services were being provided by hundreds of other companies) but are limited in number.

The position put forward by the authors of this report is that despite certain limited shortcomings in meeting demand and despite the Hofner judgement, **it may still be safely said that WSC’s position is not in infringement of EU rules in this respect.**

This is not only because cases of infringement of exclusivity are limited but more importantly because of the Corporation’s role as a **provider of utility services**, in this case, water. Clearly, the provision of water services is in no way comparable to the provision of employment services as in the Hofner case. More so in Malta, where water is such a scarce and expensive resource.

In fact, the European Court of Justice also backs this view. Thus, in the Corbeau case<sup>2</sup>, where the issue of “incompetent monopolies” was also raised, this time with regard to postal services, the Court decided **that the monopoly was nevertheless justified because it was necessary to provide a minimum level of service to the population as a whole.** Thus, the preferred view is that the Hofner judgement is not dead but that it cannot be applied to all cases of inability to meet the market demand.

**Indeed, as Blum argues, Hofner may be difficult to apply to utility services, including water, although this too, cannot be said in absolute terms.**

**The conclusion to derive from these teachings is therefore that WSC’s monopoly does not fall foul of EU law because of its inability to meet demand in absolute terms. More**

**importantly, however, WSC monopoly does not fall foul of EU competition law because this monopoly is justified because it is necessary to provide a minimum level of service to the population as a whole.**

**Combination of regulatory and operational functions:**

Another important point relates to the combination within one entity of exclusive rights to supervise and regulate on the one hand and to operate on the other hand as a commercial entity, as is the case, with WSC. In fact, in accordance with information submitted by officials of WSC, WSC performs a number of activities that are subject to competition, where it also has a regulatory function. These include the following:

- drilling service,
- Other commercial services – e.g. filtration installation provided to Malta Film Facilities, supply of seawater R.O. Plants to local hotels etc.,
- Water tankering service – a service which in emergency situations is provided free of charge to customers but may also be given to fee-paying customers in other situations.

Thus WSC is a service provider for drilling operations and at the same time regulates the importation and licensing of drilling rigs (LN 25/1997). Similarly, the Corporation also has regulatory powers in connection with licensing of water tankers, whilst it carries out its own water tankering service as noted above. This link between the regulatory and operational functions of the Corporation could have far-reaching consequences for WSC's position, under EU law, since it could lead to an infringement of Article 82 – hence, an ABUSE OF DOMINANCE.

It has been noted that in general the above-mentioned activities contribute to only a very minor portion of the WSC turnover. Furthermore, with the possible exception of the drilling service, the WSC has only a small part of the market share for each respective activity. Nonetheless, once these activities can still be considered as being ancillary to the exclusive tasks performed by WSC, **it is advisable that these functions must be separated if an entity enjoying special and exclusive rights, even if justified under Article 86 (2) is to be in line with its obligations under Article 28 as linked with Article 82.**

*reform*

**of WSC as a monopoly is not threatened by EU rules on competition. This applies largely because of its function as a utility service provider and despite certain shortcomings in living up to demand or in closing an eye to infringement of its exclusivity.**

**On the other hand, it is also submitted that the Corporation's regulatory powers may conflict with its second role as operator. This may lead to incompatibility with EU law and should be avoided. Indeed, it is known that a law should be enacted to divest the Corporation of its regulatory functions and to pass regulatory powers on to a new Authority.**

**In this regard, the authors of this report have seen a copy of the draft law on the Malta Resources Authority and are of the view that the bill gives no cause for concern. The only two points that may be highlighted and which may merit reconsideration are the following:**

- (a) The "independence" of the Authority from Government may be virtually annihilated by section 6 of the Bill which speaks about the relations between the Minister and the Authority.
- (b) Secondly, and perhaps more worryingly, the bill affords the Authority with functions of ensuring fair competition between licensees/operators. It is submitted that this function usurps the powers of the Office for Fair Competition (OFC), now itself due to become an authority. This is also worrying from the point of view of consistency in interpretation and legal certainty. What principles are applicable, what concept of competition, the same one as in the Competition Act? Should not the OFC at least be consulted on issues? It is submitted that this issue IS of EU relevance given Malta's obligation to abide by the EU competition rules which have direct effect in our jurisdiction.

### **Negotiating Position**

*Proposals for negotiating position to be adopted*

With regard to the issues discussed above, it is submitted that WSC should have no difficulty with abiding by EU rules and that therefore there is no scope for requesting any special arrangement.

