What the FRANDT?! Understanding the Regulation of Pricing Power in the Single Market for ESG Ratings

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The European co-legislators have adopted the Regulation on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities (ESGR). The ESGR requires fees charged by rating providers to be fair, reasonable, transparent and non-discriminatory, to reduce the ability of providers to exploit their pricing power.

This pricing rule, which belongs to a class of rules known as FRAND(T) rules, does not provide any context or guidance that clarifies how to apply the pricing policy to a provider's pricing policy. As a consequence, providers are facing considerable legal uncertainty.

This article applies established interpretation methods, including a comparative analysis using other FRAND(T) rules in the body of European Union financial and digital regulation, to guide the interpretation of the pricing rule in practice.

Keywords: excessive pricing, FRAND, ESG ratings, oligopoly pricing, investment funds, sustainable finance

1 INTRODUCTION

Policy makers in the European Union (EU) place much reliance on the funds of wholesale and retail investors to finance the transition to a sustainable economy. They consider financial markets to play a crucial role in the channelling of private capital flows toward investments necessary for the achievement of the EU climate and environmental objectives, implementing policies to 'mainstream sustainability factors into risk management and reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth'.[1] In that policy approach, ratings of financial instruments in terms of their environmental, social and governance (ESG) characteristics take centre stage.

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1 Recital 5 ESGR; European Commission, *Strategy for Financing the Transition to a Sustainable Economy*, COM/2021/390 final, 6 Jul. 2021, s. 3.

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The idea is straightforward. Good ESG ratings compress information on a company's ESG profile in a data point that is easy to interpret, and are useful for an investor to determine whether investing in financial instruments issued by the company meets its ESG investment objectives.[2] These ratings must be widely available to investors, to mobilize their funds at the required scale. In the words of the co-legislators: 'ESG ratings play an important role in global capital markets, as investors … increasingly use those ESG ratings as part of the process of making informed, sustainable investment and financing decisions'.[3] As they are used as references, they significantly impact the operation of financial markets.[4]

To promote the supply of good ESG ratings in the European Union (EU), the co-legislators have adopted the Regulation on the transparency and integrity of ESG rating activities (**ESGR**).[5] The ESGR regulates various aspects of ESG ratings and their providers. The pricing of ESG ratings is one of these aspects. Article 27.1 ESGR reads: 'ESG rating providers shall take steps that are adequate to ensure that fees charged to clients are fair, reasonable, transparent and non-discriminatory' (the pricing rule). The provision is not accompanied by a recital explaining its rationale, not supported by clarifying definitions and undifferentiated in its application. The ESGR applies to the distribution of ratings to retail and wholesale investors, but also to issuers of financial instruments and borrowers in various loan arrangements, with the ESGR acknowledging the variety in business models in the ESG ratings market.[6]

The pricing rule raises several questions, which have not been discussed at length in the literature. For example, does this market really need price regulation? Price regulation is generally imposed if there are structural limitations to sufficient price competition, or where the market fails to meet distributional goals, such as to protect the economic interests of buyers or to guarantee wide access. Is that the case for ESG ratings? Also, assuming price regulation is necessary, why would the pricing rulebe the right regulatory choice? There are various tools in the price regulation toolkit, each with different impacts on the behaviour of providers. Could the pricing rule frustrate rather than promote wide availability, for example by reducing competition due to its costs of compliance or supervisory enforcement? More importantly, what does the pricing rule actually mean? Each of the four standards in the pricing rule are open-textured principles that are notoriously

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2 Finance Watch, Regulating ESG ratings to strengthen sustainable investors, Policy Brief, Mar. 2023.
3 Recital 10 ESGR.
4 *Ibid*.
5 Regulation (EU) 2024/3005 of the European Parliament and of the Council of 27 Nov. 2024 on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities, and amending Regulations (EU) 2019/2088 and (EU) 203/2859.
6 Recital 12 ESGR.

hard to apply to concrete pricing instances. It is therefore necessary to resort to established interpretation methods to explore possible meanings of the rule.

This article seeks to address these questions. To this end, it first discusses the market for ESG ratings, the competitive issues that may arise due to outsized pricing power by certain providers and how they affect pricing choices (II). It then turns to an analysis of the pricing rule. More specifically, it explains the regulatory approach underlying the rule and its supervision (III). The next section applies the classic interpretation methods (literal, teleological and systematic) to the rule (IV). As these methods do not yield conclusive answers, the following section applies the comparative interpretation method, by comparing the rule with similar rules in other EU legislative acts, delegated rules and supervisory guidance (V). This part of the analysis uncovers useful interpretations and considerations regarding the four principles set out in the pricing rule. The next section uses those insights to recommend principles of interpretation for the pricing rule, driven by a teleological interpretation and supported by the particularities of the market for ESG ratings (VI), and is followed by concluding remarks (VII).

2 MARKETS FOR ESG RATINGS

2.1 Products

To understand the pricing power of ESG rating providers (providers), it is primordial to understand ESG rating products. ESG ratings, scores and other quantitative assessments are opinions regarding an entity, issuer, or debt security's impact on or exposure to ESG factors, alignment with international climatic agreements or sustainability characteristics, issued using a defined ranking system of rating categories.[7] Under the ESGR, an ESG rating is an 'opinion, a score or a combination of both, regarding an entity, a financial instrument, a financial product, or an undertaking's ESG profile or characteristics or exposure to ESG risks or the impact on people'.[8] The universe of ESG ratings is rather diverse, with *risk* ratings and *impact* ratings as more common products, and alternative products such as disclosure scores and relevance scores.[9] The definition of 'ESG rating' in the ESGR covers all these products.[10] Providers also offer other products and services, such as raw data, rankings and screening tools.[11]

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7 ESMA, 'ESG ratings: Status and key issues ahead', Report on Trends, Risks and Vulnerabilities No. 1, 2021, , at 106.

8 Article 3.1 ESGR.

9 ESMA, *supra* n. 7, at 106.

10 Article 3.1 ESGR.

11 *See* ERM, *Study on Sustainability-Related Ratings, Data and Research*, study commissioned by EC (DG FISMA), 2020, para. 2.4.

2.2 Competition

The global for-profit market for ESG ratings is fairly concentrated, with a few large players occupying most of the market, and many smaller providers offering speciality sustainability-related products.[12] This concentration is the result of acquisitions by larger firms and established data providers of smaller specialty sustainability firms in order to expand their product mix and expertise.[13]

To some authors, this concentration is unavoidable. To them, the market for ESG ratings is a natural oligopoly, just like the market for credit ratings.[14] They argue that competition in the latter market are driven by the following factors: (1) credit ratings are experience goods (the quality of the rating is only revealed ex-post using a large sample, so a provider's market reputation requires the issuance of many ratings), (2) investors value comparability and consistency of ratings and thus the more ratings a single provider issues the greater its value to investors (investors thus do not want to interpret many different standards), and (3) rated entities prefer to build trusting relationships with the providers most trusted by investors.[15] As a consequence, the market cannot sustain many providers and in the long term, the market remains an oligopoly in which providers compete to become a standard.[16]

However, despite the fact that both markets deal in ratings, markets for ESG ratings differ from markets for credit ratings. *First*, the economic value of credit ratings is different from that of ESG ratings, especially since there is a lack of consensus on what is a good ESG rating[17] and various methodologies exist.[18] This lack of standardization presents opportunities for new entrants. *Second*, due to the availability of external data, ESG ratings are less reliant on relationships with rated entities than credit ratings. Thus, there may be similarities between the *activities* of credit rating agencies and ESG ratings providers,[19] but the markets are different.

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12 Kenza Bryan, *ESG Ratings: Whose Interests Do They Serve?*', Financial Times (2 Oct. 2023); ERM, *supra* n. 11, para. 2.2.

13 ERM, *supra* n. 11, para. 2.2.

14 Daniel Cash, *ESG Rating Agencies and Financial Regulation* (Edward Elgar Publishing 2024) Chs 2 and 4. *See* on credit rating agencies, OECD, *Competition and Credit Rating Agencies*, DAF/COMP(2010)29; Nicolas Petit, *The Oligopoly Problem in EU Competition Law*, in *Handbook on European Competition Law* 259–349 (Ioannis Lianos & Damien Geradin eds, Edward Elgar Publishing 2013), s. 1, on credit ratings; European Commission, *Study on the State of the Credit Rating Market*, Final Report, MARKT/2014/257/F4/ST/OP.

15 Testimony Patricia Langohr, in: OECD, *Competition and Credit Rating Agencies*, DAF/COMP(2010) 29, at 5.

16 *Ibid*.

