

**Case C-87/24**

**Summary of the request for a preliminary ruling pursuant to Article 98(1) of the Rules of Procedure of the Court of Justice**

**Date lodged:**

2 February 2024

**Referring court:**

Administratīvā apgabaltiesa (Regional Administrative Court, Latvia)

**Date of the decision to refer:**

3 January 2024

**Applicants:**

AS Gaso

AS Conexus Baltic Grid

**Defendant:**

Sabiedrisko pakalpojumu regulēšanas komisija (Public Utilities Commission)

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**Subject matter of the main proceedings**

Requests by AS Gaso and AS Conexus Baltic Grid ('the applicants') for the court to set aside the decision adopted by the Council of the Sabiedrisko pakalpojumu regulēšanas komisija (Public Utilities Commission, 'regulatory authority') fixing the rate (weighted average) of return on capital (in real terms) for the calculation of the (draft) tariffs for natural gas transmission system, natural gas distribution system and natural gas storage services, since they believe the decision is vitiated by material and procedural errors that have resulted in that rate being fixed at an unjustifiably low level, preventing the applicants from obtaining an appropriate profit from the services they provide.

## **Subject matter and legal basis of the request**

The referring court asks, pursuant to Article 267 TFEU, for an interpretation of Article 41(8) of Directive 2009/73/EC in order to determine whether the regulatory authority, when adopting the decision fixing the rate of return on capital that is to be used for the calculation of tariffs in the natural gas supply sector, must provide an appropriate statement of reasons, in particular with regard to the compatibility of that rate with the objectives pursued by EU law. The court also asks about the meaning of the concepts ‘appropriate incentive’ and ‘appropriate profit’ and whether, and in what way, a regulatory authority can or must apply, in full or in part, the financial methodology and principles used to calculate comparable indicators in the case of undertakings operating in the free market, and rely, if applicable, on the assessment of an independent third party.

## **Questions referred for a preliminary ruling**

1. Does Article 41(8) of Directive 2009/73/EC preclude a national provision that does not impose an obligation on the regulatory authority, when calculating tariffs or establishing methodologies, to explain how they ensure that transmission and distribution system operators are granted an appropriate incentive, over both the short and long term, to increase efficiencies, foster market integration and security of supply and support the related research activities?
2. Is it consistent with Article 41(8) of Directive 2009/73/EC to interpret a national provision as meaning that an appropriate incentive, over both the short and long term, to increase efficiencies, foster market integration and security of supply and support the related research activities, is ensured when the tariff payments by users cover only the economically substantiated costs of public utilities and ensure a profit, albeit at a minimum level?
3. Is a national provision which, when fixing an ‘appropriate incentive, over both the short and long term’ and incentives to ‘foster market integration and security of supply and [...] research activities’, does not provide for account to be taken of principles that are accepted in the financial sector when determining the weighted average rate of return on capital, principles which take into consideration comparable undertakings that operate in the free market, consistent with the objectives set out in Article 41(8) of Directive 2009/73/EC?
4. In interpreting the concepts of ‘appropriate return on investments’, within the meaning of Article 13 of Regulation [(EC) No 715/2009], and of ‘incentives for investment’, under Article 41 of Directive 2009/73, must the regulatory authority be guided by the concept of the average rate of return on capital (weighted average cost of capital, ‘WACC’) accepted in the financial sector and by the methodology used to determine it?
5. If the answer to the above question is in the affirmative, may the regulatory authority legitimately depart from the methodology used in the financial sector

when determining the average rate of return on capital and adjust that rate as it considers appropriate?

6. If the answer to the above question is in the affirmative, may the regulatory authority legitimately adjust the average rate of return on capital so that its calculation takes into account a size premium based on the borrowing costs of other companies in the Member State's economy?

7. If the answer to the fourth question is in the affirmative, may the regulatory authority legitimately adjust the average rate of return on capital in such a way that it does not have to compensate natural gas transmission or storage system operators for the increase in inflation during the preceding tariff period?

8. If the answer to the fifth question is in the affirmative, and in a case where the system operator does not agree with the amount of the average rate of return on capital proposed by the regulatory authority or with the elements underpinning it, should the regulatory authority, when determining the average rate of return on capital (WACC), use an independent third party to assess the appropriate amount for that rate?

9. Is a procedure for fixing tariffs in which the average rate of return on capital is determined by the regulatory authority and in which the natural gas transmission or storage system operators are not entitled to adjust that calculation in accordance with the individual indicators of the system operator's business contrary to the aims set out in Article 41(8) of Directive 2009/73/EC?