### **The Directive on Financial Transparency**

*Transparency*

Directive 80/723/EEC deals with the **transparency of financial**

*of financial relations between member states and public undertakings*

**relations** between Member States and public undertakings and was issued under Article 86 (3) of the EC Treaty. This Directive is applicable to “public undertakings” as defined in our previous report.

The Directive lays down the obligation on Member States of ensuring that financial relations between public undertakings are **transparent**. Further details as to what this obligation implies have been indicated in our previous report on competition law.

However, it may be also be apt to recall that there is **no obligation** of transparency of financial relations between public authorities and public undertakings **in certain specific cases** (as highlighted in our previous report).

#### **WSC Position**

*WSC's present position*

As noted earlier, the WSC performs a number of activities which are subject to competition. An issue related to financial transparency that may arise is in the accounting methodology adopted by the WSC and the fact that no differentiation is made between monopolistic and oligopolistic activities. This is considered relevant since Government subvention is obtained by taking into account all operating costs and all the turnover (also see below under the section dealing with State aids).

#### **Reform & Implementation**

*Proposals for reform*

**For transparency purposes, it is submitted that the Corporation should be careful to render its accounting methodology more transparent and to distinguish between activities which are monopolistic and others which are not or which are even subject to competition. The ‘EU worry’ arises if there is suspicion that any funds forwarded by the government to the Corporation may be utilised to subsidise ‘commercial’ activities rather than ‘monopoly’ activities which are strictly essential as utility services.**

#### **Negotiating Position**

*Proposals for negotiating position to be adopted*

It is submitted that the exercise involved in rendering the accounting methodology of the Corporation more transparent as indicated above, whilst requiring adequate planning and effort, does not warrant any need for requests for special concessions.

#### **Free movement of goods**

*Free  
movement of  
goods*

The articles in issue here are articles 28-31 and article 86 and the position can be summarised as follows:

- The Treaty prohibits, as a general rule, any barriers to trade between Member States whether these are fiscal measures such as customs duties, quotas or any other restrictive measure which impedes the free flow of trade from one Member State to another within the Community.
- Restrictions can only be imposed by Member States for certain specified reasons and they can only be justified on the basis of certain specific grounds mentioned by the Treaty itself or accepted by the European Court of Justice.
- These grounds (examples of which have been given in our previous report) have been furthermore given a very strict interpretation.
- The free movement of goods provisions entail obligations for the State itself rather than individual enterprises.
- However, there are also certain obligations imposed on undertakings. The one which is perhaps of the most concern for WSC, concerns the issue of **type-approval**: public undertakings may be granted the exclusive power to lay down specifications for equipment intended for connection to the public network or to grant type-approval. This may be legal if it falls under one of the exceptions, provided they meet the proportionality test (that is, the measure is not more restrictive than absolutely necessary). They must also include the right to appeal against decisions refusing type-approval. Justifications may include, safety of users, safety of the network, animal health, protection of the environment, efficient operation of a product, public security, socio-economic reasons.
- There could also be an infringement owing to a link between Article 28 and Article 82 for an abuse of a dominant position is also likely to infringe Article 28 insofar as it makes imports from other Member states more expensive.
- Article 31 deals with commercial monopolies. The main obligation arising out of this Article is for Member States to **prevent any discrimination in favour of domestic products** through their national import and export agencies. It does not catch the laws of the Member States by which they impose quotas etc. **but the actions of the state agencies themselves which are entrusted to operate the monopoly**, as is the case with WSC.

- The derogation found in Article 86(2), might apply to infringements of Article 31, provided the criteria therein are satisfied.

#### Free movement of services

*Free movement of services*

The provisions dealing with the free movement of services are of no importance to WSC since utilities such as electricity and gas have been held to constitute **goods and not services**. The same would probably apply to water. This would mean that water would be covered by the rules regulating the free movement of goods rather than the free movement of services.

However, if the essential part of an activity carried out by WSC constitutes a service rather than the sale of a product, then Article 49 of the Treaty dealing with the free movement of services, prohibiting restrictions on the freedom to provide services within the Community, would apply.

#### WSC Position

*WSC's present position*

As noted above and in our previous report on competition law, the provisions dealing with the free movement of goods in the EC Treaty have the following implications:

- the existence of monopoly over the importation and marketing of goods is considered illegal;
- absolute bans on imports and exports are considered normally contrary to free movement of goods;
- compulsory pricing at retail level is likely to infringe on Article 28;
- Type approval (e.g. exclusive power to establish specifications for equipment connection to network or grants of type-approval) may be permitted.

Nonetheless, it might be apt to recall that justifications on certain grounds (such as protection of the environment) are also possible in some cases.