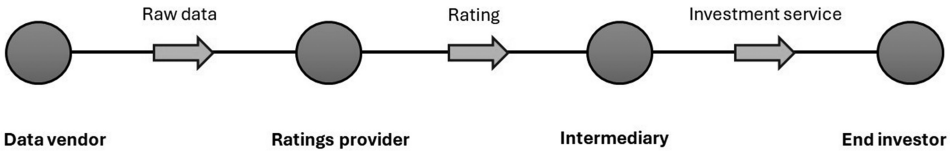
17 ESMA, *supra* n. 7, at 113; Florian Berg, Julian Kölbel & Roberto Rigobon, *Aggregate Confusion: The Divergence of ESG Ratings*, 26(6) Rev. Fin. 1315–1344 (2022), doi: 10.1093/rof/rfac033.

18 Recital 36 ESGR.

19 *See* the EU legislature's view in recital 41.

Nevertheless, given the concentration in the market for ESG ratings, the competitive process may be similar to oligopolistic competition, which may lead to higher prices.[20] In fact, in a natural oligopoly the dominant providers may engage in fierce price competition (competitive oligopoly), but may also refrain from doing so and set prices in response to each other (i.e., coordination or collusive oligopoly).[21] They may also engage in product differentiation in order to gain pricing power.[22] Especially when the ratings are so widely used that they are de facto industry standards, customers cannot easily switch to an alternative provider and new entrants cannot provide an alternative, giving the company pricing power.[23] The provider can use that power to raise prices above the level that it could charge in a competitive market, but also engage in discriminatory pricing favouring some customers over others, especially if it competes in (down-stream) markets that rely on the use of the ratings.[24] To understand this point, it is useful to briefly describe the distribution of an ESG rating, and its value chain.

2.3 DISTRIBUTION



In most cases, this value chain involves four actors: (1) raw data content provider, (2) ratings provider, (3) customer[25] (e.g., credit institution, pension fund), and (4) the end investor (e.g., a private wealth client or employee who selects securities for his pension allocations).[26] The demand for the ESG rating comes from the end investor, as discussed in section 1 above. The customer provides this

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20 Opinion AG Wahl, delivered on 6 Apr. 2017, Case C-177/16, paras 3 and 4; BaFin, *Market Study on the Collection and Handling of ESG Data and ESG Rating Procedures by Asset Management Companies* 4 (18 Mar. 2024), accessed via www.bafin.de (accessed 1 Nov. 2024).

21 ESMA, Technical Advice Competition, choice and conflicts of interest in the credit rating industry, 30 Sep. 2015 | ESMA/2015/1472; Petit, *supra* n. 14 ss 2 and 3.7.

22 Paul Belleflamme & Martin Peitz, *Industrial Organization – Markets and Strategies* (Cambridge University Press 2010), para. 3.1.3.

23 OECD, *Roundtable on Price Discrimination*, note by BIAC, DAF/COMP/WD(2016)75, at 5; on benchmarks, UK Financial Conduct Authority, *Fair, Reasonable and Non-discriminatory Access to Regulated Benchmarks*, CP15/18, paras 1.7–1.8.

24 UK FCA, *supra* n. 23, para. 1.9.

25 Article 3.9 ESGR defines a user as any natural or legal person to which an ESG rating is distributed by subscription or other contractual relationships.

26 Of course, there are situations where the end investor is also the customer, think of an investment firm that engages in trading on its own account.

information to the end investor, for example via an interface displaying the sustainability profiles of the securities.[27] The customer is compensated by the end investor for providing this service, through a fee or commission.[28] To provide this service, the customer purchases the rating from the ratings provider for a fee, which is now subject to the ESGR's pricing rule. The provider, in turn, sources the data to produce the rating from the data vendor in return for compensation.

This value chain represents the *user-pays* model, as the investor purchases ESG ratings for investment decisions, which accounts for the lion's share of the industry's revenues.[29] Alternatively, providers can sell ESG ratings to issuers (*issuer-pays* model), who use the ratings to assess risks and opportunities with their operations and to signal their attractiveness of the securities to investors.[30] The discussion of the related value chain is beyond the scope of this article. However, it is worth noting that in both business models, the development of strong institutional relationships is key to maximizing distribution.

How would a profit-maximizing provider with pricing power set its fees? Economic theory suggest that the provider would use its power to minimize the compensation of the data vendor and to differentiate its prices to customers, depending on its activities in the downstream market.[31] If it provides services to end investors, it charges (1) high prices to customers who provide competing services with a strong market position such that their prices to end investors are less attractive, and (2) lower prices to other customers, but still above the competitive price.[32] If it does not operate in the downstream market, it charges all customers prices above the competitive price. By contrast, a provider without pricing power, thus a price taker, would charge lower prices, either at the competitive price level or even below that level (in order to gain market share), provided its financial position permits this price strategy.

2.4 Pricing

As discussed in the previous section, ratings are sold via issuer-pays and user-pays business models.[33] The dominant fees in those business models include

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[27] Such disclosure is mandatory under EU law, particularly the Sustainable Finance Disclosure Regulation, as well as level 2 texts under MiFID II and UCITS.

[28] This fee or commission may be linked to the assets under management, but could also be charged as part for the general investment service or portfolio management service.

[29] Recital 12 ESGR; ESMA, *supra* n. 7, at 107; IOSCO, *Environmental, Social and Governance (ESG) Ratings and Data Products Providers – Final Report*, FR 09/21, 18 Nov. 2021.

[30] Recital 12 ESGR; ESMA, *supra* n. 7, at 107.

[31] This is a function of the market power of the dominant players in a vertical oligopoly, *see* Belleflamme & Peitz, *supra* n. 22, para. 17.4.1; UK FCA, *supra* n. 23, para. 1.9 regarding benchmarks.

[32] Belleflamme & Peitz, *supra* n. 22, generally Ch. 17.

[33] ESMA, *supra* n. 7, at 107.

subscription fees, licensing fees and bespoke service fees, with subscription fees being the most common.[34] Investors, asset managers and investment banks tend to represent the greatest share of customers, followed by issuers and intermediaries or consultants.[35] Journalists report that globally, issuers pay up to USD 500,000 for ratings and investors up to USD 360,000.[36] While it is beyond the scope of this article to evaluate the fairness of current price levels, it should be noted that customers generally consider pricing to be rather high.[37]

2.5 Regulatory dilemma

The foregoing paragraphs show how providers can wield their pricing power in an abusive manner, presenting the regulator with a dilemma. On the one hand, a *laissez-faire* approach in which the regulator does not impose any interventionist rules, but subjects pricing exclusively to the competitive forces of supply and demand, may (1) allow efficient allocation of diverse products to investors and entities, and (2) stimulate innovation, market entry and a steady supply of good quality products, as providers have uncapped economic incentives to produce those ratings and share their economic value. On the other hand, that approach, in the absence of effective competition between a large number of providers, may lead to an insufficiently wide availability of ratings due to market consolidation, where fees reach levels that are high enough to exclude a sufficiently large number of investors. In that market, pricing practices that lead to exploitation, undesirable rent-extraction or price differentiation that unduly prejudice certain customer segments, may also abound.[38] In other words, the regulator must devise an approach that strikes a balance between efficiency and market access tailored to the competitive dynamics of the ESG ratings market. Rules such as the pricing rule aim to strike that balance, seeking to achieve that entities operate effectively and price in a manner that reasonably reflects the costs and risks of the service and generates profit, while preventing unfair, unreasonable or discriminatory pricing.[39]

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[34] ERM, *Study on Sustainability-Related Ratings, Data and Research*, study commissioned by EC (DG FISMA), 2020, para. 2.5. Those fees are set using cost-based, market-based and value-based pricing, *see* s. 6.2[a].

[35] *Ibid.*, para. 2.5.

[36] Reuters, *Companies Pay up to $500,000 for Sustainability Ratings – Report* (27 Mar. 2023).

[37] *See* ERM Group, *Rate the Raters 2023: ESG Ratings at a Crossroads* 40, accessed via www.erm.com (accessed 1 Nov. 2024).

[38] William Sharkey, *The Theory of Natural Monopoly* 147–151 (fifth edition, Cambridge University Press 2008).

[39] *See* e.g., UK Financial Conduct Authority, *PS16/4: Fair, Reasonable and Non-discriminatory Access to Regulated Benchmarks*, 2016, para 1.8, in respect of benchmarks.

3 THE PRICING RULE

With this understanding of the economic context and the regulatory dilemma, the next step is to discuss the regulatory technique behind the pricing rule (1) and its supervision (2).