10. Must Article 1[(1)](b) of Regulation [(EC) No 715/2009], in relation to the second paragraph of that article, be interpreted as meaning that recitals 7 and 8 and Article 13(1) of the Regulation are applicable to natural gas storage facilities and to the tariffs fixed by the regulatory authority if access to liquid natural gas storage facilities is regulated?

### **Provisions of European Union law relied on**

Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC ('the Directive'; OJ 2009 L 211, p. 94): recital 35, Articles 32(1), 33(1), (3) and (4), 40(f) and 41(1) and (8).

Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 ('the Regulation'; OJ 2009 L 211, p. 36): recitals 7 and 8 and Articles 1 and 13(1).

## Case-law

Judgment of the Court of Justice of 12 July 2022, *Nord Stream 2 v Parliament and Council*, C-348/20 P, EU:C:2022:548

Judgment of the General Court of 16 March 2022, *MEKH v FGSZ/ACER*, T-684/19 and T-704/19, EU:T:2022:138

Judgment of the Court of Justice of 24 February 2022, *Latvijas Gāze*, C-290/20, EU:C:2022:119

Judgment of the Court of Justice of 2 September 2021, *Commission v Germany* (Transposition of Directives 2009/72 and 2009/73), C-718/18, EU:C:2021:662

Judgment of the Court of Justice of 3 December 2020, *Commission v Belgium* (Electricity and natural gas markets), C-767/19, EU:C:2020:984

Judgment of the Court of Justice of 16 July 2020, *Commission v Hungary* (Charges for access to electricity and natural gas transmission systems), C-771/18, EU:C:2020:584

Judgment of the Court of Justice of 30 April 2020, *Overgas Mrezhi and Balgarska gazova asotsiatsia*, C-5/19, EU:C:2020:343

Judgment of the Court of Justice of 19 December 2019, *GRDF*, C-236/18, EU:C:2019:1120.

Judgment of the Court of Justice of 6 October 2015, *Capoda Import-Export*, C-354/14, EU:C:2015:658, paragraph 25

Judgment of the Court of Justice of 19 March 2015, *E.ON Földgáz Trade*, C-510/13, EU:C:2015:189

## Provisions of national law relied on

Enerģētikas likums (Law on Energy) (*Latvijas Vēstnesis* No 273/275 of 22 September 1998, in the version in force on 20 August 2020): Articles 15, 44(8) and 85(1)

Likums “Par sabiedrisko pakalpojumu regulatoriem” (Law on Regulators of Public Utilities) (*Latvijas Vēstnesis* No 394/395 of 7 November 2000, in the version in force on 20 August 2020): Articles 2(2) and (4), 6(1) and (2), 7(6), 9 and 20(1)

Ministru kabineta 2009. gada 27. oktobra noteikumi Nr. 1227 “Noteikumi par regulējamiem sabiedrisko pakalpojumu veidiem” (Cabinet Regulation No 1227 of 27 October 2009 entitled ‘Regulations Regarding Types of Regulated Public

Utilities’) (*Latvijas Vēstnesis* No 172 of 29 October 2009, in the version in force on 20 August 2020): paragraph 4

Sabiedrisko pakalpojumu regulēšanas komisijas padomes 2018. gada 13. augusta lēmums Nr. 1/23 “Kapitāla atdeves likmes aprēķināšanas metodika” (Decision No 1/23 of 13 August 2018 of the Board of the Public Utilities Commission on the methodology for calculating the rate of return on capital) (*Latvijas Vēstnesis* No 161 of 15 August 2018; ‘the Methodology’), as amended by Decision No 1/12 of the Board of 22 August 2019: paragraphs 3 to 7 and 9<sup>1</sup>

Sabiedrisko pakalpojumu regulēšanas komisijas padomes 2020. gada 20. augusta lēmums Nr. 109 “Par kapitāla atdeves likmi dabasgāzes pārvades sistēmas, dabasgāzes sadales sistēmas un dabasgāzes uzglabāšanas pakalpojumu tarifu projekta aprēķināšanai” (Decision No 109 of 20 August 2020 of the Board of the Public Utilities Commission on the rate of return on capital for the calculation of the draft tariffs for natural gas transmission system, natural gas distribution system and natural gas storage services) (*Latvijas Vēstnesis* No 164 of 26 August 2020; ‘the contested decision’)