The following is the present position of WSC in so far as the importation and marketing of certain goods is concerned:

1. **Importation of Pumps**<sup>3</sup>: The importation of pumps is referred to the WSC for approval. Permission to use this equipment is also regulated by the WSC ACT XXIII 1991, Article 45 (d). In practice, little importation is prohibited by the WSC but in the case of submersible pumps, the WSC imposes conditions regulating their use (e.g. conditions prohibiting their use in illegal boreholes).

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<sup>3</sup> HS code not submitted.

2. **Bleaches** (H.S. Code 28.28 and 84.13). It is unclear why these goods are referred to WSC at importation stage and generally no objections are made by WSC with respect to their importation. Drainage authorities may however be more interested over control on their importation due to the potential impacts on sewage treatment works.
3. **Drilling rigs**. Conditions regarding the use of drilling rigs and/or ancillary equipment is regulated by the WSC Act XXIII Article 45 (d). As noted earlier a permit from WSC is required and this is established to protect against illegal abstraction from groundwater resources.
4. **Any other equipment used in the production, manufacturing or distribution of water**. Conditions regarding the use of this equipment is theoretically also regulated by the WSC ACT (Article 45 (d)). This includes a wide range of equipment but practically this provision is not enforced or regulated and items are not referred to the WSC at the importation stage or in any other way controlled. As has been highlighted by WSC officials, what is of major interest to the WSC is the use of **tapping equipment** since its sole purpose is to carry out connection between consumers services and the water distribution network. Although this equipment does not appear under the Customs Code of items imported, the WSC is interested in retaining its importation restriction to ensure against illegal tappings being carried out. In fact tapping equipment is used solely by WSC employees.
5. **Meters**. There are verbal agreements with the local distributors from whom revenue meters were purchased not to import the same model of meters as those purchased by WSC. However this arrangement is based solely on a verbal agreement with local distributors and cannot be effectively controlled.

## Reform & Implementation

Proposals for reform

**It is submitted that all of the above concerns with regard to WSC's role in dealing with import restrictions can be easily circumvented with the separation of the regulatory from the operational functions. It is assumed that once the Authority is set up, all the above powers relating to issuing of permits and control of importation would, of course, become part of the responsibilities of the new Authority.**

**This would divest WSC from its role in controlling or**

**restricting importation but it will also free it from worries of potential incompatibility with the free movement of goods (/services) provisions of the EC treaty.**

**Negotiating  
Position**

*Proposals for  
negotiating  
position to be  
adopted*

In view of the above, there does not appear to be any need for WSC to request any special concession with regard to the EU treaty rules on freedom of movement of goods and services.

## State aids

### *State aids*

Under this heading, we shall examine briefly the position of public undertakings in so far as articles 87 and 88 of the EC treaty and Article 86 are concerned:

- **Article 87** of the EC Treaty lays down the general rule that 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 is, in so far as it affects trade between Member States incompatible with the common market.
- The same article also makes provision for certain forms of state aid which is or which may be considered to be compatible with the common market (reference may be made to our previous report on competition law for further details).
- The Commission together with the Member States is obliged to keep under constant review all systems of aid existing in the Member States.
- State aid rules apply in their entirety to state-related undertakings which have been granted a task of general economic interest.
- It follows, therefore, that any new aid granted to these undertakings must be notified by the member states to the Commission under article 88. Existing aids (one which existed prior to the Member State's accession into the EU) do not have to be notified but remain subject to supervision by the Commission.
- Both in the case of new aid and of existing aid, it is up to the Commission to ascertain whether, having regard to article 86(2) (the derogation), an aid which is not exempted by article 87(2) and (3) may nevertheless be exempted on the ground that it meets the "necessity test" of article 86(2).
- Some cases establish that a state aid granted to a state-related enterprise may be legal pursuant to article 86(2) if **it goes no further than necessary to enable the enterprise to carry out its task of general economic interest and does not enable it to cross-subsidise activities in the competitive sector.**

### WSC Position

WSC's  
present  
position

As alluded to above and in our previous report on Competition law, state aid may take various forms. Thus any form of aid whatsoever presently being given to WSC by the Maltese government is to be examined in order to establish its legality or otherwise vis a vis EU law. This to establish the legality or otherwise of such aid under EU law.

#### Government Subventions:

A form of state aid par excellence are government subventions. In accordance with information forwarded by WSC officials, the present position of WSC seems to be the following, at least in so far as such subventions are concerned :

Article 27 of the WSC Act 1991 establishes provisions for tariffs charged by the Corporation. The WSC Act does not provide for a Government subvention as such. In fact, Article 27 states that the tariffs are required to provide sufficient revenue to:

- cover operating expenses,
- meet provisions for maintenance, depreciation, interest payments on borrowings, other interest payments,
- meet periodic repayments on long term indebtedness where repayments exceed provisions for depreciation,
- create reserves to finance reasonable part of cost to finance future expansion.