3.1 META-REGULATION

The pricing rule implements a regulatory technique known as 'meta-regulation'. Meta-regulation is a regulatory approach that involves imposing standards on market outcomes and requiring regulated entities to meet these standards.[40] Unlike command-and-control regulation, meta-regulation does not prescribe specific conduct for compliance. The entities have discretion to decide how to comply with the rules – it is a management-based command[41] and they must demonstrate their compliance to the regulator.[42] More specifically, an entity should implement a set of policies tailored to its specific context, which will be scrutinized by the regulator.[43]

In the pricing rule, there are four substantive standards imposed on one market outcome (pricing). More specifically, it imposes two standards that concern the sharing of economic value (prices must be fair and reasonable), one disclosure standard (prices must be transparent), and one standard on price differentiation (prices must be non-discriminatory). Providers must adopt pricing policies that meet these standards and ESMA can scrutinize these policies, per Article 27.2 ESGR.

3.2 SUPERVISION

Supervision and enforcement are crucial to ensure effectiveness of meta-regulation. It is the threat of such enforcement that impacts the behaviour of regulated entities, generally.[44] The ESGR centralizes enforcement by empowering ESMA with the supervision of compliance with its provisions.[45] To this end ESMA may require

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[40] Julia Black, *Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis*, 75(6) The Modern L. Rev., 1037–1063, 1045, doi: 10.1111/j.1468-2230.2012.00936.x.

[41] For more, Cary Coglianese & Evan Mendelssohn, *Meta-Regulation and Self-Regulation*, in *Oxford Handbook of Regulation* (Robert Baldwin, Martin Cave & Martin Lodge eds, OUP 2010), Chs 8, 150.

[42] David McNulty, Andrea Miglionico & Alistair Milne, *Data Access Technologies and the 'New Governance' Techniques of Financial Regulation*, 9 J. Fin. Regulation 225–248 (2023), para. II.

[43] Robert Baldwin, Martin Cave & Martin Lodge, *Understanding Regulation: Theory*, Strategy and Practice (OUP 2011, 2nd edition), at 147.

[44] Bronwen Morgan & Karen Yeung, *An Introduction to Law and Regulation – Text and Materials* 151 (Cambridge University Press 2007).

[45] Chapters 4 and 5 ESGR. National supervisory authorities play a secondary role, as they are only involved in the enforcement following delegation by ESMA of specific powers (Art. 43 ESGR).

ESG rating providers to provide it with documented evidence on their pricing policy, including the fee structure and pricing criteria, whenever it deems so necessary.[46]

The pricing rule does not impose screening: providers can determine their pricing policy and apply this policy to transactions without prior supervisory approval.[47] Even though not expressly specified, supervision of the rule will likely take place on an *ex post* basis, after the policy has been adopted. More specifically, ESMA can perform information requests, general investigations and on-site inspections to gather information.[48] Where ESMA finds that a provider has not complied with the pricing rule, ESMA can impose various administrative enforcement measures, such as withdrawing or suspending the authorization or recognition, temporarily prohibit the publication or distribution of ratings by that provider, impose fines and periodic penalty payments to compel compliance.[49] ESMA can therefore tailor its enforcement strategy to the provider.

It is important to underscore that pricing will not only be impacted by ESMA's enforcement of the pricing rule and enforcement, but also the provisions governing market access. Pricing power is dependent on the number and strength of competitors (section 2.1) and market access rules imposing conditions on the entry of new competitors.[50] To operate in the Single market for ESG ratings, companies must (1) be authorized, if they are based in the EU, or if they are based outside the EU, through (2) an equivalence mechanism after notifying ESMA, (3) endorsement by an EU-based provider, or (4) recognition by ESMA.[51] ESMA's interpretation of these requirements will thus to some extent determine the number and strength of competitors, which in turn will impact pricing choices by providers. As a consequence, where ESMA interprets the fairness and reasonableness components of the pricing rule using benchmarks or other market-based approaches, the result will partly depend on ESMA's interpretation of the market access rules.

3.3 Conclusion

In conclusion, the approach taken by the EU legislature in the price rule is meta-regulation. ESMA is explicitly charged with enforcement of this rule, and can

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[46] Article 27.2 ESGR.
[47] The ESGR does not contain any reference to such prior approval (e.g., the application for authorization does not need to include a price schedule).
[48] Articles 32–34 ESGR.
[49] Article 27.2 ESGR.
[50] Christos Gortsos, *The Case for Banking Regulation, The European Banking Regulation Handbook, Volume I* (Switzerland: Springer International Publishing AG 2023), para. 1.2.2.
[51] Article 4 ESGR.

impose financial sanctions to compel compliance. The impact of the pricing rule on providers' pricing practices will also depend on the Authority's interpretation of the market access rules.

4 CLASSIC INTERPRETATION METHODS

With this understanding of the ESGR's regulatory structure, it is now opportune to examine the meaning of the pricing rule by applying the 'classic methods of interpretation': literal, teleological and systematic interpretation.[52] These methods are routinely used by the Court of Justice of the European Union (CJEU).[53] It is settled case-law that to interpret a provision of EU law, the Court considers it appropriate to consider 'its wording' (literal interpretation), but also its context (systematic interpretation) and the objectives pursued by the legislation of which it forms part (teleological interpretation).[54] This is especially the case if the provision of EU law does not contain any express reference to the law of the Member States for the purpose of determining its meaning and scope, in which case it must normally be given an autonomous and uniform interpretation throughout the EU,[55] such as the pricing rule.

4.1 Literal interpretation

The literal interpretation involves uncovering the meaning of the text conveys by looking at the usual meaning of the words contained therein.[56] Generally, the CJEU not only uses the usual meaning, but also defined terms of the text.[57]

The pricing rule stipulates that providers 'shall take steps that are adequate to ensure that fees charged to clients are fair, reasonable, transparent and non-

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[52] Quoting Koen Lenaerts & José A. Gutiérrez-Fons, *To Say What the Law of the EU Is: Methods of Interpretation and the European Court of Justice*, Academy of European Law (AEL), 2013 (2013/9).

[53] Of course, this is not an exhaustive set of methods or arguments to interpret provisions in statutes. *See* Douglas Walton, Fabrizio Macagno & Giovanni Sartor, *Statutory Interpretation: Pragmatics and Argumentation* (Cambridge University Press 2021), para. 1.6, for an overview.

[54] *See* for recent e.g., Case C-35/23 (Greiszel) 20 Jun. 2024, para. 67; Case C-438/23 (Protéines France) 4 Oct. 2024, para. 86; Case C-166/23 (Naturvårdsverket) 6 Jun. 2024, paras 44–57; Joined Cases C-795/21 P and C-796/21 P (WEPA Hygieneprodukte GmbH) 26 Sep. 2024, paras 66–77; Case C-361/22 (Inditex), para. 43. The Court also uses a historical method, which relies on using the preparatory works of the EU legislature to clarify legislative intent, to be taken into account in the teleological and contextual interpretations, *see* e.g., Joined Cases C-611/22 P and C-625/22 P (Illumina) 3 Sep. 2024, para. 129.

[55] Joined Cases C-38/21, C-47/21 and C-232/21, 21 Dec. 2023, paras 133 and 188 et seq.

[56] Lenaerts & Gutiérrez-Fons, *supra* n. 52; Walton, Macagno & Sartor, *supra* n. 53, referring to D. Neil MacCormick & Robert S. Summers, *Interpreting Statutes A Comparative Study* (Routledge 1991) ('arguments from ordinary meaning').

[57] *See* e.g., Case C-409/23 (Arvato Finance), 17 Oct. 2024, paras 40–41.

discriminatory'.[58] The first part of the pricing rule, 'shall take steps that are adequate to ensure', lays down an *obligation of effort* for providers to take actions that *can* lead to the charging of fees as set out in the second part of the rule. *Can*, as the rule imposes adequacy as a standard, a regulatory technique also found in other Regulations[59]. Rather than being *required* to ensure that the pricing policies meet the standards set out in the second part, the provider must take steps that are sufficient to cause its prices to meet these standards with some degree of certainty. In practice, the provider will make use of pricing policies and procedures to comply with this obligation. Those policies and procedures will depend on the provider's business model and target market. Where the provider focuses on bespoke services to institutional investors, (human) relationship managers generally negotiate bespoke pricing schedules with these customers. By contrast, where the provider focuses on selling standardized products to retail investors via mass direct distribution, the provider may use automated pricing algorithms to implement the pricing policy. Hence, what counts as 'adequate' should consider these different distribution models.

The second part stipulates the desired outcome, i.e., that fees charged by the provider to clients are fair, reasonable, transparent and non-discriminatory. The ESGR does not define any of these four standards. Similarly, 'clients' is not defined. The term is also used in section 1.l of Annex III ESGR, which stipulates that general information on criteria used for establishing fees to clients must be disclosed. However, common sense allows one to deduce that a client is a user which has entered into a contractual relationship with the fee-setting provider.[60] Finally, 'fees' is also not defined in the ESGR. Nevertheless, given that Article 27.2 ESGR states that the provider's pricing policy may be requested to verify compliance with the rule, including the fee structure and pricing criteria, it may be inferred that fee should be interpreted broadly as 'price', i.e., any form of remuneration charged by the provider in exchange for the issuance or distribution of the rating, regardless of the nomenclature used by the provider in its policies.