### **Succinct presentation of the facts and procedure in the main proceedings**

- 1 The applicants are public utilities operators in the natural gas supply sector in Latvia, in particular, AS Gaso, which is the (sole) natural gas distribution system operator, and AS Conexus Baltic Grid, which is the (sole) natural gas transmission system operator and natural gas storage system operator.
- 2 On 20 August 2020, the regulatory authority adopted the contested decision, which determined the rate (weighted average) of return on capital in real terms (with two variants) to be used to calculate the tariffs for natural gas transmission system, natural gas distribution system and natural gas storage services. The decision was to enter into force in 2021.
- 3 On the basis of the rate of return on own capital calculated in accordance with paragraph 5 of the Methodology, the rate of return on borrowed capital calculated in accordance with paragraph 7 of the Methodology, the rate of company tax in force and the average of the variations in the consumer prices index recorded in the official statistics for the previous five calendar years, the regulatory authority determined that the rate (weighted average) of return on capital (in real terms) applicable to operators falling into the category of micro enterprises or small enterprises was 4.37%, while, for operators in the category of medium-sized or large enterprises, the rate was 2.65%.
- 4 In support of that decision, the regulatory authority indicated that the rates of return on capital fixed were in line with the situation of the financial markets, including the risks corresponding to obtaining finance, and that, therefore, they enabled a natural gas transmission system operator, a natural gas distribution system operator and a natural gas storage system operator to take out loans, invest

in the renovation and development of the natural gas network and obtain a reasonable return, at the same time ensuring that users could receive uninterrupted, reliable and high-quality services whose tariffs (prices) corresponded to economically substantiated costs.

- 5 As they disagreed with the contested decision and with the reasons given for it, the applicants brought an action before the Administratīvā apgabaltiesa (Regional Administrative Court) asking for it to be set aside.

### **The essential arguments of the parties in the main proceedings**

- 6 In their requests, the applicants submit the following pleas in law:
- 7 In their view, in establishing the criteria for the calculation of the rate of return on capital, the regulatory authority made serious material and procedural errors, and therefore the rate of return on capital applicable to the applicants was fixed at an unduly low level, without taking into account the applicants' interest in tariffs being fixed that allowed an appropriate profit. They submit that such a limitation on the allowable profit of a public utility operator constitutes an excessive restriction on the property rights of the applicants.
- 8 According to the applicants, the Methodology (as amended) adopted by the regulatory authority significantly expands the content of the criteria laid down in the legislation, amounting to *ultra vires* conduct, as well as an infringement of the principles of sound administration, legal certainty and the protection of legitimate expectations.
- 9 In their view, the regulatory authority has failed to meet the legal obligation to provide reasons for its decisions.
- 10 They submit that the regulatory authority did not set out facts to demonstrate the necessity for such a decision and that it relied on erroneous and unsubstantiated assumptions about the business activities of the applicants and the indicators relating to them.
- 11 In their opinion, the regulatory authority, acting contrary to the principle that prohibits arbitrary action, did not adequately set out or assess objective, rational legal considerations deriving from those factual materials, nor did it adequately assess considerations relating to the advisability of amending the methodology or provide reasons for the conclusions relating to the components of the calculation of the rate of return on capital.
- 12 According to the applicants, the regulatory authority failed to provide reasons for its conclusions regarding the variables used to calculate (in real terms) the rate (weighted average) of return on capital. It did not explain why the benchmarking of the new rate of return on capital did not use data on natural gas storage, why

specific values were chosen for the benchmarking nor the reasons for the choice of the period for which the national risk premium was calculated.