Due to the social dimension of water and to ensure affordability to domestic consumers, Government has opted to adopt an increasing block tariff structure for water consumption, **which encompasses a subsidy to consumers.**

In fact, LN 105/1994 established a tariff structure that considered metered water consumption and household occupancy. **Government subsidy to consumers was thus based upon the number of persons registered at each household.**

Water tariffs were subsequently amended in 1998 and 1999 (LN 57/1998; LN 213/1998 and LN58/1999).

The water consumption tariff was established at Lm 0.75 / m<sup>3</sup> in 1994. This was reviewed in 1998 and increased to Lm 1.10 /m<sup>3</sup>. This rate was calculated taking into account WSC financial considerations for the base year 1995/96 as follows:

Total operating costs	Lm16,693,000
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Depreciation costs	Lm 2,369,000
Net interest	Lm 4,517,000
Government debenture interest was excluded from this computation	Lm (2,760,000)
	Lm 20,779,000

This figure reflected WSC costs for the year (1995/96) and it was subsequently divided by the billed consumption (19,217,616 m<sup>3</sup>) for the corresponding period. Thus the water rate of approximately Lm1.10 /m<sup>3</sup> was established.

At the same time Government has opted to retain the increasing block tariff by giving a subsidy to consumers. In theory this subsidy should be equal to the Government subvention which is passed on to the Corporation on an annual basis. **In practice there are some differences between this subsidy and Government subvention, as highlighted by WSC officials, so that the actual government subvention being forwarded to the WSC is less than that which theoretically should be given.**

In fact, this difference between Government subvention and subsidy on water to consumers is due to the manner in which the subvention is calculated. Calculation of the subvention is shown in the Estimates of Revenue and Expenditure which are prepared by the Corporation on an annual basis and are then submitted to Government and House of Representatives for approval.

The Government subvention is established by computing the difference in the estimates between turnover and operating and other costs that would be incurred by the Corporation for the ensuing financial year.

Turnover estimates include the following items:

1. Sale of Water Services Corporation,
2. Service charges,
3. Other income.

On the other hand, operating and other costs are subdivided into production, distribution, administration and financial costs and detailed costs are also included in the estimates.

Finally, it has also been noted that subvention is transferred to WSC in the form of transfer vouchers on a periodic basis throughout the year.

**Loan guarantee:**

Government also guarantees the loans issued by banks for

capital projects. In fact, although as noted above the WSC Act (article 27[c]) provides for the Corporation to create reserves to finance reasonable part of the costs of future expansion, in practice all loans are guaranteed in toto by Government.

Thus WSC is obtaining its loans on the basis of such guarantees, which guarantees are not necessarily provided by the State to other undertakings.

## **Reform & Implementation**

### *Proposals for reform*

**There are two key state aid issues at stage. The first relates to the government subvention which is linked to the tariff subsidies and the second relates to the loan guarantee on capital projects. These shall be tackled separately:**

**(a) Government subvention: It is submitted that the government subvention passed on to the WSC is clearly a reflection of the government's desire to pass on subsidies water tariffs to the direct benefit of consumers. Indeed, government subventions actually fall short of requirement in this regard as has been explained above. This renders the government payment an aid which is awarded for social purposes to the direct benefit of consumers. It is submitted that such aid falls within the scope of Article 87(2)a and is therefore to be considered as compatible with the common market.**

It must be said that the authors of the report has researched extensively this matter and it has transpired that there has been no interpretation by the European Court of Justice on the above-mentioned Article 87(2)a. Nor has there been any interpretative notice issued by the Commission. This means that the above submission is solely based on an interpretation of law as perceived by the authors of this report which is their understanding of this position under EU law.

**(b) Loan guarantees: On this issue, the report has found that some cases establish that a state aid granted to a state-related enterprise may be legal pursuant to article 86(2) if it goes no further than **necessary to enable the enterprise to carry out its task of general economic interest and does not enable it to cross-subsidise activities in the competitive sector.****

It is submitted that the Maltese government's loan guarantees relates to loans issued by banks for capital

projects only. This means that the aid is clearly given to enable the Corporation to invest in new infrastructure in order to be able to carry out its task of general economic interest and certainly not to be able to cross-subsidise.

In view of the above, it is submitted that the loan guarantee should be considered as legal once it goes no further than to enable the Corporation to carry out its main task of producing and supplying water services.