Putting both parts together, it can be concluded that the process-oriented wording of the pricing rule reflects a meta-regulatory approach. That said, a literal interpretation does not bring clarity. If the outcome is not achieved (e.g., a price is considered unfair), did the provider fail to comply with the rule? In other words, is the adequacy of the provider's steps evaluated against the outcome (inadequate because failed to produce the outcome), or against the quality of its policy

[58] Article 27.1 ESGR.

[59] Example, Art. 4.1 Regulation 2016/1011/EU or Art. 27.2 Directive (EU) 2015/849. An alternative to this rule would be impose the pricing rule outright on transactions, such as the FRANDT rules discussed in s. 4.1 below.

[60] *See* the heading of Art. 3.8 ESGR and the definition of 'user' in the ESGR.

(adequate even if the outcome is not attained)? The former reading turns the provider's obligation of effort into an obligation of result (to achieve the outcome), which would violate the literal meaning of the provision.

4.2 Teleological interpretation

The teleological method, in the strict sense, involves uncovering the meaning of a provision in light of the objectives it pursues.[61] In the case of acts of European law (i.e., 'Level 1' Directives and Regulations), the recitals of the acts and the preparatory documents published by the European Commission (EC), European Parliament (EP) and the Council, normally provide information on these objectives.[62]

From its staff working documents, it is evident that the objectives pursued by the EC with the ESGR are lowering prices, improving transparency and limiting price differentiation. The EC reported that the stakeholder consultation among investors revealed that more than 50% of investors 'consider the fees charged by providers are not proportionate to the services provided', and a few 'suggested that cost-based pricing mechanisms or FRANDT principles be imposed on providers'.-[63] Increasing price transparency was another objective. The EC reported that more than 70% 'consider that the information provided about fees is not transparent or clear enough'.[64] As to price differentiation, the EC quotes the contention of ESMA that due to a lack of transparency, different users would contract for the same products under differing contractual terms regarding minimum term and fee rates.[65] That authority noted 'very large ranges for their fees related to various products and services' and some providers reportedly engaged in second-order price discrimination.[66] Those objectives are clearly reflected in the four chosen standards in Article 27.1 ESGR.

The EP and the Council have not provided much publicly available commentary on their objectives, to the extent they differ from the EC's goals. The EC's original Article 27.1 read 'fees charged to clients are fair, reasonable, transparent, non-discriminatory and based on costs', and both co-legislators removed the reference to costs in

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61 Lenaerts & Gutiérrez-Fons, *supra* n. 52, at 25; Walton, Macagno & Sartor, *supra* n. 53, referring to D. Neil MacCormick, Robert S. Summers, *Interpreting Statutes A Comparative Study*, Routledge 1991 ('arguments from purpose').

62 *See* e.g., Case C-409/32 (Arvato Finance), 17 Oct. 2024, para. 47.

63 European Commission, *Impact Assessment Report accompanying the proposal for the ESGR*, COM(2023) 314 final, at 60.

64 *Ibid*.

65 European Commission, *supra* n. 63, para. 2.2.

66 *Ibid*.

their comments.[67] The exact motivations for this removal are not spelled out, but from the deletion itself one can deduce that the provider's actual costs should not have a decisive normative bearing on the interpretation of the rule. Another reading of the deletion is that according to the EU legislature, prices should be more freely determined by competitive forces, allowing for pricing approaches that provide stronger economic incentives than cost-based pricing. Fostering competition in the supply of ESG ratings is a core objective of the ESGR,[68] which is also evident from the EP's considerations. The EP's ECON Committee Rapporteur remarked that 'encouraging competition among ESG rating providers and fostering an environment where smaller rating providers can enter the market is essential', and pointed to the potentially negative consequences of consolidation, including higher prices, higher barriers to entry, reduced competition and inadequate coverage of smaller issuers.[69]

It is unfortunate that the institutions have not clarified whether the fairness standard is solely intended to apply in relation to the customer (contractual fairness), or also in relation to competitors (fair competition). In other EU regulations, such as the Credit Ratings Agencies Regulation, fair competition has been expressly indicated as a concern (*see infra*). Neither the background documents nor the recitals of the ESGR address this point.

4.3 Systematic interpretation

The systematic (or contextual) interpretation involves interpreting the provision in such a way as there is no conflict between it and the general scheme of which it is part (the other provisions of the legal act, the other legal acts in the relevant body of law).[70]

The pricing rule is the only provision specifically addressing product pricing. It is part of Title III named 'Integrity and reliability of ESG rating activities', sitting in Chapter 3 named 'Independence and conflicts of interest', with the heading 'Fair, reasonable, transparent and non-discriminatory treatment of users of ESG ratings'. The other chapters of the title are named 'Organisational requirements, processes and documents concerning governance' and 'Transparency requirements'. This statutory context prompts a few considerations. *First*, the common thread across these three chapters is the imposition of compliance obligations. This observation aligns with the finding in the literal interpretation that the pricing rule

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67 Council document 17067/23 in procedure 2023/0177(COD), 21 Dec. 2023.
68 Recital 21c ESGR.
69 Draft report EP ECON Committee in procedure 2023/0177(COD), 6 Oct. 2023.
70 Lenaerts & Gutiérrez-Fons, *supra* n. 52, at 14; Walton, Macagno & Sartor, *supra* n. 53, referring to MacCormick & Summers, *supra* n. 61('arguments from contextual harmonization'); Case C-409/23 (Riverty), 17 Oct. 2024, para. 46.

primarily requires providers to take steps to comply with the standards. *Second*, it should also be noted that the pricing rule is the sole provision in the ESGR that deals with price regulation. That is not a *unicum*: similar provisions in other EU regulatory texts, which discussed below, are also similarly situated. In this sense, this class of pricing rules differ from pricing rules which are concretizations of general principles set out in the same title.[71] *Third*, relating to the fair competition point discussed in the preceding section, it should be noted that the heading of Article 27 ESGR expressly refers to the treatment of *users*. This reference supports the position that the fairness standard should be only applied in relation to users and not to competitors – in other words, the pricing rule does not expressly address fair competition. Those users can be natural persons or legal persons, acting as consumers,[72] professionals or on a non-profit basis.

When considering the wider regulatory context of the pricing rule, i.e., the entire body of EU rules that regulates pricing by regulated entities, it is important to underscore that this body of law is underpinned by the principle of pricing freedom set out in the Treaty for the Functioning of the European Union (TFEU), as a component of the competition principle.[73] As the pricing rule requires entities to take measures to ensure that their prices meet substantive standards, it should be constructed as a sector-specific limitation of that freedom principle. Whether this limitation is needed, above and beyond the other limitations of this principle stipulated in Articles 101 and 102 TFEU, is discussed below.

4.4 Conclusion

In conclusion, the application of the classic interpretation methods to the pricing rule has shed light on the meaning of some parts of the rule. However, these methods do not elucidate the meaning of the four standards set out in the rule. For this purpose, it is opportune to proceed with a different approach: the comparative interpretation method.

5 COMPARATIVE INTERPRETATION METHOD

The comparative interpretation method involves the use of other legal acts for the purposes of interpreting provisions of EU law.[74] Those acts include acts of foreign

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71 *See* e.g., the product oversight and governance obligations in Art. 16 Directive 2014/65/EU.

72 Articles 1 and 3.8 ESGR, read in conjunction, clarify that this regulation also applies .

73 Niamh Dunne, *Price Regulation in the Social Market Economy*, LSE Legal Studies Working Paper No. 3/2017.

74 Koen Lenaerts and Kathleen Gutman, 'The Comparative Law Method and the European Court of Justice: Echoes Across the Atlantic', The American Journal of Comparative Law, Volume 64, Issue 4, 1 Dec. 2016, 841–864, 842.

law, the laws of the Member States, other legislative acts of the EU legislature and other language versions of the same act.[75] In fact, as the CJEU has explained in *Vapenik* in respect of consumer, this comparative interpretation promotes consistency *and* helps to achieve the objectives pursued with a particular body of EU rules. It held that 'in order to ensure compliance with the objectives pursued by the European legislature in the sphere of consumer contracts, and the consistency of European Union law, account must be taken, in particular, of the definition of "consumer" in other rules of European Union law'.[76] The same view can be taken here, regarding price regulation.

