# THE OFFICE OF THE COMPETITION OMBUDSMAN AND THE LOCAL AUTHORITIES. A COLLISION BETWEEN LOCAL GOVERNMENT LAW AND BUSINESS LAW

BY

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## I. INTRODUCTION. THE POINT AT ISSUE

The Office of the Competition Ombudsman deals with matters covered by the Competition Act (1982:729), the object of which is to further, by means of measures against harmful restrictive practices, competition within industry and commerce that is desirable in the public interest (sec. 1). If a restrictive practice affects price formation, inhibits productivity within industry and commerce or impedes or prevents the business activities of another entrepreneur, and if the restriction is harmful from the point of view of the public interest, then the Competition Ombudsman and—ultimately—the Market Court are obliged to endeavour to eliminate this effect.[1] The Competition Act applies to "entrepreneurs", by which is meant each person who is professionally engaged in activities of an economic kind.[2] It is not a requirement that the activities in question must be undertaken for profit. If, for example, a municipality operates a driving school then it is regarded as an entrepreneur within the meaning of the Act.[3]

The services provided by municipalities vary quite a lot. While certain of the tasks carried out by municipalities are mandatory—a municipality must for instance undertake to remove household refuse (sec. 4 of the Refuse Collection Act 1979:596), to provide a life-saving service etc. (sec. 2 of the Fire Prevention Act 1974:80) and an education service for children attending the compulsory school (sec. 2 of the Education Act 1962:319)—others which fall within the framework of the administration of the municipality (the "free" sector) are completely optional. Sometimes these latter services involve normal business activities where the municipality charges for its services in providing, for example, electricity, gas, heating and transportation. A municipality can also, to a certain extent, operate a business which has a natural connection with an existing municipal activity,[4] and certain types of services, for example instruction in a driving school, may be provided in competition with some other service.

[1] See also secs. 1 and 11 of the Act, 1970:417, relating to the Market Court etc., and the decree, 1982:1048, containing instructions for the Competition Ombudsman.

[2] See *prop.* 1981/82:165, p. 251.

[3] *Prop.* 1981/82:165, p. 159.—Concerning the usual practice of the Competition Ombudsman, see, *inter alia*, Stina Holmberg, *Mot monopolisering?*, Lund 1981, as well as Curt Riberdahl in *Förvaltningsrättslig tidskrift* 1976, pp. 29 ff., and *SvJT* 1983, pp. 495 ff.

[4] See on this point *SOU* 1982:20, pp. 79 ff.

A special problem will arise if the municipality—when engaged in an activity in *competition* with private entrepreneurs—*subsidizes* its own operations by using tax revenues and is thereby enabled to charge lower fees than its competitors ("price cutting"). Such a decision concerning a subsidy can be appealed against to the Supreme Administrative Court by means of a municipal appeal, but over and above this the competitor can turn to the *Competition Ombudsman* and it is the duty of the Ombudsman, under the provisions of the Competition Act, to intervene against harmful restrictive practices which limit competition. If municipal funds are channelled into municipal enterprises or activities and if competition is distorted as a result then the Competition Ombudsman can take the matter up for consideration, regardless of whether the activity in question is authorized or not under local government law.

The purpose of this essay is to throw light on how the above situation is judged according to, on the one hand, the legislation concerning local government law and, on the other hand, the Competition Act itself. Is there in this respect a collision between the two systems of rules? To start with let us examine the question from the point of view of the law relating to local government.

## II. THE LOCAL GOVERNMENT ACT

There is *no obligation to charge fees in order to raise funds* under the Swedish local government law. The point of departure is instead that the municipality's financial requirements shall be met by means of tax revenues (ch. 4, sec. 2 of the Local Government Act 1977:179).[5] This state of affairs—or rather the fact that the authority to impose fees in certain cases does not involve a corresponding obligation to do so—is also evident from the statutory provisions relating to this sphere; one need only note that the municipality "is permitted to" stipulate that a refuse collection fee shall be paid (sec. 15 of the Refuse Collection Act), "may" charge fees for street and marketplace trading (secs. 1–2 of the Act (1957:259) relating to the right of a municipality to charge a fee for making a certain use of a public place), and "has a right" to impose a meat inspection fee (sec. 13, item 1 of the Act (1959:99) relating to meat inspection etc.).