- 13 In the applicants' view, the new rate of return on capital fixed by the regulatory authority has an unduly adverse impact on the applicants' capacity to meet their obligation to develop their business and participate in the planning, provision and development of a coordinated and efficient energy supply.
- 14 According to the case-law of the Court of Justice of the European Union ('the Court of Justice'), Member States have an obligation, when fixing tariffs, to ensure a return on the investments made. It follows from the Directive that the regulatory authority of a Member States has an obligation to promote the development and operation of the natural gas market, by offering investors sufficient incentives for making the necessary investments in infrastructure. Similarly, the provisions of the Regulation impose an obligation on the regulatory authority, when fixing tariffs, to provide for an appropriate return on the investments made.
- 15 The applicants argue that they were not properly heard prior to the adoption of the contested decision and that their claims and observations were not considered. They therefore submit that their participation in the determination of the new rate of return on capital was not ensured.
- 16 In their opinion, the contested decision does not foster competition or development, contrary to the legislator's aim of regulating the sector.
- 17 They therefore submit that the flaws in the calculation of the new rate of return on capital are serious and make it impossible to understand how the regulatory authority reached the conclusions on which the contested decision is based; the absence of an adequate statement of reasons restricts the ability of the applicants to effectively exercise their rights of defence.
- 18 For its part, the regulatory authority submits that its task, laid down in Article 20(1) of the Law on Regulators of Public Utilities, consists solely in ensuring that the tariffs cover the economically substantiated costs of public utilities (and that, moreover, the content of that concept is determined by the regulatory authority) and ensuring profitability in general. It is of the opinion that, in essence, those concepts are not linked to the objectives pursued by Article 41(8) of the Directive, namely, ensuring an appropriate incentive, over both the short and long term, to increase efficiencies, foster market integration and security of supply and support the related research activities.

### **Succinct presentation of the reasoning in the request for a preliminary ruling**

- 19 The referring court observes that in the main proceedings Articles 40(f) and 41(8) of the Directive and Article 13(1) of the Regulation, read in conjunction with recitals 7 and 8 thereof, are applicable. Those provisions lay down the obligation

of Member States to ensure an appropriate return on the investments made, but the content of the provisions is not adequately clarified or specified. That prevents the referring court from ruling on the substance of the case.

- 20 As one of the Directive's aims is to ensure sufficient investment for the development of the network, in its recital 35 and in its Article 40(f) reference is made to the obligation of the Member State's regulatory authority to contribute to the development and operation of the natural gas market by providing investors with an adequate incentive to make the necessary investments.
- 21 Article 13(1) of the Regulation provides that the regulatory authority is to fix a tariff for access to the transmission network that includes an appropriate return on investments. Tariffs must be of such a kind as will facilitate efficient gas trade and competition and provide incentives for investment and interoperability for transmission networks.
- 22 Tariffs continue to be one of the instruments available to the regulatory authority for promoting investment, including after the original vertically integrated natural gas sector enterprise (historic operator) (AS Latvijas Gāze) divided into various different parts. With regard to the storage function, Article 41(1)(n) of the Directive imposes an obligation on the regulatory authority to monitor and review the access conditions to storage, linepack and other ancillary services as provided for in Article 33. Article 44(8) of the Law on Energy provides that access to the underground gas storage facility shall be organised through a procedure governed using tariffs fixed in accordance with the procedures laid down in Article 15(1<sup>1</sup>) of the Law. Therefore, access to the underground gas storage facility must also be justified in technical and economic terms, which means that the regulatory authority must review the tariffs that it monitors.
- 23 In the present case, the regulatory authority determines, within the scope of its competence, the tariffs or methodology for the calculation of tariffs, including the rate of return on capital. Despite the fact that it follows from the provisions of the Directive and the Regulation that, when setting the amount to be paid in order to access the natural gas transmission network, namely tariffs, Member States must include an appropriate return on investment in the calculations of such tariffs, those provisions do not specify the content of the concept of 'appropriate return on investment'.
- 24 Thus, they have not established legal criteria under which the regulatory authority might determine whether the return is to be considered 'appropriate'. The referring court does not have clear guidelines available to it on how to assess the compliance with EU law of the methodology to determine the return (rate of return on capital).
- 25 To date, the Court of Justice has not clarified the concept of 'appropriate return on investment'. Although its case-law on the Directive and the Regulation (see the section headed 'Case-law') has interpreted Article 41 of the Directive, in none of

those cases has the Court of Justice interpreted Article 41(8) in factual and legal circumstances comparable to those of the present case.