The comparative interpretation method is a particularly fruitful approach to interpret the pricing rule, as this section will demonstrate. It bears fruit, because the pricing rule is hardly a novelty of EU law. EU law contains an entire class of pricing rules that juxtaposes the principles of fairness, reasonableness, non-discrimination and transparency, known as *FRAND(T)* rules.[77] FRANDT is an acronym for these standards. Some of these rules omit the transparency requirement (hence *FRAND*). The EU legislature uses FRAND(T) rules to regulate pricing by a variety of regulated entities, from benchmark administrators to trading infrastructures. These markets are subject to similar pricing risks, posing similar regulatory dilemmas, which may explain the use of the same solution by the EU legislature. Drawing from these frameworks, as well as related delegated and supervisory acts, may facilitate the interpretation of the pricing rule, based on the principle that similar provisions across legal acts must be given similar meanings.[78]

In addition to the FRAND(T) rules, EU regulatory law also includes multiple frameworks with pricing rules that incorporate one or more, but not all, of the standards set out in the ESGR's pricing rule. Those frameworks have also proven useful in the below comparative analysis.

5.1 FRAND(T) PROVISIONS

This section focuses on FRANDT provisions in two EU regulations, the European Market Infrastructure Regulation (EMIR) and the Data Act,[79] and FRAND

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[75] Case C-76/23 (Cobult), 21 Mar. 2024, para. 25; Case C-409/23 (Riverty), 17 Oct. 2024, paras 40, 43–44; Case C-63/2 (Belgian Association of Tax Lawyers), 29 Jul. 2024, paras 39–41; Case C-508/12, Vapenik, 5 Dec. 2013, paras 24–25.

[76] Case C-508/12, Vapenik, 5 Dec. 2013, paras 24–25.

[77] Commission Delegated Regulation (EU) 2021/1456 of 2 Jun. 2021 supplementing Regulation (EU) No 648/2012, recital 1; Gregory Sidak, *The Meaning of FRAND*, 9(4) Part I: Royalties, J. Comp. L. & Econ., 931–1055 (2013).

[78] *See also* Walton, Macagno & Sartor, *supra* n. 53, referring to MacCormick & Summers, *supra* n. 61 ('arguments from statutory analogy').

[79] Regulation (EU) 2023/2854 of 13 Dec. 2023 on harmonized rules on fair access to and use of data.

provisions in two EU regulations, the Digital Markets Act (DMA) and the proposed Regulation on Standard Essential Patents[80] (SEPR). There are more regulations with FRAND(T) provisions, such as the Markets in Crypto-Assets Regulation[81] and the Benchmarks Regulation,[82]but for the purposes of brevity (and because the limited added value), they will not be discussed. There is one important caveat to the comparative exercise in this section. These FRAND(T) provisions apply to 'terms and conditions' generally, not just to price terms. This difference has consequences for the interpretation, as the discussion below demonstrates.

5.1[a] *EMIR*

The EMIR regulates the pricing of clearing service providers in the European derivatives market, which provide essential services in the clearing infrastructure. The FRANDT rule is set out in Article 4.3a EMIR, which states that clearing service providers 'shall provide those services under fair, reasonable, non-discriminatory and transparent commercial terms'. The rule is further elaborated in a delegated act of the EC (EMIR CDR).[83] Article 2 EMIR CDR provides that commercial terms for clearing services provided by clearing service providers shall be considered to be fair, reasonable, non-discriminatory and transparent where they meet the requirements laid down in the Annex of the CDR

The Annex has a special section on fees and pass-on costs, setting out three sub-rules. *First*, fees, prices and discounts should be 'transparent and based on objective criteria'.[84] *Second*, the provider must disclose information on fees which pass on costs relating to the provision of clearing services.[85] *Third*, 'all fees, prices, discounts and pass-on costs, as agreed between the clearing service provider and the client, are clearly specified in the commercial terms'.[86] It should be remarked that these rules do not impose substantive fairness or reasonableness criteria. The sole requirement is that they are based on 'objective criteria', a concept which is left undefined and could also be applied to the non-discrimination standard. Instead, the rules seem to focus on disclosure, which must be comprehensive

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80 EC, *Proposal for a Regulation on Standard Essential Patents*, 2023/0133 (COD), COM(2023)232.
81 Article 45.2 MiCAR (Regulation (EU) 2023/1114).
82 Article 22 Regulation (EU) 2016/1011, titled 'Mitigation of market power of critical benchmark administrators'.
83 4.3a EMIR; Recitals 4–5, Art. 2 and Annex Commission Delegated Regulation (EU) 2021/1456; ESMA, Final Report – Technical advice on FRANDT commercial terms for clearing services (Art. 4 (3a)), ESMA70-151-3012, 2 Jun. 2020.
84 Paragraph 6.1 Annex EMIR CDR.
85 Paragraph 6.2 Annex EMIR CDR.
86 Paragraph 6.3 Annex EMIR CDR.

and clear (despite the lack of clarity of the 'clear specification' concept), pointing to procedural fairness as the guiding principle.[87]

5.1[b] *Data Act*

The Data Act regulates the pricing by data holders, who must provide access to these data to users and third parties. Such access must be fair and the Data Act seeks to prevent exploitation of contractual imbalances that hinder such access.[88] Article 8.1 Data Act states that in business-to-business relations, such access should be based on fair, reasonable and non-discriminatory terms and conditions and in a transparent manner.

The Data Act provides more granular rules to concretize the standards. It provides substantive fairness rules that relate to terms other than the price itself, including a list of unfair contract terms.[89] Recital 45 clarifies that the non-discrimination standard does not preclude any form of discrimination between comparable categories of data recipients: using different contractual terms for making data available if those differences are 'justified by objective reasons', is not unlawful discrimination. With respect to the compensation, the transparency standard is operationalized procedurally: it is an important principle for ensuring that the compensation requested by a data holder is reasonable and for allowing recipients to verify that it complies with the Data Act (holders must disclose 'sufficiently detailed information' on its calculation).[90]

The reasonableness standard is concretized with a 'reasonable compensation' principle: the compensation for making data available in business-to-business relations 'shall be non-discriminatory and reasonable and may include a margin'.[91] The rule seeks to promote investments in generating and sharing data while avoiding excessive burdens on access to and the use of data.[92] Interestingly, the rule differentiates among recipients. The compensation cannot include a margin if the recipient is a small or medium-sized enterprise or a non-governmental research organization,[93] and does not apply altogether when recipients or both parties are large enterprises.[94] The Data Act also specifies the components of the compensation. Parties must 'take into account in particular' (1) costs incurred in making the

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87 On the distinction between substantive and procedural fairness, *see* e.g., Gizem Alper, *Contract Law Revisited: Algorithmic Pricing and the Notion of Contractual Fairness*, 47 Computer L. & Sec. Rev. 105741 (2022), doi: 10.1016/j.clsr.2022.105741.

88 Recital 5 Data Act.

89 Recital 44, Arts 8.2 and 13 Data Act.

90 Recital 51 and Art. 9.7 Data Act.

91 Recital 46 and Art. 9.1 Data Act.

92 Recital 46 Data Act.

93 Recitals 47 and 49 and Art. 9.4 Data Act.

94 Recital 48 Data Act.

data available, and (2) investments in the collection and production of data.[95] The Data Act also imposes regulatory considerations on the margin. It may vary depending on factors related to the data itself (e.g., volume, format or nature of the data) and data collection costs, which means that it may be reduced or even excluded, depending on the role of the data in the holder's own activities.[96]

5.1[c] *Digital Markets Act*

The DMA regulates the pricing by large online platforms or 'gatekeepers'. Under Article 6.12 DMA, a gatekeeper shall apply fair, reasonable, and non-discriminatory general conditions of access for business users to certain software application stores, online search engines and online social networking services. Its noteworthy provisions related to the fairness standard. In contrast to the EMIR and the Data Act, the DMA lays down a substantive fairness standard. To address the 'imbalance in bargaining power' between gatekeepers and business users, gatekeepers are prohibited from imposing pricing conditions that would be unfair or lead to unjustified differentiation.[97] Pricing conditions are unfair if (1) they lead to an imbalance of rights and obligations imposed on business users, (2) confer an advantage on the gatekeeper which is disproportionate to the service provided by the gatekeeper to business users, or (3) lead to a disadvantage for business users in providing the same or similar services as the gatekeeper.[98] Benchmarks that may be used to guide the fairness assessment are (1) prices charged for same or similar services by other providers, (2) prices charged by the same gatekeeper for different related or similar services, or different types of end users, and (3) prices charged for the same service in different geographic regions.[99]

In other words, the DMA's uses the fairness standard to protect the interests of customers by imposing substantive requirements on prices charged by gatekeepers. To apply the standard, the DMA proposes market prices and the gatekeeper's other pricing choices. In addition, the DMA non-discrimination standard does *not* prohibit *all forms of* price differentiation, only *unfair* price differentiation.