Consequently, it is up to the municipality alone to decide whether the costs of, say, refuse collection are to be wholly or partly—or not at all—covered by the charging of fees, what is known as the *deficit principle*.[6] That the same

[5] See concerning this order of priority, Hans-Heinrich Vogel in *Förvaltningsrättslig tidskrift* 1985, p. 39.

[6] See Carsten Welinder, *Kommunala avgifter i de svenska städernas hushållning*, Lund 1935, p. 123, *SOU* 1963:29, p. 31, and Alf Bohlin, *Kommunala avgifter*, Lund 1984, p. 59.

applies also when the fee is of a private law type, that is to say, it is charged even though statutory authority for it does not exist, is clearly indicated in a court case concerning driving instruction fees—*1974 RÅ A 1426*—where a municipal council reversed its earlier decision to authorize the local school board to charge cost-price fees to students. The appellant claimed that the decision constituted price control for the private driving schools, but the Supreme Administrative Court rejected the appeal and ruled that—since it fell within the authority of the municipality to operate a driving school[7]—the municipality was *free to use tax revenues in order to cover the cost of the activity, either wholly or in part.*

A case noted in *1979 RÅ Ab 54* is similar to the above, in that in the appeal against a municipal council's decision to adopt a budget it was maintained that the municipality was not authorized to subsidize a regular business enterprise; the point was that the municipal driving school was going to make a loss even though according to a previous council decision it was to pay its way. The appeal was disallowed, though, on the same grounds as in the 1974 case.

Yet another illustrative example of the fact that the municipality can subsidize an activity that it undertakes in competition with others is afforded by *1975 RÅ Ab 327*, where the municipality had voted 300,000 SEK for its own electricity plant. As there were a number of electricity distribution companies within the municipality which covered their costs by charging fees, the appellant claimed that voting funds for an "enterprise" was a violation of the rights of the individual taxpayer. The appeal was rejected. As the municipality had the authority to operate an electricity plant the council was within its rights in allocating funds for the purpose.

Thus, when the municipality provides a utility in competition with others it is allowed to make special allocations in order to subsidize its own activities, and this could lead to it charging lower fees than the other distributors. The municipality is in fact legally even free to finance entirely from tax revenues a service which could in itself be financed from fees. The deficit principle is, consequently, quite clear, but there are times when points of view of equality argue against it. If the municipality subsidizes services with tax revenues this gives rise to inequality of treatment of a user who is served by a competing enterprise that is compelled to charge fees in order to cover its costs. The present author has in another connection criticized the effect of the deficit principle in this respect; in a situation where the municipality finances, say, a driving school entirely out of tax revenues those would-be holders of driving licences who are obliged to attend private driving schools not only have to pay

[7] This was laid down by the Supreme Administrative Court in the case RÅ 1965 ref. 43.

for their lessons but, by being obliged to pay income tax, are also helping to defray the cost of the lessons provided free of charge to the pupils attending the municipal driving school.[8]

Even if the municipality were to decide that the service in question should be financed entirely from fees it is not, when fixing the fee, as free as a private company is when that company is fixing the price of goods or services. The maximum fee chargeable is in fact limited by the *cost price principle*, which has long been maintained in case law and which, briefly, means that the fees must *not* be fixed at a level that represents a *profit* for the municipality. As long as it is possible to do so from an estimates and accountancy point of view the fees must be so fixed as to avoid any surplus of income over expenditure.[9]