- 26 The Court of Justice has referred to the obligation of Member States to take into account investments made or to be made when fixing the tariffs for access to the natural gas transmission or storage network [judgment of 16 July 2020, *Commission v Hungary* (C-771/18, EU:C:2020:584)]. However, the Court of Justice has not precisely specified the way in which they should be taken into account when fixing the tariffs.
- 27 Article 1 of the Law on Regulators of Public Utilities provides: ‘the purpose of this Law is to ensure that continuous, safe and qualitative public utilities may be obtained, under tariffs (prices) that are in line with economically substantiated costs, and also to promote development and economically justified competition in regulated sectors, determining the procedures for the regulation of public utilities and the legal relations in the provision of public utilities’. Article 20(1) of the Law provides: ‘tariffs shall be set at such levels that the tariff payments made by users cover the economically substantiated costs of public utilities and ensure their profitability, unless the special laws and regulations of the sector provide for other principles for fixing tariffs. In the event of a change to the factors impacting tariffs, such as profitability, the regulatory authority may propose a review of tariffs and request that a public utility provider submit, within a specific time period, draft tariffs together with a supporting statement substantiating the costs making up the tariffs’. From those provisions, the referring court concludes that, in transposing Article 41 of the Directive, the Latvian legislature did not use the wording of that article. The Law on Regulators of Public Utilities does not contain any provision that is in line with the wording of Articles 40 (General objectives of the regulatory authority) or 41 (Duties and powers of the regulatory authority) of the Directive.
- 28 Having examined whether the objectives pursued by Article 20(1) of the Law on Regulators of Public Utilities correspond to those laid down in Article 41(8) of the Directive, the referring court concludes that the Directive’s objectives are broader and that it is possible that the wording of the above Law, pursuant to which the regulatory authority adopted the legal provision applicable to the present case, does not address all the objectives of EU law relating to the right of regulated public utilities providers to an appropriate incentive in the short and the long term.
- 29 Therefore, there are grounds to make a reference to the Court of Justice in relation to the transposition into Latvian law of the above-mentioned provisions of the Directive.
- 30 Article 1(2) of the Regulation provides that the objectives referred to in the first subparagraph of that article shall include the setting of harmonised principles for tariffs, or the methodologies underlying their calculation, for access to the network, but not to storage facilities, the establishment of third-party access services and harmonised principles for capacity-allocation and congestion-

management, the determination of transparency requirements, balancing rules and imbalance charges, and the facilitation of capacity trading. The referring court concludes that the Regulation is applicable to the determination of the principles or methods for calculating access tariffs with regard to the natural gas transmission network, but not to storage facilities.

- 31 Pursuant to Article 1(3) of the Regulation, the Regulation is to apply only to storage facilities falling under Article 33(3) or (4) of the Directive. Article 33(1) of the Directive implies that the procedures established in paragraphs 3 and 4 of that article in relation to storage services are not mandatory, but are applicable when technically and/or economically necessary for providing efficient access to the system for the supply of customers, as well as for the organisation of access to ancillary services.
- 32 The referring court concludes that, having regard to the provisions of the Directive and the obligations of the Member States, Article 13(1) of the Regulation – which applies to the tariffs and methodologies applied by the transmission system operators and approved by the regulatory authorities pursuant to Article 41(6) of the Directive and to tariffs published pursuant to Article 32(1) of the Directive – and, therefore, also the concept of ‘appropriate profit’ contained in it, refers solely to the tariffs applicable to natural gas transmission system services and not to natural gas storage services. The criteria mentioned in recitals 7 and 8 of the Regulation, regarding tariffs for access to networks, do not apply to storage services either.
- 33 The referring court takes the view that there are well-founded grounds for referring questions to the Court of Justice concerning the interpretation of those provisions.
- 34 Referring to the case-law of the Court of Justice on the admissibility of requests for a preliminary ruling [see, for example, the judgment of 6 October 2015, *Capoda Import-Export* (C-354/14, EU:C:2015:658, paragraph 25)], according to which the Court of Justice may refuse to examine such requests only where the interpretation that is sought is unrelated to the actual facts of the main action or its object, where the problem at issue is hypothetical or where the Court of Justice does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it, the referring court observes that the interpretation of the above-mentioned provisions of the Directive and Regulation are directly related to the factual and legal circumstances of the main action. In order for the referring court to be able to rule in the main proceedings, it is necessary for the Court of Justice to provide clarification with the aim of eliminating any reasonable doubt concerning the interpretation of the relevant provisions of EU law.
- 35 In particular, it is necessary to raise questions as to the criteria to be applied when assessing the concepts of ‘appropriate profit’ and ‘appropriate incentive’ that appear in Article 13(1) of the Regulation, read in conjunction with recitals 7 and 8

thereof, and in Articles 40(f) and 41(8) of the Directive, and as to the correct interpretation of those concepts in the specific circumstances of the present case. The answers to the questions referred for a preliminary ruling will enable the referring court to determine, when considering the merits of the case, whether the contested decision, adopted on the basis of the Methodology, fixing a new rate of return on capital, and the Methodology itself, are in accordance with the obligation of the Member State, deriving from EU law, to include an appropriate return on investment in that calculation.

WORKING DOCUMENT