5.1[d] *SEPR*

The implementation of the FRAND rule in the proposed SEPR contrasts starkly with the aforementioned approaches. The SEPR's objective is similarly focused on

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95 Article 9.2 Data Act.
96 Recital 47 Data Act.
97 Recital 62 DMA.
98 *Ibid.*
99 *Ibid.*

access, as it seeks to ensure that 'end users … benefit from products based on the latest standardized technologies at reasonable prices'.[100] However, rather than providing more granular provisions on the content of the FRAND's standards (i.e., a prescriptive approach), the approach in the SEPR is to make available information on terms negotiated by market parties that meet the FRAND rule, and to provide for an alternative dispute resolution mechanism for setting FRAND terms and conditions (i.e., a facilitative approach).[101] As in the other frameworks, FRAND terms and conditions means fair, reasonable and non-discriminatory terms and conditions.[102] Parties are free to negotiate to negotiate these terms and conditions and where disputes arise, the SEPR applies an institutional procedure for the determination of the FRAND terms and conditions.[103] Its inclusion in this comparative exercise is to demonstrate that a facilitate approach to the supervision of the ESGR's pricing rule, in which ESMA relies more on private ordering, may be more efficient than detailed prescriptive rules.[104]

5.2 Individual standards

Strictly speaking, a provision that incorporates all FRANDT standards and a provision that incorporates only one or two of the standards, are dissimilar. Nevertheless, the objective to preserve similarity of meaning across frameworks also applies at the level of individual standards, so it is worth considering pricing rules and judicial decisions that elaborate on the individual FRANDT standards.

5.2[a] *Fairness*

The most relevant framework that imposes a single substantive fairness standard on entities wielding pricing power, is Article 102(a) TFEU. This provision prohibits a dominant undertaking from exercising its pricing power through charging unfair selling prices. Fairness is interpreted substantively here: an unfair price is a price that is excessive.[105] In its case law, the CJEU has developed a test to assess when a price is excessive. It has ruled that the

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[100] EC, *supra* n. 63, s. 1.
[101] *Ibid*., s. 1 and Art. 1 SEPR.
[102] Article 2.8 SEPR.
[103] Articles 1.1.d and 2.9 SEPR. *See also* Arts 11 and 26–27 SEPR and Title VI SEPR.
[104] ESMA can provide guidelines to inform market participants on its interpretation of the pricing rule under Art. 16 of Regulation (EU) 1095/2010.
[105] Article 102 TFEU, Case C-27/76 United Brands 14 Feb. 1978, paras 252-253; Case C-177/16 AKKA/LAA, paras 35-61.

economic value of the product,[106] prices of competitors for similar products, prices charged in other markets, and the seller's profit margins, are benchmarks that should be used for this exercise.[107]

Other frameworks have also implemented the fairness standard substantively, using different benchmarks. For example, the rule in the European Crowdfunding Service Providers Regulation, which requires price offers to be 'fair and appropriate', has been operationalized with benchmarks that must be taken into consideration to meet the standard. 'Prevailing market prices' and the 'business strategy' of the provider, are among these benchmarks.[108] The CJEU has applied the unfairness assessment under the Unfair Contract Terms Directive to price terms in consumer credit and mortgage contracts. This test considers the balance between the contractual rights and obligations of the counterparties (similar to the DMA), and the CJEU has used market prices and the loan principal (which could be considered a part of the lender's costs) among its benchmarks.[109] Generally, where the fairness standard is used as a substantive standard to assess pricing, the assessment involves the estimation of the product's value in monetary terms using one or several benchmarks, a narrative with supporting arguments for the chosen benchmark(s) and a comparison of the (lack of) equality between the price and the estimated value.[110]

5.2[b] *Reasonableness*

A particularly relevant framework that uses the reasonableness (and non-discrimination) standards to regulate pricing, is the Markets in Financial Instruments Regulation (MiFIR). Article 37.1 MiFIR provides that central counterparties and trading venues must have access to benchmark information and licences at a 'reasonable commercial price' that differs between customers only to the extent that it can 'objectively justified'. The non-discrimination element is further detailed,[111] but the reasonableness element itself lacks definition. Article 13.1 MiFIR provides that market operators and investment firms operating a trading venue must make the market data available to the public on a 'reasonable commercial basis'.[112] This notion has been fleshed out in a delegated regulation.[113] Similarly to the notion of

[106] Case C-27/76 United Brands, paras 252-253.
[107] Opinion AG WAHL, delivered on 6 Apr. 2017, Case C-177/16, paras 17–23 and cited references.
[108] Commission Delegated Regulation (EU) 2024/358 of 29 Sep. 2023 supplementing Regulation (EU) 2020/1503, Art. 14.
[109] Case 421/14 Banco Primus 26 Jan. 2017 (CJEU), paras 59, 65 and 67; Case 621/17 Gyula Kiss 3 Oct. 2019 (CJEU), para. 55.
[110] Opinion AG WAHL, delivered on 6 Apr. 2017, Case C-177/16, paras 36–42.
[111] Article 3 Commission delegated regulation 2016/2021 of 2 Jun. 2016 supplementing MIFIR with regard to RTS on access in respect of benchmarks.
[112] Article 13.1 MIFIR.
[113] Articles 6–11 Commission Delegated Regulation (EU) 2017/567 of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to

'reasonable compensation' in the Data Act, the regulation links to costs, stating that 'the price of market data shall be based on the cost of producing and disseminating such data and may include a reasonable margin'.[114] The reasonable margin may be based on factors such as the operating profit margin, the return on costs, the return on operating assets and the return on capital'.[115] These factors differ from the factors listed in the Data Act. In its guidance on this rule, ESMA focuses on disclosure: providers must have 'clear and documented cost accounting methodologies' for setting the price[116] and specify how the margin has been determined.[117] While the list of factors is helpful, the framework does not define what constitutes reasonableness.

In any event, the reasonableness standard in MiFIR and the Data Act, does not require that fees are limited to actual costs. In this respect, they clearly differ from other frameworks, in particular the Credit Ratings Agencies Regulation (CRAR), which requires that the fees charged by these agencies to their clients for the provision of credit rating and ancillary services are based on actual costs.[118] Therefore, next to the teleological analysis in section 4 .2, the comparative interpretation method presents another argument to support the view that the reasonableness standard does not require pricing based on costs.

5.2[c] *Transparency*

The transparency standard is also fleshed out with diverging concretizations. EMIR requires 'clear specification' of all fees, prices, discounts and pass-on costs under this standard. MiFIR, in its delegated act, imposes a number of mandatory disclosures tailored to the regulated service, in a manner which is easily accessible to the public.[119] It includes current price lists, advance disclosure of future price changes, information on revenue obtained from making market data available and information on how the price was set, including the costs accounting methodologies used by the provider.[120] Between the two, MiFIR requires more granular disclosure.

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definitions, transparency, portfolio compression and supervisory measures on product intervention and positions.

114 Article 7.1 Commission Delegated Regulation (EU) 2017/567.

115 Recital 5 Commission Delegated Regulation (EU) 2017/567.

116 ESMA, *Final Report Guidelines on the MiFID II/MiFIR Obligations on Market Data*, 1 Jun. 2021 | ESMA70-156-4305, Guideline 2.

117 *Ibid*.

118 Article 6.2 CRAR in conjunction with Annex I, s. B, para. 3c.

119 Article 11 Commission Delegated Regulation (EU) 2017/567.

120 Article 11 subs a, b, d and e Commission Delegated Regulation (EU) 2017/567.

The CRAR lies between these two regimes and focuses more the customer's decision-making process. Rating agencies are not required to publicly disclose fee schedules, but they must provide their clients with all necessary information (list prices, standard fees or fee ranges for credit ratings and ancillary services) which may help users compare different offerings and facilitate their decision-making process.[121] ESMA has stipulated a number of good practices, which are based on the same notion of transparency, meaning 'transparent enough to allow clients to make informed decisions as well as to understand the key elements and drivers of the specific fees applied to them and the fee changes made over time'.[122]

5.2 [d] Non-discrimination

In an economic sense, price discrimination (or more neutrally, price 'differentiation') involves charging different prices to different customers for the same product, on the basis of their preferences or the volume of the product purchased.[123] Price differentiation is not allowed to the same degree under each of these interpretations analysed thus far.