Unless specially stipulated to the contrary,[10] the cost price principle applies to the *power to charge a fee in its entirety* and, consequently, also in cases where a municipality charges a fee as provided for by a legal regulation or other statute but where the statutory rules in question make no specific mention of the size of the fee.[11] The notion has been advanced in legal writing "that a municipality is in principle free to charge the market price for services for which there is in actual fact such a price" (*competitive market price*).[12] Such an arrangement, which in itself produces a satisfactory result from the equality point of view, would have the consequence that the cost price principle would become less relevant as soon as the municipality was allowed to engage in activities undertaken also by private persons and where it could be said that the service provided did have a competitive market price. In such circumstances the fees for, say, driving instruction provided by the municipality in competition with private driving schools could be fixed at a higher level than the true costs of the activity. Concerning the ruling of the Supreme Administrative Court in the case *1965 RÅ ref. 43* it has been remarked that "a municipality is considered to have permission to run a driving school in a case where it is not the intention to make a profit".[13] It would then appear rather strange if the municipality—having had the authority question answered affirmatively on the grounds that the activity was not intended to yield a profit—were thereafter to disregard the cost price principle or, to express it in other words, charged the pupils fees

[8] Bohlin, *op.cit.*, p. 375.

[9] See, e.g., *prop.* 1970:118, p. 104.—It may be noted that it was proposed that the cost price principle be embodied in law. In its report the Municipal Appeals Committee—*SOU* 1982:41—recommended that ch. 1, sec. 6, of the Local Government Act should incorporate a regulation to the effect that "municipal fees must be fixed so that they do not exceed the cost incurred by the municipality".

[10] An example of a fee that is not linked with actual costs is the parking fee, which can be fixed at a sum that is required to enable road traffic to be regulated (sec. 2 of the Act relating to the right of a municipality to charge a fee for making certain use of a public place).

[11] See *prop.* 1980/81:132, p. 12.

[12] Ulf Lindquist, *Kommunala befogenheter*, Uddevalla 1982, p. 88.

[13] Riberdahl in *Förvaltningsrättslig tidskrift* 1976, p. 23.

fixed with a view to making a profit. For this reason, the fixing of driving instruction fees at the level of a prevailing market price that is higher than the true costs of the activity must be regarded as conflicting with the cost price principle, which is undoubtedly intended to ensure that an activity that is authorized *per se* does not yield a profit.[14] It is likewise clear that the cost price principle regulates the charging of harbour dues, despite the fact that a municipality can provide harbour services in competition with other harbours.[15]

## III. THE COMPETITION ACT

In the preceding section it was noted that under the law relating to local government there is nothing to prevent a municipality from financing, either wholly or in part, from tax revenues a service it provides in competition with private entrepreneurs. The question now arising is whether the Competition Ombudsman, who has to consider the matter from the point of view of the rules in the Competition Act, sees things in the same way. An account will be given here of two cases involving alleged price cutting that were brought to the attention of the Competition Ombudsman.

In the first case[16] an agreement had been entered into between the Mora municipal fire brigade and a local company, *Brand & Låstjänst*, according to which the municipality undertook to service and recharge hand-held fire extinguishers belonging to the company's customers. The price was based on price-lists issued by the principal manufacturer in the trade, *AB Svenska Tempus*, but the municipality allowed the company a sizeable discount (45%) on replacement prices. It was claimed in the submission to the Competition Ombudsman that no company in the trade was in a position to allow an equivalent resale discount and that the obvious subsidy that was involved represented a serious impediment to the activities of the other service firms in the trade. To begin with the Ombudsman stated that it was at times very difficult to create uniform conditions of competition between municipal business activities and activities undertaken by private entrepreneurs. For this reason, continued the Ombudsman, it is desirable for municipalities, on the one hand, to take account of the possible risk of a distortion of competition and, on the other hand, to exercise restraint when undertaking external

[14] Another point is that it is not always possible in practice to ensure that costs and fees are exactly equal and for this reason it must be accepted that there will be occasions when an activity for which a fee is charged does yield a profit. On this and on the use of surplus funds, see Bohlin, *op.cit.*, pp. 315 ff.