In this case, however, it must also be said that, upon membership, Malta would have to see Commission authorisation for aid given in the form of loan guarantees.

It is finally submitted, that the strength of the Malta's case on subsidies given to WSC should be all the more stronger when one considers the climatic conditions in Malta and the disproportionate costs that Malta and the Maltese public must bear in order to benefit from an adequate supply of water. This renders the issue of water services all the more evidently one where social considerations ought to prevail over the strict application of competition law.

### **Negotiating Position**

*Proposals for negotiating position to be adopted*

Working on the assumption that the above submissions on WSC's position are endorsed also by the Maltese government, there should be no reason to ask for special concessions since the current situation should be well within the allowable parameters of EU law. If anything, WSC and the Maltese authorities should endorse this view and seek to obtain the comfort of the EU and the Commission that the above is the only reasonable interpretation that can be given to the application of EU state aid rules to the situation arising with regard to WSC.

### **The Merger regulation**

*The Merger regulation*

- The Merger Regulation applies to state-related undertakings.
- However, in this case certain problems may arise in that it may be difficult to calculate the turnover of these undertakings for the purpose of determining whether the thresholds of the regulation are met and the question also arises whether there is a **concentration** (a full-function joint venture or a complete merger) within the meaning of the Regulation when the merger is between two state-owned enterprises of the same member state.
- An internal restructuring within the same group without a change of control is not however a relevant concentration under the Regulation.

**WSC Position**

*WSC's present position*      No reaction given.

**Reform & Implementation**

*Proposals for reform*      **Not applicable.**

**Negotiating Position**

*Proposals for negotiating position to be adopted*      Not applicable.

## 2. The principle of non-discrimination

*The principle of non-discrimination on grounds of nationality*

Hereunder, is a brief examination of the principle of non-discrimination:

- The principle of **non-discrimination on grounds of nationality** is a fundamental principle of EU law.
- This essentially means that it is unlawful for any Member State of the EU to treat less favourably than its own domestic counterparts any goods, persons, services and moneys originating from any other Member State.
- In so far as the Water Services Corporation is concerned, this principle of non-discrimination on grounds of nationality also known as “**the principle of equal treatment**“ means that in the provision and access to the particular service provided by WSC as well as in the tariffs charged, no distinction on grounds of nationality should be made or should arise.
- Maltese nationals permanently residing in Malta and foreign nationals permanently residing in Malta - not tourists - are to be treated equally.

### WSC Position

*WSC's present position*

The principle of non-discrimination gives rise to an examination of the following issues in so far as the present position of WSC is concerned:

1. As noted above, the cost of water is established by LN 58 / 1999. A subsidy is applied depending on the household occupancy. This subsidy<sup>4</sup> is only granted to permanent residents. Foreign **and** Maltese property owners in Malta who do not possess permanent residency status are not granted the subsidy. It might be apt to note that permanent residency is determined on the basis of whether individuals are holders of an ID card. This is issued to those who have resided in Malta for a period of 6 months over the previous 2 year period.
2. Service charges are established by LN 58 / 1999. The WSC supply regulations (LN100/1972) provide for the WSC to request a deposit of Lm80 as a security for regular payments. This deposit is requested by the WSC from foreigners and is then used as part of final settlement of the account. In the case of Maltese nationals the WSC waives

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<sup>4</sup> This subsidy is also given to diplomatic staff.

the request for this deposit.

### **Reform & Implementation**

*Proposals for  
reform*

**With regard to the above two points, the following submissions are being made:**

- 1. Provided that no discrimination is applied between Maltese and non-Maltese EU citizens, then the grant of subsidies to “residents in Malta” seems to be perfectly reasonable. For clearly, it is only reasonable to expect that the granting of the subsidy should only apply to persons who are resident in Malta. However, no discrimination may be made between Maltese nationals who are resident in Malta and EU nationals who are resident in Malta.**
- 2. The issue of the deposit may again be tied to residence in Malta rather than to nationality since discrimination on the basis of nationality (Maltese vs EU) is illegal. However, the WSC may be prepared to concede that this deposit be waived even with respect to foreigners.**

**It must be pointed out that neither of the above issues are likely to come up in negotiations. If any thing, such issues may be more likely to come up in future on some specific occasion when a complaint is lodged to contest the criteria on the applicability of the Corporations’ rules on who benefits from subsidies and who does not.**

### **Negotiating Position**

*Proposals for  
negotiating  
position to be  
adopted*

**In view of the above, there does not appear to be any need for WSC to request any special concession with regard to the EU treaty rules on the principle of non-discrimination.**