The EMIR provides the greatest flexibility. Prices merely have to be based on 'objective criteria', a notion left undefined. By contrast, the CRAR provides that the fees charged to its clients for the provision of credit rating and ancillary services are not discriminatory, in addition to being based on actual costs.[124] This provision was introduced to 'mitigate conflicts of interest' and 'facilitate fair competition in the credit rating market'.[125] The CRAR adopts a very strict standard, leaving little room for price differentiation strategies. Under the CRAR, any differences in fees for the same type of service should only be justifiable by a difference in the actual costs in providing this service to different clients.[126] Therefore, 'non-discriminatory' means no price differentiation between clients served at the same cost level.[127] As a result, this perspective neither allows basing fees on the perceived or estimate value of the service or product to the client, nor engage in value-based price differentiation.[128] The provider is not required to always offer the same price

[121] ESMA, *Thematic Report on fees charged by Credit Rating Agencies and Trade Repositories*, ESMA80-196-954, 11 Jan. 2018, para. 45.
[122] ESMA, *Follow-up to the Thematic Report on Fees Charged by Credit Rating Agencies and Trade Repositories*, ESMA80-196-3218, 20 Dec. 2019, para. 44.
[123] A. C. Pigou, *The Economics of Welfare* 278–279 (London: Macmillan 1920).
[124] Article 6.2 CRAR in conjunction with Annex I, s. B, para. 3c.
[125] Recital 38 of Regulation 462/2013 amending CRAR.
[126] *Ibid*.
[127] ESMA Report, *supra* n. 122, paras 12–13.
[128] *Ibid*.

to all clients, however. Price discounts are allowed, if they are offered to all users on the same grounds[129] and provided that they are not a prejudicial exercise of market power.[130]

The approach in the MiFIRis different from the CRAR. Providers of market data must make such data available at the same price and on the same terms and conditions to all customers falling within the same category in accordance with published objective criteria.[131] The categorization criteria must be based on factual elements, which are sufficiently general to pertain to more than one customer.[132] Price differentiation and a value-based pricing approach are allowed. The delegated act states that 'any differentials in prices charged to different categories of customers shall be proportionate to the value which the market data represents to those customers, considering the scope and scale of the market data as well as the use made by the customer of the market data'.[133] Price discounts are allowed as well, provided that the conditions are based on factual elements which are sufficiently general to pertain to more than one customer.[134] Thus, while the CRAR excludes value-based price differentiation, MiFIR explicitly allows such differentiation.

5.3 Conclusions

The following conclusions can be drawn from the comparative analysis in this section. First, as a preliminary matter, none of the standards has a consistent meaning across the reviewed acts. In fact, each standard is given different interpretations, or is implemented with rules that differ in granularity. This observation also holds when considering the standards as used in a FRAND(T) rule. The observed divergence is partly due to the fact that the FRAND(T) provisions refer to 'terms and conditions', and apply either fairness or reasonableness to the price term.

Fairness is interpreted either procedurally or substantively.[135] As a procedural standard, it does not set norms regarding the price, but only on the pricing process (*see* e.g., the SEPR). As a substantive standard, it requires consideration of the

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129 *Ibid*.
130 ESMA, *supra* n. 122, paras 12–13 and ESMA, *supra* n. 122, s. 2.1.
131 Article 8.1 Commission Delegated Regulation (EU) 2017/567.
132 ESMA, *supra* n. 116, Guideline 4.
133 Article 8.2 Commission Delegated Regulation (EU) 2017/567.
134 ESMA, *supra* n. 116, Guideline 7.
135 *See* e.g., Jodie L. Ferguson, Pam Scholder Ellen & William O. Bearden, *Procedural and Distributive Fairness: Determinants of Overall Price Fairness*, 121(2) J. Bus. Ethics 217–231 (May 2014), on this distinction.

(monetary) value of the product the provider in exchange for the fee. That value is assessed using a set of familiar benchmarks (costs, market prices, economic value to the customer, *see* e.g., DMA or CJEU's case law under Article 102(a) TFEU).[136] It may also require 'objective criteria' (EMIR), but it is not clear whether this relates to fairness or reasonableness.

Reasonableness is also interpreted substantively, to assess the price level. Where it has been operationalized, it follows a 'cost-plus' approach and requires consideration of objective elements. A reasonable price or compensation allows the seller to recover the costs of producing the product, to invest in the development of its products, and to generate a profit (e.g., Data Act, MiFIR). The regulation may limit the margin based on specific criteria, or merely require that it is 'reasonable' (thus requiring a contextualized assessment and ultimately judicial circumscription).

Transparency is interpreted on a spectrum, with varying disclosure obligations imposed to provide the requisite level of transparency. At one end, transparency simply requires disclosure of all fees, prices and pass-on costs (EMIR). At the other end, the standard is implemented with a list of mandatory disclosure elements tailored to the business model (MiFIR). Requiring only disclosure of information that is 'necessary' to make an informed choice (CRAR), thus limiting the range of disclosure by a functional criterion, is a third concretization of the standard.

Non-discrimination is a standard that does not always prohibit price differentiation, but places diverging constraints on the segmentation variables that entities can use for this purpose. While one regulation only allows price differentiation to reflect actual costs (CRAR), other regulations allow price differentiation based on customer value (e.g., MiFIR), provided that the segmentation (or categorization) variables are sufficiently general.

The final step is to determine which meaning should be attributed to each of the standards in the pricing rule.

6 RECOMMENDATIONS

This section presents recommendations for the interpretation of the four standards of the pricing rule by ESMA. Before proceeding with those recommendations, it is necessary to make a few preliminary remarks.

[136] The use of benchmarks for comparison is also called the 'comparator approach', *see* Frontier Economics, *FRAND in the DMA – the Quest for a Fair Price in the Digital World* 14 (2022).

6.1 Preliminary remarks

6.1[a] *Enforcement Challenges*

'Good luck'. That is what the EC's chief competition economist has said about enforcing the DMA's FRAND rule to regulate access pricing.[137] The same can be said about the ESGR's pricing rule. The rule incorporates four general standards, none of which have been sufficiently crystallized in EU law. In fact, in areas where FRAND rules have been used, this lack of clarity has generated much litigation, with courts clearly struggling to apply the rule.[138] For example, it is particularly hard to come up with cost measures and even harder to come up with a reasonable margin to compensate investors for the commercial risk to which they are exposed, or the financial share of generated economic value that they should receive.[139] And for prices that exceed a particular benchmark, how does one distinguish reasonable prices from unreasonable prices?[140] It can therefore be expected that this pricing rule may lead to lengthy and costly pricing procedures. There is also evidence suggesting that comprehensive regulation with intense monitoring by supervisors raises compliance costs and may ultimately increase market concentration.[141]

6.1[b] *Concurrence With Other Norms*

These enforcement challenges raise the more general point of comparative regulatory effectiveness. Is the pricing rule the best approach? What about EU competition law? In fact, EU competition law could have been more effective to mitigate the feared risks, without the same adverse effects on competition. Article 102(a) TFEU seems a more concise and efficient rule aimed to combat the exploitation of pricing power. It applies to both individually dominant undertakings, and undertakings enjoying 'collective dominance'[142] (even if some argue that it has an oligopoly gap).[143] Moreover, Article 102 TFEU is time-tested,

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137 Mlex market insight, *Apple, Google, other gatekeepers' access will be hard to assess, says Régibeau*(1 Jun. 2022).

138 Yann Ménière, *Fair, Reasonable and Non-Discriminatory (FRAND) Licensing Terms: Research Analysis of a Controversial Concept*, JRC Science and Policy Report (2015); Michael A. Carrier, *Why Is FRAND Hard?*, Utah L. Rev. 931 (2023); Roger Brooks & Damien Geradin, *Interpreting and Enforcing the Voluntary FRAND Commitment*, 9(1) Int'l J. IT Standards & Standardization Res. 1–23 (2011), doi: 10.4018/jitsr.2011010101.

139 Similarly, Frontier Economics, *supra* n. 136, at 3 and 4.

140 *Ibid*.

141 Garrett A. Johnson, Scott K. Shriver & Samuel G. Goldberg, *Privacy & Market Concentration: Intended & Unintended Consequences of the GDPR*, 69(10) Mgmt. Sci. 5695–5721 (2023), doi: 10.1287/mnsc.2023.4709.

142 *See* e.g., Case T-102/96 Gencor.

143 Petit, *supra* n. 14.

supported by a substantive body of case law from the CJEU and guidance from the EC, providing some certainty to market participants. Unfortunately, providers will now have to comply with two regulatory frameworks supervised by two different European institutions, who may diverge in their appreciation of factual elements in concrete instances.

6.1[c] *Stimulating Competition*

As discussed above, the pricing rule implements a meta-regulation approach to price regulation, by requiring providers that their pricing policies are adequate to ensure that their prices meet the substantive standards of the rule.[144] It puts a heavy burden on these entities, since nobody knows *ex ante* which prices meet those standards. The teleological interpretation revealed that the regulatory objective of *this rule* is protecting customers by preventing providers, that abuse their pricing power, from charging excessively high prices. However, that objective must be seen in light of the broader regulatory aims *of the ESGR* to develop price competition in the market in ESG ratings which (1) is open to small players, (2) promotes product diversity, (3) covers many different securities, and (4) investors have broad access to ratings.[145] FRAND price regulation can indeed be used for different objectives,[146] but it is a challenge to ensure that new entrants are not deterred, investors in those new entrants can earn a reasonable margin *and* to avoid excessive pricing.[147] These objectives can be aligned, for example where the pricing rule is applied to end excessive pricing by a larger player, allowing more investors to have access to the player's ratings.