[15] *Prop.* 1980/81:132, p. 12.

[16] *Day-book number 4–152/84, decision 1985:87.*

business activities and activities in markets where competition does work. He then took up the specific issue in dispute and stated, "If the activities of the Mora fire brigade that are exposed to competition *do not cover their own costs* there will be a *risk of price cutting* as a result of the misuse of the special position enjoyed by a municipality in that it is able to *transfer funds from* activities that are not exposed to competition, or are *financed from tax revenues, to activities that are exposed to competition*. For example, in the case in dispute the staff of the fire brigade, whose labour is paid for by tax revenues, also operate in the market where there is competition. Even if from the point of view of the people living in the municipality it may seem reasonable to improve services in the municipality, weighty arguments can be advanced against the municipality engaging in economic activities. Since the question is one concerning an activity in a market where there is competition then *for reasons of fair trade practice* the municipality should in any case *not sell its services at less than the market price*. The municipality ought not to apply any form of price cutting in a competitive market. If a correctly performed estimate of cost should indicate that the price ought to be higher than it is at present then the municipality should either increase the price or phase out the activity." With these words the Competition Ombudsman concluded his consideration of the matter. (Italics added.)

Here, it would seem, there is a case for discussing whether the activity in question, which is associated with a specially regulated task that the municipality is obliged to carry out, falls within the framework of what the municipality is authorized to do. However, as was noted in the introduction, the question of whether the activity falls within the sphere of competence of the municipality or not is of no consequence as regards the consideration of the matter by the Competition Ombudsman under the Competition Act. It is also true that activities which in themselves are within the competence of a municipality can result in harmful restrictions of competition if they are subsidized by the municipality.[17] As a municipality must make provision for a life-saving service and for measures designed to prevent fires and to this end must maintain a fire brigade (sec. 2 of the Fire Prevention Act) it goes without saying that the costs of this activity—including wages and salaries—must be met from tax revenues. If the fire brigade staff can be employed on tasks such as servicing fire extinguishers owned by members of the public, and if the municipality can then fix the charge for this service without taking any account of any "direct labour cost" then it is equally clear that the municipality is in a position to charge less than its competitors. Even if the risk of such price cutting cannot be entirely eliminated it can at least be reduced if it can be agreed that the portion

[17] See statement by the Competition Ombudsman on this matter, *Day-book number 350/83, decision 1984:254.*

of the wage bill that is attributable to fire prevention as such is financed from tax revenues, while the rest is included in the service charge and is covered by the fees received by the municipality. Even if it ought to be decreed that some differentiation is made between the costs of the fire prevention service and the costs of other, optional services (see section 2 above), there would seem to be little doubt that under local government law the municipality is not allowed, when providing its fire extinguisher service, to charge a market price which—over and above the real costs—includes an element of profit. It could also be mentioned that the municipality involved in this matter referred to a communication from the Association of Local Authorities which stated, *inter alia*, that the municipality could stipulate in return for the service "a fee within the framework of the *cost price principle*".[18]

The *second* case[19] is of a similar type. The Norrköping public transport department had manufactured and sold to outsiders shelters for erection at stopping places. In a communication to the Competition Ombudsman reference was made to a bulk purchase deal with *Linköpings Trafik AB* as a customer in which, according to the complainant, the Norrköping public transport department "had quoted prices that could not possibly have had any basis in reality". Doubts were expressed as to whether the transportation department had applied "a commercially correct method of fixing its price". The Ombudsman could not give a precise answer to this question since no statement of the actual costs of the activity had been submitted, but—as in the preceding case—he maintained that if the activity does not cover its own costs there is "a risk of price cutting as a result of the misuse of the special position enjoyed by a municipality in that it is able to transfer funds from an activity that is not exposed to competition to one that is exposed to competition". The Ombudsman suggested that in future the municipality should draw up estimates that would enable an assessment to be made of the finances of the activity that was exposed to competition. As the activity in question was on a small scale and as the complainant had a considerable share of the market the Ombudsman took no further action.[20]