But the objectives may conflict, for example where ESMA shuts down value-based pricing by an innovative but small player which is reliant on retained earnings to grow its market share, impairing its ability to compete.[148] As the discussion in section 2 .2 has shown, the market is currently characterized by a high degree of concentration, which makes it hard for small players to thrive. This situation may not be caused, or sustained, by large players exploiting their pricing power, but ultimately smaller players must become more competitive to reduce this concentration. Also, as the degree of competition increases, the incidence of pricing power abuse should decrease. Therefore, the interpretation *and* supervision of the pricing rule should be carefully calibrated to current market realities

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144 Sections 3.1 and 4.1.
145 Section 4.2.
146 Compass Lexecon (Ciara Kalmus, Kadambari Prasad & Tanja Salem), *What are Fair and Reasonable Prices? Making a Flexible Concept Tractable* 1 (6 Jul. 2024).
147 Frontier Economics, *supra* n. 136, at 5, calls this sweet spot the 'Goldilocks level of access pricing'.
148 The ESGR does not explicitly consider how the provider's financing structure affects pricing, but this could be considered as part of the reasonableness assessment.

to secure the broader aims of the ESGR. Also, if FRAND rules are indeed used to prevent exploitative pricing, it is key to use value-based pricing in order to preserve the economic incentives for companies to compete in the market.[149]

6.2 Interpretation

6.2 [a] Fairness and Reasonableness

The fairness of a fee charged by the provider will likely be interpreted substantively by ESMA and the CJEU. In particular, it may be modelled as the balance between the total amount of fees and the economic value of the product, focusing on the reciprocal obligations of parties. The value of the product should be assessed using several benchmarks (following the CJEU's case law under Article 102(a) TFEU), including the production costs , the fees charged by other providers and the economic utility of the product to the customer.[150] When using economic utility (i.e., value-based pricing), it is important to underscore that the benchmark involves computing a theoretical and unobservable price (the 'reservation price'). In other words, even where providers share documented evidence on their pricing policy, it is necessary to understand how the price divides the economic value of the product between the provider (i.e., the margin, which is the fee minus the marginal costs) and the customer (i.e., the difference between the reservation price and the fee).[151] Some authors argue that a fair price requires these shares to be equal and that the price becomes unfair as it deviates from this partition.[152] That view should not be followed, as it ignores the considerations required by reasonableness.

Instead of focusing on the exchange of values, reasonableness should focus on the individual components constituting the fee, and the evidence provided to justify the amounts. The reasonableness of the fee should require consideration of (1) the production costs incurred by the provider, (2) the investments that the provider should make in order to develop its products, and (3) the profit margin. Important: the costs should not carry special weight in the assessment. By its very nature and given the competition objective of the ESGR, reasonableness will be highly contextualized to the circumstances. For example, the necessary investments will depend on the individual provider's situation and maturity. Similarly, the

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149 Compass Lexecon, *supra* n. 146.

150 *See* Robert Phillips, *Pricing and Revenue Optimization*, 2nd edition (Stanford University Press 2024), Ch. 2.

151 *See* e.g., Gregory Sidak, What *Makes FRAND Fair? The Just Price, Contract Formation, and the Division of Surplus from Voluntary Exchange*, 4 Criterion J. Innovation 701, 2019, 705–706 (2019).

152 *See* the comments of Robert Frank in Sidak (n. 151).

margin must reflect the provider's cost of capital and sufficiently compensate of the commercial risk taken by managers and shareholders, especially in the current context of volatile sustainability politics. The most important element is the margin, because it constitutes the provider's share of the surplus and how it is policed will affect which objectives the pricing rule is likely to achieve. For example, a provider that provides an innovative rating which leverages state-of-the-art climate research, should arguably be allowed to capture a larger margin to compensate it (and its investors) for the commercial risk of developing that rating. Also, smaller providers may need larger margins to scale their operations and effectively compete with dominant providers. But if a dominant provider appropriates all consumer surplus with a high fee for a low-cost product that does not generate any economic value, the outcome should be different. In sum, reasonableness may therefore not favour an equal division of economic surplus.

Given these operational challenges of fairness and reasonableness assessments,it is recommended to rely on competitive forces and only intervene using these standards where the pricing policies and procedures indicate an unequivocal and structural breakdown of those forces.

6.2 [b] Transparency

The transparency requirement should be interpreted in a manner that allows prospective customers to compare different offerings and make an informed decision, while not burdening smaller providers with a set of disclosure obligations that make compliance prohibitively costly and therefore unduly draining resources that they need to compete against larger providers. For this reason, ESMA should not exercise its discretion under Article 27.2 to require 'documented evidence on their pricing policy' by requiring a long and granular list of items to be disclosed, in-depth explanations of the pricing criteria, disclosure of the full roster on costs of data collection and processing from the ecosystem of data vendors used to create the products, and similar disclosures that are costly to elaborate. Instead, the transparency standard should follow the pragmatic, need-driven standard set out in the CRAR, emphasizing the disclosure of all fees (and fee ranges) applicable to products and ancillary services in an efficient manner.

6.2 [c] Non-discrimination

The non-discrimination standard should be interpreted in a manner that allows for price differentiation between consumer segments, while preventing arbitrary discrimination of specific customers. That interpretation is congruent with a value-based pricing approach, where the economic value of the product to that

consumer segment determines the price in that segment. The interpretation of the non-discrimination standard should thus be more similar to the MiFIR implementation than the CRAR implementation. A framework that allows value-based price differentiation between segments allows providers more latitude to adopt price differentiation strategies that increase access, for example through cross-subsidization. Providers engage in cross-subsidization when they charge higher prices (with higher profit margins) to one group of customers so they can charge lower prices (with lower profit margins or below costs) to another group of customers, so they maintain the same overall profit margin.[153] This way, providers can serve both investors with less financial means and investors with ample means, while sharing in the economic value generated.

6.3 Conclusion

The reader may be disappointed by the absence of easy answers and facile frames that can be readily applied to each interpretation exercise involving the pricing rule. Such disappointment would be unwarranted. The pricing rule – as every FRAND(T) rule – is meant to be vague, given that it is intended to apply to a large and diverse set of situations in which the competitive dynamics in the market and the contracting behaviour of the provider may result in practices that unduly prejudice its customers. In order to fulfil this function, it has to be vague and open-ended and multi-faceted, because those properties endow it with the flexibility to regulate those variables. Accordingly, rather than seeking to propose narrow interpretations, it makes more sense to think about analytical frameworks that facilitate the application of the rules by making the key considerations underlying such application more explicit, and evaluating the trade-offs between intervention and stimulating price formation in healthy competitive conditions. The recommendations in this section are intended start that discussion. The discussion in section 4 illustrates the complexity of interpreting the pricing rule, and resolving the underlying issues go beyond the scope of this article. The recommendations only scratch the surface, and the hope is that they will stimulate discussion in policy, academic and commercial circles. The ultimate goals is to promote the understanding of the key issues and dissuade unnecessary litigation that would only burden the functioning of the Single Market in ESG ratings.

[153] On cross-subsidization, *see* e.g., UK Financial Conduct Authority, *Price Discrimination and Cross-Subsidy in Financial Services*, Occasional Paper 22, at 14 et seq.

7 FINAL REMARKS

The purpose of this article was to interpret Article 27.1 ESGR, a rule which requires ESG rating providers to take steps that are adequate to ensure that fees charged to clients are fair, reasonable, transparent and non-discriminatory. To this end, it first discussed the regulatory dilemma. Subsequently, the article applied the literal, teleological, systematic and comparative interpretation methods to the rule. The interpretation exercise has produced some insights, but more research is required. The pricing rule belongs to a class of rules commonly known as FRAND(T) rules, which are vague and notoriously difficult to apply. This article has provided recommendations on *how to think* about the application of the pricing rule in light of the diverging objectives pursued with its adoption, by providing an analytical framework that incorporates those objectives. Hopefully, ESMA and the CJEU will consider those recommendations.

When the legislature empowers the regulator to intervene in the pricing of services, it puts the functioning of the relevant market in the hands of that regulator. Whether new entrants will enter the market or how many users can afford the product: all these behaviours depend on pricing. Even if the regulator does not dictate prices, its actions will strongly influence market outcomes. When a market is of great social importance, such as the market for ESG ratings, the stakes are too high to make regulatory errors. When a rule has a track record as bad as the FRANDT rule, the best way to enforce the rule may be to not enforce it at all.