Finally it may be noted that the investigation according to the Competition Act raises a special question that has not hitherto been given enough attention

[18] Cf. the following statement by the responsible Minister in *prop.* 1980/81:132, p. 6: "An application of the Act relating to Restriction of Competition (1953:607) in the municipal sphere must, however, be viewed against the background of the general principles of local government law which apply to municipal activities. Where municipal fees are concerned it is above all the cost price principle that asserts itself."

[19] *Day-book number 3-65/84, decision 1984:359.*

[20] It can also happen that the municipality subsidizes a private company with the result that the latter can sell its goods or services at prices below those its competitors are obliged to charge; on this point see the matter considered by the Competition Ombudsman, *Day-book number 366/82*, decision 1985:84.

and which is connected with the fact that the *power where municipal finances and allocations* are concerned is exercised by a *municipal council*.[21] It is, therefore, the council that decides how the costs of municipal activities and duties are to be met. The question of the legality of a council's decisions in this respect can be considered, not by the Competition Ombudsman, since the council is hardly an entrepreneur in the sense of the Competition Act,[22] but by an administrative court following a municipal appeal. When the Competition Ombudsman considers whether a municipally-owned enterprise has applied "a commercially correct method of fixing its price" he is, however, *indirectly* adopting a position with regard to the council's decision as to how the activity is to be financed. In this respect a comparison may be made with the situation that applies as regards the work of the Parliamentary Ombudsman according to his instructions (1975:1345). As the supervisory duties of the Parliamentary Ombudsman do not extend to cover members of decision-making municipal assemblies (sec. 2), he cannot "as a rule take note of the measures that municipal boards or officials initiate when implementing the decisions of the assemblies or otherwise carry out in accordance with directives issued by the assemblies".[23] For this reason, one could question whether in the legislation pertaining to business and marketing law sufficient attention has been paid to the principle concerning municipal self-government laid down in the opening section of the Instrument of Government (ch. 1, sec. 1). When supervising the work of municipal authorities the Parliamentary Ombudsman—but not the Competition Ombudsman—must take into account the forms in which municipal self-government is exercised.[24]

## IV. CONCLUSION

From the *municipal law point of view* the municipality is free to finance from tax revenues, either wholly or in part, a service for which a fee can be charged on a cost price basis. If the municipality chooses to finance the service by charging a fee then according to the cost price principle the fee must not exceed the sum required to cover the costs of the activity. The charging of a municipal fee equal to the prevailing market price, which must include a certain profit, must be regarded as incompatible with the cost price principle, regardless of whether the service provided by the municipality competes with another service.

However, this is not the case from the *point of view of the Competition Act*. If the

[21] On this point see, e.g., Håkan Strömberg, *Kommunalrätt*, 11th ed. Stockholm 1985, p. 56.
[22] See Riberdahl in *SvJT* 1983, p. 497.
[23] *SOU* 1985:26, p. 148.
[24] Instructions for the JO office, sec. 3, para. 2.

municipality subsidizes from tax revenues an activity that is exposed to competition this may lead to such a distortion of competition that the Competition Ombudsman can intervene against it by invoking the Competition Act. To avoid running the risk of contravening this Act the municipality ought to charge the market price for the service when operating in a competitive market.

The matters brought to the attention of the Competition Ombudsman illustrate the lack of uniformity that characterizes the present system of regulation. *"Because of the law relating to competition" municipalities should "not sell their services at lower than the market price"; however, under the law relating to local government they can be prevented from charging a market price.* To put the point even more forcibly one could say that if the municipality charges the market price it is acting in contravention of the basic principles of municipal activity, whereas if it does not charge the market price it is contravening the Competition Act.